



2018 NCPERS Legislative Issues Book



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NCPERS
Legislative and Regulatory Issues

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Tax Legislation and Unrelated Business Income Tax (UBIT)



In the election of 2016, voters handed the complete machinery of the federal government to the Republican Party. With control of both houses of Congress and the presidency, Republicans were immediately under pressure to take action on one of their biggest priorities – rewriting the federal tax code.

On November 1, the House Ways and Means Committee released H.R. 1, the Tax Cuts and Jobs Act of 2017. With changes that would affect almost every taxpayer, the over-400-page bill was quickly scoured by every industry group, major corporation, taxpayer group, charity, and yes, the public pension community. Tucked into the legislation was a provision that would subject certain investments of public pension plans to UBIT.

This UBIT proposal was 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, both in 2014 and in H.R. 1. There was a big difference on the revenue analysis, however. In 2014, the Joint Committee on Taxation scored the UBIT provision as raising \$100 million in new revenue over 10 years. In H.R. 1, it was scored as raising \$1.1 billion, which immediately made it a much more attractive provision.

Inclusion of the UBIT provision kicked off a frenzied six-week period in which state and local governmental pension plans from around the country e-mailed, telephoned and met directly with key staff and members of the House Ways and Means Committee, Senate Finance Committee, and House and Senate Leadership. NCPERS was in constant contact with its members and allies in the public pension community.

The House moved with such speed that we were unable to effect a change in the UBIT provision. Moreover, the Ways and Means Committee’s tax staff firmly believes that the provision is a simple clarification of existing law and that UBIT should be applied to state and local pension plans. Their

argument is that public pensions are qualified plans under Internal Revenue Code (IRC) section 401(a), and section 401(a) is referenced in the UBIT section of the tax code. Public plans take a different position on this question. We strongly believe that state and local governmental pension plans are exempt from all taxes by virtue of IRC section 115, which excludes from gross income certain income of entities that perform an essential government function. Furthermore, application of a federal tax to public pension plans would erode the immunity states and the federal government each enjoy from taxation by the other.

As debate moved to the Senate, we focused on making contacts there to keep the provision out of the Senate version of the bill. This effort proved successful. That set up a House-Senate conference committee. The UBIT provision could have emerged from the conference in one of three ways: (1) the original House provision; (2) the House provision modified to provide a so-called soft landing (e.g., grandfathering existing investments, delaying the effective date, and/or applying UBIT to only a very narrow set of investments); or (3) no provision.

In the end, the conference report did not include the UBIT provision. This remarkable victory was made possible only because of the willingness of NCPERS’ members to drop their important day-to-day work and write an e-mail, pick up the phone, or get on a plane to travel to Washington, D.C. In some cases, they did all of the above. It was a tremendous team effort. The tax legislation is now Public Law 115-97.

In 2018, Congress may consider legislation to make technical corrections to the new tax law or separately to focus on retirement savings. UBIT could be raised again in the context of this legislation.

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



On December 18, 2017, in the final days of Congressional action on H.R. 1, Ways and Means Chairman Kevin Brady (R-TX) said, “This is not our last tax reform bill.” Chairman Brady went on to say that he plans to address tax issues related to retirement savings in 2018. He added that Republicans had initially planned to tackle some of these issues in this tax bill but didn’t due to a lack of time to address all issues and restrictive procedures in the Senate.

In light of the continued focus on tax legislation and likely emphasis on retirement savings, we need to be prepared for future action. Some of the key tax issues are outlined below:

1. Rothification and Other Proposals

Rothification and a number of other proposals received varying degrees of interest during consideration of H.R. 1 and could be revisited.

Prior to the initial unveiling of H.R. 1, House Republicans considered including a provision to make it a requirement that all new contributions to defined contribution (DC) plans (e.g., IRAs, 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 tax free at distribution. This provision was not included in either the House or Senate bills but did appear in a modified form on Senate Finance Committee Chairman Orrin Hatch’s (R-UT) list of possible amendments. That version would have required the Roth method for all age 50 or over catch-up contributions. However, the amendment was not offered.

