ADVOCACY RESEARCH EDUCATION

2023 LEGISLATIVE CONFERENCE

January 22–24
Renaissance Washington, DC Hotel
Washington, DC

LEGISLATIVE ISSUES BOOK

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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 $4 trillion in pension assets. Our core missions are federal **Advocacy, Research** vital to the public pension community, and **Education** of pension trustees and officials – it's who we **ARE**.

Who do we benefit? The approximately $4 trillion in public pension assets in the United States is managed on behalf of 7 million public retirees and 15 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 $29,000 per year – that helps provide 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, *Pensionomics 2023*, state and local pension plans had a total of $719 billion in economic output and $406 billion in value-added impact; supported more than 3.7 million American jobs that pay a total income of $232 billion; and provided $86.8 billion in annual federal, state, and local tax revenue in a single year. Every taxpayer dollar invested in state and local pensions supported $7.89 in total economic activity, while each dollar paid out in benefits supported $2.13 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.

NCPERS Legislative and Regulatory Issues 2023

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Tax Policy

State and local governmental pension plans are qualified plans under Internal Revenue Code (IRC) Section 401(a). As such, the plans and their participants receive certain tax advantages – pension plans are not subject to tax on assets or earnings generated by investments, and participants are not subject to income and employment taxes on contributions made by their employers or on earnings of the trust fund until pension distributions are made.

These are significant tax advantages. Due to their importance, the public pension community pays close attention to changes in federal tax law or regulation that could affect the qualified status of pension plans. In Congress, this means paying attention to the actions of the House Ways and Means Committee and the Senate Finance Committee, which have exclusive jurisdiction over the federal tax code. In the executive branch, this means monitoring the regulatory activities of the U.S. Department of the Treasury and the Internal Revenue Service (IRS).

The SECURE Act

In 2019, Congress approved and President Trump signed the SECURE (Setting Every Community Up for Retirement Enhancement) Act into law. The legislation increased the age for triggering required minimum distributions (RMDs) from 70 1/2 to 72. This provision affects IRC Section 401(a) qualified retirement plans, 457(b) plans, 403(b) plans, 401(k) plans, and IRAs. The new law also allows participants to take a distribution of a lifetime income investment and roll it into another plan, without withdrawal restrictions, provided their plan no longer offers that investment option. Further, provided the plan permits such withdrawals, taxpayers are allowed to withdraw up to $5,000 from their retirement accounts in the 12-month period beginning on the date a child of the individual is born or the legal adoption of an eligible adoptee is finalized, without incurring the 10 percent early withdrawal tax penalty. Finally, non spousal, inherited retirement accounts now have to be distributed within 10 years of the death of the employee or account owner, with certain exceptions. For IRC Section 414(d) governmental plans, this section applies to distributions with respect to employees who die after December 31, 2021.

The American Miners Act, which technically was not part of the SECURE Act but was also enacted in the same massive end-of-year legislation, reduced the age at which a qualified plan may provide in-service distributions. The previous age was 62; the American Miners Act reduced it to age 59 1/2, provided the plan sponsor allows in-service distributions to plan participants and adopts the lower age for such distributions.

The CARES Act

In March of 2020, the CARES (Coronavirus Aid, Relief, and Economic Security) Act was signed into law in response to the Covid-19 crisis. There were three major provisions of the CARES Act of particular importance to public pension plans. First, the CARES Act provided that plans were allowed to make Covid-19-related, penalty-free distributions to eligible participants from IRC Section 401(a) plans, governmental 457(b) plans, 403(b) plans, 401(k) plans, and IRAs of up to $100,000 in 2020. This was a permissive provision that expired at the end of 2020. Distributions were subject to regular income tax over three years and could be repaid to the plan within three years of the distribution. Individuals were eligible to take distributions if they, their spouse, or dependents were diagnosed with Covid-19 by a test approved by the Centers for Disease Control, or if they suffered adverse

Tax Policy (cont'd)

financial consequences as a result of being quarantined, furloughed, laid off, or having work hours reduced due to the virus, or were unable to work due to a lack of child care.

Second, there were two changes to the rules on participant loans. First, eligible individuals (under the same definition as above) could receive loans from 401(a) plans, governmental 457(b) plans, or 403(b) plans up to a maximum loan amount of $100,000 in the 180 days beginning on the date of enactment of the CARES Act. (The previous limit was $50,000.) Further, loans were allowed up to the greater of $10,000 or 100 percent (previously 50 percent) of the present value of the participant's account. The increased loan caps were permissive. Plans do not have to allow loans at all and may impose limits that are lower than the statutory caps. In addition, eligible individuals affected by Covid-19 with plan loan repayments due between the date of enactment of the CARES Act and December 31, 2020, were given an additional 12 months to make the payment and the subsequent payment schedule was adjusted accordingly. (This provision was mandatory.)

The third and final provision of importance to public plans found in the CARES Act modified retirement plan RMD rules. As discussed above, the SECURE Act raised the age trigger for receiving RMDs from 70 1/2 to 72. That change applied to individuals turning 70 1/2 on or after January 1, 2020. For individuals under the old age trigger, the CARES Act waived RMDs for 2019 that would have been made by April 1, 2020, and any RMD required to be paid in 2020. It was a one-year delay and applied to defined contribution 401(a) plans, governmental 457(b) plans, 403(b) plans, 401(k) plans, as well as IRAs. (This was a mandatory provision.)

