North Carolina
Department of State Treasurer

N.C. DEPARTMENT OF STATE TREASURER
RETIREMENT SYSTEMS DIVISION

JANET COWELL
TREASURER

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RETIREMENT SYSTEMS DIRECTOR

Administrative Changes Retirement System/Treasurer

The Department of State Treasurer aims to provide public employees and retirees, including teachers, police officers, firefighters, and public servants from all over the state with secure pensions and retirement. This legislative proposal incorporates provisions that will clarify interpretations of current law, conform to federal regulation and increase efficiency of administration of the retirement systems administered by the Department.

Statutes Affected: 58-86-60; 58-86-90; 135-5(n); 128-27(i) 135-1(14a); 135-5(a); 135-5(b19); 135-5(b21);135-5(m4); 128-21(14a); 128-27(a); 128-27(b1); 128-27(b22); 128-27(m3); 135-1(7b); 135-1 (11b); 135-6(q); 128-21(7b); 128-21(11b); 128-28(r); 135-4(jj); 128-26(y); 135-5(a3); 128-27(a3); 135-5(c); 135-5(e); 128-27(c); 128-27(e); 135-5(f); 135-5(l); 135-63; 128-27(f); 128-27(l); 120-4.25; 135-6(g); 128-28(h); 135-6(u); 128-28(v); 126-5(c13); 135-7(g); 128-29(g); 135-6.1; 128-33.1; 126-22; 115C-321(b1); 115D-29(c); 153A-98(c3); 160A-168(c3); 135-10.1; 128-32.1; 135-18.8; 135-75; 128-38.3; 120-4.32; 135-106(b); 143B-426.40G(b); 147-68.2; 147-79.

Type of Bill: Public Agency Bill requested by the Department of State Treasurer

SECTION ONE: FRSWPF Name Beneficiaries/Revise Order of Payment

Allows members of the Firefighters' & Rescue Squad Workers' Pension Fund (FRSWPF) to name beneficiaries for return of contributions available upon the death of a member of the fund. Additionally, the provision specifies the order of payments for the return of contributions for a member who does not select a beneficiary first as spouse, then estate. This removes a current requirement that the Retirement System identify all children of a deceased FRSWPF member regardless of their age for a return of contributions. As such, by simplifying the return of contributions, the provision will reduce the administrative complexity and align procedures for this pension fund with the Department's other funds.

SECTION TWO: FRSWPF Overpayments/Applicability of Overpayment Statute of Limitations

Allows the Department to collect overpayments owed to other N.C. state pension funds from members of the FRSWPF who are in receipt of a monthly benefit. Additionally, the provision clarifies a long standing interpretation that the Retirement System overpayment statutes of limitation against civil action do not limit the ability of the state to collect funds from an ongoing monthly benefit.

SECTION THREE: Retirement Age Modernization/Federal Compliance

Sets a minimum retirement age of 50 for members of the state, local and judicial retirement systems first hired on January 1, 2017 or later. It does not affect current employees. This provision is in response to IRS-proposed regulations on the definition of "normal retirement age" for qualified governmental retirement plans. The proposed regulations are found at 81 FR 4599 (Jan. 27, 2016). Normal retirement age is a concept that is important for a number of purposes, including the fact that in-service distributions are not permitted before normal retirement age, that vesting is required on normal retirement age, and that it provides for the exclusion of health insurance premiums for eligible public safety officers of up to $3,000 a year under Internal Revenue Code Section 402(l) that applies only after disability or normal retirement age. The proposed regulations state that they will become effective for employees hired during plan years beginning on or after the later of (1) January 1, 2017 or (2) the close of the first regular legislative session of the legislature with the authority to amend the plan that begins on or after the date that is 3 months after the final regulations are published in the Federal Register. Given that uncertainty, the deadline to implement this new federal law could result in the necessity to apply this provision retroactively to employees hired on or after January 1, 2017, the Department believes it is prudent for the General Assembly to act on these proposed regulations during the short session of 2016 to avoid having any possibility providing unclear or inconsistent information to new employees next year.

SECTION FOUR: Fraud Statute Applicability/Enable Compliance Investigations
Provides guidelines and authorization for the Retirement Systems Compliance team that was recommended by the 2013-14 LRC study on *Treasurer Investment Targets and State Employee Retirement Options*. Primarily, this change allows the current fraud investigation statute to be used for compliance audits without first suspecting fraud. The Department is requesting this change in order to conduct compliance audits of agencies without creating a stigma of conducting fraud investigation.

SECTION FIVE: Anti-Pension Spiking Contribution-Based Benefits Cap Payment Plans
Extends the length of payment plans for monies owed to the Retirement System under the anti-pension spiking contribution-based benefit cap from 12 months to up to 15 months to allow agencies more time to correct records and to provide that payment plans may always cross a fiscal year.

SECTION SIX: Anti-Pension Spiking Contribution-Based Benefits Cap Inflation Adjustment
Changes the time period from calendar year to fiscal year for setting the inflation adjustment to the threshold of average final compensation used to determine the anti-pension spiking contribution-based benefits cap. The initial threshold was set at $100,000 for calendar year 2015 and was adjusted to $100,750 for calendar year 2016. It would next be adjusted in July 2017 for inflation covering January 2016-June 2017, and thereafter on a fiscal year basis. This change is requested by the Department to increase the ease of providing advance notice to agencies regarding pension spiking invoices.

SECTION SEVEN: Conform Employee Disability Determination Criteria to Single Standard
Conforms disability plans for state and local public employers to the same legal test for benefit eligibility. This change will provide for more consistent application of the law, ease of administration, and simplicity of communication to employers by reducing confusion regarding eligibility for employers covered under different plans. The disability tests for the plan for local government employers and the closed plan that applies to some teachers and state employees is being changed from a “gainful employment” test to an “usual occupation” standard currently used by the Disability Income Plan of North Carolina, the largest of the three programs.

SECTION EIGHT: Electronic change for beneficiaries/ten years
Removes statutory prohibition against current state and local employees changing named beneficiaries online for death benefits only if they have more than ten years of service. Current law requires beneficiary changes be made using paper forms if the member has more than 10 years of service. This change will simplify administration of death benefits for the Retirement System and will facilitate the ability of employees to keep their beneficiary designation up to date.

Technical Corrections Retirement System/Treasurer

The Department of State Treasurer aims to provide public employees and retirees, including teachers, police officers, firefighters, and public servants from all over the state with secure pensions and retirement. This legislative proposal incorporates provisions that will clarify interpretations of current law, conform to federal regulation and increase efficiency of administration of the retirement systems administered by the Department.

Statutes Affected: 58-86-45; 128-25; 128-26(a1); 135-5(g); 128-27(g); 135-5(m2); 128-27(m2); 135-8(b)(5); 128-30(b)(4); 135-8(f); 128-30(g); 135-48.40(d)(13); 147-86.51(b)(3); 147-86.52(c)(3); 147-86.50(b)(4); 147-86.51(d)(4)
Type of Bill: Public Agency Bill requested by the Department of State Treasurer

SECTION ONE: Clarify Service Purchase Provision for FRSWPF
Clarifies wording of the service purchase provision of the Firefighters' and Rescue Squad Workers' Pension Fund (FRSWPF) with regard to which cost calculation to use, given the age of the member. The long standing interpretation and administrative practice has been that the state policy set forth in the statute is to encourage members to purchase service when they are younger than 35 years old. To that end, the statute requires the Retirement System to charge members 35 or older more to purchase service. The change in this provision clarifies the wording of the statute regarding the availability of the lower cost calculation to existing, as well as new members of the fund.

SECTION TWO: Repeals Outdated Statute
Repeals a section of the Local Governmental Employees' Retirement System (LGERS) employer participation statutes that is no longer needed because Session Law 2015-168 amended G.S. 128-21 and G.S. 128-26(a) to disallow the granting of retirement service credits for years that employees worked at a local government agency before the agency joined LGERS. The statute being repealed provided an optional procedure for employers to pay for that service credit.

SECTION THREE: Uniformed Services Employment and Reemployment Rights Act (USERRA)
Conforms a service purchase statute in LGERS to federal law related to the treatment of active duty military service and clarifies that the employer's required payment includes the employer and employee portions of the service purchase. The Retirement System has handled these cases correctly under the federal law, but the LGERS statute has not been updated to reflect USERRA.

