

**National Conference of State Legislatures
International Association of Fire Fighters
National Association of Counties
National League of Cities
Fraternal Order of Police
National Association of State Treasurers
National Association of Police Organizations
National Association of State Retirement Administrators
International City/County Management Association
National Conference on Public Employee Retirement Systems
National Association of State Auditors Comptroller and Treasurers
American Federation of Teachers
National Council on Teacher Retirement
American Federation of State County and Municipal Employees
Government Finance Officers Association
National Education Association
International Personnel Management Association
National Public Employer Labor Relations Association
United States Conference of Mayors**

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VIA FEDERAL EXPRESS

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Courier's Desk

Internal Revenue Service

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Washington, D.C. 20224

CC:ITA:RU (REG-108697-02)

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Internal Revenue Service

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Ladies and Gentlemen:

This letter is in response to the Internal Revenue Service's request for comments on Treas. Temp. Reg. §1.401(a)(9)-6T relating to minimum distributions from defined benefit plans (hereafter the "temporary regulation").

Overview

The above listed group of national organizations represent state and local governments, public employee unions, public retirement systems, and millions of public employees, retirees, and

beneficiaries. The temporary regulation is of substantial concern to these organizations and their public sector defined benefit plans and the participants and beneficiaries they serve. Specifically, the regulation imposes significant restrictions on the benefits that may be provided by governmental defined benefit plans, to the detriment of state and local police officers and firefighters, public school teachers and other public employees.

State and local retirement plans cover over 23 million public employees, retirees, and beneficiaries, paying benefits in excess of \$91 billion and holding financial assets totaling \$2.2 trillion.¹ Although there has been a well-publicized decline in the number of defined benefit plans in the private sector, defined benefit plans have continued to flourish in the public sector.

IRC §401(a)(9) is intended to assure the benefits of a 401(a) plan inure primarily to the plan participant and only incidentally to any beneficiary of the participant. We understand why Congress determined to regulate distributions from defined contribution plans—absent a distribution requirement, account balances can grow indefinitely free of tax and ultimately benefit only the participant's beneficiaries years after the participants have left service.

This concern cannot arise in the case of public sector defined benefit plans. First, public employees typically retire well before age 70½. Thus, they are receiving distributions well before IRC §401(a)(9) would require them to commence distributions. Second, the benefits provided by governmental defined benefit plans are typically the primary source of participants' retirement income. In fact, many public employees are not covered by Social Security and the benefits provided by their public sector defined benefit plans can be their sole source of retirement income. Participants in governmental defined benefit plans will want to draw their benefits as soon as possible and to the maximum extent possible. Indeed, the incentives work exactly the opposite from defined contribution plans; participants who fail to draw benefits at the earliest opportunity lose money that can never be recouped. Finally, the annuity benefits of public sector defined benefit plans are paid pursuant to statutory terms applicable to broad groups of public employees similarly situated. They are adopted through state and local governmental processes which are open to public scrutiny. In many cases, the benefits are subject to collective bargaining. They are, therefore, not subject to manipulation for tax avoidance or other purposes.

Concerns with Temporary Regulation

Although public sector defined benefit plans do not give rise to the kind of concerns which motivated the enactment of IRC §401(a)(9), in its present form, the temporary regulation is of substantial concern to public sector defined benefit plans in at least three significant respects:

- COLA Restrictions - Public sector plans have adopted a wide variety of approaches to protect their retired participants from the ravages of inflation. Some plans provide a cost of living

¹ U.S. Bureau of the Census, National Summary of State and Local Government Employee-Retirement System Finances: Fiscal Year 1999-2000

adjustment based upon the annual change in an inflation index of the Bureau of Labor Statistics. Others, however, provide for a fixed annual increase in benefits. For planning purposes, some systems use the prior year's inflation index. Others provide for an increment or additional payment based upon plan earnings. Others will adjust the retired participant's benefit based upon increases in the salary of the position or grade from which the participant retired. Although the form of protection varies considerably, the purpose of these provisions does not. They are all intended to maintain in one way or another the purchasing power of the retired participant's benefit. They are not intended to enable retired participants to "backload" their pension benefits. Although Congress clearly intended to allow for cost of living increases,² the temporary regulation (A-1(a)(1)) is written in such a highly restrictive fashion that it will cause most of the methods long used in the public sector to maintain retiree purchasing power to violate IRC §401(a)(9).

- Non-spouse Surviving Beneficiaries - Although the temporary regulation generally allows for joint and survivor annuities, A-2(c) inexplicably restricts the availability of joint and survivor annuities when the beneficiary is a non-spouse who is more than 10 years younger than the participant. It essentially requires the participant to be treated as if s/he were retiring at age 70½, even though the participant is, in fact, retiring at a much younger age. This restriction is particularly harsh on public sector employees. Public employees typically retire well short of age 70½. Their selection of a joint and survivor option in favor of a non-spouse beneficiary who is more than 10 years younger than the participant results in a far lower actuarial reduction in the participant's lifetime benefit than is the case when the participant is retiring at age 70½. By requiring such participants to be treated as if they were age 70½, the temporary regulation unreasonably curtails the ability of public sector defined benefit plan participants to provide for beneficiaries, such as a handicapped child or other needy dependent, or a significant other who relies upon the participant for financial support.

