Contents

NCPERS: Who We ARE ................................................................. 3
Annuity Accumulation Retirement Plan ......................................... 5
The Public Employee Pension Transparency Act ................................. 7
Tax Reform and Retirement Savings .................................................. 8
Excise Tax on High-Cost Health Insurance ........................................... 9
Normal Retirement Age .................................................................. 10
Definition of Governmental Plan ...................................................... 11
Employer Pickups .......................................................................... 12
National Conference on Public Employee Retirement Systems

NCPERS: Who We ARE

The National Conference on Public Employee Retirement Systems (NCPERS) is the largest trade association for public-sector pension funds, representing more than 500 funds throughout the United States and Canada. We are a unique network of public trustees, administrators, public officials, and investment professionals who collectively manage approximately $3.7 trillion in pension assets. Our core missions are federal Advocacy, conducting Research vital to the public pension community, and Educating pension trustees and officials—it’s who we ARE.

Who do we benefit? The approximately $3.7 trillion in public pension assets in the United States is managed on behalf of 7.3 million public retirees and 14.5 million active public servants who provide vital services, such as law enforcement, fire and rescue, education, health care, and more, to our communities. Currently, NCPERS member pension funds provide a modest retirement benefit—an average of approximately $25,000 per year—that helps afford a secure retirement for our public servants and heroes.

Public pensions are financially sound and good for the economy. On average, the nation’s public pension plans are well funded. Almost all public plans require employee contributions, and all public plans invest their assets in growth vehicles that earn additional income. According to a recent National Institute on Retirement Security study, state and local pension plans had a total economic impact of more than $358 billion, supported more than 2.5 million American jobs, and provided more than $57 billion in annual federal, state, and local tax revenue in a single year. Each taxpayer dollar invested in state and local pensions supported $11.45 in total economic activity, while each dollar paid out in benefits supported $2.36 in economic activity.

Public pensions are regulated by state and federal laws. All public plans are governed by federal and state laws that regulate how those plans are established and the level of benefits they can provide. Public plans are also governed by comprehensive financial reporting standards established by the Governmental Accounting Standards Board (GASB). These standards provide the framework for the annual financial audits that most governments contract to independent accounting firms. Because credit rating agencies pay close attention to the auditor’s report in assessing a government’s credit quality, there is significant incentive to adhere to GASB’s standards. Although public plans are not subject to many of the provisions of the federal Employee Retirement Income Security Act (ERISA) of 1974, state fiduciary laws governing public plans often reflect ERISA’s language.
Annuity Accumulation Retirement Plan

In December 2015, Senate Finance Committee Chairman Orrin Hatch (R-UT) introduced S. 2381, the Puerto Rico Assistance Act, which includes a modified version of his previously introduced annuity accumulation retirement plan proposal (S. 1270, 113th Congress).

The annuity accumulation plan proposal is unrelated to providing fiscal assistance to Puerto Rico. However, using the financial distress of Puerto Rico and claiming that unfunded pension liabilities of state and local governments are undermining the fiscal health of states and municipalities, Sen. Hatch is positioning the proposed annuity accumulation plan as a replacement for defined-benefit (DB) pension plans.

The annuity accumulation plan would allow state and local governmental plan sponsors to purchase private insurance annuity contracts for public employees. Most experts believe that once a state or local government begins down the path of the annuity accumulation plan, it will freeze existing DB plans. The result will be that the annuity accumulation plan will become the primary retirement vehicle for state and local workers.

Important issues have been raised by NCPERS with regard to annuity accumulation plans as a replacement for DB plans:

- **Replacement Income** – The threshold question for our nation’s firefighters, policemen, teachers, and other state and local governmental employees is whether distributions from the aggregation of fixed-rate annuity contracts would provide a comparable level of replacement income during retirement to that of a prefunded DB plan. In considering this question, it is important to note that under the proposal, the plan sponsor would be able to change its contribution percentage each year, provided it is done for all employees. It is likely, then, that the employer contribution would change each year depending on the plan sponsor’s financial and political situation.

- **Disallowance of Employee Contributions** – Another factor in the replacement income discussion is that the vast majority of current DB plans for state and local governmental employees are contributory plans – meaning that the plans are funded by contributions from both employers and employees – and the number of contributory plans continues to grow. In contrast, the proposed annuity accumulation scheme would not allow employees to contribute to their own retirement plans. It is unlikely that employer-only-funded annuities would be able to provide an adequate level of replacement income for retirees.