SECTION FOUR: Beneficiary Selection When Member Dies While Filing For Retirement
Provides that if a member dies after having filed an application for retirement, but before selecting payment options and selecting a beneficiary, the administrator or executor of the member's estate may select the an option and name the beneficiary or beneficiaries. This change clarifies how to handle a situation not explicitly named in the current statute and is consistent with similar statutes.

SECTION FIVE: Clarification of Transfer Benefit Irrevocability
Clarifies long time interpretation and practice that choosing "transfer benefit" is an irrevocable option, just like selecting any other benefit payment option.

SECTION SIX: Typo Correction & Conforming Change to Educational Leave
Corrects a typo in a change made to educational leave for the Teachers' and State Employees' Retirement System (TSERS) in Session Law 2015-241 and makes a conforming change to the Local Governmental Employees' Retirement System (LGERS), in order to simplify communication and administration of the two systems.

SECTION SEVEN: Accounting Fund & Procedure for Penalty Assessment Clarification
Clarifies that funds collected under the anti-pension spiking contribution-based benefit cap will be included in the Pension Accumulation Fund, which is consistent with other required employer payments. Additionally, clarifies that to receive a one-time exception to payment of the penalty for late payment of retirement contributions an agency must make arrangements in advance with the Retirement System.

SECTION EIGHT: Typo Correction in Name of FRSWPF
Corrects spelling of name of the Firefighters' and Rescue Squad Workers' Pension Fund (FRSWPF) name in the State Health Plan statute.

SECTION NINE: ABLE Program Definition of "Cash"
Clarifies the definition of "cash" in the Achieving a Better Life Experience (ABLE) Program Trust legislation passed in 2015 means "U.S. Dollars."

SECTION TEN: ABLE Procurement Exception
Clarifies that the ABLE procurement exception applies to all professional services needed to start up the program.

SECTION ELEVEN: Conforms State ABLE Act to new Federal Law #1 of 2
Conforms the state ABLE act passed in 2015 to changes made in the federal ABLE act by the U.S. Congress after the General Assembly adjourned. This change is necessary to ensure that residents from other states will not be prohibited from participating in the N.C ABLE program. This section repeals language that envisions a distinction between "contracting" and "contracting" states that is no longer needed because of the federal change.

SECTION TWELVE: Conforms State ABLE Act to new Federal Law #2 of 2
Similar to Section eleven, this provision conforms the state ABLE act passed in 2015 to changes made in the federal ABLE act by the U.S. Congress after the General Assembly adjourned. This change is also necessary to ensure that N.C. residents will not be prohibited from participating in the N.C ABLE program. This section repeals language that envisions a distinction between "contracting" and "contracting" states that is no longer needed because of the federal change.

SECTION NINE: Retirement Systems Boards of Trustees' Chair Statutes
Clarifies governance statutes of the Retirement Systems by providing that the State Treasurer is the ex-officio Chair of the Teachers' and State Employees' (TSERS) and the Local Governmental Employees' (LGERS) Boards of Trustees and provides that the Director of the Retirement Systems Division is selected by the Treasurer. This statute change is consistent with long-time practice. The Department is recommending this change in advance of the transition to a new Treasurer because current statute could allow the Boards to select two different chairs and two different Directors of the Retirement Systems Division. Further, under the current statute, the state would lack the administrative infrastructure to recognize and compensate a Retirement Director that was not hired by the Treasurer.

SECTION TEN: Human Resources Flexibility for Retirement Systems Division Managers
Provides an exemption from the State Human Resources Act for approximately 16 employees in the Retirement Systems Division management roles who possess specialized skills or knowledge necessary for the effective administration of retirement benefits.

SECTION ELEVEN: Legislative Enactment Implementation Arrangement (LEIA)
Provides an incentive to reduce the costs of providing benefits. When the General Assembly passes legislation that reduces the cost of providing retirement benefits, this allows the Board of Trustees to divert a portion of any immediate savings toward implementation of the cost-saving measure by the Retirement System.

SECTION TWELVE: Public Records Statute for Retirement
Creates new consolidated statutes defining how the public records law relates to retirement records. Currently, the Retirement Systems Division relies on nine different statutes governing groups of public employees and three separate opinions from the Department of Justice to respond to requests for public information regarding all members of the Retirement Systems. This provision would consolidate the laws that apply to retirement records into the retirement statutes. This provision does not make any information that is currently public into private information or vice versa.

SECTION THIRTEEN: Electronic Cancellation of Retirement Application
Allows the Retirement System to notify a member by electronic means regarding the cancellation of a retirement application due to failure to provide necessary information. Current statute requires regular U.S. mail notification. The Department is requesting this change to enhance the online retirement application process. The Department plans to still use U.S. Mail notification for applications made by paper, but needs this change in order to provide electronic notification regarding online applications.

SECTION FOURTEEN: Require Proof of Authorization for Monthly Deductions
Requires that organizations allowed to make monthly deductions from monthly retirement benefits must provide proof of a retiree's authorization on request of the Department. Increases the membership threshold for organizations allowed to do this from 2,000 to 10,000 in order to harmonize this statute with the state law limiting provision of addresses. Authorizes local governments that had made arrangements with the Department prior to January 1, 2016, to continue to deduct monthly premiums for retiree health insurance from retiree benefits. Disallows additional local governments from making similar arrangements with the Department.

SECTION FIFTEEN: Prevent Benefits Reduction on Conversion from Disability to Service Retirement

Recommended to the General Assembly by the Department pursuant to a settlement agreement between the Retirement System and the federal EEOC. Current state policy requires that state employees and teachers who separate from active employment because of a disability be converted to a service retirement at their earliest date of eligibility. This change would mean that many former active employees who are currently in receipt of benefits from the Disability Income Plan of North Carolina (DIPNC) would opt out of converting to a service retirement. Typically, DIPNC pays 65% of an employee's pre-disability income while a service retirement pays about 54% of pre-retirement income after 30 years of service.

SECTION SIXTEEN: Prevent Counterfeit State Checks

Allows the State Treasurer to protect portions of records regarding outstanding, unpaid state checks, called "warrants," to the extent that the information contained therein could be used to counterfeit state checks. State Banking System staff have ascertained that there is sufficient information that is public record that could enable a counterfeiter to successfully pass a bad check to a community bank that does business with the State. The State Banking System would reject the check, resulting in a loss for the community bank.

SECTION SEVENTEEN: Applicability of Deposit Fee from State Funds

Removes $15 fee for overdrawn checks to the State Banking System for agencies that only have State funds. Currently, the fee may not be paid with state funds and requires that an agency that only has state funds pay the fee from personal funds of the agency's Chief Financial Officer.

SECTION EIGHTEEN: Collateralization of Deposits/FOD

Updates the statute specifying documents that may be used to collateralize deposits in the State Banking System by allowing the use of letters of credit issued by a Federal Home Loan Bank. This change was requested by the State Banking System staff to simplify administration of the system.

Sick Leave Reporting

The Department of State Treasurer aims to provide public employees and retirees, including teachers, police officers, firefighters, and public servants from all over the state with secure pensions and retirement. This legislative proposal clarifies proper reporting of sick leave that is converted to Retirement Service credit.

Statutes Affected: 135-4(e); 128-26(e)
Type of Bill: Public Agency Bill requested by the Department of State Treasurer

SECTION ONE: Standardize Reporting of Sick Leave to the Retirement System
Requires that creditable service for unused sick leave be reported to the Retirement System in accordance with a standardized definition of hours per day and days in a week applicable for Retirement System purposes only. This change clarifies the process to make the sure that agencies are reporting their hours consistent with the law. Specifically, sick leave must be reported to the Retirement System as days granted as if the agency's duly adopted sick leave policy awarded sick leave with a day being equal to eight hours within a 40-hour workweek. This change is a reporting requirement only and does not increase or decrease the amount of sick leave credited to a member. The Retirement System will provide a chart for agencies to use to convert their policy to the standardized reporting requirement.

April 15, 2016

TO: Members of the Boards of Trustees

FM: Steve Toole, Retirement Systems Director

RE: Administrative Budget Requests for Fiscal Year 2016-17

Request #1: Retirement Systems Division IT Costs

Recurring	$ 402,548 (Receipt Supported)
Nonrecurring	$ 200,000 (Receipt Supported)
Positions	4 (2 Developers, 1 Business Analyst, 1 Retirement Counselor)

The Retirement Systems Division (RSD) received funding in the 2015 Legislative Session to develop and implement several modules to enhance the functionality of the self-service portal for ORBiT, RSD's online platform. These modules would allow members to apply for retirement and designate beneficiaries electronically. The Retirement Systems Division anticipates a "Retirement Boom" in coming years: retirements are projected to increase 43% from 2012 through 2024. Moreover, membership continues to grow steadily, increasing at a rate of 2% of non-retired members served each year.