SECURE 2.0

Building on the SECURE Act of 2019, President Biden signed the SECURE 2.0 Act of 2022 as part of the Consolidated Appropriations Act, 2023, which was passed by Congress on December 23, 2022. SECURE 2.0 consolidates portions of three separate bills: (1) the House's Securing a Strong Retirement Act, (2) the Senate's Enhancing American Retirement Now (EARN) Act, and (3) the Retirement Improvement and Savings Enhancement to Supplement Healthy Investments for the Nest Egg (RISE and SHINE) Act. The final package increases the age for RMD from 72 to 73 effective January 1, 2023, and to 75 effective January 1, 2033. This provision affects IRC Section 401(a) qualified retirement plans, 457(b) plans, 403(b) plans, 401(k) plans, and IRAs. SECURE 2.0 eliminates predeath RMDs from in-plan Roth accounts in 401(k), 403(b) and governmental 457(b) plans. SECURE 2.0 allows 401(k), 403(b) and governmental 457(b) plans to treat a student loan payment as an elective employee contribution for purposes of triggering matching contributions. This provision is effective for contributions made for plan years beginning after December 31, 2023. SECURE 2.0 eliminates the previous first-day-of-the-month rule only for governmental 457(b) plans, effective for taxable years beginning after the date of enactment. Effective upon enactment, the legislation expands the exemption from the early distribution tax for distributions from a governmental plan to public safety officers with 25 years of service and corrections officers who are employees of state and local governments.

NCPERS will continue to closely monitor federal tax policy for any significant developments in either Congress or the executive branch agencies.

Employer Pickups

One provision that passed the House in recent years but was not approved by the Senate dealt with the pickup rule, which is widely used by state and local pension plans. Under IRC Section 414(h)(2), governmental entities may pick up (i.e., pay for) their employees' pension contributions and, in effect, transform post-tax employee contributions into pre-tax employer contributions. Employee contributions that are picked up by the employer are not includible in the employee's gross income until distributed.

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 arrangement (CODA) 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.

In recent years, PLR requests sought approval for use of the pickup in situations where a new defined-benefit (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 legacy tier. Existing employees who elect into the new plan would see their salaries increase by virtue of the lower contribution rate. The IRS reasoned that if they were allowed to choose between the legacy and new tiers, existing employees would have a right to a CODA. Therefore, the election between tiers would not be permitted.

Stand-alone federal legislation to make the pickup rule more flexible has been introduced in four recent Congresses, with H.R. 3213 (116th) being the most recent version.

In 2018, the Family Savings Act included a pickup provision as well. It stated: "[The] contribution shall not fail to be treated as picked up by an employing unit merely because the employee may make an irrevocable election between the applications of two alternative benefit formulas involving the same or different levels of employee contributions." This language is identical to that found in the previous legislation.

Also in 2018, the following report language accompanied the House-passed Financial Services Appropriations Bill: "The Committee recommends that the Secretary of the Treasury and the Commissioner of the IRS initiate a review of the existing regulatory guidance in Revenue Ruling 2006-43 and issue a revised revenue ruling that allows state and local pension plan sponsors to give existing plan participants the choice to make certain elections between pension plans or plan tiers without changing the tax treatment of employer contributions."

Revising the pickup rule to provide more flexibility for plan sponsors was a priority for the GOP-controlled House during the 115th Congress (2017–2018). It is possible that the new Republican majority in the current 118th Congress will once again take an interest in this proposal.

NCPERS will closely monitor the pickup issue for any significant developments in either Congress or the executive branch agencies.

Unrelated Business Income Tax

During consideration of the Tax Cuts and Jobs Act of 2017 (TCJA), the House passed a provision that would have subjected certain investments of public pension plans to the unrelated business income tax (UBIT). Private equity and hedge fund investments would have been most affected.

The UBIT proposal was first included in tax reform legislation introduced in 2014 by then Ways and Means committee chairman Dave Camp (R-MI). The provision was described as a “clarification” of current law. In 2014, the Joint Committee on Taxation scored the UBIT provision as raising $100 million in new revenue over 10 years. In 2017, it was scored as raising $1.1 billion, which immediately made it a much more attractive provision for inclusion in a large tax bill.

The proponents of the provision defended it by saying that public pensions are qualified plans under IRC Section 401(a), and Section 401(a) is referenced in the UBIT section of the tax code (IRC Section 511). Public plan propoenents argued a different view. NCPERS strongly believes that state and local governmental pension plans are exempt from all taxes by virtue of IRC Section 115, which excludes from gross income any income derived from the exercise of any essential governmental function and accruing to a state or political subdivision thereof. Furthermore, NCPERS argued that application of a federal tax to state and local pension plans would erode the immunity from taxation that states and the federal government each enjoy from the other.

In the end, the UBIT provision was not included in the final 2017 tax law. While the provision has not been seen since that time, it could be raised again in future tax legislation.

NCPERS will continue to oppose the extension of UBIT to public pension plans.