- Forms of Annuity Benefits- The temporary regulation allows only for three forms of annuity benefit, namely, single life, joint and survivor, and period certain. Although most annuities provided by public sector defined benefit plans may be in these forms, there is no reason why these plans should not be allowed to provide actuarially acceptable alternative forms of annuity benefits where necessary to meet participant needs. For example, while the temporary regulation allows for an annuity benefit from an insurance company that involves the payment of the unexpended reserve upon the death of the participant in retirement, it does not allow plans to provide a comparable form of annuity benefit. There is no reason why a public sector defined benefit plan cannot provide this type of annuity benefit or other types of annuity benefits that are actuarially appropriate and do not reduce the participant's lifetime annuity any more than the forms of annuity that are permitted under the temporary regulation. Additionally, while the temporary regulation seems to provide for certain increases in a benefit due to the death of a survivor in a joint and survivor annuity or under a domestic relations order, it does not necessarily take into account other conversions to and from a single-life and joint and survivor annuity that are provided in certain systems. In addition, the temporary regulation seems to make exceptions so that a plan can meet both the minimum distribution and federal spousal consent and qualified domestic relations order requirements, but does not provide the same accommodation for plans that must comply with state or local spousal consent and domestic relations laws.

² See 1 RIA Pension and Profit Sharing 2nd ¶401-1.04 at page 3042.

Each of these matters needs to be reconsidered so as to assure that public sector defined benefit plans can continue to serve their participants as they have in the past without causing a violation of IRC §401(a)(9).

Impact on State/Local Statutes, Contractual Guarantees

Pension plans of States and localities are established by these governments acting in their sovereign capacity and generally are adopted by and subject ultimately to the oversight of popularly-elected governmental bodies. The temporary regulations would in essence deem many state and local laws a violation of IRC §401(a)(9). The benefits provided by many public employee retirement systems are also subject to state constitutional or statutory provisions that bar public employers from taking back or reducing system benefits, once they have been established. To the extent that the temporary regulation would now bar systems from providing long established benefits, it will put systems in the utterly untenable position of either complying with the laws governing the system and violating IRC §401(a)(9) or complying with IRC §401(a)(9) and violating applicable law. Moreover, in many cases post-employment cost-of-living-adjustments are collectively bargained. To require that governments reduce such benefits would also require them to violate these contractual agreements.

Conclusion

Public sector plans have no incentive to engage in the kind of manipulative practices which motivated the enactment of IRC §401(a)(9). Public sector plans are adopted in open political processes or through collective bargaining. Public sector employees have every incentive to receive their benefits as rapidly as possible. The benefits provided by plans are established by public laws and subject to the oversight of states, localities and the public. They are available to broad classes of public employees and do not provide an opportunity for highly paid employees to engage in schemes to defer benefits to their beneficiaries.

The proposed regulation unduly curtails existing practices of State and local government plans with virtually no advancement of the public policy objectives of IRC §401(a)(9). We respectfully urge the temporary regulation be amended to exclude public sector defined benefit plans from its coverage. Given that the regulations provide considerable flexibility for annuity distributions from annuity contracts provided by private sector insurance companies, we believe the benefits provided by public sector defined benefit plans should receive, at the very least, similar accommodations. At a minimum, the temporary regulation needs to be modified so that it addresses the many concerns that are unique to public plans.

In any event, pursuant to the notice of proposed rule-making, we request a public hearing be held so that we can present our concerns orally.³ We appreciate the opportunity to comment on the

³ Public policy supports the holding of a hearing where the interests of governmental entities are involved. A hearing would be consistent with Executive Order 12866 (Section 1 (9))(which provides that “[w]herever feasible, agencies shall seek views of appropriate State, local and tribal officials before imposing regulatory requirements that

temporary regulation. We respectfully urge your favorable consideration of our request for an exemption.

If you have any questions or need additional information, please contact our federal representatives:

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Cc: Hon. Max Baucus, Chairman, Senate Finance Committee
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might significantly or uniquely affect those governmental entities” and that “[e]ach agency shall assess the effects of Federal regulations on [such entities], . . . and seek to minimize those burdens that uniquely or significantly affect such governmental entities, consistent with achieving regulatory objectives”), as well as the Unfunded Mandates Reform Act of 1995 (which “requires each Federal agency, unless otherwise prohibited by law, to assess the effects of Federal regulatory actions on State, local and tribal governments”).