RSD firmly believes that further promoting the fiscal integrity of the retirement systems is essential to maintain the financial stability of the pension funds, as well as to achieve the fiscal integrity needed to continue to meet the ever-changing needs of a burgeoning population of current and future retirees in North Carolina. This request would significantly improve the operational efficiency of the Retirement Systems Division and allow us to better serve our members by enhancing our staff's capacity to handle the current workload while simultaneously reducing costs in the long term. These enhancements would ensure that RSD is more capable of adapting and expanding its services and operational processes to accommodate a dynamic, continually evolving retirement environment. Greater adaptability and reduced costs despite continued growth will further promote RSD's continued fiscal integrity.

Thus, this request includes three positions required for this project who will provide initial and ongoing personnel functions(?), which include permanent staff with extensive technical skills and expertise who will be responsible for developing, overseeing, and implementing the project, for providing technical support throughout the process, and for coordinating with management in several Divisions within the Department to accommodate retirement, IT, and other needs associated with the project. Additionally, this request includes funding for a retirement benefits counselor position to provide much-needed additional support for operational staff, and funds for development of an additional module to allow members to apply for refunds of contributions electronically.

Request #2: Retirement Systems Division Operating Costs

Recurring	$ 1,230,000 (Receipt Supported)
Nonrecurring	$ 0
Positions	0

Since 1999, the annual base allocation for all financial/audit services has remained at $368,647 despite considerable increases in both the complexity and the cost of these necessary services. In the last

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PUBLIC PENSION PROVISIONS (PEPTA/SAFE ACT) IN THE PUERTO RICO ASSISTANCE ACT

The "Puerto Rico Assistance Act of 2015" (S. 2381), sponsored by Finance Committee Chair Orrin Hatch (R-UT), Senate Judiciary Committee Chair Charles Grassley (R-IA), and Senate Energy and Natural Resources Committee Chair Lisa Murkowski, (R-AK), was introduced on December 9, 2015, and included problematic provisions applicable to all state and local government pension plans:

- Section 202 - Federal reporting requirements originally contained in the Public Employee Pension Transparency Act (PEPTA) from previous Congresses (HR 1628, 113th Congress; S 779, 113th Congress).
- Section 203 – A modified version of the annuity accumulation retirement plan for employees of State and local governments contained in the Hatch SAFE Act (S 1270, 113th Congress).

There was interest in including Puerto Rico-related legislation in the massive, year-end omnibus spending and tax legislation that Congress was rushing to complete in order to avoid a government shut-down. If the Puerto Rico provision, including the non-germane public pension provisions, were to be included, it would be virtually impossible to have them stripped out. Therefore, the day after the Puerto Rico Assistance bill was introduced, a letter from NCTR, NASRA and 16 other national organizations representing public officials, governmental employers, and public employees and their pension systems was sent to the Senate Finance Committee, House Ways and Means Committee as well as the Congressional leadership. The letter called the non-germane pension provisions "a federal mandate on all state and local governments in areas that are the fiscal responsibility of sovereign States and localities," and warned that the pension language is "conflicting, administratively burdensome and costly."

State and local government retirement systems from across the country were also quick to respond to calls for help, including a number of NASRA and NCTR members who made phone calls and sent strong e-mails to key Representatives and Senators. While the final year-end legislation ultimately did not include any provisions addressing the Puerto Rico financial crisis, Congress is expected to take up some form of assistance in the near future. For example, Speaker of the House Paul Ryan (R-WI) has told the appropriate House committees with jurisdiction that he wants them to develop "a responsible solution" by the end of March, 2016.

More recently, Senator Hatch sent a detailed, 4,000-word letter to Puerto Rico's governor on February 10, 2016, requesting extensive financial disclosures, including information related to Puerto Rico's public pension plans. Hatch has asked specifically about the sustainability of each of the Commonwealth's three major public pension plans and when their assets would be depleted. Significantly, Hatch prefaced his request related to pensions by noting that "many state and local public pension plans are critically underfunded," and that "underfunded public pension plans have factored into resolutions of a number of recent, large municipal bankruptcies, and it is likely that future municipal bankruptcies will also involve, in one way or another, underfunded pension plans."

Finally, during Treasury Secretary Jack Lew's annual budget testimony before the Finance Committee that same day, Hatch committed to introducing a new legislative proposal to deal with the Puerto Rico situation, saying that he was also "trying to get this done before the end of March." Hatch's general comments concerning public pensions in his letter to Puerto Rico's governor suggest that his new legislation may once again contain problematic public pension requirements. NASRA and NCTR members are therefore strongly urged to contact their Congressional delegations in opposition to these problematic. A draft sample letter has been provided for use in such communications.

Up until the introduction of the Hatch/Grassley/Murkowski bill, the public pension community's interest in the Congressional handling of Puerto Rico's financial crisis – as well as other governmental financial challenges such as that of Detroit – was a concern that attempts to modify Chapter 9, which many in Congress had proposed to deal with Puerto Rico's debt crisis, could rekindle interest in exploring the use of bankruptcy filings to adjust public pension obligations, as was demonstrated in past Congresses.

The original PEPTA legislation, which has not been reintroduced as a stand-alone measure this Congress, would impose many onerous pension reporting requirements on state and local governments, including 60-year projections using a risk-free Treasury obligation yield curve. Any failures in such reporting would result in the state or local government losing its ability to issue tax-exempt bonds (this penalty is not included in S. 2381).

Under the original SAFE Act provision, which would be voluntary, public employers could annually purchase qualified individual deferred fixed income annuity contracts from private insurers for their employees, payable at age 67 (age 57 for public safety). These would be funded entirely by voluntary employer contributions, up to 20 percent of compensation (30 percent for public safety) and there would be no employee contributions. The annuity purchase plans are intended to be a replacement for coverage under a governmental defined benefit plan, as the Senator published a report prior to introducing the bill that called the current defined benefit plan model inappropriate for state and local governments. In a letter to Senator Hatch, NCTR formally opposed the legislation as introduced in the last Congress, as it was not limited solely to removing whatever current impediments may exist in the present structure of the Internal Revenue Code (IRC) that might inhibit an annuity purchase option to be utilized. In addition, NCTR objected to the measure's Federally-mandated "one-size-fits-all" process on the purchase of annuities from private sector companies for such use, instead of leaving the details of the optional implementation of such an approach to the plan sponsor.

Changes in S. 2381 from the original proposal include:

- Expansion to cover pension plans of any U.S. possession or territory;
- Permission to seek annuity providers pursuant to a formal, public procurement process "not less frequently than every 5 years," instead of mandating an annual process;
- Replacement of the requirement that the largest allocation to any one annuity provider not exceed 75 percent of the aggregate purchase amount of all annuity contracts with a provision simply authorizing the selection of one or more providers;
- Authority to use a group annuity contract, and not just individual annuity contracts;
- Removal of language that would require, "to the maximum extent possible," that (1) each employee's entire interest under an annuity contract would be fully guaranteed by a State guaranty association, and (2) each employee's entire interest under all contracts provided by any single annuity provider does not exceed the maximum amount to be covered by such a guaranty association in the case of the insolvency of the provider;
- Change in the permissible start date for such annuities from no earlier than age 57 to age 50 in the case of a public safety employee, and from age 67 to age 62 in the case of any other employee; and
- The inclusion of an "employer option" to provide one or more "alternative benefit forms," including (1) distributions under a joint and survivor annuity, (2) an annual adjustment in the amount of benefit payments based on a fixed percentage not to exceed 3 percent, and (3) a 10-year period certain and life payment option.

PENSION-RELATED AMENDMENTS TO EDUCATION LEGISLATION

Two problematic pension-related amendments were successfully stopped from being included in the re-write of the "No Child Left Behind" Act that cleared the Congress in December 2015, and which has now become public law. One problematic provision, referred to as the "Dold" amendment after its sponsor, Congressman Bob Dold (R-IL), would have placed restrictions on the use of Federal education funds to pay for the pension benefits of teachers hired using such monies. The amendment would provide that no State receiving funds authorized under the Elementary and Secondary Education Act (ESEA) may require any local educational agency "to use such funds to make contributions to a teacher retirement or pension system for a plan year in excess of the normal cost of pension benefits for such plan year for which the employing local educational agency has responsibility."