- **Survivor and Disability Benefits** – The plan would not include traditional survivor or disability benefits. This is an essential benefit for those engaged in public safety, such as those who provide firefighting services, police protection, or emergency medical services. If plan sponsors add survivor or disability benefit policies separately, premium costs for the annuities will rise significantly.
- **Aggregation Costs** – The systematic aggregation of the annuity contracts will be necessary if plan participants are to receive their full retirement income. It is not reasonable to place the burden on retirees to track each of their annuity contracts. Private-sector aggregation services will charge fees, which are a hidden cost to the plan participants. If a governmental entity is created to aggregate the annuity contracts, then taxpayers will bear the cost.

- **Transition Costs** – In the past, after careful review, many jurisdictions that were considering a change from DB to defined-contribution (DC) plans chose not to proceed because of the high transition costs that were involved. Costs associated with a transition to the annuity accumulation model are likely to be significant as well.

*NCPERS opposes the Annuity Accumulation Plan.*
Also included in S. 2381, the Puerto Rico Assistance Act, is a modified version of the Public Employee Pension Transparency Act (PEPTA). This legislation would for the first time impose a federal reporting requirement on the funding status of state and local pension plans.

Fulfilling the reporting requirement would be the responsibility of the plan sponsor, that is, the state or municipal government. Reporting would be required using two distinct methods. First, funding status would be reported based on the economic assumptions and rates of return that each plan currently uses as its expected (long-term) return. Second, all plans that do not calculate their funding status based on either fair market value of assets or the US Treasury bond obligation yield curve (as defined in the legislation) must recalculate their funding status based on the yield curve.

The Treasury obligation yield curve method would result in funding status outcomes that would show a dramatically lower funded status for the vast majority of public plans. This will serve only to create negative headlines for public plans but will not add any new economic information to aid in the analysis of individual plans.

NCPERS opposes the Public Employee Pension Transparency Act.
Tax Reform and Retirement Savings

While experts believe that Congress will wait to take action on comprehensive tax reform until after the November elections, tax expenditures will remain under the microscope during the 114th Congress. One area that has been raised as a potential source of income to be tapped in order to lower tax rates is tax-preferred contributions to both DB and DC plans, which, combined, result in a tax deferral of almost $650 billion over a five-year period, according to the Joint Committee on Taxation. The tax deferral is computed as the income taxes forgone on current tax-excluded pension contributions and earnings, less the income taxes paid on current pension distributions.

The expenditure of $650 billion over five years, or $1.3 trillion over 10 years, will be difficult to ignore for purposes of revenue generation during the debate on tax reform. Although eliminating the tax-preferred treatment of pension contributions is not politically attainable or sound long-term economics, reductions to the annual contribution limits could certainly be on the table.

NCPERS supports maintaining the current tax treatment of pension contributions and does not support reductions in the annual contribution limits.
Excise Tax on High-Cost Health Insurance

The Affordable Care Act (ACA) contains a provision to impose a 40 percent excise tax on health care plans that exceed certain annual cost thresholds. The recently enacted Omnibus Appropriations Act delayed the effective date of the tax by two years – from 2018 to 2020. In the meantime, however, we expect the Treasury Department and IRS to continue working on regulatory guidance for the implementation of the tax.

The annual thresholds are set at $10,200 for individual and $27,500 for family coverage. The thresholds are set higher for certain high-risk professions, such as firefighters and police officers. Those rates are $11,850 for individual and $30,950 for family coverage. The excise tax will be imposed on issuers of insured plans and plan administrators (usually plan sponsors) of self-funded plans. Estimates show that more than 60 percent of public-and private-sector employers with more than 500 employees will trigger the excise tax.

NCPERS will continue to provide input to the Treasury Department, the IRS, and Congress on this important topic.
Normal Retirement Age

In May 2007, the Department of the Treasury and the Internal Revenue Service (IRS) promulgated regulations that would define the term normal retirement age for pension plans. Specifically, the regulations provide that pension plans must have an age-based criterion for normal retirement.

Most pension plans for public employees provide eligibility for nondisability retirement based on years of service (YOS) or a combination of YOS and age, not on attainment of a certain age. Therefore, in order to comply with the 2007 regulations, many public plans may be forced to devote considerable resources to pursuing changes in governing state laws.

