



National Conference on Public Employee Retirement Systems

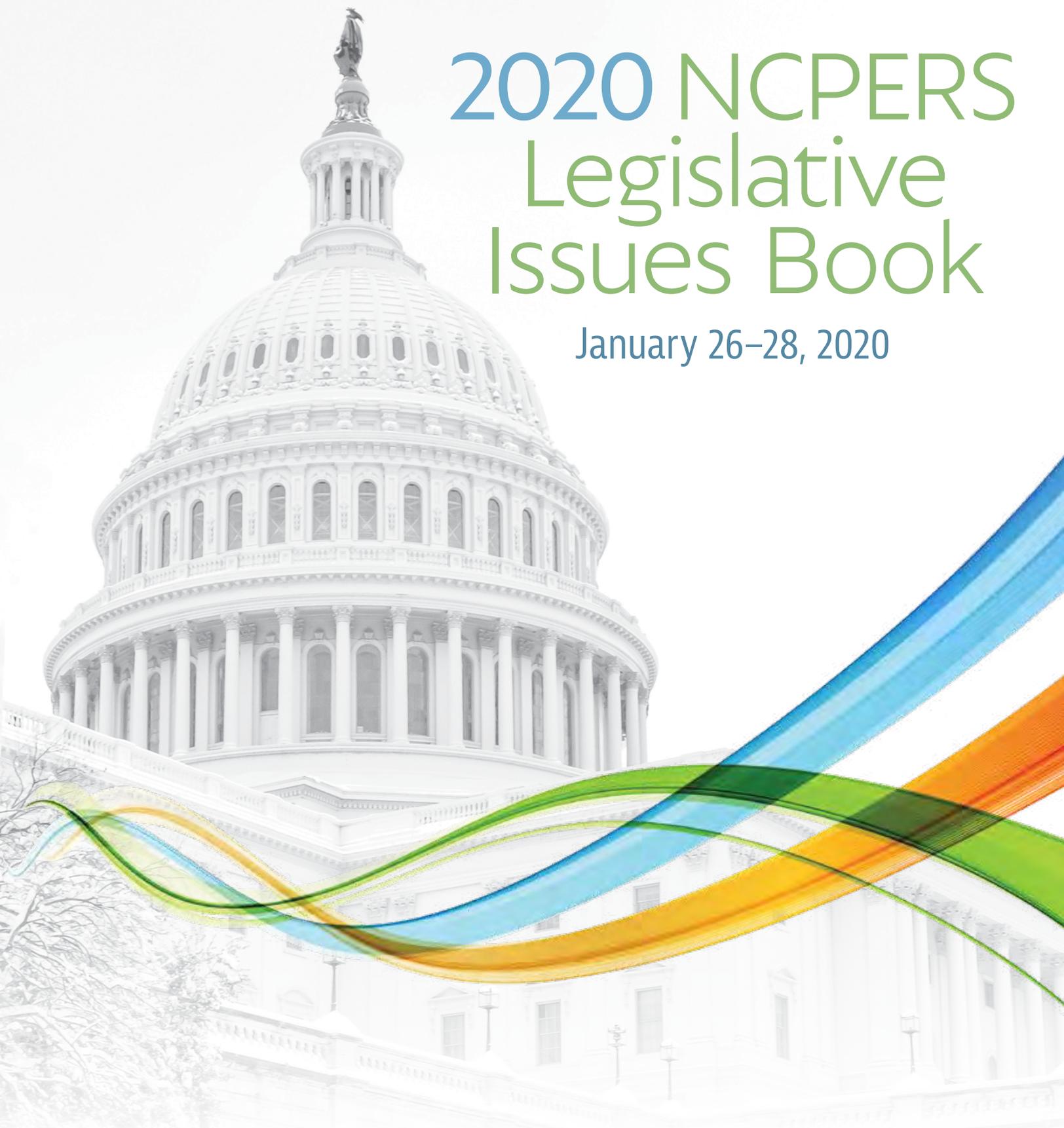
ADVOCACY

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# 2020 NCPERS Legislative Issues Book

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# National Conference on Public Employee Retirement Systems

## NCPERS: Who We ARE

**T**he National Conference on Public Employee Retirement Systems (NCPERS) is the largest trade association for public-sector pension funds, representing more than 500 funds throughout the United States and Canada. We are a unique network of public trustees, administrators, public officials, and investment professionals who collectively manage approximately \$3.7 trillion in pension assets. Our core missions are federal **Advocacy**, conducting **Research** vital to the public pension community, and **Educating** pension trustees and officials – it's who we **ARE**.

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

**Public pensions are financially sound and good for the economy.** On average, the nation's public pension plans are well funded. Almost all public plans require employee contributions, and all public plans invest their assets in growth vehicles that earn

additional income. According to a recent National Institute on Retirement Security study, state and local pension plans had a total economic impact of more than \$358 billion; supported more than 2.5 million American jobs; and provided more than \$57 billion in annual federal, state, and local tax revenue in a single year. Each taxpayer dollar invested in state and local pensions supported \$11.45 in total economic activity, while each dollar paid out in benefits supported \$2.36 in economic activity.