Public Employee Pension Transparency Act

The Public Employee Pension Transparency Act (PEPTA) was first introduced in 2010 by Rep. Devin Nunes (R-CA). The most recent iteration of the bill is H.R. 6290 (115th). The bill has not been reintroduced since the 115th Congress and Rep. Nunes has now retired from Congress.

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 expected long-term rate of return that each plan currently uses. 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 vast majority of public plans – on paper. This would create negative headlines for public plans but would not add any new, useful economic information to aid in the analysis of these plans. Versions of PEPTA have also included a provision that would penalize any plan sponsor that did not comply with the reporting requirements by denying the sponsor the ability to issue bonds that are exempt from federal tax.

NCPERS opposes the Public Employee Pension Transparency Act.

Discount Rates

Of considerable interest to actuaries, economists, trustees, and policy makers is the discussion of what is an appropriate assumed rate of investment return (i.e., discount rate) for pension plans.

During Senate consideration of President Biden's 2021 Covid-19 relief package, which included financial assistance for private sector, multiemployer pension plans (Taft-Hartley plans), Senator Chuck Grassley (R-IA) introduced legislation (S. 598) that would have capped the discount rates these plans could use in applying for and during partition of plan benefits of critical and declining plans:

> In no case shall the assumption for future returns be less than 5.5 percent for purposes of determining the initial partition amount, and
>
> In no case, while the partition amount is being determined or while the partition is in effect, shall the assumption be less than the lesser of (1) the 24-month average of the third segment of the yield curve plus 2 percent, or (2) 5.5 percent.

Senator Grassley has voiced his concern over the years that the average discount rate used by multiemployer pension plans is inappropriately high in today's economy – 7.13 percent. However, this average rate is well below the average rate currently used by state and local governmental plans, which is approximately 7.4 percent. It is clear, then, that the same argument would be used in an effort to cap the discount rates of public pension plans and that those arguments will continue to be presented with an even greater sense of urgency.

Grassley's S. 598 has not yet been reintroduced in the 118th Congress. However, while the 2021 enacted federal legislation to provide financial relief to multiemployer plans did not include restrictions on discounts rates, future legislation may reinvigorate the discussion of a cap.

The public pension community will continue to monitor legislation in this area because of potential parallels in how Congress may treat state and local governmental plans in future legislation.

NCPERS opposes a federal cap on the discount rate that state and local governmental pension plans may use.

Rothification and Miscellaneous Tax Provisions

During the lead-up to the release of the original version of the TCJA in 2017, House Republicans considered including a provision to make it a requirement that all new contributions to defined-contribution (DC) plans (e.g., IRAs and 401(k), 457(b), and 403(b) plans) be made under the rules related to Roth accounts. Those rules require that contributions be made with after-tax dollars but that distributions are free from tax. This provision ultimately was not included.

However, in the recently enacted SECURE Act 2.0, the Roth method is mandated for catch-up contributions made by participants who earn more than $145,000 in income from the employer sponsoring the retirement plan. Under the tax law, participants age 50 and older who have contributed the annual maximum to their defined contribution plan ($22,500 in 2023) may make additional catch-up contributions to their defined contribution plans of up to $7,500 (2023 maximum). The SECURE Act 2.0 also increases the annual maximum catch-up contribution to $10,000 for those age 60, 61, 62, and 63.

Also included in the original Senate bill in 2017 but dropped prior to Senate passage were two provisions aimed at normalizing contribution rules for 457(b) and 403(b) plans. The first provision would have prevented participants from maxing out contributions to both a 403(b) and a 457(b) plan; this provision also would have repealed all special rules related to post-employment contributions to 403(b) plans and catch-up contributions to 457(b) plans within three years of reaching normal retirement age. The second provision would have subjected 457(b) plan distributions to the early withdrawal penalty under IRC Section 72(t), where applicable. These provisions were not included in the House bill or the final tax legislation.

NCPERS will continue to provide input to Congress on these tax proposals if they are raised in the 118th Congress.

Annuity Accumulation Retirement Plan

A proposal to create a new qualified plan in the federal tax code (the annuity accumulation plan) was last introduced in the 114th Congress, S. 2381, Section 203. 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 initiates an annuity accumulation plan, it will freeze existing DB plans. The result would be that the annuity accumulation plan would become the primary retirement vehicle for state and local workers and would replace DB plans.

In this regard, NCPERS has several major concerns:

- **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 level of replacement income during retirement comparable to that of a prefunded DB plan. In considering this question, it is important to note that, under the previous legislative proposal, the plan sponsor would be able to change its contribution rate each year, provided it does so for all employees. It is likely, then, that the employer contribution would change each year depending on the plan sponsor's financial and political circumstances.

- **Disallowance of Employee Contributions** – Another factor in the replacement income discussion is that the vast majority of DB plans for state and local governmental employees are contributory plans, which means that the plans are funded by contributions from both employers and employees. Moreover, the percentage of plans that are contributory continues to grow. In contrast, the annuity accumulation plan proposal would not allow employees to contribute to their own retirement plans. It is unlikely that annuities funded only by employers 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. These are essential benefits for those who provide firefighting services, police protection, or emergency medical services. If plan sponsors separately add survivor or disability benefit policies, premium costs for the annuities will rise significantly.