Congressman Dold explained that his amendment was designed to ensure that "Federal education dollars will go to students and schools that need them most and that the Federal education funds are not redirected into State pension programs that pay off the States' unfunded liabilities." "It will prevent the States from forcing school districts to use Federal funds to bail out State pension plans and will leave school districts free to make the best decisions for their needs," Dold told his colleagues when the language was originally added to the House version of the bill in February of 2015.

Dold said his amendment was intended to address what he thought was a somewhat unique problem in Illinois, and that it "only prevents States from redirecting Federal education dollars to pay off unfunded liabilities and instead leaves the school districts free to use the Federal funds for their intended purposes: improving our schools, hiring more teachers, and giving children the opportunity to receive a better education."

However, a number of retirement systems expressed concern with the provision due to the great differentiation that exists with regard to the degree to which States vs. local educational agencies pay for the pension costs of non-Federally funded teachers. The degree to which the Dold amendment would have restricted the use of Federal funds for Federally-funded teachers' pensions would have potentially disrupted long-standing state and local arrangements, assuring significant disruptions in such payments and further exacerbating the funding challenges that confront public pension plans and their sponsors.

Tennessee in particular was concerned with the potential impact on its programs and recently-adopted changes in its pension systems, and the Tennessee State Treasurer became very active in pressing Senator Lamar Alexander (R-TN), Chairman of the Senate Committee on Health, Education, Labor, and Pensions (HELP), as well as Congressman David P. Roe (R-TN), Chairman of the House Subcommittee on Health, Employment, Labor, and Pensions, to ensure that the amendment was not included in the final version of the education bill. In addition, Minnesota's plans advised the House Education and the Workforce Committee Chairman, Congressman John Kline (R-MN), that it, too, would be confronted with costly problems, having to develop a complex accounting and reporting structure in order to comply with the Dold amendment.

Despite efforts by Dold and his supporters in the House to try to re-write the amendment to be more acceptable to opponents, ultimately it was dropped from the final compromise version of the legislation during the House-Senate conference.

Earlier in the year, another problematic amendment appeared in a discussion draft of possible legislation to reform the law posted on the website of the Senate HELP Committee by Senator Alexander. It would have mandated an annual Federal analysis of state and local spending on teacher pensions as part of a proposed new "national report card on the status of elementary and secondary education in the United States." This report would have been required to be prepared by the U.S. Department of Education, beginning in 2017, and presented to the Senate HELP Committee as well as the House Committee on Education and the Workforce.

Among other things, this "report card" would have been required to include an analysis of "data on Federal, State, and local expenditures on education, including per-pupil spending, teacher salaries and pension obligations, school level spending, and other financial data publicly available," along with a report on "current trends and major findings."

While the information used to prepare the report "shall be derived from existing State and local reporting requirements and data sources," there was concern that the report would be compiled by those without an understanding of the nuances of public pension finance or the role pensions play in total compensation and retention of teachers. Ultimately, the Federal analysis of state and local spending on teacher pensions did not advance and was not included in the new law.

ENACTED PUBLIC SAFETY BENEFIT PROVISIONS

As part of the 2015 National Police Week, two pieces of legislation that apply to the benefits of public safety employees were moved through Congress and ultimately enacted into law. The Don't Tax Our Fallen Public Safety Heroes Act (Public Law 114-14) would codify that federal and state death benefits for public safety officers killed in the line of duty are not subject to federal income tax. The Internal Revenue Service (IRS) ruled in 1977 that federal Public Safety Officer Benefit (PSOB) payments should be treated like worker's compensation (and not subject to taxation), however, this legislation now codifies this ruling in law. In addition, the legislation ensures that similar state benefits are not subject to federal income tax.

The Defending Public Safety Employees' Retirement Act (Public Law 114-26) would expand the exception from the 10 percent early distribution penalty for public safety employees who separate from service after attaining the age of 50. For distributions after December 31, 2015, the new law extends this exception to include federal public safety personnel in addition to state and local public safety employees. Further, the exception would apply to distributions from both defined benefit and defined contribution plans. Prior to the law's enactment, this exception did not apply to defined contribution plans, including rollovers from a DB plan (such as from a refund or DROP) into a defined contribution plan that are subsequently withdrawn, even in the case of a rollover to a governmental 457 plan, which is exempt from the 10 percent penalty. The new law also exempts changes in substantially equal payments for distributions to qualified public safety employees that separate after attaining age 50.

TAX TREATMENT OF EMPLOYEE DEFINED BENEFIT PLAN CONTRIBUTIONS

On August 7, 2015, the Internal Revenue Service issued a Private Letter Ruling on pick-up contributions to elective and mandatory plan tiers. Among other findings, the IRS generally found that governmental plans with individual member elections into differing benefit tiers with varying contribution levels would be an impermissible cash or deferred arrangement (CODA). Mandatory changes to employee contributions (as well as benefit accruals) would, however, be a valid pick-up arrangement. The PLR also clarified the federal income and FICA taxation of such picked-up amounts.

Prior to this PLR, there had been confusion surrounding IRS and Treasury interpretation of Revenue Ruling 2006-43 and the treatment of individual elections/options that change an employee's tax-deferred contribution to a governmental defined benefit plan. In addition to new optional plan tiers, many current features of public defined benefit plans permit employees to make an individual election that would result in a change in the employee's contribution – such as purchase of service credit, DROP plans, etc. Many meetings were held with Treasury, public employee groups and public employer groups. The former Mayor of San Jose had spurred interest with certain elected officials and successfully urged the U.S. Conference of Mayors and National League of Cities to adopt resolutions supportive of individual elections (USCM resolution, NLC resolution). However, public employee groups remained concerned that any clarifications in this area not pave the way for efforts to coerce employees to individually elect lower benefit tiers.

Legislation (HR 205, 113th Congress) was introduced in previous Congresses to allow individual employee elections, however, employee groups opposed such measures. While there appears to be renewed interest in crafting a new legislative fix, particularly given the new PLR, there is also concern regarding repeal of the tax-deferred treatment of public employee defined benefit contributions. A 2005 report by the Congressional Joint Committee on Taxation characterized the tax-deferred treatment of employee DB contributions under IRC

414(h)(2), the pick-up rule, which solely applies to state and local governments, as a tax loophole that would raise billions in federal tax revenues if closed.

"No Bailout" Legislation

National state and local government and public employee groups have been consistent in their insistence that federal interference into the fiscal affairs of state and local governments is neither requested nor warranted and public retirement systems have also made it clear that they do not seek federal assistance. That said, on July 29, 2015, New Jersey Senate President Stephen Sweeney held a press conference calling for a Federal pension debt restructuring program to provide low-interest loans to states to pay off their unfunded liabilities. Specifically, states would have access to 30-year Federal loans at the current U.S. Treasury long-term rate of 2.7 percent; states would be required to seek voter approval of repayment agreements as a condition of participation in the program.

The last such proposal suggesting federal intervention into public pension financing was made by Joshua Rauh, currently a Professor of Finance at the Stanford Graduate School of Business and a Senior Fellow with the conservative Hoover Institution. Rauh, a prolific critic of public pension plans, would allow states to issue tax-exempt "Pension Security Bonds", if they closed their DB plans and covered new hires with a 401(k) and Social Security. Neither Rauh's proposal nor Sweeney's was supported by national public sector organizations.

This past fall, Senator Sweeney proposed that the National Conference of State Legislatures (NCSL) consider a resolution in support of his national pension loan program. Like the press release, the resolution mischaracterized the current state of public pensions, and sought a federal financial assistance for public plans. The resolution, however, was ultimately withdrawn from consideration in the face of objections from a number of other state legislators who raised concerns with the proposal.

There were also a number of federal proposals introduced and reintroduced to oppose or prevent a bailout of state and local governments and/or their pensions in 2015. Sen. David Vitter (R-LA) reintroduced legislation, S. 94, that would prevent the federal government from providing assistance to any state or local government - including loans, loan guarantees, lines of credit, and grants - that has filed for bankruptcy, defaulted, is "at risk of defaulting" or is "likely to default." The legislation has been strongly opposed by local government organizations, as it would greatly expand the role of the federal government to impose federal auditing requirements and new comprehensive assessments of the current and future financial stability of states, cities and counties. Public pension valuations would most certainly be a part of such assessments. Following the City of Detroit's Chapter 9 filing, there were attempts to "hotline" (expedite) the bill for floor consideration as well as add versions of it to various appropriations bill, but none were successful.