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

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# NCPERS Legislative and Regulatory Issues 2020

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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 their 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 our 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 paying attention to the regulatory activities of the U.S. Department of the Treasury and the Internal Revenue Service (IRS).

In 2019, Congress approved and the president signed the SECURE (Setting Every Community Up for Retirement Enhancement) Act into law. The legislation will increase the age for triggering required minimum distributions (RMDs) from 70½ 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, taxpayers will be allowed to withdraw up to \$5,000 from their retirement accounts in the 12-month period beginning on the date on which a child of the individual is born or on which legal adoption of an eligible adoptee is finalized, without incurring the 10 percent early withdrawal tax penalty. Finally, inherited retirement accounts will 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.

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

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# Employer Pickups

One provision that passed the House in 2018 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. Treasury and IRS reasoned that by being able 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 of the last five Congresses, with H.R. 3213 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 application 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..."

While 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 much less likely that the current Democratic-controlled House will share that view. Instead, efforts on this issue are likely to turn to the Senate, the Treasury, and IRS.

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

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# Unrelated Business Income Tax (UBIT)

In 2017, the House passed major tax legislation, which included 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.

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. Public plans take a different view. 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 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 we have not seen the provision since that time, it could be raised again in future tax legislation.

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

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# Public Employee Pension Transparency Act

The Public Employee Pension Transparency Act (PEPTA) was first introduced in 2010 by Rep. Devin Nunes (R-CA), who is now the second-most-senior Republican on the Ways and Means Committee. The most recent iteration of the bill is H.R. 6290 (115th 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 will create negative headlines for public plans but will 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.

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***NCPERS opposes the Public Employee Pension Transparency Act.***

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# 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. The discussion on discount rates had been rhetorical until just recently. It is now a more practical challenge for multiemployer plans – the collectively bargained plans for private-sector workers known as Taft-Hartley plans. We’ve been watching legislation in this area because of potential parallels in how Congress might treat state and local governmental plans in future legislation.

In late 2019, Senate Health, Education, Labor, and Pensions Committee Chairman Lamar Alexander (R-TN) and Finance Committee Chairman Chuck Grassley (R-IA) unveiled a new proposal on multiemployer pension plans. Discount rates that these plans may use in the future would be capped by the following formula:

- The assumed rate is limited to the lesser of the actuary’s best estimate of future investment experience under the plan, or a cap.
- The cap is equal to the lesser of (1) a 24-month average of the third segment of the yield curve plus 2 percent, or (2) 6 percent.
- The maximum rate will be phased in over five years, beginning in plan year 2020. The cap applies to the assumptions with respect to the determination of all plan liabilities.

The authors of the bill made clear that they are concerned that the average discount rate being used by multiemployer plans is inappropriately high – 7.13 percent. That 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 arguments would be used in an effort to cap the discount rates of public pension plans and that those arguments will be presented with an even greater sense of urgency.

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

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# Miscellaneous Tax Provisions

**D**uring the lead-up to the release of the original version of the 2017 tax legislation, 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 be tax free. This provision ultimately was not included in either the House or Senate bill but did appear in a modified form on then–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, but 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 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.

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***NCPERS will continue to provide input to Congress on these tax proposals if they are raised in the 116th Congress.***

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# 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 begins down the path of the annuity accumulation plan, it would also 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 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 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.

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***NCPERS opposes the annuity accumulation retirement plan.***

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# 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 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.

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.

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***NCPERS supports maintaining the current tax treatment of pension contributions and does not support reductions in the annual contribution limits.***

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# 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. In particular, the question is whether the plan’s governing structure satisfies prong four 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.

H.R. 6276, the Strengthening Pensions through Investment in Infrastructure Act, was introduced in the 115th Congress by then-Rep. Mike Bishop (R-MI). The bill would make two changes to the tax code.

First, it would amend 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. It goes on to define 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 amend IRC Section 148(b) to state that the term *investment-type property* shall not include public infrastructure property. This portion of the bill is the legislative parallel to a pending proposed regulation by Treasury-IRS, which would bring about the same result. Without this clarification – by either legislation or regulation – the bonds used to finance the public infrastructure property would almost certainly be treated as arbitrage bonds and would lose their tax-exempt status.

Rep. Bishop did not win his bid for reelection, so it is left to be seen whether another member of Congress will reintroduce this legislation in the 116th Congress.

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## Infrastructure (cont'd)

In addition, House Budget Committee Chairman John Yarmuth (D-KY) is developing legislation that would 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 at the request of the bank. Under the draft legislation, the bonds mature in 40 years and they may not be resold until 10 years after the date of issuance. The bonds will bear an interest rate of 200 basis points above the 30-year Treasury bond.