- **Aggregation Costs** – 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 annual 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 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 retirement plan.

Annual Contribution Limits

A tax expenditure that has been discussed over the years as a potential source of revenue is tax-preferred contributions to both DB and DC plans, which, combined, would result in a tax deferral of over $1.7 trillion over 10 years, according to the Treasury. 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.

This expenditure could become difficult to ignore for purposes of revenue generation during consideration of future tax legislation. While 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 annual contribution limits.

Federal Aid to States and Localities

The American Rescue Plan Act of 2021 (ARPA), now Public Law 117-2, authorized $350 billion in new federal aid to state, local, tribal, and territorial governments. The ARPA stipulated that no state or territory may use funds made available under the ARPA for deposit into any pension fund. An identical restriction was contained in the aid provisions for localities.

Bipartisan legislation released at the end of 2020 but not enacted would have included a much more onerous restriction. This proposal would have created a general condition for receiving funds under the ARPA, saying that a state or local government shall not make a change to its pension program that would result in total pension obligation payments in state fiscal years 2021 or 2022 exceeding total pension obligation payments for state fiscal year 2019, with some exceptions, including one for cost-of-living adjustments already provided for in the state or local law.

In addition, legislation approved by the House in 2015 would have barred any state that received funds under the Elementary and Secondary Education Act (ESEA) from requiring a local education agency to use those funds to make contributions to a teacher retirement system in excess of normal cost, which was defined to not include any accrued unfunded liabilities. This restriction was not included in the final law.

If attempts are made in the future to include such restrictions on public pensions, proponents may fall back on one of the previous unsuccessful approaches (conditioning federal assistance or normal pension cost). Such attempts could be instigated by attempts by states or localities to creatively use funds under ARPA, which will be the subject of oversight hearings in the 118th Congress.

NCPERS will closely monitor all legislative and regulatory proposals related to federal funding and restrictions on public pensions.

Infrastructure

Facilitating increased investment in infrastructure by public pension plans is not a new idea. Since 2014, there have been periodic meetings in Congress on the subject. Given the lack of political support for an increase in the federal gas tax, a search for alternative means of financing has been underway for years. Public pension plan assets appear as a ready pool of investment dollars.

Some proponents of greater participation by public plans argue that it would be a benefit to plans to have full or partial ownership of the actual infrastructure asset and the revenue stream produced by that asset. They identify a barrier in federal tax law that they say creates an unlevel playing field among public plans today, specifically the question of whether the public pension plan designated to acquire the public infrastructure asset meets the criteria of "an instrumentality of one or more states or political subdivisions" as outlined in Rev. Rul. 57-128. The question is whether the plan's governing structure satisfies the fourth condition of the ruling's six-part test: "whether control and supervision of the organization is vested in public authority or authorities." In addition, a second question is whether, for purposes of the private business test under IRC Section 141, the acquisition by a public plan would trigger the arbitrage rule under IRC Section 148(b), which would result in the underlying bonds losing their tax-exempt status.

In the 115th Congress, H.R. 6276, the Strengthening Pensions through Investment in Infrastructure Act, was introduced by Rep. Mike Bishop (R-MI). The bill would have made two changes to the tax code. First, it would have amended IRC Section 141(b) to state that use by a public pension fund of public infrastructure property shall not be treated as private business use. The bill defined the term *public pension fund* as "a pension fund established or maintained for employees or former employees of a state, political subdivision of a state, or an agency or instrumentality thereof." Second, the legislation would have amended IRC Section 148(b) to state that the term *investment-type property* shall not include public infrastructure property. Without this clarification, proponents argue that the bonds used to finance the public infrastructure property would almost certainly be treated as arbitrage bonds and would lose their tax-exempt status.

This previous legislation has been included in a new proposal, which has not yet been introduced, called the Public Infrastructure Finance and Innovation Act (PIFIA). The new proposal would authorize federal dollars to be borrowed by a state or locality with a population over one million in the form of a 30-year loan. Then, the borrower would transfer the monies to the pension plan(s) that it sponsors. The plan must use 10–20 percent of the loan proceeds (depending on population density) for public infrastructure investments. In theory, providing the pension plan with the new money would mean that the plan's unfunded liability would be reduced and, in turn, the borrower's actuarially determined contribution (ADC) would be reduced. Then, beginning in the fourth year , the borrower must use 50 percent of any budget relief it realizes due to the reduction in the ADC for public infrastructure projects. The first three years of budget relief would be used for expenses related to Covid-19.

Infrastructure (cont'd)

In addition, over the years Rep. John Yarmuth (D-KY) has discussed a proposal to create a National Infrastructure Development Bank, which would be financed through the sale of $75 billion worth of Rebuild America Bonds on the credit of the United States. An additional $300 billion in bonds could be issued. The bonds would mature in 40 years and could not be resold until 10 years after issuance. They would bear an interest rate of 200 basis points above the 30-year Treasury bond and could be purchased only by pension plans – both ERISA and governmental plans.

On November 15, 2021, President Biden signed into law the $1.2 trillion infrastructure legislation. The new law does not contain any of the proposals discussed above. However, the proposals may be discussed in future infrastructure legislation.

