

Federal Update 2004-26

October 18, 2004

TO: NCTR Membership
FROM: Cindie Moore, Washington Counsel
RE: Update of Report Provided at NCTR Convention

Hi, everyone. For those of you who did not have the opportunity to attend the Convention, I am providing my federal report for you here.

For those of you who were at the Convention and attended my presentation, I have updated the report to include developments since I first prepared it.

Introduction

The House and Senate left Washington on October 9 and 11 respectively to hit the campaign trail, but will return on November 16 in a lame duck session to complete unfinished work. Of the 13 spending bills, only two have been signed into law by the President. Two more await his signature. Lawmakers passed a stop-gap funding bill that will keep the government in operation until November 20.

The most urgent issues for NCTR members at present are regulatory, not legislative. The report describes three regulatory items, two of which are action items and the third is an issue that will likely require action shortly. The report then provides information about the top legislative issues.

Regulatory Issues and Action Items for NCTR Members	Legislative Issues	Attachment
-Minimum Distribution Rules -Social Security "Section 419 Notice" -Phased Retirement	-Terrorism Investments -Protection of 415(m) Plans -Social Security Numbers	-Comparison between Senate and House Pension Bills

Regulatory Issues (Action Required or Will be Required Shortly)

Minimum Distribution Rules

IRS and the Department of the Treasury released on June 14 the final regulation on the minimum distribution rules (MDRs) for defined benefit plans and other retirement vehicles. The MDRs, located in Section 401(a)(9) of the Internal Revenue Code, specify

how and when payments from various retirement programs must be made. The final regulation applies to COLAs, benefit distribution options, and other features of state and local government plans. Key points to keep in mind:

➤ Grandfathering for Governmental Plans: Any annuity distribution option provided under the terms of a governmental defined benefit plan in effect as of April 17, 2002 will satisfy Section 401(a)(9), provided “the distribution option satisfies [Section 401(a)(9)] based on a reasonable and good faith interpretation of the provisions of [Section 401(a)(9)].” The final regulation does not give a definition of “reasonable and good faith interpretation.” However, it is likely a broad standard that would permit most types of options.

➤ Changes Made after April 17, 2002: You must follow the final regulation. Note two scenarios:

-If you made a change on or after April 17, 2002 and before June 15, 2004, the final regulation provides an opportunity to make changes. See NCTR Federal Update 2004-20, http://www.nctr.org/pdf/fedupd2004_20.pdf, for more detail.

-If you make a change on or after June 15, 2004, you must make it in conformance with the final regulation.

➤ General Reaction to Final Regulation; Problems for Future; Solution: IRS incorporated into the final regulation most of the concerns expressed by NCTR members. The final regulation provides for a wider range of permissible indices for COLAs. It also allows a flat percentage increase of not greater than five percent. It liberalizes the restrictions in the IRS’ temporary regulations and proposed regulations on a joint and survivor annuity with a younger non-spouse beneficiary. These changes, along with the grandfathering, make the final regulation workable for most NCTR members **for the present**. The **future** is a **different story**. **Problems** with the final regulation will likely arise in two areas. First, to what extent will future changes in the existing distribution options negate the grandfather? Second, in the event a state or local government wishes to make major changes in distribution options, those options must precisely follow the final regulation, even if it would create a more restrictive design than desired by the state or local government. A **solution** appears in the key House and Senate pension bills (H.R. 1776 and S. 2424). Each bill has a provision that allows governmental plans to be deemed as having complied with Section 401(a)(9) if they follow a reasonable good faith interpretation. NCTR intends to lobby to retain this important provision in the final version of any pension bill.

Action Items for NCTR Members on MDR Regulation

Before any changes are made in your COLAs, retirement options, benefit increases, and the like, be sure to **review the MDR regulation**, located in NCTR Federal Update 2004-19, http://www.nctr.org/pdf/fedupd2004_19.pdf. For an analysis of the rules, see NCTR Federal Update 2004-20, http://www.nctr.org/pdf/fedupd2004_20.pdf.

Social Security “Section 419” Notice

Representatives of state and local governments (SLG) groups, including NCTR, NASRA, and NCPERS, met with Social Security Administration (SSA) officials about the “Section 419” notice requirement. State and local government employers who hire individuals for non-Social Security covered positions on or after January 1, 2005, must provide them with a new notice. The notice explains the possible reduction of their future Social Security benefit because they are taking a non-Social Security covered position. The reductions occur by operation of the Government Pension Offset (GPO) and Windfall Elimination Provision (WEP). The individuals must sign the notice. The employer must then send the notice to the retirement system that covers the individuals. Section 419 is the location of the new requirement in the Social Security Protection Act, signed into law on March 2, 2004.

