

Federal Update 2004-6

TO: NCTR Members

FROM: Cindie Moore, Washington Counsel

DATE: February 12, 2004

RE: Legislative Committee in Washington; Developments on Several Issues

This past week has been busy in Washington. Members of the NCTR Legislative Committee convened the morning of February 9. Steve Yoakum, Executive Director of the Public School Retirement System of Missouri, and Chair of the Committee, led the discussion. Committee members then went to Capitol Hill and spent the day meeting with their congressional offices. This Update will summarize the meeting. It will then provide updates about the following issues of interest to NCTR members:

- Clarification about Purpose of Notice Requirement in H.R. 743
- Adjustments to GPO/WEP Contemplated
- GASB OPEB Finalization Nears
- Corporate Governance Issues Percolating in Congress and SEC

### **NCTR Legislative Committee Activity**

#### ***Key Gains Made in 2003***

In a two-hour session, the Committee members covered a great deal of material. They first looked at the key gains made during 2003: 1) elimination of a 1099R reporting provision about whether a pension is based on non-Social Security covered work; 2) relief from temporary regulations about the Minimum Distribution Rules that make certain COLAs and other features of public pension plans impermissible; and 3) passage in both House and Senate Committees pension legislation that clarifies purchases of service credit.

#### ***NCTR's Federal Priorities***

The Committee members then reviewed NCTR's ongoing federal priorities:

-Enhancing the effectiveness of state and local government retirement systems through: 1) making permanent the pension provisions in the tax cut bill of 2001 (known as EGTRRA, the Economic Growth and Tax Relief Reconciliation Act); 2) clarifying purchase of service credit issues; and 3) expanding portability.

-Maintaining the well-established line between state and local government (SLG) and federal government regulation of SLG retirement systems through: 1) harmonizing SLG COLAs and other benefits with the Minimum Distribution Rules of the Internal Revenue Code; and 2) retaining SLG jurisdiction over notices to participants about benefits and investments.

-Addressing Social Security issues, both ensuring its long-term solvency and preserving the voluntary affiliation of SLGs with Social Security.

### ***Administration's Savings Proposal***

Finally, the Committee members discussed the Administration's Savings Proposal. The Proposal sets up two types of individual savings accounts: Lifetime Savings Accounts (LSAs), which could be used for any purpose; and Retirement Savings Accounts (RSAs), which would be for retirement only. Like Roth IRAs, contributions to the accounts would be after-tax and the income generated in the accounts would be tax-free. The Proposal would also consolidate 401(k)s, 403(b)s, and 457s into a single new savings vehicle called an Employer Retirement Savings Account (ERSA). The Administration argues that the LSAs and RSAs would spur savings and that ERSAs would simplify the current programs.

An initial analysis of the Proposal raises the following concerns. First, even though the Proposal concentrates on 1) individual savings through the LSAs and RSAs and 2) voluntary defined contribution plans through the replacement of 403(b)s and 457s by ERSAs, it could undermine the existing structure of state and local government plans. Those plans provide a defined benefit plan as the principal benefit and a supplemental defined contribution plan, such as a 403(b) or 457. State and local governments and their employees and retirees have worked hard to make such programs work to ensure that retirees are self-sufficient to the largest degree possible during their retirement years.

Second, the consolidation of 403(b)s, 457s, and 401(k)s into an ERSA may be more complex than current law and ongoing efforts. The Administration says that the differences among the three types of plans need to be simplified. Over the years, Congress has been working toward that goal. It has provided portability among the three types of plans. It has also made uniform the maximum amount of contributions that can be contributed annually to the three types of plans. These gradual efforts toward uniformity are less disruptive for both plan participants and the administrators who manage the plans.

Third, the LSAs, which can be used for any type of savings, could displace retirement savings and undermine employer-sponsored arrangements. Employer-sponsored plans have low administrative costs because they are usually large enough to enjoy economies of scale. Moreover, employer-sponsored plans are effective in providing education to employees about the importance of retirement savings. A movement away from employer-sponsored plans toward individual savings accounts such

as LSAs would result in higher administrative costs and fewer opportunities for retirement education.

### ***Debriefing after Congressional Office Visits***

The Committee members met at the end of the day to discuss the feedback received during their visits. Two issues frequently arose. First, most of the congressional offices are still absorbing the details of the Administration's Savings Proposal, although some of the Democratic offices expressed reservations about it. Second, congressional offices are aware of the portability provisions in EGTRRA 2001 and are pleased that they are working well.

### ***Next Legislative Committee Meeting***

The Committee will next meet on July 17 in Chicago to review NCTR's policy resolutions. They will also discuss the corporate governance issue. Ann Yerger, Deputy Executive Director of the Council of Institutional Investors, will lead the discussion.

## **Updates About Issues Of Interest To NCTR Members**

### ***Clarification about Purpose of Notice Requirement in H.R. 743***

As I reported recently, H.R. 743, a Social Security bill that affects state and local governments and their retirement systems, cleared Congress on February 11 and is now on its way to the White House. The President will likely sign it into law. H.R. 743 imposes a notice requirement on individuals hired to fill non-Social Security covered positions. The individual must sign a notice that he/she understands that because his/her position is non-covered, his/her Social Security benefit may be reduced by the Government Pension Offset, the Windfall Elimination Provision, or both. The employer of the individual must send a copy of the signed notice to the retirement system that covers the individual. The Social Security Administration will prescribe the form of the notice. The requirement is effective for individuals commencing employment on or after January 1, 2005.