NCPERS will closely monitor all legislative and regulatory proposals related to infrastructure investments by public pension plans.

Affordable Care Act

A major focus of NCPERS since enactment of the Affordable Care Act (ACA) was to repeal the 40 percent excise tax on health care plans that exceed certain annual cost thresholds, formerly known as the Cadillac tax. The annual thresholds were set at $10,200 for individual and $27,500 for family coverage. The thresholds were set higher for certain high-risk professions, such as firefighters and police officers: $11,850 for individual and $30,950 for family coverage. The excise tax would have been imposed on issuers of insured plans and plan administrators (usually plan sponsors) of self-funded plans.

We are pleased to report that the Cadillac tax was fully repealed in 2019.

NCPERS will closely monitor all legislative and regulatory work on the ACA.

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 remain out of Social Security coverage if they provide a separate retirement plan that meets certain criteria, commonly known as a FICA (Federal Insurance Contribution Act) replacement plan. 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 a recent revenue options report; it would raise $131.5 billion over the next 10 years. If Social Security reform legislation gains traction in 2023, mandatory Social Security, in some form, could be a part of the debate.

Mandatory Social Security is being advanced by some as a panacea to ensure Social Security's solvency, but it is not a panacea at all. In fact, while the 10-year estimate mentioned above shows substantial additional revenues, CBO also points out that the estimate does not include any changes to outlays during the scoring period. In fact, CBO states that outlays, due to the increase in the number of eligible beneficiaries, would grow in the following decades and would partly offset the additional revenues.

Mandatory Social Security would also increase payroll taxes for state and local governments. Governmental employers would have to pay 6.2 percent of payroll up to the wage cap ($160,200 in 2023) for all new employees. A new report by the consulting firm Segal estimates that the employer and employee cost of Social Security coverage for newly hired workers for the first five years of coverage would reach $35 billion and possibly as high as $50 billion. This increased cost in payroll taxes would be felt in every state.

NCPERS opposes expanding Social Security coverage to noncovered state and local governmental employees.

Windfall Elimination Provision/Government Pension Offset

The Windfall Elimination Provision (WEP) is a reduction of Social Security benefits that is applied to retirees of state and local governments who earned a pension in public-sector employment that was not covered by Social Security. The Government Pension Offset (GPO) is a reduction of Social Security's dependent or survivor benefits that is applied to beneficiaries who receive a pension from employment that was not covered by Social Security.

H.R. 82 (117th), the Social Security Fairness Act, which was introduced by Rep. Rodney Davis (R-IL), would repeal both WEP and GPO. The bill had 305 co-sponsors. Senator Sherrod Brown (D-OH) introduced the Senate version of this legislation, S. 1302. Unfortunately, despite having a significant number of co-sponsors, full repeal legislation was not considered by either the House or Senate because of the high costs associated with repeal.

In addition to the full repeal bills in the 117th Congress, Ways and Means Chairman Richard Neal (D-MA) and Committee Ranking Member Kevin Brady (R-TX) introduced different versions of WEP-only repeal bills, H.R. 2337 and H.R. 5834, respectively, in the 117th Congress. There was hope that the two lawmakers would be able to agree on a compromise bill, but that was not the case.

If enacted, the Neal bill would provide a rebate from the WEP penalty of $150 per month for those currently affected by WEP and those who turn age 62 before 2023. Those who are not in the rebate category and all future hires would receive the higher benefit of current Social Security law, which includes the substantial earnings exemption, or the new proportional formula. The proportional formula would be based on each worker's actual work history. If the Brady bill were enacted, it would phase in a new formula for determining the benefit amounts under WEP, adjusting total lifetime earnings based on the portion of those earning subject to Social Security. It would apply to those who become eligible for Social Security after 2061. Beneficiaries who become eligible between 2022 and 2062 would receive the higher of the amount calculated under the existing WEP or the new formula. Certain currently affected beneficiaries would also receive a $100 monthly payment.

Under current law, once you reach 21 years of substantial earnings (i.e., earnings from Social Security–covered employment over a certain dollar amount) your WEP penalty begins to phase out by 5 percent each year. Once you reach 30 years of substantial earnings, the WEP penalty is completely eliminated. Those who are on a path to this phaseout would like for it to remain available to them rather than being subjected to the new proportional formula.

None of the proposed WEP or GPO bills were included in the final SECURE 2.0 legislation enacted in 2022. In addition, Republican champions of the bills Rep. Davis and Ranking Member Brady have both retired. It is unclear what action may occur in the 118th Congress.

NCPERS will closely monitor all legislative proposals that would repeal or modify the WEP and GPO penalties.

Healthcare Enhancement for Local Public Servants

In the Pension Protection Act of 2006, NCPERS successfully lobbied Congress to approve the Healthcare Enhancement for Local Public Safety Retirees Act (HELPS). This act allowed a yearly pretax distribution of up to $3,000 from a governmental DB, 403(b), or 457(b) plan to retired public safety officers for use toward health care or long-term care insurance, provided the premium payments were made directly by the governmental retirement system to the provider of the insurance. HELPS took effect on January 1, 2007. It is found at IRC Section 402(l).

Prior to HELPS, retirees paid for their health or long-term care premiums entirely 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 some of their 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.