During the meeting, the SLG representatives had a chance to ask the SSA officials about the procedures surrounding the use of the notice and its wording. The SSA officials say that the notice text will be available soon. See NCTR Federal Update 2004-24, http://www.nctr.org/pdf/fedupd2004_24.pdf, for more information

Action Items for NCTR Members on Section 419 Notice

Retirement systems must accept the signed notices from employers. The statute is silent about what the systems should do with the form. SSA officials say that systems should decide such issues as where to keep the form and how long to retain it.

Retirement systems will likely receive calls from employers about the operation of the notice and also for copies of the notice and any background information. SSA will be sending out information and NCTR will assist in disseminating the information. Thus, systems will need to stay alert to any developments.

Phased Retirement

Treasury and IRS have collected comments on phased retirement, including some from NCTR. Phased retirement allows an individual to transition from work to retirement by means of a position of reduced hours, lower compensation, or reduced physical or mental stress before full retirement. The concept is related to, though separate from, the “return to work” provisions that are common in state statutes. Under return to work, an individual retires then returns to work in a part- or full-time capacity while continuing to draw his/her pension. Treasury plans to provide some draft guidance on the phased retirement issue and could get involved in the return to work issue.

Action Items for NCTR Members on Phased Retirement

No proposed guidance has been issued. Thus, there are no action items as yet for NCTR members. The Treasury Department hopes to release something before year's end. As soon as Treasury releases the proposal, NCTR will analyze it and will seek feedback from retirement systems.

Legislative Issues

Terrorism Investments

Focus has been directed on public plan investments **in companies** with activities in seven countries (Cuba, Iran, Saddam Hussein's Iraq, Libya, North Korea, Sudan, and Syria) that the U.S. government has identified as sponsors of terrorism. A report by the Center for Security Policy (CSP) alleges that 87 of the nation's 100 largest public pension plans invested from 15 to 23% of their portfolios **in companies** with business in terrorist sponsoring countries. Entitled "The Terrorism Investments of the 50 States," the report fails to differentiate between companies doing business in these countries and companies actually supporting terrorist activities. Moreover, the report does not trace revenue generated by publicly traded companies to sponsorship of terrorism. In addition, the report singles out public plans for criticism even though other institutional investors as well as individuals invest in these companies. The CSP, according to its website, is a non-profit group that promotes "international peace through American strength."

Public pension groups and others wrote to the President of CSP, Frank Gaffney. They said the report was based on faulty premises, contained an inflammatory title, and provided a distorted and misleading picture of states and their pension funds.

CSP is related to a company called the Conflict Securities Advisory Group (CSAG). According to legal records and web site information, CSP and CSAG share offices and a top official. CSAG is marketing Global Security Risk Monitor, a software product that analyzes public plan portfolios. It offers the software on a subscription basis for \$12,500 per year. CSAG has approached some NCTR members about subscribing to the service.

Meanwhile, Senator Frank Lautenberg (D-NJ) wrote to some public fund executives asking them for information about their portfolios. He wished to know whether any investments in the portfolios had ties to or activities with countries designated as sponsoring terrorism. The Senator also planned an amendment that would require divestment by certain companies with foreign subsidiaries doing business in countries that sponsor terrorism. His activities have abated for now.

What is the bottom line here? Only the federal government has the power to decide whether U.S. companies can do business in other countries based on national security concerns. State and local governments have no jurisdiction in the area.

The Securities and Exchange Commission has a new division, the Office of Global Security Risk (OGSR) that will focus on disclosure issues, particularly regarding the disclosure of operations of foreign and U.S. companies on U.S. exchanges that operate in terrorist-sponsoring countries. NCTR and other public pension groups are hoping to meet with the OGSR.

Protection of 415(m) Plans

Provisions in corporate and international tax reform legislation approved by the House and Senate threatened the Section 415(m) plans used by state and local governments (H.R. 4520, the “American Jobs Creation Act of 2004”). As initially drafted, the bill appeared to apply to Section 415(m) plans some changes in the rules applicable to nonqualified deferred compensation plans, which are voluntary salary and bonus deferrals for executives of private sector entities. Public pension representatives met with staff of the tax writing committees in an effort to ensure 415(m) plans were exempt.

Section 415(m) plans have acquired a variety of names, such as excess benefit, spill-overs, slivers, and tag-alongs. Their sole purpose is to provide participants with the portion of their annual benefit otherwise payable under the terms of the defined benefit plan that exceeds the Section 415(b) dollar limits. Typically, benefits under Section 415(m) plans are paid at the same time and in the same form as the employee elects under the underlying qualified plan when the employee retires.

