The following is a summary of 2013 Federal legislative and regulatory activity of interest to public plans. Subjects covered, in order of their appearance, are as follows:

U.S. CONGRESS

Public Employee Pension Transparency Act (PEPTA): PEPTA legislation was introduced in the House of Representatives as HR 1628 by Congressman Devin Nunes (R-CA) on April 18, 2013; in the Senate, an identical bill, S 779, was introduced by Senator Richard Burr (R-NC) on April 23, 2013. This is the third Congress in which this legislation has been introduced in both the House and Senate.

PEPTA would require state and local governmental plan sponsors to provide specific plan funding information to the US Treasury Department, including a "Supplementary Report" that would restate the funding status of a plan by valuing assets at fair market value and by using certain Treasury obligation yield curves in place of the plan's expected rate of return to determine liabilities. Failure to do so would cause the offending state or political subdivision to lose Federal tax benefits with respect to any State or local bond issue.

PEPTA saw no action in 2013. Introduced with two other original cosponsors – Congressman Darrell Issa (R-CA) and Congressman Paul Ryan (R-WI) – the legislation has added only eight new cosponsors since then. The Senate companion bill was introduced with two original cosponsors – Senator Tom Coburn (R-OK) and Senator John Thune (R-SD) – and has picked up no additional cosponsors since it was introduced.

Also, unlike 2011, when there were five hearings in the House of Representatives before three different Committees that discussed PEPTA, there were no Congressional hearings in 2013 with PEPTA as a subject.

Finally, there were no efforts made in 2013 to add PEPTA to other legislation, as was the case in 2012, when an attempt was made to attach PEPTA to legislation reauthorizing the Federal Highway Trust Fund and providing a fix to the interest rate subsidy for Stafford student loans. This effort was ultimately unsuccessful.

This does not mean that PEPTA should be considered "dead." Writing in the *Washington Examiner* in August, 2013, following Detroit's filing for bankruptcy, Congressman Nunes used the insolvency to argue that his legislation should be passed in order "to stabilize the nation's public-employee pension systems and to prevent federal taxpayers from being billed for failed pension funds." In addition, a week after the Detroit filing, Senator David

Vitter (R-LA) attempted to have legislation adopted that would bar the federal bailout of any city, state or county. His attempt failed, but it also underscored that the Detroit insolvency has served to breathe new life into potential Federal efforts to address state and local government pension funding.

Secure Annuities for Employee (SAFE) Retirement Act: On July 9, 2013, Senator Orrin Hatch (R-UT), the Ranking Republican on the Senate Finance Committee, introduced S 1270, legislation to create what he referred to as a "new public pension design" that would be based on annual annuity contracts providing employees with a "vested, portable and fully funded pension that will never need a government bailout," according to his staff.

Senator Hatch's so-called SAFE bill would create a new "Annuity Accumulation Retirement Plan." Under this new optional plan, employers would be permitted to purchase "Qualified Individual Deferred Fixed Income Annuity Contracts" for their employees. The employer could continue to maintain a defined benefit plan and/or a defined contribution plan, but employees participating in the new Annuity Accumulation Retirement Plan would not be eligible to receive any other form of employer-provided retirement benefit.

The annuity contracts would be voluntarily purchased by the employer on an annual basis, and the employer generally could contribute up to 30 percent of compensation annually for public safety employees and up to 20 percent for other employees. However, the employer could reduce or skip its contribution, in the employer's sole discretion, as long as the employer makes such election before the beginning of the applicable plan year. The annuities would be purchased with only employer money; no employee contributions would be involved.

The new annuity contracts would be owned by plan participants and not the employer, and would be non-forfeitable. They would commence payment at age 57 for public safety employees and age 67 for any other employees. The annuities would be distributed in the form of monthly annuity payments under a single life annuity, in equal installments fixed at the time of purchase, with no lump-sum option and no loans permitted.

Each annual purchase of the annuities would be made pursuant to a formal public competitive bid process under State law and procedure, and would require institutional pricing on a group contract basis. Not all of a given year's purchase could go to the same single annuity provider; the largest allocation must go to the superior bid, but it can be no more than 75% of the aggregate total.

Finally, the annuity contracts are to be guaranteed (to the maximum extent possible) by each state's insurance guaranty association.

At the time he introduced his legislation, Senator Hatch said that "America cannot continue sleepwalking into the financial disaster that awaits us if we do not get the public pension debt crisis under control." Senator Hatch, who has previously said that he believes the current DB plan model is "inappropriate for state and local governments," reiterated his belief that they are irreparable, saying that "The problem is getting more serious every day and cannot be remedied merely by fine-tuning the existing pension structures available to public employers."

The legislation does not have any cosponsors, and there is no companion measure in the House of Representatives. However, Preston Rutledge, Senator Hatch's chief staffer on the proposal, has said that the Senator intends to try to attach his measure to any tax legislation that is considered by the Congress.

Universal, Secure, and Adaptable (USA) Retirement Funds Act: On January 30, 2014, Senator Tom Harkin (D-IA), the Chairman of the Senate Health, Education, Labor and Pensions (HELP) Committee, introduced S 1979, legislation designed to rebuild the private pension system.

The new Harkin proposal would create a "new type of privately-run retirement plan that combines the advantages of traditional pensions—including lifetime income benefits and pooled, professional management—with the portability and ease for employers of a 401(k)," in the words of a press release from Harkin's office that announced the measure's introduction.

