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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.
Tax Reform and Retirement Savings

A top issue for the 115th Congress and the Trump Administration will be consideration of legislation to reform the federal tax code. NCPERS will be closely monitoring a number of key areas, which we discuss in detail below. Specifically, NCPERS will oppose attempts to (1) place further limits on annual contributions to retirement plans, (2) include the annuity accumulation plan proposal, or (3) include the Public Employee Pension Transparency Act.

1. Annual Contribution Limits

A central goal in the tax code reform effort is to lower corporate and individual tax rates. To keep the reform bill revenue neutral, so-called tax expenditures – exclusions, deductions, credits, and other special tax treatment – will have to be pared back.

One tax expenditure that has been discussed as a potential source of revenue is tax-preferred contributions to both defined benefit (DB) and defined contribution (DC) plans, which, combined, result in a tax deferral of approximately $820 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.

In the tax reform debate, the expenditure of $820 billion over five years, or $1.6 trillion over 10 years, will be difficult to ignore for purposes of revenue generation. 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.

2. Annuity Accumulation Retirement Plan

In the 114th Congress, Senate Finance Committee chair 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 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. Hatch, at least rhetorically, is positioning the annuity accumulation plan as a possible replacement for DB plans.

While legislation to create an oversight board for Puerto Rico has been enacted without including the annuity accumulation
plan, Senator Hatch is expected to continue pushing the proposal in the 115th Congress. Tax reform legislation presents one such opportunity.

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, police officers, 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 this 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 majority of current DB plans for state and local governmental employees are contributory – meaning that they are funded by contributions from both employers and employees. In addition, 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, which 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 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 DC plans chose not to proceed because of the high transition costs involved. Costs associated with a transition to the annuity accumulation model are likely to be significant as well.

*NCPERS opposes the annuity accumulation retirement plan.*
3. The Public Employee Pension Transparency Act

Also included in S. 2381 (114th Congress) was 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 U.S. 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 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.

PEPTA legislation has been introduced in the House since 2010. The most recent version, H.R. 4822 (114th Congress), by Representative Devin Nunes (R-CA), also included a provision that would penalize any plan sponsor that did not comply with the reporting requirements by denying them the ability to issue federally tax-exempt bonds.

NCPERS opposes the Public Employee Pension Transparency Act.

4. Employer Pickups

Under Internal Revenue Code section 414(h)(2), governmental entities may “pick up” their employee’s 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 employee’s gross income until distributed and are considered pretax employer contributions.

There are no regulations under section 414(h)(2). Revenue ruling 2006-43 and related private letter rulings (PLRs) provide the primary guidance 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 has been a focus of the Department of the Treasury, the Internal Revenue Service (IRS), and Congress. The issue was triggered by a PLR request. In addition, federal legislation was introduced in the 113th Congress under H.R. 205.

The PLR sought to approve the use of the pickup in a situation in which 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 lower 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), Treasury and the IRS conclude that 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 in which 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 remains disallowed.

*NCPERS will continue to provide input to the Treasury Department, the IRS, and Congress on this important topic.*
Given the 2016 election results, the six-year Republican campaign’s rallying cry to repeal the Affordable Care Act (ACA) now has a legislative path forward in Washington. Republicans in Congress have already begun the effort to repeal the ACA.

Senate majority leader Mitch McConnell (R-KY) continues to emphasize that the Senate will work expeditiously to develop a program that is better than current law but has not been able to provide a timetable for that process. In fact, there is significant disagreement within GOP circles on the timetable, with some saying the replacement must be completed within six months, while others are saying that up to two years may be needed.

Republicans are aware that certain repeal steps could lead to instability and disruptions in the individual insurance marketplace. Patient groups, such as the American Cancer Society Cancer Action Network, have urged Congress not to repeal major parts of the ACA without first developing a replacement that guarantees patients the same protections.

One provision likely to be repealed quickly is the 40 percent excise tax on healthcare plans that exceed certain annual cost thresholds, formerly known as the Cadillac 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.

The Omnibus Appropriations Act of 2015 delayed the effective date of the tax by two years – from 2018 to 2020.