Rep. Jason Chaffetz (R-UT) has again also introduced a Sense of the House resolution, H.Res.41, that the federal government should not bailout state and local government employee pension plans and other post-employment benefit plans, and that state and local governments should immediately institute reforms to their employee pension plans, including replacing defined benefit plans with defined contribution plans.

Finally, in the 2016 Concurrent Budget Resolution, an amendment (Section 4341) was successfully added to "prevent the use of federal funds for the bailout of improvident state and local governments." While touted as nothing more than a message, the provision allows the Chairman of the Senate Budget Committee to revise federal allocations of funds from any entity of federal government to state and local governments "to prevent receivership or to facilitate exit from receivership or to prevent default on its obligations by a State government."

NORMAL RETIREMENT AGE REGULATIONS

The Internal Revenue Service (IRS) has now formally issued proposed regulations on the definition of "normal retirement age" for governmental plans, clearly hoping to finalize this project -- which has been going on now for almost a decade -- prior to President Obama's departure in January of 2017.

The IRS, which in 2012 (in IRS Notice 2012-29) had indicated its intentions to propose modifications to its 2007 regulations on normal retirement age in order to address concerns of the public pension community with the original rules, released these long-awaited draft Normal Retirement Age (NRA) regulations applicable to governmental plans for public comment on January 27, 2016.

In a major victory, the new proposed regulations essentially revert back to the definition effectively in use prior to 2007 in the governmental plan community, which was to permit a normal retirement age to be based on years of service at any age. As the notice for the new proposed regulations puts it, "The Department of the Treasury and the IRS generally agree with those commenters who indicated that the pre-ERISA vesting rules applicable to normal retirement age may be read to permit a governmental plan to use a normal retirement age that reflects a period of service."

However, if a plan does not explicitly define the term "normal retirement age," the terms of the plan must nevertheless specify the earliest age at which a participant has the right to retire without the consent of the employer and to receive retirement benefits based upon the amount of the participant's service on the date of retirement at the full rate set forth in the plan (that is, without actuarial or similar reduction because of retirement before some later specified age). This age will then be considered the plan's normal retirement age.

Furthermore, consistent with IRS Notice 2012–29, the proposed regulations would clarify that a governmental plan *that does not provide for the payment of in-service distributions before age 62* will not fail to satisfy the requirement that the plan provide "definitely determinable benefits to employees after retirement or attainment of normal retirement age" merely because the pension plan has a normal retirement age that is earlier than otherwise permitted under the requirements of the 2007 NRA regulations. (The 2007 regulations provide that for plans with normal retirement ages between ages 55 and 62, there will be a presumption that they are acceptable based on a "good faith determination of the typical retirement age for the industry in which the covered workforce is employed that is made by the employer." For a normal retirement age that is lower than age 55, there is a presumption that it does not meet the standard "absent facts and circumstances that demonstrate otherwise." For plans where substantially all of the participants in the plan are qualified public safety employees, a normal retirement age of age 50 or later is deemed to meet the standard.)

However, governmental plans must still continue to have normal retirement ages that meet the "reasonably representative" requirement in the 2007 regulations. That is, the normal retirement age under a governmental plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

The proposed regulations provide several "safe harbors" in this area. (Generally speaking, a "safe harbor" is a provision that provides that a requirement of law or regulation – in this case, the "reasonably representative" mandate – is deemed to be satisfied under specific situations or if certain conditions are met.)

These safe harbors include the general safe harbor provided in the 2007 regulations, applicable to all plans, of a normal retirement age of age 62 or the later of age 62 or another specified date, such as five years of service; In addition, in response to what the IRS describes as "comments regarding the need for additional safe harbors for governmental plans, including safe harbors that reflect permissible periods of service," several additional alternative safe harbors that a governmental plan could satisfy are provided. In general, these are:

- age 60 and 5 years of service;

- age 55 and 10 years of service;
- a combination of the participant's age and years of service that equals 80 or more; and
- any age with 25 years of service, as long as this is combined with some other safe harbor with an actual age component, such as 25 years of service or age 60 and 5 years of service.

Finally, safe harbors for qualified public safety employees are also provided. (For this purpose, a "qualified public safety employee" is generally "any employee of a State or political subdivision of a State who provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision.") These include:

- age 50;
- a combination of the participant's age and service that equals 70 or more; and
- any age with 20 years of service.

It should also be noted with regard to these public safety safe harbors that a governmental plan is permitted to use one or more of the safe harbors for qualified public safety employees to satisfy the "reasonably representative" requirement for such employees even if a different normal retirement age or ages is used under the plan for one or more other categories of participants who are not qualified public safety employees. (However, these safe harbors for qualified public safety employees are not permitted to be used for other categories of participants in a public safety plan; only qualified public safety employees receive these safe harbors.)

And, in recognition of the fact that governmental plans typically provide multiple normal retirement ages, often based on different benefit structures or classifications of employees in a single plan, in addition to qualified public safety employees, such different normal retirement ages for different classifications of employees would also be permitted.

What about a case in which a governmental plan's normal retirement age may not meet any of the governmental plan safe harbors? In such a situation, the IRS says that the plan's normal retirement age may still be found to satisfy the "reasonably representative" requirement based on all of the relevant facts and circumstances. That is, the treatment of normal retirement ages between ages 55 and 62 under the 2007 NRA regulations would apply, whereby a good faith determination of the "typical retirement age for the industry in which the covered workforce is employed" that is made by the employer will be "given deference."

Finally, the new proposed regulations would be effective for *employees hired* during plan years beginning on or after the later of (1) January 1, 2017 or (2) the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is 3 months after the final regulations are published in the *Federal Register*. This would appear to provide a very generous grandfathering of existing plan members.

Comments on the proposed regulations are due no later than April 26, 2016.NASRA, NCTR and NCPERS are considering filing joint comments that would be available for individual member systems to join as signatories.

DEFINITION OF GOVERNMENTAL PLAN

The Internal Revenue Service and the Treasury Department first published their "Advance Notice of Proposed Rulemaking" (ANPRM) relating to the definition of the term "governmental plan" on November 8, 2011, along with a draft of "possible" – but not yet formally proposed -- regulations. Briefly, the draft proposed regulations would provide that if the employer that has established and maintained the plan (1) is a governmental entity, and (2) the only participants covered by the plan are employees of the governmental entity, then the plan qualifies as being "established and maintained for the employees of a governmental entity," and therefore would be considered to be a governmental plan.

The ANPRM provides 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." Five major factors for making such a determination are provided, as well as eight "other" factors. Unfortunately, the IRS has so far refused to provide any weighting of these factors. NCTR and NASRA, along with other national associations representing public plans, submitted joint comments. NCTR executive director Meredith Williams and NASRA's then-President, Cindy Rougeou, also delivered oral testimony at the IRS' public hearing on the ANPRM in Washington, DC.

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 did not explicitly exclude charter schools' employees from participation in governmental plans. Charter school employees contacted the IRS by the thousands in 2012, arguing that the degree of state control over charter schools and public funding of such schools justified their being considered agencies or instrumentalities of the state. Governors and some members of Congress also weighed in, supporting the charter school industry.

After reviewing the 2,300 comments that have been received, the IRS issued Notice 2015-07 in January of 2015, announcing that they are considering issuing proposed regulations regarding whether a state or a local retirement system which covers employees of a public charter school is a governmental plan. Essentially, the proposal establishes a safe harbor clarifying under what circumstances this charter school participation would be permitted without jeopardizing a retirement system's status as a "governmental plan." The guidance under consideration would take into account the special and unique nature of public charter schools, the governance structure associated with these schools, the structure of many public school systems that permit or encourage public school teachers to move between public charter and traditional public schools, and the relationship between public charter schools and the agencies authorized by the State or political subdivision of the State that hold these schools accountable for academic results.

NCTR, NASRA, the National Conference on Public Employee Retirement Systems (NCPERS), the National Association of Government Defined Contribution Administrators (NAGDCA), and the National Conference of State Social Security Administrators (NCSSSA) filed comments on these proposed regulations on May 11, 2015. The letter does not address the appropriateness of different charter school structures or the relationship between traditional public schools and charter holders. Instead, the group comments focused primarily on several areas where clarifications would be helpful; certain possible transition rules; and possible "grandfathering" rules.