The key features of USA Retirement Funds include:

- *Universal Coverage*. USA Retirement Funds would be available to everyone, including those without access to a workplace retirement plan as well as the self-employed. Employers of more than 10 would have to automatically enroll their employees in a USA Retirement Fund unless they already offered a retirement plan with automatic enrollment and a lifetime income option.
- *Automatic Enrollment*. Employees would be automatically enrolled at a rate of 6 percent of salary per year, with a cap of $10,000 annually, but could choose to increase, lower, or stop their contributions; employers could also contribute up to $5,000 a year per employee, as long as they did so uniformly.
- *Professionally Managed*. Each USA Retirement Fund would be a privately run plan approved and overseen by the Department of Labor and managed by a qualified board of trustees. The assets of each fund would be pooled and professionally managed by the trustees.
- *Secure Lifetime Income*. People participating in a USA Retirement Fund would earn a benefit paid out over the course of their retirement, with survivor benefits and spousal protections, like a traditional pension; the amount of a person's monthly benefit would be based on the total amount of contributions made by, or on behalf of, the participant and investment performance over time.
- *Portability*. Participants would be permitted to change USA Retirement Funds every year and would be allowed to roll their 401(k) or IRA balances into a fund. Additionally, a person under 60 with a small account balance would be able to roll that account balance over to another retirement plan.

In addition to creating these new USA Retirement Funds, Senator Harkin's legislation would also make it easier for small employers to offer pooled retirement plans, encourage plan sponsors to incorporate lifetime income solutions into their defined contribution plans, provide increased fiduciary and other protections for plan participants, simplify the administration of private sector defined benefit pension plans, and improve the pension insurance system.

Diane Oakley, Executive Director of the National Institute on Retirement Security (NIRS), issued a statement saying that the Harkin proposal "represents a significant leap forward to improve the nation's retirement security for generations." She went on to note that it could "go a long way to put Americans on a solid financial track for their future." She expressed particular approval of the legislation's provision for a lifetime benefit "that won't run out while also providing risk sharing."

Mary Kay Henry, President of the Service Employees International Union (SEIU), joined Senator Harkin at a press conference announcing the new legislation. She said that that SEIU believes that the Harkin proposal "will fill a critical need for the half of the working population who have no access to a retirement plan at work." Denise Bowyer, Vice President at the American Income Life Insurance Company, was also at the press event, and pointed out that the Harkin bill "fills in many blanks now left by the IRA or company-sponsored retirement plan options with an approach that is easy and low-cost for the many employers who want to offer a plan but feel that existing programs are too costly."

Bowyer also noted that the legislation "importantly begins to address a critical problem facing business leaders today: the prospect of an aging customer base with limited means." "Businesses thrive only when there are enough customers with enough income to afford goods and services," she said. "This plan should give every business leader more confidence in the future strength of our economy," she concluded.

In a letter to Senator Harkin, NCTR's Executive Director, Meredith Williams, commended the Senator for his efforts, noting that NCTR shares his belief that all Americans should have access to a pension plan that will provide adequate and reliable retirement security. "While we may differ on some specific aspects of your plan to provide for retirement security," Williams wrote, "your basic concept for rebuilding pensions is compatible with the policy positions of NCTR, and we strongly support your efforts."

Meredith Williams' letter to Harkin also picked up on the impact on the economy of the retirement crisis. He noted that when workers have not saved enough to meet their retirement needs, many will have to continue at their current jobs. "This," he went on, "can have a serious impact on employers, who will be paying higher salaries to these longer-tenured workers." There will also be negative impacts on workers' morale and productivity, and other employees' career advancement can be blocked, with serious ramifications for an employer's overall workforce talent. "America's economic future will pay the price of a failed retirement policy," Williams warned.

Senator Harkin was joined by Senator Sherrod Brown (D-OH) in introducing his legislation and it has subsequently been cosponsored by Senator Tim Johnson (D-SD). Senator Harkin will be retiring from the Senate at the end of this year, and can be expected to make every effort to see his legislation enacted. However, it would represent a major reform of the private sector pension model, and final action on the measure in 2014 is doubtful.

GPO/WEP Repeal: HR 1795, the Social Security Fairness Act of 2013, would repeal the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP), and was introduced by filed by Congressmen Rodney Davis (R-IL) and Adam Schiff (D-CA) on April 26, 2013. The Senate version of the legislation is S 896, introduced by Senators Mark Begich (D-AK) and Susan Collins (R-ME) on May 8, 2013.

The GPO applies only when the Social Security (SS) benefits are received by a spouse or widow(er); generally, under this provision, any SS benefit may be reduced by two-thirds of the amount of a government pension that the spouse or widow(er) is also receiving. The WEP affects how a SS retirement or disability benefit is determined for persons eligible for their own (not spousal) SS benefits when they also receive a pension from work not covered by Social Security. The formula used to figure the SS benefit amount is modified, and essentially provides for a smaller benefit.

HR 1795 currently has 109 cosponsors; S 896 has 17. Both bills are pending in the tax committees of the appropriate Chamber of Congress, and neither have been the subject of a hearing since their introduction.

GPO and WEP have been the subject of repeal efforts for the last several decades. However, support for a total repeal seems to be waning. For example, similar repeal legislation in the 111th Congress (2009-2010), had 334 cosponsors in the House and 31 in the Senate; in the last Congress (2011-2012), House cosponsors dropped to 170, and in the Senate, there were 18. The primary problem continues to be the cost of repeal. Based on recent estimates (2010), the total cost of repealing both the GPO and WEP would be about $90 billion combined.

The potential linkage of GPO/WEP repeal to mandatory Social Security as a means of paying for its cost continues to be a concern, and is one reason why, once again, repeal legislation in this area garners support but continues to go nowhere, as was the case in 2013.

Mandatory Social Security: Social Security covers about 94% of all workers in the United States, but about one-fourth of state and local government employees are not covered by Social Security. When Social Security reform efforts are seriously in play, they often include proposals to place newly-hired public employees in Social Security. However, there were no major Social Security reform proposals that received serious attention from the Congress in 2013, and so mandatory Social Security was also pretty much off the table as well.

