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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 550 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 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 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 $21,800 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.
The Secure Annuities for Employee (SAFE) Retirement Act

In July 2013, Sen. Orrin Hatch (R-UT) introduced S. 1270, the Secure Annuities for Employee (SAFE) Retirement Act. Title I of S. 1270 would allow states to replace their public pensions by purchasing private insurance annuities for public employees. Once the public plans are replaced with annuities most experts believe that the public pensions would be closed.

Claiming that unfunded pension liabilities of state and local governments are undermining the fiscal health of states, Sen. Hatch proposes a new state-regulated, privatized, fixed-annuity product for public employees. Under his proposal states would be allowed to purchase group annuity insurance for their employees and close the traditional public pension plan. The group annuity contracts would be bid out every year. So theoretically, a public employee could have a different group annuity insurance company for each and every year he or she worked for the state. At the end of his or her career all these individual yearly annuity contracts would be amalgamated to provide retirement income. The annuity premiums would be paid by the employer only.

Important issues have been raised by NCPERS and the public pension plan community:

- **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 annually negotiated, single-year, fixed-rate, individual annuity contracts would provide a comparable level of replacement income during retirement to that of a pre-funded defined benefit (DB) plan. In considering this question, it is important to note that, under the legislation, the plan sponsor would not be required to enter into any annuity contracts at all for its employees. This would be a purely voluntary system and one which could and most likely will 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 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. 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 legislation does not contemplate any provisions for 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.
The Secure Annuities for Employee (SAFE) Retirement Act (continued)

- **Hidden and Additional Costs** – The aggregation of the annual annuity contracts will be necessary if plan participants are to be confident that they will receive their full retirement income. It is not reasonable to place the onus 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 pay the bill. Further, if plan sponsors add survivor or disability benefits, premium costs for the annuities will rise significantly.

- **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.

- **Impact on Existing Retirement Plans** – The legislation would require that any plan moving to the annuity model freeze its existing DB or DC plan, which would starve frozen DB plans of new contributions and jeopardize their ability to make ongoing retirement distributions.

- **Financial Backstop** – There are questions related to the ability of state guaranty funds to provide a dollar-for-dollar backstop for annuity accumulation plan participants in the event of the financial collapse of a single life insurance company or more than one company. While the legislation is designed to shift risk from plan sponsors to insurance companies, in reality the plan participants and retirees will always bear the risk under the proposed system.

- **Question of Law** – There are questions related to which state law will apply in the event of a collapse: The state in which the annuity contract was purchased? The state in which the plan participant resides? The state in which the plan sponsor resides? The state in which the insurance company has its headquarters or primary place of business?

NCPERS opposes the Secure Annuities for Employee Retirement Act.
The Public Employee Pension Transparency Act

In April 2013, Representative Devin Nunes (R-CA) and Senator Richard Burr (R-NC) introduced H.R. 1628 and S. 779. Titled the Public Employee Pension Transparency Act, 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. Failure to comply with the reporting requirement would result in the loss of the plan sponsor’s ability to issue bonds that are exempt from federal tax. Reporting would be required using two distinct methods. First, pension liabilities 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 are not fully funded would be required to report their pension liabilities on a rate of return based on a U.S. Treasury obligation yield curve. The Treasury obligation yield curve method would predictably produce a dramatic increase in the correlated calculation of unfunded liabilities of plans.

NCPERS opposes the Public Employee Pension Transparency Act.
Medicare Payroll Tax Voluntary Opt-In Proposal

Certain public employees hired on or before March 31, 1986, may not be eligible for premium-free Medicare Hospital Insurance (HI), which is commonly known as Medicare Part A.

The Consolidated Omnibus Budget Reconciliation Act of 1985 requires employees who began working for a state or local government after March 31, 1986, to pay the Medicare HI tax. However, the act did not make the tax mandatory for workers hired before that date. Under the Omnibus Budget Reconciliation Act of 1990, the Medicare tax was extended to those state and local government workers who were not covered by a retirement plan through a current employer. Even with this change, about 2 percent of state and local workers do not pay the Medicare HI tax today.

All states have agreements with the federal Social Security Administration (Section 218 agreements) that designate employee positions that will be covered by the Medicare HI payroll tax, including some positions held by employees hired on or before March 31, 1986. These agreements can be modified and new positions added by a referendum of employees in separate retirement groups, but individuals cannot opt in on their own.

Unless the affected public-sector employees build Medicare credit quarters through other employment or can qualify through their spouses, they are ineligible for the Medicare Part A coverage that most Americans receive. Paying the Medicare HI tax for 10 years (40 credit quarters) generally qualifies workers for free Medicare Part A coverage; paying the tax for at least 7½ years (30–39 credit quarters) qualifies workers for a reduced Part A monthly premium.