The comment letter also strongly encouraged the IRS to establish a "timely robust ruling process" that will provide a workable and available way for charter schools to secure appropriate rulings from the IRS with regard to their specific situation.

Finally, the letter stressed that, should a plan include a charter school that is later determined not to be eligible to be in a government plan, and it is not grandfathered, "there should be provisions to allow the removal of the school and its employees without jeopardizing in any way the larger plan of which the school was a member."

The IRS has yet to issue final regulations for charter schools as contemplated in last year's notice. Furthermore, despite this effort to address charter schools' concerns with the potential application of new definitions defining a governmental plan, quick action on the underlying ANPRM does not appear likely before the end of the Obama Administration.

Changes to the IRS Determination Letter Process

On July 21, 2015, the Internal Revenue Service (IRS) released Announcement 2015-19, describing major changes to the Employee Plans determination letter program for qualified retirement plans. While some have described this as the end of an era, it is more a major curtailment of the process than it is its actual death knell.

The changes to the program are due to what is described in the Announcement as "the need of the Internal Revenue Service (IRS) to more efficiently direct its limited resources." In other words, it was costing them too much in terms of both their budget and their time. In brief, the IRS said that it was planning to eliminate the staggered 5-year determination letter remedial amendment cycles for individually designed plans, effective January 1, 2017, and to limit the scope of the determination letter program for individually designed plans to initial plan qualification and qualification upon plan termination. It also said that both the IRS and the Treasury Department were "considering ways to make it easier for plan sponsors to comply with the qualified plan document requirements," and that this could include:

- providing model amendments;
- not requiring certain plan provisions or amendments to be adopted if and for so long as they are not relevant to a particular plan (for example, because of the type of plan, employer, or benefits offered); or
- expanding plan sponsors' options to document qualification requirements through incorporation by reference.

The IRS next issued Notice 2016-03 in January of this year, providing further guidance related to its previously-announced plans to modify the determination letter process. Perhaps most significantly, the IRS said that expiration dates on determination letters issued before January 4, 2016, will no longer be operative. Previously, the rule was that determination letters issued for individually designed plans included a statement that the letter may not be relied on after the end of the plan's first 5-year remedial amendment cycle that ends more than 12 months after the application was received, and included a specific "expiration date." The Notice further provides that future guidance will clarify the extent to which an employer may rely on a determination letter after a subsequent change in law or plan amendment.

There are a number of concerns for governmental plans as a consequence of the IRS actions related to the determination letter process that are being raised by practitioners. For example, it has been pointed out that because of their size and complexity, governmental plans will find it difficult to take advantage of any "model amendment" approach that the IRS may envision as a partial solution. The uncertainties surrounding the typical governmental legislative process will also likely exacerbate the ability to adopt any such model amendments in a timely manner.

"Work-arounds" related to the absence of the determination letter process have also been discussed by some practitioners. One suggestion is to consider adopting an entirely new plan in lieu of amending an existing plan when major plan changes for new employees are being considered, as the determination letter process will still be available for the purposes of initial plan qualification. Another option may be to seek a private letter ruling related to any such new benefit structure. This does not guarantee that the IRS will offer an opinion on anything but the permissible nature of the benefit structure, however, as the IRS does not typically issue a private letter ruling on qualification issues.

In any case, the absence of the determination letter process is certain to increase pressure on plans and their sponsors to handle any plan changes with the greatest of care.

ACA "Cadillac" Excise Tax

The so-called "Omnibus" spending bill that funds the government through September of 2016, adopted at the last possible minute in December, 2015, included a two-year delay in the implementation of the so-called

“Cadillac tax” on high-value health insurance plans, otherwise set to take effect in 2018 under the provisions of the Affordable Care Act (ACA).

The ACA, enacted in 2010, created an excise tax of 40 percent on that portion of the aggregate cost of employer-sponsored healthcare that exceeds a statutory dollar limit, revised annually, to take effect in 2018. The annual limits in the law are $10,200 for self-only coverage and $27,500 for self and spouse or family coverage, but these will be adjusted for 2018 and thereafter for health costs, age and gender, and cost-of-living adjustments. Also, these thresholds are higher for high-risk professions such as law enforcement ($11,850 for individual coverage and $30,950 for family coverage, before being adjusted). The tax is expected to produce about $93 billion in new revenues over the first 10 years, not from the tax itself, but rather from income taxes on wages that are expected to be increased as a way for employers to offset decreases in health benefits.

There is very strong support for doing away with the tax, with a large broad-based coalition of private and public employers and employees called the “Alliance to Fight the 40” pressing for its repeal. Members include groups as diverse as the American Benefits Council, a public policy organization representing principally Fortune 500 companies that sponsor health and retirement coverage for workers and their families; the Government Finance Officers Association (GFOA); the Laborers' International Union of North America (LIUNA), representing members of the construction industry; and the National Association of Counties (NACo).

Indeed, on December 3, 2015, the United States Senate voted 90-10 to support its repeal; as the *Washington Post* editorialized after the Senate vote, “With both the U.S. Chamber of Commerce and the AFL-CIO lobbying for repeal, it’s a miracle the Senate vote wasn’t 100-0.” However, supporters of the tax firmly believe that it is succeeding in applying downward pressure on health care spending, and that the revenues it is supposed to generate are needed to pay for other provisions of the overall healthcare reform legislation.

Recent nonpartisan analyses of the impact of the excise tax suggest that it will apply not just to a small number of “overly rich” plans, but to modest health plans that are expensive simply because they are offered in high-cost areas, or because they cover large numbers of people whose health costs are typically higher than average, namely women, older and disabled workers, and families experiencing catastrophic health events. Also, because it is an excise tax, the 40 percent levy will apply to health plans covering Federal, state, and local government employees, and not just private sector workers. Furthermore, it is measured as a direct function of plan cost, and not actuarial plan value, and it is therefore possible that a plan with relatively modest actuarial benefit value may have high net claims costs and therefore incur the tax. Also, other factors could have a significant effect on potential exposure to the tax, including the presence of high cost claimants, high use of care driven by the plan’s demographic profile, or high underlying unit pricing for healthcare due to the plan’s peculiar geography or provider network arrangements.

Accordingly, several public pension plans that administer healthcare are very concerned with the possible effects of the tax, and have been working as part of the Public Sector HealthCare Roundtable to provide the Internal Revenue Service with their concerns. The actuarial consulting firm of Cavanaugh Macdonald has also filed a very good overview of concerns with the impact of the tax on the other postemployment benefits (OPEB) plans of state and local governments.

Even with the delay, pressure for repeal continues to mount. Critics are now insisting that the assertion that the Cadillac tax will help pay for the ACA is based on an overstated assumption that employers will make up for reduced health benefits with higher taxable compensation, pointing to a Kaiser Family Foundation study that shows that since 2010, employees' share of deductibles increased by 67 percent, but wages only rose by 10 percent. Also, some are saying that a better way to put downward pressure on healthcare spending would be to repeal the income tax exclusion for employer-provided health benefits, which, as the *Washington Post* has editorialized, "promotes overutilization of health care, thus driving cost inflation." President Obama has also responded to this growing dissatisfaction with the potential impact of the excise tax by proposing in his FY 2017 budget that in any state in which the annual premium for a "Gold" plan in the health insurance exchanges exceeds the statutory threshold for the tax, its threshold would be adjusted to reflect this average Gold premium.

MEDICARE PART B PREMIUM INCREASE

The 52 percent hike in the Medicare Part B standard premium, that was set to affect millions of public employees not covered by Social Security in 2016, was held instead to only an 18 percent increase. This is the increase that would have applied to all Medicare Part B enrollees in 2016, save for the fact that a "hold-harmless" provision protects the vast majority of them from any increase in years in which a Social Security COLA is not granted.

This softening of what would have otherwise been the largest increase in Medicare's history, presenting a devastating financial blow to many public employees, was achieved as part of the two-year budget deal reached between the bipartisan Congressional leadership and President Obama the week of October 21st of last year. This deal would suspend the limit on Federal borrowing until March 16, 2017, raise Federal spending levels above the 2011 Budget Control Act, and increase funding by $80 billion through September 2017, and was signed into law on November 2nd.

Accordingly, the 2016 standard premium increase for the approximately one in seven Medicare beneficiaries who will be affected, including millions of public employees who are not covered by Social Security, will NOT increase by 52 percent to $159.30, as originally scheduled. Instead, the 2016 increase (including a $3 surcharge) will represent an 18 percent hike. For the vast majority of Medicare Part B enrollees whose standard Part B premium is already taken out of a Social Security check, the standard premium will NOT increase at all—remaining $104.90 per month—and they will NOT be subject to the monthly $3 surcharge, which will apply for the next five years.