On catch-up contributions, in general, a provision included in the original Senate bill that would have prevented a taxpayer who had wages of \$500,000 or more in the preceding tax year from making a catch-up contribution was dropped prior to Senate passage and not included in the House bill or the final conference report.

Also included in the original Senate bill 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 457(b) plan; this provision also would have repealed all special rules related to postemployment 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 conference report.

Finally, the House-passed version of H.R. 1 would have allowed qualified plans to make in-service distributions beginning at age 59 ½ instead of the current-law age of 62. This provision was not included in the Senate bill or the final conference report.

NCPERS will continue to provide input to Congress on these tax proposals.

2. The Public Employee Pension Transparency Act (PEPTA)

PEPTA was first introduced in 2010. Its advocates include Finance Chairman Hatch and senior Ways and Means Committee member Devin Nunes (R-CA). Thus far, PEPTA has not been introduced in this 115th Congress. However, it can be introduced in 2018 and/or offered as an amendment to future tax legislation.

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 rate of return. Second, all plans that do not calculate their funding status based on either fair market value of assets or the US Treasury bond obligation yield curve (as defined in the legislation), must recalculate their funding status based on the yield curve.

The Treasury obligation yield curve method would result in funding status outcomes that would show a dramatically lower funded status for the vast majority of public plans. This would serve only to create negative headlines for public plans but would not add any new economic information to aid in the analysis of individual plans. Versions of PEPTA have also included a provision that would penalize any plan sponsors that did not comply with the reporting requirements by denying them the ability to issue bonds that are exempt from federal tax.

NCPERS opposes PEPTA.

3. Annuity Accumulation Retirement Plan

In the 114th Congress, Finance Chairman Hatch introduced S. 2381, which included a modified version of his previously introduced annuity accumulation retirement plan proposal. Like PEPTA, the annuity accumulation plan has not been introduced in this 115th Congress. However, it could be raised in 2018.

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 defined benefit (DB) plans. The result will be that the annuity accumulation plan will become the primary retirement vehicle for state and local workers.

Chairman Hatch, at least rhetorically, is positioning the annuity accumulation plan as a possible replacement for DB plans. While Chairman Hatch recently announced that he would not be running for reelection in November 2018, he will remain the chairman of the Finance Committee for the remainder of the 115th Congress.

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

- **Replacement Income** – The threshold question for our nation’s firefighters, policemen, teachers, and other state and local governmental employees is whether distributions from the aggregation of fixed-rate annuity contracts would provide a comparable level of replacement income during retirement to that of a prefunded DB plan. In considering this question, it is important to note that, under the legislative proposal, the plan sponsor would be able to change its contribution rate each year, provided it is done for all employees. It is likely, then, that the employer contribution would change each year depending on the plan sponsor’s financial and political 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 – meaning that the plans are funded by contributions from both employers and employees – and the number of contributory plans continues to grow. In contrast, the proposed annuity accumulation scheme would not allow employees to contribute to their own retirement plans. It is unlikely that 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. This is an essential benefit 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** – 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 annual 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 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.

4. 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 result in a tax deferral of approximately \$1.778 trillion over 10 years, according to the Treasury Department. The tax deferral is computed as the income taxes forgone on current tax-excluded pension contributions and earnings, less the income taxes paid on current pension distributions.

The expenditure may be difficult to ignore for purposes of revenue generation during consideration of subsequent tax legislation. 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.

5. Employer Pickups

Under IRC section 414(h)(2), governmental entities may “pick up” their employees’ pension contributions and, in effect, transform posttax employee contributions into pretax employer contributions, provided certain conditions are met. Employee contributions that are picked up by the employer are not includible in employees’ 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 a PLR sought approval for use of the pickup in a situation where a new 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. Treasury and the Internal Revenue Service (IRS) reasoned that by being able to choose between the current and new tiers, existing employees would have a right to a CODA. Therefore, the election between tiers would not be permitted.