Several NCTR members have asked *what retirement systems must do with the signed notice*. The bill text implies that the only obligation of the retirement system is to accept it. The NCTR members were concerned that, because the retirement system would have information that the individual is not covered by Social Security, it would have the obligation to report that information to the federal government at a later time.

We posed the question to a congressional staff member who worked on the notice provision. He said that the reason for the requirement is to allow, but not require, a retirement system to notify or remind the individual that he/she is not covered by Social Security. No reporting requirement to the federal government is implied because the federal government already has the information about whether the individual is

contributing to Social Security. Despite this assurance, I will work in conjunction with other public pension groups to ensure that the staff member's statement is reflected as the Social Security Administration develops the notice.

### ***Adjustments to GPO/WEP Contemplated***

Kim Hildred, staff director of the House Social Security Subcommittee, says concerns have been raised about the fairness of the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP). The GPO reduces the Social Security spouse/widow(er) benefit by two-thirds of the amount of the public retirement benefit. In some cases, the offset will entirely eliminate the spouse/widow(er) benefit. Under the WEP, a modified benefit formula reduces an individual's Social Security benefit from work covered by Social Security.

Kim said an opportunity exists to make adjustments in the current law. Her use of the word "adjustments" indicates that the changes would likely be modest. While she did not discuss any details, she warned that any fix is costly. For example, H.R. 75, a Social Security reform bill introduced by Kim's boss, Rep. Clay Shaw (R-FL), includes a provision to mitigate the effect of the GPO. Specifically, it would lower the GPO reduction from two-thirds to one-third and would cost the Social Security trust fund \$8 billion over 10 years. Despite the cost issue, Kim's acknowledgment that change is needed is encouraging.

### ***GASB OPEB Finalization Nears***

Paul Zorn of Gabriel, Roeder, Smith & Company reports that the Governmental Accounting Standards Board (GASB) is getting closer to completing its Other Post-Employment Benefits (OPEB) project. The project establishes the framework for state and local governments to measure and report OPEBs, the largest of which is retiree health care. The final statement is expected June 2004. The effective date applicable to a state and local government depends on its size. The largest governments must begin to comply for periods beginning after December 15, 2006 and for smaller governments, either December 15, 2007 or December 15, 2008.

Paul has developed a comprehensive and understandable explanation of the GASB OPEB project. A copy will be posted on [www.nctr.org](http://www.nctr.org) under the Federal Developments button.

### ***Corporate Governance Issues Percolating in Congress and SEC***

Ann Yerger, who serves as Deputy Executive Director of the Council of Institutional Investors (CII), recently shared with public pension plans its top four priorities in corporate governance. CII members are large public, union, and corporate pension funds. The organization encourages its members, as major shareholders, to take an active role in protecting plan assets and to help members increase return on their

investments as part of their fiduciary obligations. Two of the priorities are before Congress while the others involve the Securities and Exchange Commission (SEC).

Issue I: Protecting and Further Strengthening the Sarbanes-Oxley Act of 2002 (Congress). The Act toughened auditor independence standards and strengthened government standards for companies. In order to increase penalties against wrongdoers, H.R. 2179 has been introduced to give the SEC authority to fine anyone who violates securities laws up to \$2 million per violation. Unfortunately, the bill also contains a provision that would strip states of their power over certain aspects of securities regulation. The provision would reduce the effectiveness of individuals such as Eliot Spitzer, New York's Attorney General, who has been instrumental in bringing corporate wrongdoers to justice. If the anti-state regulation provision remains, H.R. 2179 will not move.

Issue II: Supporting FASB in Requiring Expensing of Stock Options (Congress). The Financial Accounting Standards Board (FASB) is moving forward on a rule to require companies to expense stock options. Legislation both for and against such expensing is pending before Congress. FASB will likely release the proposed rule in March.

Issue III: Improving Access to the Proxy (SEC). The SEC has proposed regulations to give institutional shareholders the ability to participate meaningfully in the election of corporate board members. In some companies, corporate directors are seen as largely unaccountable to shareholders and too closely aligned with company management. Institutional shareholders have been unable to address this situation because of limitations imposed by companies and the securities laws. NCTR and NASRA submitted comments to the SEC on December 22, 2003 in support of the proposed regulations. SEC has extended the comment period to March 31 and has set a hearing on March 10.

Issue IV: Separating the Business and Regulatory Functions of Stock Exchanges (SEC). Stock exchanges are "self-regulatory organizations" in that they have certain oversight of their members. At the same time, they are also business entities with a separate set of concerns. CII believes that the regulatory and business functions should be separated. Concern is concentrated on the New York Stock Exchange (NYSE). For example, broker-dealers and specialists currently choose the individuals charged with their oversight. CII sees possible progress on the issue during 2004. The SEC is reportedly planning a concept release on the effectiveness of self-regulatory organizations. In addition, SEC Commissioners have suggested that they may re-examine NYSE's governance later this year.