In the past, mandatory Social Security coverage of newly hired state and local government workers was proposed in part to address Social Security funding needs. For example, it has been projected that doing so would close an estimated 8% to 9% of Social Security's projected average 75-year funding shortfall and extend Social Security trust fund solvency by 2 to 3 years.

However, when seriously considered in the past, the proposal has always eventually been abandoned as too disruptive and expensive, projected to cost states, localities and public workers an estimated $53.5 billion in the first five years alone, based on a report for the Committee to Preserve Retirement Security (CPRS) prepared by The Segal Company in September of 2011. Indeed, it has always been assumed that mandatory Social Security would not be considered separate and apart from an overall discussion of needed changes to Social Security as a whole.

Now, however, this linkage appears to no longer be a given. In 2010, both the President's Deficit Commission (aka the Simpson-Bowles commission) and the Domenici-Rivlin Budget Task Force proposed that all newly-hired employees of state and local governments after 2020 be covered under Social Security. Furthermore, the reasons for this had more to do with perceived threats to the retirement security of public employees and the desire to avoid a federal bailout of public pension plans than it did with the solvency of Social Security.

For example, the Simpson-Bowles report argued that "Full coverage will simplify retirement planning and benefit coordination for workers who spend part of their career working in state and local governments," and will "ensure that all workers, regardless of employer, will retire with a secure and predictable benefit check."

The Domenici-Rivlin Task Force took a somewhat similar tack, explaining that including these new government employees in Social Security would "provide better disability and survivor insurance protection for many workers who move between government employment and other jobs." Furthermore, according to the Task Force, "Over the long run, covering all of their employees under Social Security could help states and localities get their fiscal houses in order through transitioning to more sustainable pension programs."

Most recently, concerns have been raised with the possibility that mandatory Social Security, having been de-linked from overall Social Security reform, could present an attractive source of revenue as Congress struggles to address the fiscal challenges facing the nation. Furthermore, if mandatory Social Security for all new public employees can be justified as a means of helping states and localities get their fiscal houses in order, providing them with more sustainable pension programs and helping to make a possible Federal bail-out of public pensions less likely, then such a temptation might be irresistible.

There are other worrisome signs that mandatory Social Security for state and local government employees could be on the table in 2014. For example, last year, the Business Roundtable (BRT) announced that it was recommending mandatory Social Security coverage for all new State and local government employees as part of any "comprehensive economic growth and deficit-reduction strategy" that Congress and the Administration develops. (The BRT is an association of chief executive officers of leading U.S. companies with more than $7.3 trillion in annual revenues and nearly 16 million employees.)

Also, in June of 2013, the Senate Finance Committee Staff released the last in a series of ten papers compiling tax reform options that Finance Committee members "may wish to consider" as part of any tax reform legislation. One of these options was mandatory Social Security coverage for "all State and local government employees."

Finally, in November of 2013, the Congressional Budget Office (CBO) released its newest "Options for Reducing the Deficit" publication, which is prepared periodically to help inform lawmakers about the budgetary implications of various approaches to changing Federal policies. This latest version presents 103 options that would decrease Federal spending or increase Federal revenues over the next decade (from 2014 to 2023). Among these options was "Expand Social Security Coverage to Newly Hired State and Local Government Employees," which the CBO estimated would raise $ 81.1 billion over the next ten years.

Tax Reform: Throughout 2013, both the House Ways and Means Committee and the Senate Finance Committee conducted extensive reviews of the Federal tax code in anticipation of major tax reform proposals. Now, according to recent press reports, Ways and Means Committee Chairman Dave Camp (R-MI) is prepared to release his initial draft during the week of February 24th. Reportedly, Camp recently wrote Republican Committee members that he is moving forward with a proposal, despite the apparent reluctance of House leaders to offer support.

As of this writing, details are few, but there are rumors that efforts to cut top individual and corporate tax rates to 25 percent have not been successful, and that the final rate will likely be between the 28-to 30 percent range. For pension interests, the key question is what, if any, changes will be made with regard to the tax code's support for employer-provided benefits. Furthermore, the temptation to make changes in this area will be driven as much by revenue, pure and simple, as by any overall retirement security policy concerns.

For example, it is well to note that in February, 2013, the Congressional Joint Committee on Taxation (JCT) released its annual analysis of Federal tax expenditures for the five year windows of 2012-16 and 2013-17. (The new 2014 analysis has yet to be released.)

These JCT analyses are very important, and will be much-used in any tax reform debate in which Congress engages. They calculate the amount of revenue "losses" (the term the Budget Act uses) that the Federal government will incur due to certain provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income, or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.

The 2013 report shows that among the top three most expensive classes of tax expenditures is that related to retirement security. The JCT estimates that for the period 2012-16, the tax expenditures associated with defined benefit plans will amount to $198.9 billion, and those associated with defined contribution plans will total $306.4 billion. For the period 2013-17, the amounts increase to $212.2 billion for DB plans and $335.6 billion for DC plans.

When all other types of retirement savings incentives are included, such as Keogh plans and IRA's, the Federal revenue losses associated with the net exclusion from taxation of pension contributions and earnings are estimated to total $654.3 billion for 2012-16, and $714 billion for 2013-17. (See pages 39-40 of the JCT report.)
This is more than the $364 billion in losses due to the home mortgage interest deduction for 2012-16, (estimated to increase to $379 billion for the 2013-17 window). The only tax expenditure that produces more revenue losses for the Federal government than retirement security is employer-provided health care, with $706.6 billion in losses associated with the exclusion of employer contributions for health care, health insurance premiums, and long term care insurance premiums for 2012-16 (estimated to rise to $760.4 billion for the 2013-17 window.)