On October 27th, NCTR, NASRA, NCPERS, the National Education Association (NEA), and the American Federation of Teachers (AFT) sent a letter to President Obama and the Congressional leadership urging them to do all in their power to find a solution as soon as was possible to block this dramatic increase in the Medicare Part B premium. The letter stressed that these higher costs "could literally mean a choice between health and hunger" for many of the "oldest and most vulnerable public sector retirees."

Although the national public sector organizations would have preferred to see affected public employees treated the same as other Medicare Part B enrollees, getting this modification in such a major last-minute bipartisan deal was a significant accomplishment. For example, when similar, if less dramatic, increases were presented in 2010 and 2011, when Social Security COLAs were also not provided, Congress failed to stop the premium hikes for those ineligible for the "hold-harmless."

Likely aiding in obtaining relief was the fact that State governments were also not protected by the "hold-harmless" provision of law and would therefore also have had to pay substantially greater premiums for individuals who are considered to be "dually eligible" for Medicaid and who therefore do not pay the Medicare Part B premium themselves but have all or a portion of it paid by State Medicaid programs. This could have amounted to a very significant impact, with the National Governors Association (NGA) estimating that the higher premiums would have cost states a total of $2.3 billion in 2016.

If inflation continues to remain very low, and it appears that a Social Security COLA may once again not be granted in 2017, Congress may well have to seek a more permanent solution to this situation.

DISTRIBUTION CHANGES TO NON-SPOUSE SURVIVOR BENEFITS

A provision that was first proposed four years ago as a revenue offset for highway legislation, has been included in several proposals since, including many Presidential budget proposals. The proposal would require retirement accounts, qualified annuities and defined benefit pension benefits to be distributed within five years of the death of the account holder, unless the beneficiary is within 10 years of the account holder's age, an individual with special needs, a minor, or the account holder's spouse.

Public pension attorneys have raised issues with how this would affect certain public plans, including the inability for employees to name various beneficiaries that might be more than 10 years younger for a joint and survivor benefit, such as domestic partners, civil unions, siblings, children, nephews/nieces or any other relative which might otherwise currently be permitted under state law. Also, the measure would be difficult to administer because it would determine an "eligible beneficiary" as of the date of death, whereas the selection of the beneficiary is done at the time of the commencement of the retirement benefit. The provision is estimated to raise billions in federal revenues, and will likely come up again in moving legislation.

TAX REFORM

Despite extensive reviews of the Federal tax code conducted during the last Congress by both the House Ways and Means Committee and the Senate Finance Committee, and continued work on the topic during 2015, no significant reforms have either been formerly proposed or undertaken during the current 114th Congress. Nevertheless, the topic continues to receive attention. For example, in January of 2015, Senate Finance Committee Chairman Orrin Hatch (R-UT) created five separate bipartisan Finance Committee Tax Working Groups to analyze current tax law and make policy recommendations. The goal was for the Working Groups' recommendations to serve as a foundation for the development of bipartisan tax reform legislation in the 114th Congress.

The Working Group on Savings & Investment, which had jurisdiction over the tax treatment of retirement savings, capital gains and dividends, and financial products, was co-chaired by Senators Mike Crapo (R-ID) and Sherrod Brown (D-OH). NASRA, NCTR and numerous other national public sector organizations submitted comments urging any changes to the federal tax code continue to support the ability of state and local governments to successfully design, invest, finance, and manage their public employee retirement systems. The working group ultimately decided to restrict its work to private retirement "given the Committee's directive that the working groups should develop consensus, bipartisan policy solutions."

Accordingly, it did not include any public pension provisions in the recommendations that it submitted to the full Finance Committee in July of last year. Instead, it identified three key goals for policy makers to pursue: (1) increasing access to tax deferred retirement savings; (2) increasing participation and levels of savings; and (3) discouraging leakage while promoting lifetime income.

Nevertheless, members of the Working Group recognized "that there are other important issues in our group's portfolio that were not likely to result in consensus recommendations in this working group format," but that they "would hope that these areas will still be addressed as the Committee moves forward with further efforts to reform the tax code." To get some sense of what such proposals might look like, a draft tax reform proposal that was developed by former Ways and Means Committee Chairman Dave Camp (R-MI) in 2014 included consolidating and capping contributions to 403(b) plans and governmental 457(b) plans and applying the 10% early distribution tax to governmental 457 plans. Camp also wanted to begin to cap the tax expenditures associated with the IRC retirement savings incentives by imposing a 10% surtax on those in the 35% tax bracket, computed by taking the taxpayer's adjusted gross income, adding back the expenses related to the excluded retirement savings preferences, and then multiplying the sum by 10%.

The outlook for tax reform in the increasingly dwindling days that remain in the 114th Congress remains unclear, but it is highly unlikely.

GPO/WEP Repeal

According to the Congressional Research Service (CRS), as of December 2014, about 1.6 million Social Security beneficiaries were affected by the Windfall Elimination Provision (WEP), with the highest number (220,783) in California, and North Dakota and Wyoming essentially tied for the lowest, at 2,274 and 2,273 respectively. More than 1.4 million people (93 percent) affected by the WEP were retired workers, and about 3 percent of all Social Security beneficiaries (including disabled and spouse beneficiaries) and about 4 percent of all retired worker beneficiaries were affected by the WEP.

Legislation to reform WEP has been introduced in the House of Representatives by Ways and Means Committee Chairman Kevin Brady (R-TX) and Representative Richard Neal (D-MA). Their bill, H.R. 711, was introduced on February 5, 2015. It would replace the WEP with a new formula for those turning 62 in 2017 and later, which, according to a press release that accompanied the introduction of the same legislation in November of 2014, would mean that current WEP retirees may see their Social Security benefits increased by more than $1,000 a year on average, and future retirees by more than $1,600 a year.

The legislation was developed in conjunction with the Texas Retired Teachers Association, the Association of Texas Professional Educators, the School Employees Retirement System of Ohio, the State Teachers Retirement System of Ohio, the Ohio Retired Teachers Association, and the Retired State, County and Municipal Employees Association of Massachusetts.

The Brady/Neal legislation would provide for a new "proportional" formula, which would apply the regular Social Security formula to all earnings, whether covered or non-covered. Then the resulting benefit would be multiplied by the share of the average monthly indexed earning amount that came from covered earnings. As CRS explains, the progressivity of the benefit would thus be based on the worker's total lifetime earnings, and the benefit would be proportional to the amount of Social Security taxes paid.

However, there would be both "winners" as well as "losers" under this new approach. Generally, for retirees who would become subject to the WEP in the future, those employees with lower average total career wages would receive a smaller reduction than currently occurs under the WEP. But those workers who have higher average total career wages would see a greater reduction than they do currently. Finally, workers who have between 30 and 35 years of Social Security earnings, who are currently exempt from the WEP, would lose that exemption, as the threshold for such an exemption under the Brady/Neal legislation would be 35 years.

Given that Congressman Brady is now the Chairman of the Ways and Means Committee, the likelihood for action on such a reform of WEP has increased significantly. In addition, a recent recommendation by the Social Security Advisory Board (SSAB) in its position paper entitled "The Windfall Elimination Provision: It's Time to Correct the Math" that the current WEP formula should be repealed and replaced with a "proportional formula" such as that contained in H.R. 711 also provides important justification for such a reform.

As for repeal of the WEP in its entirety, as well as repeal of the Government Pension Offset (GPO), legislation to accomplish both, H.R. 973, was introduced in the House on February 13, 2015, by Congressmen Rodney Davis (R-IL) and Adam Schiff (D-CA), and currently has 137 cosponsors; an identical Senate companion bill, S. 1651, was introduced by Senator Sherrod Brown (D-OH) on June 23, 2015, and has 21 cosponsors. 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; in the 112th Congress (2011-2012), House cosponsors dropped to 170; and in the last Congress, House cosponsors fell to 133. The primary problem continues to be the cost of repeal of the GPO and the WEP, which could be about $90 billion combined. The potential linkage of GPO/WEP repeal to mandatory Social Security as a means of paying for its cost is also always a concern.