PLRs continue to be issued that allow pickup treatment in a case where an election for existing employees is between two tiers that have 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.

This issue has been a focus of the Treasury Department, IRS, and Congress. Federal legislation has been introduced in three of the last four congresses, with H.R. 2187 being the current version.

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

Affordable Care Act



In 2017, congressional Republicans were unable to achieve their longstanding promise to repeal and replace the Affordable Care Act (ACA). They were able to repeal the individual mandate to have health insurance. This was done as part of the tax legislation. It is unclear whether Congress will return to the larger repeal-and-replace effort this year.

Without an acceptable replacement, some Republicans are unwilling to take actions that would lead to instability and disruptions in the individual insurance marketplace. Patient groups have urged Congress to not repeal major parts of ACA without first developing a replacement that guarantees patients the same protections.

A continuing focus of NCPERS will be 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 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 effective date of the excise tax has been delayed to 2020.

***NCPERS will closely monitor all legislative and regulatory work on 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 remain out of Social Security coverage 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 a recent revenue options report; it would raise \$78.4 billion over the next 10 years. If Social Security reform legislation gains traction in 2018, mandatory Social Security, in some form, could be a 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. In fact, 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 (\$128,400 in 2018) for all new employees.

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



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.

S. 915, introduced by Sen. Sherrod Brown (D-OH), would repeal both WEP and GPO. The measure has 15 co-sponsors. H.R. 1205, introduced by Rep. Rodney Davis (R-IL), is the House companion bill with 167 co-sponsors. Both have a bipartisan list of co-sponsors. In the past, despite having a significant amount of co-sponsors, full repeal legislation has not gotten any traction in Congress because of the high costs associated with repeal.

In addition to the full repeal bills, Ways and Means Chairman Brady has developed a WEP reform bill, H.R. 711 (114th Congress). H.R. 711 divides the universe into two groups: (1) those currently being hit by the WEP penalty and those who turn age 62 before a date certain and (2) those who turn age 62

on or after the date certain. The first group gets relief from WEP in the form of a percentage reduction of the WEP penalty. For the second group, WEP is fully repealed, and group members' Social Security benefit would be calculated under an entirely new formula, which is based on their actual work histories.

Issues have been raised about H.R. 711, principally concerning the interplay between the new proportional formula and the existing exemption from WEP known as the substantial earnings test. Under current law, once one reaches 21 years of substantial earnings (Social Security-covered employment over a certain dollar amount) the WEP penalty begins to phase out by 5 percent each year. Once one reaches 30 years of substantial earnings, the WEP penalty is completely eliminated. Those who are on a path to this phase-out would like for it to remain available to them rather than be subjected to the new proportional formula.

NCPERS will closely monitor all legislative proposals that would repeal both WEP and GPO.

Healthcare Enhancement for Local Public Servants (HELPS II)



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 allows a yearly distribution of up to \$3,000 pretax from a governmental DB or 403(b) or 457(b) plan to retired public safety officers for use toward healthcare insurance and/or long-term care premiums. HELPS took effect on January 1, 2007.

Prior to HELPS, retirees paid for their entire health 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. The HELPS II proposal would accomplish the following:

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

NCPERS supports and will work toward enactment of HELPS II.



Healthcare costs for retirees continue to drain the pension benefits of our retired public-sector 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 through 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 employees' beneficiary association (VEBA) for the sole purpose of purchasing health care in retirement. Distributions from the qualified medical trust or VEBA would be taxfree.

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 to 25 years of service, and most in physically and mentally demanding occupations, such as law enforcement officers and firefighters, retire in their mid-50s. In most cases, the average savings accrued by DB pension plans allow first responders to enjoy approximately 50 percent of their yearly salaries 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 we could 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 employees who have already contributed to the Part A program. Public safety employees 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 buy into Medicare at age 55.