There are a number of "reforms" in the area of retirement savings that have been suggested, and which could be included in the Camp tax reform draft. These include:

- The 2010 National Commission on Fiscal Responsibility and Reform (AKA Simpson-Bowles) recommended consolidating and capping tax-deferred contributions to all DC plans to the lower of $20,000 or 20% of income, which is estimated would raise $45.9 billion/10 years.
- In November, 2013, the Congressional Budget Office (CBO) released a revenue "options" report that included a proposal limiting elective deferrals to 401(k), 403(b), and 457(b) governmental plans to $15,500 per year ($5,000 for IRAs), with no catch-up contributions, and converting the current section 415 per-employer limit on contributions to DC plans to a per-taxpayer limit of $46,000. The option would raise $89 billion over ten years.
- In 2013, both the Obama Administration and the Brookings Institution have supported capping at 28 percent the rate at which deductions and exclusions related to retirement saving reduce a taxpayer's income tax liability, thereby reducing the benefit associated with contributions to DC plans for higher income taxpayers whose tax rate exceeds 28 percent. The proposal is expected to raise $7.5 billion per year (i.e., the 39.6% tax bracket would pay an 11.6% tax on DC contributions). The Obama Administration would apply this cap to all itemized deductions, which would raise $529 billion over 10 years.
- The Obama Administration proposed in 2013 to limit the total amount individuals can save for retirement in all tax-favored settings, both DC and DB, to an amount necessary to provide an annual benefit of $205,000 at age 62, or about $3 million. This would raise $9 billion over 10 years.

Aside from the revenue these changes would raise, the policy rationale is that current retirement tax subsidies disproportionately benefit higher-income households, many of whom would have saved for retirement with or without these tax incentives. The Obama Administration claims that an estimated two-thirds of tax benefits for retirement saving go to the top 20 percent of earners, with one-third going to the top 5 percent. "Our tax incentives for retirement can be designed more efficiently," according to the President.

TREASURY/IRS

Normal Retirement Age Regulations: After five years in which the nature of the application of the so-called Normal Retirement Age regulations to public plans remained in virtual limbo, in 2012 the Internal Revenue Service (IRS) finally provided an indication that revised guidance was in the works that would address governmental plan concerns with the original regulations. However, no draft of such revised regulations appeared for comment in 2013.

The IRS also once again extended the application date – this time until January 1, 2015, at the earliest. Before the issuance of Notice 2012-29 on April 30, 2012, the regulations as drafted in 2007 were set to take effect for governmental plan years beginning on or after January 1, 2013.

The original IRS regulations in 2007 reflected a change made by the Pension Protection Act (PPA) of 2006 that provided an exception to the general plan qualification rule that pension benefits can be paid only after retirement. This PPA exception permitted a pension plan to commence payment of retirement benefits to an employee who is not separated from employment at the time of such distribution (known as an "in-service distribution") as long as the employee has attained age 62.

However, the IRS also used this opportunity back in 2007 to (1) "clarify" that a pension plan is also permitted to make such in-service distributions after the participant has attained "normal retirement age;" and (2) provide rules on how low a plan's normal retirement age is permitted to be.

Significantly, the 2007 regulations did not provide guidance with respect to a normal retirement age that is conditioned (directly or indirectly) on the completion of a stated number of years of service, as is the case with many if not most public plans. Furthermore, in a notice (IRS Notice 2007-69) issued in August of 2007, the IRS and Treasury specifically asked governmental plans to submit comments on whether a normal retirement age under such a governmental plan may be based on years of service. The inference was that such normal retirement "ages" might not be permissible.

If this were indeed to be the case, there would be major problems ahead for governmental plans. NCTR and NASRA filed comments strongly objecting to this approach and have held a number of meetings with the IRS and Treasury over the last six years to explain the major concerns that would arise and to seek relief.

The 2012 Notice appears to provide for such. First, it indicates that the regulations will be modified for governmental plans such that if the plan does not provide for the payment of in-service distributions before age 62, then it will not be required to have a definition of normal retirement age at all. Furthermore, if such a plan <u>does</u> have a definition of what constitutes a normal retirement age, the definition does not need to meet the requirements of the 2007 regulations. This would appear to do away with any concerns as to normal retirement ages being based in whole or in part on years of service for plans that do not provide in-service distributions before age 62.

While this seems to represent a major victory for governmental plans, there are nevertheless a number of missing details in which the devil may still be lurking. For example, how, exactly, does the IRS define an in-service distribution? What about return-to-work programs in the public sector? Could these programs be seen by the IRS as in-service distributions in certain instances? Also, what about part-time work? And if a plan does provide in-service distributions before age 62, can it still have a normal retirement age based on service? There are a number of these and other concerns that are left unanswered.

In conversations with Treasury and the IRS following the issuance of Notice 2012-29, they have assured the governmental plan community that they intend to issue their modifications in the form of a proposed regulation which would be open to additional public comment. Most recently, they have publically stated that such a draft regulation should be issued for comment before the middle of 2014.

<u>Definition of a Governmental Plan</u>: Following reportedly more than 10 years of review and discussion with other Federal agencies, the Internal Revenue Service and the Treasury Department published their long-awaited Advance Notice of Proposed Rulemaking (ANPRM) relating to the definition of the term "governmental plan" under section 414(d) of the Internal Revenue Code (IRC) on November 8, 2011. The notice also contained an appendix setting forth a draft of possible proposed regulations. (These regulations have not actually been proposed yet, and are provided as an example of what a proposal in this area might look like.)

If a public plan fails to meet this definition, then ERISA titles I (Federal protection of employee benefit rights, administered by the DOL's Employee Benefits Security Administration) and IV (plan termination insurance, enforced by the PBGC) would technically apply to it. In addition, the nondiscrimination and minimum participation rules of the Federal tax code would also apply, as would the minimum funding standards. Therefore, the ultimate outcome of this process will have major implications for governmental plans, their sponsors, and participating employers and employees.