Over the years, however, NCPERS learned that the direct payment requirement was an administrative burden for many retirement systems and even caused some systems to not implement HELPS, thereby rendering their public safety retirees ineligible for the tax exclusion. In the 117th Congress, H.R. 7203 was introduced by Rep. Steve Chabot (R-OH) and Rep. Abigail Spanberger (D-VA) to repeal the direct payment requirement. Also, Senators Sherrod Brown (D-OH) and John Thune (R-SD) introduced S. 4312, which would have made the direct payment requirement optional instead of mandatory. We are pleased to report that the SECURE Act 2.0 included the Brown-Thune legislation.

In addition, there is growing recognition that the $3,000 annual cap under HELPS, which has not changed since its inception 17 years ago, needs to be increased. H.R. 7203 would have doubled the annual cap. There is also discussion of indexing the cap each year for inflation.

Finally, in the 117th Congress, S. 4267 was introduced by Sen. Michael Bennet (D-CO), who serves on the Senate Finance Committee. This bill would index for inflation the annual cap under HELPS as well as create a new and separate tax credit for retired public safety officers for their health care premiums of up to $4,800 per year.

Building on our success on the HELPS direct payment requirement issue, NCPERS will advocate for these new proposals to enhance HELPS and create a new tax credit.

NCPERS supports increasing the annual cap under HELPS, indexing that cap for inflation, and enacting a new tax credit for retired public safety officers.

Retiree Medical Trust

Healthcare costs continue to drain the pension benefits of retired public-sector employees. Employees and current employee groups across the nation have taken steps to develop prefunding vehicles for ever-expanding healthcare costs. However, 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 through consolidation of pension assets through transfers and rollovers between plans. Also, the Pension Protection Act of 2006 provided for pretax payment of a portion of healthcare premiums by public safety officers through the HELPS Retirees Act.

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 employees' 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, and most in physically and mentally demanding occupations, such as law enforcement and firefighting, retire in their mid-50s.

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 we could immediately usher in an affordable option is through a universal benefit already accessible in every state – Medicare. If made available to retired first responders, Medicare would provide a soft landing for these heroes.

In the 116th Congress, Sen. Sherrod Brown (D-OH) and Rep. Tom Malinowski (D-NJ) introduced the first-ever legislation to allow retired first responders who have reached age 50 to buy into Medicare, S. 2552 and H.R. 4527, respectively. The bills would allow eligible first responders to buy into Medicare under the same terms as individuals who have reached the current eligibility age of 65. All facets of Medicare – Part A (hospital insurance), Part B (medical insurance), Part C (Medicare Advantage), and Part D (prescription drug coverage) – would be available to the eligible first responders.

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

Both pieces of legislation were reintroduced in the 117th Congress by Sen. Brown and Rep. Malinowski as S. 2236 and H.R. 4148, respectively. It is not yet clear whether the bills will be reintroduced in the 118th Congress.

NCPERS supports legislation to allow retired first responders to buy into Medicare at age 50.

Secure Choice Plans

NCPERS has been a strong advocate for secure choice retirement plans, which are state-run retirement plans for private-sector workers. In 2016, the Department of Labor (DOL) finalized two rules related to state or local government–run retirement plans for private-sector workers. DOL's final rule on state-run savings arrangements established safe harbors from ERISA (the Employee Retirement Income Security Act) for certain state-run payroll-deduction savings programs for private-sector workers. The rule made clear that it was in the nature of a safe harbor and, consequently, did not prohibit states from taking additional or different action or experimenting with other programs or arrangements. DOL also issued a final rule that would extend the state-run plan rule to certain political subdivisions. In discussing the safe harbor approach, DOL was always quick to point out that, while this was the position of DOL, the courts would be the ultimate arbiter of whether a plan triggered ERISA.

Unfortunately, both of these safe harbors were repealed in 2017 by the Republican-controlled 115th Congress under the Congressional Review Act (CRA). Resolutions of disapproval, H.J. Res. 66 (for state-run plans) and 67 (for political subdivision–run plans), were approved by Congress and signed into law by the president. If the president and Congress are politically aligned, the CRA is a powerful tool for rescinding recently issued regulations of a prior administration. Once Congress rescinds an agency's rule through the CRA, the agency may not reissue the rule in substantially the same form or issue a new rule that is substantially the same unless Congress enacts specific statutory authorization to do so.

Following passage of the CRA resolutions, legislation was introduced to statutorily protect certain payroll-deduction, IRA-based savings plans established by states or qualified political subdivisions. The legislation, known as the Preserve Rights of States and Political Subdivisions to Encourage Retirement Savings Act (the PROSPERS Act), was introduced by Sen. Martin Heinrich (D-NM) and Rep. Suzanne Bonamici (D-OR) in S. 1035 and H.R. 2523 (115th), respectively.

While the PROSPERS Act has not yet gained traction following introduction in 2019, NCPERS is eager to work with sympathetic members of Congress to generate support for state and local efforts to create these retirement savings programs. But the real work lies at the state capitals, where NCPERS continues to work diligently with state legislators toward enactment of these programs.