Interestingly for the public pension plan community, the bonds may be purchased only by pension plans – both plans governed by ERISA and governmental plans as defined by ERISA, which include state and local governmental pension plans.

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

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# Affordable Care Act

The Republican-controlled 115th Congress and President Trump were unable to achieve their long-standing promise to repeal and replace the Affordable Care Act (ACA). They were able to repeal the individual mandate to have health insurance as part of the 2017 tax legislation.

Now, with a Democratic-controlled House, repeal and replace efforts are no longer viable. The ACA's protection for those with preexisting conditions was a potent issue in the midterm elections. Patient groups and others have long urged Congress not to repeal major parts of the ACA without first developing a replacement that guarantees patients the same protections. Going forward, the question will be whether Republicans will now work to improve and make technical corrections to the ACA. Some Republicans have been willing to advance legislation to stabilize the individual insurance marketplace.

A major focus of NCPERS since enactment of the ACA was to repeal the 40 percent excise tax on healthcare 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. Those rates are \$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 by Congress and the president in 2019.

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

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# 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 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 \$78.4 billion over the next 10 years. If Social Security reform legislation gains traction in 2020, mandatory Social Security, in some form, could be a part of the debate.

Mandatory Social Security is being advanced as a panacea to ensure 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 (\$137,700 in 2020) for all new employees.

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

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# 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.

In the 116th Congress, S. 521, introduced by Sen. Sherrod Brown (D-OH), would repeal both WEP and GPO. The measure had 36 cosponsors. H.R. 141, introduced by Rep. Rodney Davis (R-IL), is the House companion bill, with 235 cosponsors. Both have a bipartisan list of cosponsors. Historically, however, despite having a significant number of cosponsors, 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 Richard Neal (D-MA) and Committee Ranking Member Kevin Brady (R-TX) have separately introduced WEP-only repeal bills, H.R. 4540 and H.R. 3934, respectively. There is hope that the two lawmakers will be able to agree on a compromise bill prior to committee action.

Chairman Neal's bill would provide a rebate from the WEP penalty of \$150 per month for those currently affected by WEP and those who will turn age 62 before 2022. 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.

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 be subjected to the new proportional formula.

H.R. 4540 would also direct the General Accountability Office to conduct a study to determine the extent to which state and local governments (or their designees) that maintain retirement plans for their employees possess or otherwise have access to information sufficient to determine what amount of a participant's benefits are based on service not covered by Social Security.

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

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

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 pre-tax 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.

Legislation has been introduced in the House by Rep. Dan Lipinski (D-IL), H.R. 4897, which would double the annual exclusion amount, taking it from \$3,000 to \$6,000. In addition, members of Congress are considering making technical changes to the provision's direct payment requirement to accommodate innovative healthcare programs.

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***NCPERS supports H.R. 4897 and will analyze any additional proposals to modify the HELPS Act.***

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# Retiree Medical Trust

**H**ealthcare 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. 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 consolidating pension assets through transfers and rollovers between plans. Also, the Pension Protection Act of 2006 provided for pre-tax payment of a portion of healthcare premiums by public safety officers through the HELPS Retirees Act.

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***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.***

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# 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 2019, 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.

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***NCPERS supports S. 2552 and H.R. 4527, which would allow retired first responders to buy into Medicare at age 50.***

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# Proxy Advisory Firms

**M**any 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 their plans' 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.

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 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.

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) if the ombudsman is unable to resolve a complaint, and if the corporation submits a written request, require proxy advisory firms to publish the corporation's dissenting statement.

This provision would effectively allow 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 the new Democratic House majority is not expected to support H.R. 4015 or similar legislation. Instead, bipartisan Senate legislation, S. 3614, and new proposed regulations by the U.S. Securities and Exchange Commission are the likely focal points on issues related to proxy advisors.

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***NCPERS will continue to oppose legislation similar to H.R. 4015 as well as any executive branch regulations designed to achieve the same result.***

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# Secure Choice Plans

**N**CPERS 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 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.

Given that the House is now controlled by the Democrats, NCPERS is eager to work with sympathetic members of Congress to generate support for state and local efforts to create these retirement savings programs.

It’s important to note that 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), S. 1035 and H.R. 2523 (115th), respectively.

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***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. We are currently working with like-minded stakeholders to determine if additional legislation is needed in this area.***

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# 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.”

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.

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

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# 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 non-disability 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 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 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.

Issuance of final regulations on this matter is expected in the first half of 2020.

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***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.***

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# Definition of *Governmental Plan*

In November 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 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, Treasury-IRS released Notice 2015-7, which provides a five-part test for the definition of *public charter school*. The charter school community submitted some 2,000 comments 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 is included in the Treasury-IRS initial priority guidance plan for 2019–2020.

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



**National Conference on Public Employee Retirement Systems**  
*The Voice for Public Pensions*

444 North Capitol St., NW, Suite 630  
Washington, DC 20001  
202-624-1456  
info@ncpers.org  
www.NCPERS.org