Public plans protested the new regulations in formal comments to the Treasury and IRS and in subsequent meetings attended by NCPERS and other national groups. As a result, the effective date of the regulations has been pushed back multiple times and, in early 2012, the Treasury and IRS issued notice 2012-29, which announced the intention to issue revisions to the 2007 regulations to clarify their scope. In particular, the notice stated that the revised regulations would clarify that governmental plans that do not provide for in-service distributions before age 62 do not need to have a definition of normal retirement age. In addition, the notice stated that the revised regulations would modify the age 50 safe harbor provision for public safety employees to ensure its application in instances where public safety employees are only a subset of a plan that includes other public-sector employees.

Treasury Notice 2012-29 also reset the effective date of the 2007 regulations as they apply to state and local governmental plans. The notice states that the regulations will be effective for annuity starting dates that occur in plan years beginning on or after the later of (1) January 1, 2015, or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after the final regulations are published in the Federal Register. Please be aware that the proposed regulations on the issues raised in the notice have not yet been published.

NCPERS supports the direction of Treasury Notice 2012-29 and will continue to work with the Treasury Department and IRS on the revised regulations.
Definition of Governmental Plan

In November 2011, the IRS issued an Advance Notice of Proposed Rulemaking (ANPRM) that announced that the Department of the Treasury and IRS plan to issue regulations defining the term governmental plan under IRC Section 414(d). The ANPRM also included a draft notice of proposed rulemaking and invited public comment.

NCPERS joined with a number of other national groups in submitting comments. Our joint letter focused on the creation of safe harbors, grandfather treatment, transition-related issues, and certain practical administrative concerns.

The basic structure of the ANPRM, which is the initial step in creating the first set of federal regulations under IRC Section 414(d), is a facts and circumstances test. Of particular interest is the test that would determine whether an entity is an “agency or instrumentality of a state or a political subdivision of a state.” The ANPRM contains a test for this definition that is based on five major factors and eight other factors. The factors include most of the areas of inquiry that logically would be investigated in a determination of whether an entity is a governmental plan, such as state or political subdivision control of the entity, state responsibility for the general debts and liabilities of the entity, delegation of sovereign powers, treatment as a governmental entity for federal tax purposes, and whether the entity is determined by state law to be an agency or instrumentality. However, there is no certainty that meeting four or five or even six factors would be sufficient for an entity to satisfy the new federal regulatory test outlined in the ANPRM. More clarity is needed.

In January 2015, Treasury-IRS released Notice 2015-7, which provides a five-part test for the definition of public charter school. The charter school community submitted some 2,000 comments on the ANPRM because of concerns related to whether their schools would be able to meet the test of being established and maintained by a state or political subdivision of a state. The five-part test is expected to be included in the proposed regulations.

NCPERS will continue to work with the Treasury Department and IRS as they develop proposed regulations on the definition of governmental plan.
Employer Pickups

Under IRC §414(h)(2), governmental entities may “pick up” their employees’ pension contributions and, in effect, transform the employee contributions into employer contributions, provided certain conditions are met. Employee contributions that are picked up by the employer are not includible in the employees’ gross income until distributed and are considered pretax employer contributions.

Revenue Ruling 2006-43 provides the rules for a pickup. The rules do not permit participating employees to have a right to a cash-or-deferred election with respect to designated employee contributions as of the date of the pickup. Therefore, participating employees must not be allowed to opt out of the pickup treatment or receive the contributed amounts directly instead of having them paid by the employing unit to the plan. This issue is a current focus of the Department of the Treasury, the IRS, and Congress. The issue was triggered by a private letter ruling (PLR) request. Federal legislation was introduced in the previous 113th Congress – H.R. 205.

The PLR sought to approve the use of the pickup in a situation where a new, reduced DB tier was created and the new tier would be available by election to existing employees. The employer would continue to pick up the contributions of existing employees, but the employee contribution rate in the new tier would be less than the rate in the existing tier. Existing employees who elect into the new plan would see their salaries increased by virtue of the lower contribution rate. Hence, by being able to choose between the current and newly created plans (or tiers), existing employees would have a right to a cash-or-deferred election.

In early 2014, the IRS issued a PLR that allowed pickup treatment in a case where the election for existing employees was between two tiers that had the same employee contribution rate. Use of the pickup in instances where the election would be between tiers with different employee contribution rates remain disallowed.

NCPERS will continue to provide input to the Treasury Department, the IRS, and Congress on this important topic.