Briefly, the draft of proposed regulations attached to the ANPRM would provide guidance on determining whether an entity is an "agency or instrumentality of a State or a political subdivision of a State" based on a facts and circumstances test. Major factors for determining whether an entity is an agency or instrumentality of a State or political subdivision of a State include whether

- The entity's governing board or body is controlled by a State or political subdivision;
- The members of the governing board or body are publicly nominated and elected;
- The entity's employees are treated in the same manner as employees of the State (or political subdivision thereof) for purposes other than providing employee benefits (for example, the entity's employees are granted civil service protection);
- A State (or political subdivision thereof) has fiscal responsibility for the general debts and other liabilities of the entity (including funding responsibility for the employee benefits under the entity's plans); and
- In the case of an entity that is not a political subdivision, the entity is delegated, pursuant to a statute of a State or political subdivision, the authority to exercise sovereign powers of the State or political subdivision (such as, the power of taxation, the power of eminent domain, and the police power).

Other factors would include whether:

- The entity's operations are controlled by a State (or political subdivision thereof);
- The entity is directly funded through tax revenues or other public sources;
- The entity is created by a State government or political subdivision of a State pursuant to a specific enabling statute that prescribes the purposes, powers, and manners in which the entity is to be established and operated.;
- The entity is treated as a governmental entity for Federal employment tax or income tax purposes (such as, the authority to issue tax-exempt bonds under section 103(a)) or under other Federal laws;
- The entity is determined to be an agency or instrumentality of a State (or political subdivision thereof) for purposes of State laws;
- The entity is determined to be an agency or instrumentality of a State (or political subdivision thereof) by a State or Federal court;
- A State (or political subdivision thereof) has the ownership interest in the entity and no private interests are involved; and
- The entity serves a governmental purpose.

Unfortunately, the IRS has so far refused to provide any weighting of these factors. For example, at the Cleveland town hall meeting, IRS officials advised that an entity could meet all of the factors and still not be considered a governmental entity, and conversely, could fail to meet all of them and still be approved.

With regard to the determination as to whether a governmental entity has established and maintained a governmental plan for purposes of section 414(d), the draft proposed regulations would provide that a plan is established and maintained for the employees of a governmental entity if the employer that has established and maintained the plan is a governmental entity and the only participants covered by the plan are employees of the governmental entity. With the exception of union employees/representatives in the case of a collectively bargained plan, and employees of the plan itself, the draft proposed regulations do not include a de minimis rule addressing existing practices under which a small number of non-governmental employees may participate in a governmental plan without threatening its status as such. However, the IRS is specifically seeking comments on whether such a rule should be included.

In 2012, the IRS began a very methodical approach to this ANPRM, which is just the first step in what will be a multi-year process. Throughout 2012, the IRS held "town hall" meetings across the country on their proposal. NCTR, NASRA, the Government Finance Officers Association (GFOA), the National Association of Government Defined Contribution Administrators (NAGDCA), and the National Conference on Public Employee Retirement Systems (NCPERS) also filed joint comments on the ANPRM on June 15, 2012. These comments focused on safe harbors, grandfathering, and transition/administrative challenges.

The IRS also held a formal public hearing in Washington, DC, on July 9, 2012, at which NCTR, represented by Meredith Williams, NCTR's Executive Director, as well as NASRA, represented by Cindy Rougeou, Executive Director of the Louisiana State Employees' Retirement System, provided testimony.

To date, the reaction to the ANPRM by some potentially affected groups has been very vocal. This is particularly true with regard to community/charter school employees, even though the draft proposed regulations do not explicitly exclude charter schools' employees from participation in governmental plans. These employees nevertheless fear that they would be excluded from participating in public plans, and that public plans that included such employees would be disqualified.

Charter school employees contacted the IRS by the thousands in 2012. In addition, the National Alliance for Public Charter Schools has issued a position statement which concludes that charter schools are public schools and that "the degree of state control over charter schools and public funding of such schools justify amending the Proposed Regulation such that public charter schools are considered agencies or instrumentalities of the state for purposes of the Internal Revenue Service's 'governmental plan' definition."

The IRS has spent 2013 reviewing the 2,300 comments that have been received. It is unclear at this point whether it will take the next step in the ANPRM process in 2014 by issuing proposed regulations for formal public comment that reflect these earlier reviews. At any rate, the IRS continues to indicate that the project has not been abandoned, but that they are continuing at a very deliberate pace. Just what that might portend for 2014 is unclear.

Treatment of "Picked-Up" Contributions: The majority of public employees are required to share in the financing of their defined benefit (DB) pension plan – to an even greater degree in recent years. A specific section of the Federal Internal Revenue Code (Section 414(h)(2), referred to as the "pick-up rule") permits state and local government employee contributions to be tax-deferred if certain conditions are met. Treasury issued Revenue Ruling 2006-43 to clarify such conditions, including the condition that employees not be able to opt out of the tax-deferred arrangement or be able to receive contributed amounts directly instead of having them paid into the plan (in other words, employees cannot be given the option between cash or deferred compensation).

While aimed at abuses, Rev. Rul. 2006-43 has called into question the tax treatment of public employee contributions under various existing benefit structures around the country that allow state and local employees to optionally participate in a benefit, plan or tier that changes their contribution amount. This could be interpreted to include optional participation in salary reduction arrangements to purchase credit for past service, certain types of deferred retirement programs that change the employee contribution or another plan or tier that has a different contribution amount.