NCPERS supports state-run plans for private-sector workers, previous DOL regulations that provide a safe harbor for secure choice plans, and the PROSPERS Act. NCPERS is currently working with like-minded stakeholders to determine if additional legislation is needed in this area.

Proxy Advisory Firms

Many pension plan administrators employ proxy advisory firms to provide unbiased and independent data and analytical research to help them formulate their corporate governance and proxy voting policies. In addition, in some instances, NCPERS members ask the proxy advisory firms to implement proxy voting instructions on their behalf, following their plans' guidelines. The use of proxy research reports prepared by proxy advisory firms is one important way that NCPERS members exercise their due diligence to make independent, well-informed decisions.

In the 115th Congress, NCPERS wrote to House Speaker Paul Ryan (R-WI) and Minority Leader Nancy Pelosi (D-CA) in opposition to H.R. 4015, the Corporate Governance Reform and Transparency Act, which was introduced by Rep. Sean Duffy (R-WI). As the letter stated, the legislation was riddled with worrisome provisions, premised on false assumptions, that undercut the ability of pension plans to receive independent, unbiased corporate governance research, introducing new costs and burdens to pension plans and undermining their ability to effectively exercise their fiduciary responsibilities.

If enacted, H.R. 4015, which was approved by the House but not considered by the Senate, would (1) grant corporations the "right to review" proxy research reports before the pension plan receives the report; (2) mandate that proxy advisory firms hire an ombudsman – a cost that pension funds would ultimately pay – to receive and resolve corporations' complaints; and (3) require proxy advisory firms to publish the corporation's dissenting statement if the ombudsman is unable to resolve a complaint and if the corporation submits a written request.

This provision would effectively grant corporations the privilege to make the "final cut" on a report that is requested and paid for by the pension plan. Such corporate interference in the affairs of its shareholders is unprecedented and would dilute the independence of the proxy firms' reports and, ultimately, the independence of pension plans.

In the 116th Congress Rep. Bryan Steil (R-WI) reintroduced the Corporate Governance Reform and Transparency Act (H.R. 5116). While the legislation did not gain traction under a Democratic House majority, there is potential for another reintroduction in the new Republican House majority 118th Congress, although the likelihood of passage is low. The regulatory activities of the U.S. Securities and Exchange Commission under the Biden Administration will continue to be the focal point on issues related to proxy advisors and proxy voting.

NCPERS will continue to oppose legislation similar to H.R. 4015 (115th) and H.R. 5116 (116th) as well as any executive branch regulations designed to achieve the same result.

Shareholder Rights

In 2020 under the Trump Administration, the Securities and Exchange Commission (SEC) issued a new regulation that makes it substantially more challenging for shareholders to file resolutions asking companies to adopt certain policies, including the promotion of sustainable long-term financial growth.

On July 13, 2022, the SEC issued a proposal amending the 2022 Trump Administration policy. Specifically, the proposal would amend three substantive bases for excluding shareholder proposals:

1. **substantial implementation exclusion** would require a shift in SEC staff focus on the specific elements of a shareholder proposal to assess whether the company's prior actions taken to implement the substance of the proposal are sufficiently responsive.

2. **duplication exclusion** would amend current standard so that proposals are duplicative only when they address the same subject matter and seek the same objective by the same means.

3. **resubmission exclusion** would amend the standard for the resubmission exclusion from "substantially the same subject matter" to "substantially duplicates."

NCPERS will continue to monitor this regulation and actions by either the Biden Administration or Congress.

Environmental, Social, and Governance Investing

In October 2020, under the Trump Administration, the Department of Labor (DOL) finalized a rule on fiduciary responsibilities under ERISA. In 2022, under Biden, the DOL issued a new proposal and then published final rules on December 1, 2022, that amend the Trump Administration's regulations to clarify that environmental, social, and governance (ESG) factors may be relevant to a fiduciary's investment decisions. State and local governmental plans are not subject to ERISA. However, state legislators, plan trustees and other fiduciaries, and legal counsel will often look to ERISA for general guidance, particularly in the area of fiduciary responsibilities.

DOL's recent final regulations address ERISA fiduciaries' ability to consider ESG factors in investment selection and proxy voting. Specifically, the final rule's updated investment-selection safe harbor allows fiduciaries to consider any factor they reasonably determine to be relevant to the risk or return of an investment, including the economic effects of climate change and other ESG considerations. The 2022 final rule makes a shift in the prior administration's take on fiduciary duties applicable to proxy voting by clarifying that fiduciaries should vote proxies unless they have a good reason not to, such as significant associated costs.

Most provisions of the final rule will take effect January 30, 2023; however, plan fiduciaries will have until December 1, 2023, to comply with two proxy-voting requirements carried over from the 2020 rule.

In addition, during the 117th Congress, lawmakers on both sides of the aisle introduced several pieces of ESG legislation, including the Addressing Climate Financial Risk Act, S. 588 and H.R. 1549, introduced by Sen. Dianne Feinstein (D-CA) and Rep. Sean Casten (D-IL), respectively. The legislation seeks to improve the ability of federal regulators to understand and mitigate risks from climate change within the financial system. The bill would (1) establish an advisory committee on financial risk, (2) update guidance on climate risk, (3) require a Federal Insurance Office to report on insurance regulation and client risk, and (4) improve global coordination.