NCPERS will closely monitor all legislative and regulatory work on the ACA. NCPERS supports full repeal of the 40 percent excise tax.
Mandatory Social Security

The Social Security system provides coverage for all private-sector employees and federal employees hired after December 31, 1983. However, when the system was created in 1935, concerns grounded in federalism led to the exclusion of state and local governmental employees. Under federal law, state and local governments can opt to enroll their employees in the Social Security program, or they can opt out if they provide a separate retirement plan that meets certain criteria. Today, approximately 25 percent of state and local governmental employees are not covered by Social Security.

One option to extend the solvency of the Social Security trust fund is to expand Social Security coverage to include all newly hired state and local governmental employees – so-called mandatory Social Security. The Congressional Budget Office (CBO) included this option in its most recent revenue options report. This expansion of Social Security would raise $78.4 billion over the next 10 years. If Social Security reform legislation gains traction in the 115th Congress, mandatory Social Security, in some form, could be a major part of the debate.

Mandatory Social Security is being advanced as a panacea to Social Security’s solvency, but it is not a panacea at all. In fact, while the short-term estimates mentioned above show substantial additional revenues, CBO also points out that the estimate does not include any changes to outlays during the 10-year scoring period. Further, CBO states that outlays, due to the increase in the number of eligible beneficiaries, will grow in the coming decades.

Mandatory Social Security will also increase payroll taxes on state and local governments. Governmental employers will have to pay 6.2 percent of payroll up to the wage cap ($127,200 in 2017) for all new employees.

NCPERS opposes expanding Social Security coverage to noncovered state and local governmental employees.
Healthcare Enhancement for Local Public Servants (HELPS II)

In 2006, NCPERS successfully lobbied Congress to approve the Healthcare Enhancement for Local Public Safety (HELPS) Retirees Act. This act allows a yearly distribution of up to $3,000 pretax from a governmental DB 403(b) or 457(b) plan to retired public safety officers for use toward healthcare insurance or long-term care premiums. The HELPS Retirees Act took effect on January 1, 2007.

Prior to HELPS, retirees paid for their entire healthcare or long-term care premiums with after-tax dollars. Since 2007, eligible public safety retirees have been able to use pretax dollars from their qualified pension plans to pay for health premiums. For retirees who are in the 25 percent federal marginal tax rate bracket, this could be a tax savings of up to $750 per year.

In the 115th Congress, NCPERS will advocate for legislation to enhance the benefits provided in the original HELPS Retirees Act. The Healthcare Enhancement for Local Public Servants (HELPS II) legislation would:

- Expand the coverage of the act to allow all public-sector retirees to be eligible for the benefit.
- Index the $3,000 benefit to inflation.
- Transform the income exclusion into a deduction; the deduction could even be used by nonitemizers.
- Allow surviving spouses to be eligible for the deduction.

NCPERS supports and will work toward enactment of the Healthcare Enhancement for Local Public Servants (HELPS II).
Retiree Medical Trust

Healthcare costs for retirees continue to drain the pension benefits of our retired public employees. Employees and current employee groups across the nation have taken steps to develop prefunding vehicles for ever-expanding healthcare costs. Retirees and employees near retirement have little or no time to establish a meaningful savings vehicle for retiree health care. Therefore, NCPERS believes that dedicating a portion of a retiree’s savings for the sole purpose of health care in retirement is a fiscally and socially responsible position.

The Economic Growth and Tax Relief Reconciliation Act of 2001 authorized increased limits, portability, and efficiency by consolidating pension assets through transfers and rollovers between plans. Also, the Pension Protection Act of 2006 provided pretax payment of a portion of healthcare premiums for public safety officers (HELPs).

NCPERS supports allowing retirees and employees near retirement to roll over assets from a governmental plan, such as a 401(a), 403(b), 457(b), or deferred retirement option plan, into a qualified medical trust or voluntary employee beneficiary association (VEBA) for the sole purpose of purchasing health care in retirement. Distributions from the qualified medical trust or VEBA would be tax-free.
Early-Age Medicare

Our nation’s first responders – police officers, firefighters, and emergency medical personnel – risk their lives in the service of their communities for modest pay. They look forward to the benefits their pension plans provide in their retirement years. Most public employees are eligible to retire after 20–25 years of service; most of those in physically and mentally demanding occupations, such as law enforcement and firefighters, retire in their mid-50s. In most cases, the average savings accrued by defined benefit pension plans allow first responders to enjoy approximately 50 percent of their yearly salary in retirement.