Proxy Advisory Firms



In December, NCPERS wrote to House Speaker Paul Ryan (R-WI) and Minority Leader Nancy Pelosi (D-CA) in opposition to the Corporate Governance Reform and Transparency Act, H.R. 4015.

As the letter stated, the legislation is 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.

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

H.R. 4015 would (1) grant corporations the “right to review” these reports before pension plans receive the report; (2) mandate that proxy advisory firms hire ombudsmen—a cost that pension funds would ultimately pay—to receive and resolve corporations’ complaints; and (3) if the ombudsmen are unable to resolve the complaints, and if the corporations submit written requests, proxy advisory firms require to publish the corporations’ dissenting statements. This would effectively allow corporations the privilege to make the “final cut” on reports that are 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.

Unfortunately, this legislation passed the House in late December and is now pending in the Senate.

NCPERS will continue to oppose this legislation as it is considered in the Senate.

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 the Employee Retirement Income Security Act (ERISA) 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 rules were repealed in 2017 by the 115th Congress under the Congressional Review Act (CRA). Resolutions of disapproval, H.J. Res. 66 (state-run plans) and 67 (political subdivision-run plans), were approved by Congress and signed into law by the president.

If the president and Congress are politically aligned, as they are today, CRA is a powerful tool for rescinding recently issued regulations of a prior administration. President Bill Clinton signed CRA

into law on March 28, 1996, establishing a process for Congress to review new federal regulations issued by government agencies and, by passage of a joint resolution, to repeal a regulation. CRA provides for expedited consideration of disapproval resolutions in the Senate. If a disapproval resolution is passed and signed by the president, then the rules are deemed to not have had any effect at any time. Once Congress rescinds a rule through CRA, the agency may not reissue another rule that is substantially the same form or issue a new rule that is substantially the same, unless Congress enacts specific statutory authorization to do so.

We were pleased to see that legislation was introduced in May 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 (PROSPERS Act) was introduced by Sen. Martin Heinrich (D-NM) and Rep. Suzanne Bonamici (D-OR), S. 1035 and H.R. 2523, respectively.

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.

Federal Bankruptcy Law

According to press reports, the State of Illinois may be looking to Congress for help in restructuring its public pensions. While the proposal has not been specifically identified and is being described as conceptual, signals are that senior state officials are analyzing a plan first put forward last spring by the conservative-minded Manhattan Institute. The proposal, which is described in detail below, would 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, provided certain requirements are met.

In April 2016, the Manhattan Institute, which interestingly used the Illinois public pension system as its primary justification, released a proposal to create a new section 113 of the US Bankruptcy Code – Proceeding to Protect Essential State Actions. The proposal received minimal media attention at the time and due to the upcoming presidential, congressional, state and local elections was put on the backburner until a more opportune time arose. That time could be 2018.

Under the Manhattan Institute's plan, which was released in both descriptive and draft legislative form, a state 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 US Bankruptcy Court.

It's critical to understand what 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 the proposal, 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 proponents of the proposal cite the authority for section 113 as the Bankruptcy Clause to the US Constitution, which gives Congress the specific power to enact uniform laws on the subject of bankruptcies throughout the US. In addition, the Manhattan Institute's white paper states that the US Supreme Court has held that the US Constitution "does not impair Congress' ability under the Bankruptcy Clause to define classes of debtors and structure relief accordingly."

The proposal includes the ability of an affected person to challenge a petition by demonstrating by clear and convincing evidence that the petition 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 restructure state or local pension benefits. 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, Treasury-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 Treasury-IRS and direct 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. The proposed regulations 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 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.

On October 20, 2017, the Treasury-IRS published its initial priority guidance plan for 2017–2018. Included on the list is the issuance of final regulations on this matter.

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

Definition of Governmental Plan



In 2011, Treasury-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 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 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, Treasury-IRS released Notice 2015-7, which provides a five-part test for the definition of *public charter school*. The charter school community submitted some 2000 comments to the ANPRM because of concerns related to whether its 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 regulations on this matter is included in the Treasury-IRS initial priority guidance plan for 2017–2018.

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



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