Prior to Rev. Rul. 2006-43, the IRS approved tax-deferred treatment for public employees' contributions made pursuant to an election under these arrangements. Congress also affirmed the ability to use the pick-up rule to purchase service credit and to move between plans with different benefit levels. (Under the Taxpayer Relief Act of 1997, Congress stated nothing in the new purchase of service credit provisions was meant to interfere with pick-ups to purchase service credits. Under the Pension Protection Act of 2006, Congress specifically reaffirmed the ability of public employees to purchase service under a plan whereby "a lower level benefit is converted to a higher benefit level otherwise offered under the same plan").

Since Rev. Rul. 2006-43, however, there have been concerns regarding whether many of these practices would now be permitted. Specifically, a number of jurisdictions who are experimenting with new elective tiers that have been designed as elements of pension reform and that can change the level of the "picked-up" amount are concerned that these elections could be viewed by the IRS as a prohibited cash or deferred arrangement (CODA) under the plan. These jurisdictions include Orange County, California, and most recently the city of San Jose, California.

Whether through private letter ruling requests filed with the IRS, meetings with Treasury staff, discussions on the Hill, or outreach to other public employers who are looking at ways to control or shift pension costs, activity surrounding this problem continued in 2013, picking up some steam with the increased activity of Mayor Chuck Reed of San Jose related to this matter.

NCTR and NASRA believe that the resilience of state and local retirement systems in meeting the needs of both public employees and employers is critical to these plans' success. The ability to reasonably and equitably adjust plan designs, financing structures, and governing statutes to accommodate changing needs and fiscal realities should therefore be maintained.

Accordingly, NCTR and NASRA initiated discussions with Treasury in 2011 to address the potential unintended impact of the current reading of the Revenue Ruling – and any further moves to interpret its application in other settings. Specifically, concerns were expressed to Treasury that any action that officially affirms this reading of RR 2006-43, even in part, could raise issues for many plans. Furthermore, a proscriptive outline by Treasury of the timing, circumstances, financial condition, etc. under which a new tier or plan can receive picked up contributions (which was referenced in meetings as a potential amendment to the existing ruling) could easily send the wrong message as to a single one-size-fits-all Federal solution in this area where flexibility is needed, not increased Federal restrictions on state and local pension decisions.

Complicating matters is a concern on the part of some public sector unions that Treasury should not approve an interpretation that permits employees, on an individual (vs. collective) basis, to elect into different tiers with different mandatory contribution amounts, suggesting that all individually elected contributions should be excluded from pick-up eligibility unless they are to increase contributions or move to a higher benefit under the plan.

In addition to private letter ruling requests, which continue to be held up as the IRS and Treasury continue to work on a resolution to the problem, legislation was introduced in the House of Representatives by Congresswoman Loretta Sanchez (D-CA) in 2011, and reintroduced in 2013. Her bill, HR 205, would clarify the treatment of certain retirement plan contributions picked up by governmental employers to permit the treatment of certain employer contributions made to public retirement plans as picked up by an employing unit regardless of whether the participating employee is allowed to make an irrevocable election between the application of two alternative benefit formulas involving the same or different levels of employee contributions. The bill has only two cosponsors and received no consideration in 2013.

As noted earlier, Chuck Reed, the Mayor of San Jose, has become increasingly active on the issue based on a ballot measure that passed in June of 2012 in San Jose to modify pensions for current city employees, including permitting individual elections by active employees to choose a different pension tier with lower employee contributions. San Jose has filed a private letter ruling request concerning this matter with the IRS, and the Mayor has been meeting with other state and local officials, including governors and other mayors, seeking support for a solution to this problem, as well as with members of Congress and officials at the Treasury Department.

He has also been instrumental in obtaining approval by the National League of Cities as well as the U.S. Conference of Mayors, of resolutions supporting his efforts. However, having received no action by either the IRS or the Congress on the issue, in 2013 Mayor Reed and the heads of four other California cities moved to amend the California state constitution to permit public employers to unilaterally cut public pension benefits for active employees prospectively.

They are seeking to put their amendment on the statewide ballot in November of 2014. Their initiative would provide that a government employee's "vested rights" only applies to pension and retiree healthcare benefits earned for service already rendered, and explicitly empowers government employers and the voters to amend pension and retiree healthcare benefits for an employee's future years of service.

NCTR and NASRA have consulted with Mayor Reed and others to obtain a resolution to this issue that will ensure needed flexibility for state and local governments in the development of their pension policies without creating unintended consequences for important tools currently used by many plans involving the employer pick-up.

Specifically, an amendment to Revenue Ruling 2006-43 has been developed by NCTR and NASRA that sets forth proposed parameters which the IRS could adopt that would appropriately narrow the range of employee choices, while preserving defined benefit security and still providing enough flexibility to state and local governments. Under the proposed changes to the Revenue Ruling, existing employees participating in a defined benefit plan would be allowed a choice that could affect the amount of their picked-up employee contributions under IRC Section 414(h)(2) if all of the following parameters were satisfied:

1) *Defined Benefit Plans Only*. The choice presented for existing employees would only apply to qualified governmental defined benefit plans. The choices could be:
   a) between or among tiers of a defined benefit plan that is a qualified governmental plan under IRC Sections 401(a) and 414(d);
   b) between or among defined benefit plans that are qualified governmental plans under IRC 401(a) and 414(d) of the same employer;
   c) purchase of service credit within a qualified governmental plan under IRC Sections 401(a) and 414(d); or
   d) participation in a deferred retirement arrangement of the employer
2) *Protection of Accrued Benefit*. The current accrued benefits would not be affected by the choice.
3) *Prospective Only*. The employee's choice would only apply to the pre-tax treatment of future contributions.
4) *Only if Authorized by Law*. The employee's choice would be required to be made pursuant to a provision of federal, state, or local law (including any collectively bargained provision adopted in accordance with such law).
5) *Broad-Based Plans Only*. The choice being presented must apply solely to qualified governmental defined benefit plans that are broad-based plans maintained by a state or local government employer.