Unfortunately, the rising costs associated with employer-sponsored health care are gradually eroding retirement income and the peace of mind that comes with it. For retirement systems designed to provide pensions only, offering a healthcare plan has become burdensome and is putting pension reserves at risk. Public plans are finding it increasingly difficult to fund retiree health care and are scaling back or eliminating plans. One simple way to immediately usher in an affordable option is through a universal benefit already accessible in every state – Medicare.

Medicare, if made available at an earlier age, would provide more plan choices for eligible retired public safety officers who have already contributed to the Part A program. Public safety officers who have earned 40 or more credit quarters for Medicare Part A should be able to buy into not only Part A (hospital insurance), but also Part B (medical insurance), Part C (Medicare Advantage), and Part D (prescription drug coverage).

Providing this early avenue into Medicare will help ensure that our first responders have the dignified retirement they’ve earned.

NCPERS supports legislation to allow retired public safety officers to opt into Medicare at age 55.
Secure Choice Plans

NCPERS has been a strong advocate for secure choice retirement plans, which are state-run retirement plans for private-sector workers.

Two recent regulations issued by the Department of Labor (DOL) under the Employee Retirement Income Security Act (ERISA) related to state-run and political subdivision–run retirement plans for private-sector workers (i.e., secure choice plans) may be a target for repeal either by Congress through the Congressional Review Act (CRA) or by the Trump Administration through the regulatory process.

Although the first secure choice rule, which relates to state-run plans, is already effective, it is within the CRA’s window for potential repeal. The second secure choice rule, which would extend the ERISA safe harbor treatment outlined in the first rule to certain political subdivisions, was promulgated as a final rule on December 20, 2016, and will be effective 30 days after publication.

In addition to the possibility of the rules being repealed by application of the CRA, the Trump Administration could issue an interim final rule to extend the effective dates of the rules while it proposes modifications through a formal notice-and-comment rulemaking.

NCPERS supports the DOL regulations that provide a safe harbor for secure choice plans and opposes efforts to repeal or revise those rules.
Normal Retirement Age

In 2007, the Department of the Treasury and the IRS promulgated regulations that would define the term *normal retirement age* for pension plans. Specifically, the regulations provided that pension plans must have an age-based criterion for normal retirement.

Since most pension plans for public employees provide eligibility for nondisability retirement based on years of service (YOS) or a combination of YOS and age, rather than on attainment of a certain age, 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.

In 2012, Treasury-IRS issued Notice 2012-29, which announced their intention to issue revisions to the 2007 regulations to clarify their application to state and local governmental plans. Then, in early 2016, Treasury-IRS issued proposed regulations that are responsive to most of the concerns raised by NCPERS and the plan community.

For public safety, the proposed regulations 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 larger plan that includes other public-sector employees. The proposed regulations would also add two additional safe harbors: (1) rule of 70, whereby the sum of the participant’s age and years of credited service are added together; and (2) attainment of 20 years of credited service.

Regarding all other governmental plans, the proposed regulations clarify that, if they do not provide in-service distributions before age 62, they do not need to have a definition of *normal retirement age*. Additional safe harbors are as follows: later of age 60 or the age at which the participant has at least five years of credited service; later of age 55 or the age at which the participant has at least 10 years of credited service; rule of 80; and the earlier of the age at which the participant has reached 25 years of credited service or the normal retirement age under another safe harbor.

*NCPERS supports the direction of Treasury Notice 2012-29 and the proposed regulations and will work with the Trump Administration’s Treasury Department and IRS on final regulations.*
Definition of Governmental Plan

In 2011, the IRS issued an Advance Notice of Proposed Rulemaking (ANPRM) announcing that the Department of the Treasury and IRS plan to issue regulations defining the term governmental plan under Internal Revenue Code 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 joint comments. The comment 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 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 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 approximately 2,000 comments to the ANPRM due to 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 work with the Trump Administration’s Treasury Department and IRS as they develop proposed regulations on the definition of governmental plan.