In endorsing the bill, NCPERS Executive Director Hank Kim noted that NCPERS investors are long-term investors who "see the dangers and risks of climate change clearly."

Rep. Greg Murphy, M.D. (R-NC), along with a group of Republicans in Congress introduced the Safeguarding Investment Options for Retirement Act as a push against DOL's recent ESG rulemaking. The bill would amend ERISA and the IRC to limit fiduciary consideration of nonfinancial factors in investment decision making for DC plans.

NCPERS expect lawmakers to continue to introduce ESG investing legislation in the 118th Congress.

NCPERS will continue to monitor developments from the Biden Administration related to the fiduciary responsibilities of plan trustees and will continue to support the Feinstein-Casten legislation on climate risk.

Federal Bankruptcy Law

In recent years, proposals have been discussed to amend the federal bankruptcy code to allow states to bypass state-based constitutional protections and other legal impediments in order to make changes to their pension funding and benefit structures.

In 2016, the Manhattan Institute released a proposal to create a new Section 113 of the U.S. Bankruptcy Code – Proceeding to Protect Essential State Actions. Under the plan, which was released in both descriptive and draft legislative form, states would be allowed to publish a proposal to make changes to pension benefits that, in the state's view, are necessary and/or appropriate to ensure the undiminished and unimpaired performance of any essential state action by the state or any subdivision, agency, or municipality thereof. Public hearings would be required and any proposal would have to be approved by the state legislature and signed by the governor in the same manner as general statutes of that state. Such legislation (the proposal to change benefits) would then be filed as a petition in a U.S. bankruptcy court.

It's critical to understand which state or local legal protections would be cast aside by this new bankruptcy provision. The proposal states that pension benefits may be modified to ensure the performance of essential state actions, notwithstanding any prohibition against or limitations on changes to pension benefits contained in any state constitution, statute, law, regulation, judicial decision, contract, or other local legal document, decision, or rule. In order to understand the broad sweep of this proposal, we focus on two key definitions:

- **Essential State Action** – Any undertaking by the state in furtherance of (1) providing for the health, safety, or welfare of persons residing within the state; (2) addressing, remedying, or preventing fiscal emergencies of the state or any subdivision, agency, or municipality thereof; or (3) ensuring the ability of the state and its subdivisions, agencies, and municipalities to fund essential governmental services on reasonable terms.

- **Pension Benefits** – Any accrued or prospective, vested or unvested pension, health, or other employee or retiree benefit that a state or any subdivision, agency, or municipality thereof funds or is required to fund.

The proposal's proponents argue that the authority for this change is found in the bankruptcy clause to the U.S. Constitution, which gives Congress the specific power to enact uniform laws on the subject of bankruptcies throughout the United States. In addition, the Manhattan Institute's white paper states that the U.S. Supreme Court has held that the U.S. Constitution "does not impair Congress' ability under the bankruptcy clause to define classes of debtors and structure relief accordingly."

Federal Bankruptcy Law (cont’d)

The proposal includes the ability of an affected person to challenge a petition by demonstrating by clear and convincing evidence that the change it proposes is unnecessary. However, in evaluating challenges, the bankruptcy court must defer to the judgment of the state legislature and the governor regarding revenue and spending unless there is no rational basis underlying that judgment. That is a high hurdle for any challenge to clear.

Federal legislation has not yet been introduced on this or any other proposal to allow the restructuring of state or local pension benefits through the bankruptcy code. Be assured that NCPERS will closely monitor this matter.

NCPERS opposes efforts to amend federal bankruptcy law to provide a mechanism for reducing state and local pension benefits.

Normal Retirement Age

In 2007, 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, not on attainment of a certain age, public plans protested the new regulations in formal comments to the IRS and direct meetings attended by NCPERS and other national groups.

In 2012, the IRS issued Notice 2012-29, which announced its intention to issue revisions to the 2007 regulations to clarify their application to state and local governmental plans. Then, in early 2016, the IRS issued proposed regulations. The proposed regulations are responsive to most of the concerns raised by NCPERS and the pension 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) the "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 defined as follows: the later of age 60 or the age at which the participant has at least 5 years of credited service; the later of age 55 or the age at which the participant has at least 10 years of credited service; the "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.

This rulemaking probably will be revised to comport with the change in federal tax law to allow qualified plans to provide participants with in-service distributions at age 59 1/2.

Issuance of final regulations on this matter is expected during the Biden Administration, though this has not yet occurred.

NCPERS supports the direction of IRS Notice 2012-29 and the proposed regulations and will work with the Treasury and IRS on final regulations.

Definition of Governmental Plan

In November 2011, the IRS issued an advance notice of proposed rulemaking (ANPRM) announcing their intention 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 joint comments. The comment letter called for the creation of safe harbors, grandfather treatment, and a greater focus on transition-related issues, and it raised 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 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. We continue to believe that more clarity is needed.

In January 2015, the 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 in response to the ANPRM because of concerns related to whether charter 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.

Issuance of proposed regulations on this matter continue to be included in the IRS initial priority guidance plan for 2022–2023, though no action has occurred since 2011.

NCPERS will work with the Treasury and IRS as they develop proposed regulations on the definition of governmental plan.

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