6) *Equivalent Treatment Required*. The choice must be made available to all similarly situated individuals in a reasonably equivalent matter.
7) *Employer Action Required*. Only the employer could provide that the employee's contributions are picked up. The employee would not have a choice as to whether the contributions are picked up. The employer is required to have taken official action to authorize the pick-up.
8) *Only Choices Pursuant to Plan Document*. The relevant defined benefit plan document(s) must provide for the choice.

To date, the proposal has not succeeded in defusing certain union opposition to permitting individual elections. Nor is it clear, in light of continued union opposition, that the proposed changes will be adopted by the Treasury. The prospects for action on the Sanchez legislation is also unlikely unless it were to be made a part of a larger legislative tax package, and the adoption of any such tax bill prior to the 2014 elections is highly questionable.

MyRA: On January 28, 2014, the day following his State of the Union address, President Obama sent a Presidential Memorandum to Treasury Secretary Jacob Lew, directing him to develop a new retirement savings security that can be made available through employers to their employees. Called “myRA,” standing for “my Retirement Account,” the President described his proposal as “a new savings bond” that encourages Americans to build a nest egg. It “guarantees a decent return with no risk of losing what you put in,” the President explained.

While intended primarily for Americans who have no access to an employer-provided retirement vehicle, the Treasury Department, in response to an NCTR inquiry, confirmed that the new myRA’s can be offered by public employers to public employees.

The President’s memo to Treasury directs them to finalize the development of his new retirement savings proposal by the end of 2014. It is to be “focused on reaching new and small-dollar savers and shall have low barriers to entry, including a low minimum opening amount.” Additional details have been released in a January 30th op ed by Treasury Secretary Lew, as well as in a fact sheet provided by the White House. Here is how it apparently will work:

- The myRA will be totally voluntary. An employer can choose whether or not to offer his or her employees these accounts; if they are made available, contributions to them will be via automatic payroll deductions. According to the White House, the accounts have “little to no cost” and are “easy for employers to use, since employers will neither administer the accounts nor contribute to them.” There will not be tax breaks to encourage employers to participate.
- If participants have more than one job, they can direct payroll contributions from multiple employers into a single myRA. However, myRA’s will not be available to the self-employed.
- A participant can begin saving with an initial deposit of as little as $25, and can contribute as little as $5 each payday. Such contributions would be eligible for the Federal Savers’ Credit, if otherwise applicable.
- The new bond will be offered via a Roth IRA account and will operate under the same rules as a Roth. That is, contributions go into the account after taxes have been paid, although withdrawals are tax-free in retirement, and eligibility is limited to households earning up to $191,000 a year.
- There are no fees - 100 percent of any contribution goes into the account and is invested in a Treasury security. It will earn the same interest rate that is available to Federal employees for their retirement savings through the Thrift Savings Plan (TSP) Government Securities Investment Fund.
- MyRA’s will be operated by a financial agent (a bank, credit union or savings bank) chosen through a competitive bidding process.

- MyRA savers will benefit from principal protection, "so the account balance will never go down in value," the White House assures. The security in the account, like all savings bonds, will be backed by the U.S. government.
- Contributions can be withdrawn tax free at any time, and, while intend for retirement, are not restricted in their use.
- MyRA savers will have the option of keeping the same account when they change jobs and can roll the balance into a private-sector retirement account at any time. As Secretary Lew puts it, a myRA "is not tied to any one employer—it belongs to the worker, not the workplace."
- Participants could save up to $15,000 in a myRA account, and have up to 30 years in which to do so. Once the applicable limit is reached, the account would be transferred to a regular Roth IRA.
- Although myRA is largely aimed at low- and middle-income households with no existing access to an employer-provided retirement plan, a senior administration official has reportedly said that the program also would be available to other workers who already have a retirement plan and want to supplement their savings.

All in all, a very modest proposal, using after-tax dollars and earning what the White House expects will be between 1.5 and 2 percent interest. However, creating retirement accounts for workers who do not have that option on the job "represents a tiny first step toward addressing the increasingly urgent problem of Americans who do not save enough for old age," according to the *Washington Post*. A small step, perhaps, but a step in the right direction.

SECURITIES AND EXCHANGE COMMISSION

Rule to Treat Certain Public Pension Trustees as Municipal Advisors: In 2010, the Securities and Exchange Commission (SEC) proposed a new rule that would clarify what constitutes a "municipal advisor;" provide a permanent registration process for them; and impose an express Federal fiduciary duty on municipal advisors in their dealings with governmental entities.

In crafting the rule and who would be exempt from it, the SEC determined that even though the financial reform legislation passed earlier that year and often referred to as Dodd-Frank, had excluded employees of a "municipal entity" – which term is defined to include public pension funds, local government investment pools and other state and local governmental entities or funds, along with participant-directed investment programs or plans such as 529, 403(b), and 457 plans -- from the definition of "municipal advisor," the statute did not explicitly refer to members of a board or other governing body of a municipal entity who might not technically be employees.

Therefore, the SEC rationalized that elected and *ex officio* board members are "accountable" for their performance to the citizens of the municipal entity, as opposed to appointed members, who, in the SEC's view, are not. Accordingly, the SEC proposed that the former would be included in the exemption, while the latter would not. Thus, as initially proposed, some public pension trustees might have to register with the SEC, pay the registration fee, and comply with the Federal fiduciary standard, while their ex officio colleagues would not.