Upon reaching age 65, otherwise ineligible individuals may buy into Medicare Part A coverage by paying monthly premiums. The Part A premiums were $441 per month in 2013 ($5,292 per year).

NCPERS supports H.R. 2618, which was introduced by Rep. Gene Green (D-TX). The legislation would allow active public-sector employees to voluntarily opt in to the Medicare payroll tax system.
Tax Reform and Retirement Savings

Tax expenditures will be under the microscope during consideration of comprehensive tax reform this year. One area that was discussed in the president’s National Commission on Fiscal Responsibility and Reform (Simpson-Bowles Plan) is tax-preferred contributions to both defined benefit and defined contribution retirement plans, which combined cost almost $640 billion over a five-year period, according to the Joint Committee on Taxation. The cost 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 $640 billion over five years, or $1.28 trillion over 10 years, is hard to ignore for purposes of revenue generation during debate on tax reform. Although eliminating the tax-preferred treatment of pension contributions is not politically attainable or sound economics in the long term, 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.
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, 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 the IRS and in subsequent meetings attended by NCPERS and other national groups. As a result, the effective date of the regulations was pushed back multiple times and, in early 2012, the Treasury and the 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.

**NCPERS supports the direction of Treasury Notice 2012-29 and will continue to work with the Treasury Department and the 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 the IRS plan to issue regulations defining the term **governmental plan** under Internal Revenue Code (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 four or five or even six factors would be enough for an entity to satisfy the new federal regulatory test outlined in the ANPRM. More clarity is needed.

At a public hearing held by the IRS in the summer, 14 witnesses testified on the ANPRM. Five of the witnesses focused on the controversy surrounding whether charter schools would be eligible for governmental plan status under the ANPRM’s factor-based test. In the question-and-answer portion of the hearing, the IRS seemed to be giving serious consideration to adding an example to the ANPRM in its next iteration that would describe the relevant factors of charter schools – open enrollment, free tuition, state regulation and funding – and conclude that this type of entity would meet the definition of a governmental plan.

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

Under IRC Section 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 cash or deferred election right 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, H.R. 2934 (112th Congress), was also introduced.

The PLR sought approval to create a new and reduced tier of defined benefit within an existing defined benefit plan and make the new tier available 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 choose the new plan would see their salaries increased by virtue of the lower contribution rate. Hence, by being able to choose between the existing and new plans, existing employees would have a cash or deferred election.

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

On January 6, 2011, the Securities and Exchange Commission (SEC) issued a proposed rule that defined the term municipal advisor. The proposed definition included appointed, but not ex officio, members of a governing body of a municipal entity. The SEC’s rationale for the inclusion of these board members is that “the Commission is concerned that appointed members, unlike elected officials and elected ex officio members, are not directly accountable for their performance to the citizens of the municipal entity.”

The SEC received numerous comment letters on this proposed definition, including a letter from NCPERS. The thrust of the NCPERS comments is that pension trustees receive advice in connection with fiduciary duties and should not be confused with those providing investment advice or be required to register as a municipal advisor. NCPERS is concerned that unpaid pension trustees would potentially be deterred from service or would likely want the municipality to provide legal or other assistance with registration and related compliance requirements.

On September 18, 2013, the SEC approved a final rule on this matter. It states, “After considering the comments, the Commission has determined to exempt from the definition of municipal advisor, pursuant to its authority under Section 15B(a)(4), all members of a municipal entity’s governing body, its advisory boards and its committees, as well as persons serving in a similar official capacity with respect to the municipal entity, to the extent they are acting within the scope of their official capacity, regardless of whether such members or officials are employees of the municipal entity. Specifically, Rule 15Bal-1(d)(3)(ii) exempts from the definition of municipal advisor ‘[a]ny person serving as a member of a governing body, an advisory board, or a committee of, or acting in a similar official capacity with respect to, or as an official of, a municipal entity or obligated person to the extent that such person is acting within the scope of such person’s official capacity’ and ‘any employee of a municipal entity or obligated person to the extent that such person is acting within the scope of such person’s employment.’

The Commission agrees with commenters that like employees, a municipal entity’s officials, as well as members of a municipal entity’s governing body and other officials serving in a similar capacity (including members of advisory boards and committees), whether or not employed by a municipal entity, typically act on behalf of the municipal entity.”

NCPERS is pleased with the final rule issued by the SEC that removes pension trustees of governmental plans from inclusion in the definition of municipal advisor.