The conference version of the bill carves out Section 415(m) plans. As noted above, both the House and Senate approved the bill. As of October 18, the President had not signed it. He is expected to do so.

Social Security Numbers

The House Ways and Means Committee approved on July 21, H.R. 2971, which would restrict both governments and private firms from selling and publicly displaying Social Security numbers. Rep. Clay Shaw (R-FL), who sponsored the bill, has worked on this legislation for several years.

As relates to state and local government retirement systems, the bill would, among other things, prohibit federal, state, and local governments from 1) selling SSNs (limited exceptions would be made to facilitate law enforcement and national security, to ensure the accuracy of credit and insurance underwriting information, for tax purposes, and to the extent authorized by the Social Security Act); and 2) displaying SSNs to the general public.

NCTR members should note several other proposed changes. The following practices would be banned:

- Displaying SSNs on checks issued for payment and accompanying documents.

- Displaying SSNs on identification cards and tags issued to employees or their families.
- Requiring the transmission of SSNs over the Internet without encryption or other security measures.

In addition, both the public and private sectors would be required to safeguard SSNs they have in their possession from unauthorized access by employees or others. The sale, purchase, or display of SSNs in the public or private sector would be permitted by the U.S. Attorney General in other circumstances, when appropriate. In making this determination, the Attorney General would consider the costs and burdens to the public, government, and businesses. If the sale, purchase, or display were to be authorized, the Attorney General would provide for restrictions to prevent identity theft, fraud, deception, crime, and risk of bodily, emotional, or financial harm.

The bill would create new criminal (up to 5 years imprisonment and fine up to \$250,000) and civil (up to \$5,000 per incident) penalties for violations of the law relating to the display, sale, purchase, or misuse of the SSN. It would enhance prison sentences for SSN misuse associated with repeat offenders (up to 10 years), drug trafficking or crimes of violence (up to 20 years), or terrorism (up to 25 years).

The bill now moves to two other House committees for consideration: 1) Financial Services, and 2) Energy and Commerce. Similar legislation, S. 2801, is pending in the Senate Finance Committee. Because the two House Committees have yet to consider the bill and a narrow window of time exists before adjournment, the chance for passage this year is not great.

Attachment

Comparison of Governmental Plan Provisions in S. 2424, National Employee Savings Trust Equity Guarantee Act (NESTEG) with those in H.R. 1776, the Portman-Cardin Bill

Provision	NESTEG (S. 2424)	Portman-Cardin (H.R. 1776)
Clarification of Purchase of Service Credit Provisions	<p>#1-Clarifies that purchases of service credit (PSC) for periods for which there is no performance of service is allowable.</p> <p>#2-Clarifies that PSC may include service credited in order to provide an increased benefit for service credit that participant is receiving under plan, i.e., benefit to which participant not otherwise entitled.</p> <p>#3-Clarifies that trustee-to-trustee transfer of 403(b) and 457 funds into governmental defined benefit plan for purchase of PSC is not subject to limits applicable to air time (i.e., not more than 5 years of non-qualified PSC and participant must have 5 years of participation in plan).</p>	Similar to NESTEG, except that #1 is not included

	<p>#4-Clarifies that once 403(b)/457 funds are transferred to governmental defined benefit plan, they take on distribution rules of such plan.</p> <p>#5-Clarifies that transfer need not be made between plans maintained by same employer.</p>	
After-Tax Contributions to Enhance Portability	Allows defined benefit plans to accept after-tax rollovers, if they so wish, provided that they separately track the after-tax funds from the pre-tax funds. At present, defined contribution and other plans may accept these types of rollovers.	Not Included
Relief from Minimum Distribution Rules (MDR) to Ensure Special Features of State and Local Government (SLG) Plans Recognized	Allows SLG retirement plans to be deemed as having complied with MDR of Section 401(a)(9) if they follow a reasonable good faith interpretation. See NCTR Federal Update 2004-19, http://www.nctr.org/pdf/fedupd2004_19.pdf , and Federal Update 2004-20, http://www.nctr.org/pdf/fedupd2004_20.pdf .	Same provision
Relief for Public Safety Employees from 10% Early Withdrawal Tax	Exempts from the 10% early withdrawal tax any distributions from a governmental defined benefit plan to a qualified public safety employee who separates from service after age 50. Under current law, the age is 55. Provision recognizes that public safety employees often retire earlier than workers in other professions. Thus, they should be permitted to receive distributions from defined benefit pension plans without the imposition of the 10% tax.	Similar, although would define in federal law what a deferred retirement option plan is.