NCTR and NASRA filed joint comments with the SEC in 2011, objecting to this approach. Among several other points, the letter argued that all trustees of state and local government retirement systems (whether elected or appointed), as members of a governing body of a governmental pension fund, are, per se, a part of that municipal entity, and, as such, are therefore expressly excluded from the definition of a "municipal advisor."

The letter also pointed out that public pension trustees are already held to strict accountability standards, whether elected or appointed. Furthermore, the letter cautioned that creating "burdensome and costly registration requirements would also serve to discourage service on public pension boards, which could diminish rather than enhance the quality of these governing bodies."

The SEC received over 1,200 comments on its proposed rule. In addition, the SEC was pressured by Congress to change their proposed rule, with the House of Representatives passing legislation in 2012 to, among other things, exempt certain activities of nine different categories of professionals, including "any elected or appointed member of a governing body of a municipal entity or obligated person, with respect to such member's role on the governing body.'' The legislation died in the 112th Congress, but was reintroduced in the 113th Congress in 2013.

Finally, on September 18, 2013, the SEC approved its final rule in this area. This final rule exempts employees and appointed officials of municipal entities from registration, making it clear that this exemption covers people serving as members of a governing body, an advisory board, a committee, or acting in a similar official capacity.

Municipal Securities Enforcement Activity: In 2013, the Securities and Exchange Commission (SEC) continued to use its Enforcement Division's new Municipal Securities and Public Pensions Unit to apply the SEC's anti-fraud statutes in order to underscore what the SEC sees as flawed public pension disclosure by municipal bond issuers.

On March 11, 2013, the SEC charged the State of Illinois with securities fraud for misleading municipal bond investors about the State's approach to funding its pensions – specifically, the Illinois State Employees' Retirement System; the State Universities Retirement System; the Illinois Teachers' Retirement System; the Judges' Retirement System; and the General Assembly Retirement System. This represented only the second time that the SEC has used its anti-fraud statutes against a state – the first involved New Jersey in 2010.

According to the SEC's investigation, Illinois did not inform investors about the significant impact of problems with its pension funding and failed to disclose that it had "structurally underfunded" the State's pension obligations and increased the risk to its overall financial condition as a result. Illinois, without admitting or denying the findings, agreed to settle the SEC's charges and entered into a "Cease and Desist" Order with the agency.

Elaine Greenberg, Chief of the SEC's Municipal Securities and Public Pensions Unit at the time, said that the area of public pension disclosures "continues to be a top priority of the unit." It can be expected that the SEC will continue its enforcement activities in this area in 2014.

SOCIAL SECURITY ADMINISTRATION

Changes to the SSA Death Master File: Section 205(r) of the Social Security Act prohibits the Social Security Administration (SSA) from disclosing State death records—received through contracts with the States—which SSA has not independently verified. Accordingly, when SSA realized that it had not been following its own law, it removed all State death records received through the Electronic Death Registration (EDR) system from SSA's Death Master File (DMF) in November of 2011.

Furthermore, SSA decided at that time that it would not include any new State EDR records on the DMF update file available to the public through the Department of Commerce, National Technical Information Service (NTIS). This change resulted in millions of records being removed from the Social Security Death Index (SSDI) and as much as a million fewer records being included in the DMF going forward (a nearly 36 percent decrease) in 2012.

Although the SSA may disclose all death data, including State EDR records, directly to State or Federal agencies administering federally funded benefits and to States to administer benefit programs wholly funded by the State, the SSA has determined that, because employees help fund the pension plan, it is not "wholly funded" by the state. Plan requests to receive all death data have therefore been denied.

The recent two-year budget deal that was negotiated by House Budget Committee Chairman Paul Ryan (R-WI) and Senator Patty Murray (D-WA), his Senate counterpart, contained a provision (Section 203) modeled in part on a proposal recently floated by former Senate Finance Committee Chairman Max Baucus (D-MT) to address the issue of access to the DMF. It was included in the budget deal because it is viewed as a revenue raiser for the Federal government, intended to address fraudulent use of the Social Security numbers of deceased individuals to claim tax refunds and credits and Medicare payments.

The provision in the Bipartisan Budget Act would effectively maintain restrictions on access to the information contained in the DMF. However, this would be limited to a three-year period beginning on the date of an individual's death. An exception to this three-year restriction would be provided for persons who are certified under a program to be established by the Secretary of Commerce.

Under the program that the Commerce Department is to institute, persons certified by the Secretary of Commerce to have a fraud prevention interest or other legitimate need for the information and agree to maintain the information under significant safeguards may continue to access DMF information on a current basis.

While this sounds very similar to the Baucus proposal, and would appear to provide an avenue for access for public pension plans, via certification by the Commerce Department, the problem is that the definition of the DMF used in this amendment is "information on the name, social security account number, date of birth, and date of death of deceased individuals maintained by the Commissioner of Social Security, other than information that was provided to such Commissioner under section 205(r) of the Social Security Act."

Unfortunately, the information provided under section 205(r) includes the very State death records received by Social Security through their contracts with the States and which was removed from the DMF in 2011. Thus, the new certification program will only provide access to the redacted DMF, which does not include State information provided through the Electronic Death Registration (EDR) system from the States. So, in effect, the amendment fixes nothing as far as public pension plans are concerned.

It is unclear why access to only the redacted DMF was included in the provision. However, at this point, it appears highly unlikely that any changes will be made to the recently-adopted provision anytime soon.

An alternative to Federal legislation is for the States, which control the data, to explore someone other than SSA as the entity to provide the information, such as an outside, non-governmental organization. One such entity being considered is reportedly the National Association of Public Health Statistics and Information Systems (NAPHISIS) to serve as the source of death records if SSA does not continue in this role. Their members are comprised of the state boards of vital statistics and so are in a good position to serve as such, and they are currently working to complete an electronic death data reporting system. It is unclear what the costs of using them might be for plans.