MANDATORY SOCIAL SECURITY/MEDICARE

Serious legislative efforts to place newly-hired public employees in Social Security were not made in 2015, primarily because there were also no major Social Security reform proposals that received serious attention from the Congress last year. However, mandatory Social Security is no longer seen to be as linked to overall Social Security reform as it once was.

For example, beginning in 2010, during talks on deficit reduction, mandatory Social Security was characterized more as a means to address perceived threats to the retirement security of public employees, and as one way to avoid a federal bailout of public pension plans, than as a way to improve the solvency of Social Security. Furthermore, this "de-linking" from overall Social Security reform makes mandatory Social Security for newly-hired public employees a potentially attractive source of new revenue for the Congress. Indeed, in November of 2013, when the Congressional Budget Office (CBO) released its "Options for Reducing the Deficit" publication, it included mandatory Social Security coverage for newly hired state and local government employees" as such an option, with CBO estimating that this would raise $ 81.1 billion over the next ten years.

In 2014, a working paper from the Center for Retirement Research (CRR) at Boston College looked at the impact of mandatory Social Security coverage on state and local budgets, and seriously downplayed the expected costs to state governments. CRR found that, measured as a share of a state's budget, it would have "only a very modest impact." This would seem to directly contradict the impact on states, localities and public workers, estimated to be $53.5 billion in the first five years alone according to the Committee to Preserve Retirement Security (CPRS).

In addition, CRR concluded that Social Security's "guarantee of portability, generous ancillary benefits, and full inflation protection means that extending mandatory coverage would bring real gains to state and local workers and their spouses," thus supporting the argument that mandatory coverage should be extended for other than Federal fiscal reasons involved with Social Security reform.

In 2015, a new paper from the Brookings Institution, released in August, also supports mandatory Social Security coverage for all new state and local government employees, once again focusing not on the solvency of Social Security but rather on linking "the funding status of state and local pension plans and the potential risk faced by those employees" with mandatory coverage. The Brookings paper claims to have found that states with governmental pension plans that have greater levels of underfunding tend also to have a smaller proportion of public workers who are covered by Social Security, and that this "tends to raise the retirement security risks faced by those workers and provides further fuel for mandatory coverage."

The paper concludes that the most important reason for mandatory Social Security is that the coverage would improve retirement security for newly-hired public employees, "many of whom are enrolled in pension plans that are significantly underfunded and all of whom are enrolled in plans that are not very portable." This is especially true, the paper asserts, for those currently uncovered public employees who leave government service before qualifying for a pension.

If this linkage of mandatory Social Security with retirement security for public employees continues to find traction, the issue could appear as part of any comprehensive tax reform proposals that are ultimately developed in the future.

RETIREMENT PROVISIONS IN THE FY 2017 PRESIDENT'S BUDGET

Similar in many ways to his FY 2016 budget, President Obama's FY 2017 budget request has once again called for an overall cap on Federal tax expenditures related to retirement savings that would affect both defined benefit as well as defined contribution plans. The proposal would prohibit contributions to *and accruals of additional benefits in* tax-preferred retirement plans and IRAs. The limitation on aggregated balances would be about $3.4 million, enough to provide an annual income of $210,000 in retirement.

While the new Obama proposal's multi-million dollar limit may not affect many public employees, it could nevertheless create a very administratively complex burden for public sector DB plans, particularly those that provide both DB benefits and DC supplemental savings accounts. Generally speaking, these DC account balances would have to be converted to the equivalent of an annuity payable at 62, in the form of a 100-percent joint and survivor benefit, and then aggregated with the DB plan's accrued benefit. If a maximum permitted accumulation is reached, "no further contributions or accruals would be permitted," the proposal states, which could also present interesting legal problems when such benefits are guaranteed.

Among other things, retirement savings changes that are included in the President's FY 2017 budget also include:

- Demonstration funding for nonprofits and States to design, implement, and evaluate new, innovative approaches to provide more portable retirement and other employer-provided benefit coverage and to develop and test plan models.
- Finalizing rules regarding state retirement security initiatives for non-public employees to address concerns about preemption by Federal pension law.
- Encouraging pooled 401(k) plans, but removing the "common bond" requirement for employers to participate in Multiple employer plans (MEPs), a pooled retirement plan that offers benefits through the same administrative structure but with lower costs and less compliance burden than if each employer offered a separate plan.
- "Auto-IRAs," whereby every business with more than 10 employees that does not currently offer a retirement plan would be required to automatically enroll its workers in an IRA; however, employees could subsequently opt out.
- Providing tax credits for small businesses that begin offering retirement plans, or choose to automatically enroll workers in existing plans.
- Employers who offer plans would be required to permit part-time employees (those who have worked for the employer for at least 500 hours per year for 3 years or more) to make voluntary contributions to the employer's plan.
- The exception from the 10-percent penalty on early withdrawals would be expanded to cover more distributions to long-term unemployed individuals from an IRA and to include distributions to long-term unemployed individuals from a 401(k) or other tax-qualified defined contribution plan.
- The tax value of deductions or exclusions from AGI and all itemized deductions for, among other things, employee contributions to defined contribution plans and IRAs, would be limited to 28 percent for those in the 33-percent, 35-percent, or 39.6-percent tax brackets.

MYRAS

In January of 2014, President Obama ordered the development of a new retirement savings security called a "myRA," standing for "my Retirement Account." Following almost a year-long pilot program, the new program was officially launched nationwide on November 4, 2015.

The new myRA program permits qualified individuals to establish Roth individual retirement accounts (Roth IRAs) with Treasury's designated custodian, Comerica, Inc., which was selected to administer the new program. As with any Roth IRA account, there are maximum income limits applicable to who can participate, so wealthier individuals will not be eligible.

These accounts have no start-up costs and no fees, and amounts contributed will be invested exclusively in new bonds, which are only available to participants in the new program. These bonds will protect the principal contributed while earning interest at a rate previously available only to federal employees invested in the

Government Securities Investment Fund (G Fund) of the Federal Thrift Savings Plan. In short, it will be a very secure investment, with little risk, but with relatively low earnings.

Individuals can continue to participate in the program, subject to Roth IRA annual contribution limits, until their account balance reaches $15,000 – note that this means that the limit applies to interest and contributions combined – or until they have participated in the program for 30 years, whichever comes first. They can transfer their account balance to a commercial provider at any time, and, as with all Roth IRAs, they can withdraw their contributions whenever they want without penalty, and, while intended for retirement, the funds are not restricted in their use. Changing jobs does not affect the accounts either.

The nationwide roll-out included some new features. For example, in addition to being able to contribute to a myRA via automatic direct deposit through an employer, individuals can now also fund their myRA account directly by setting up recurring or one-time contributions from a checking or savings account. Also, at tax time, all or a portion of a Federal tax refund can be directed to a myRA. Allowing people to participate directly should improve the chances of the new program's success, as it will no longer depend on an employer's agreement to participate.

Since employers will neither administer the accounts nor contribute to them, their costs will be minimal, so the theory is that tax breaks to encourage employer participation are not necessary. Finally, myRAs will not be available to the self-employed. And, while intended primarily for Americans who have no access to an employer-provided retirement vehicle, the new myRAs can be offered by public employers to their employees.

FEDERAL INTEREST IN STATE AND LOCAL FINANCE AND PENSIONS

Over the last several years, there has been an increased interest on the part of the Federal government in state and local government finance, debt and pension obligations. Sometimes, the interest is in protecting plans, given their important place in the scheme of government liabilities, while at other times, it has been focused more on policing plan activities and management, again due to the role that pension plans can play in state and municipal obligations.

Perhaps the lead Federal regulatory agency with an active interest in public pension plans' activities related to public finance, and their potential regulation, is the Securities and Exchange Commission (SEC). Indeed, the SEC created an Enforcement Unit specifically focused on municipal finance and public pensions, which continues to evaluate state and local financial disclosures in connection with municipal bond offerings. Public pensions remain a primary target for review. In a report to Congress in 2012 seeking increased regulatory authority, the SEC noted pension disclosures were "at the forefront" of municipal market discussions, and among other things discussed pension disclosures, comparability and discount rates.

Furthermore, several former SEC Commissioners have, in recent years, called for more SEC authority to regulate municipal issuers, pointing to the perceived weakness of current financial rules of the Governmental Accounting Standards Board (GASB) dealing with governmental pension plans and what were suggested as inadequate disclosures related to issuers' pension plans. The SEC has in recent years charged several states with securities fraud in connection with their pension funding disclosures.

In a 2014 keynote address before the Municipal Securities Regulatory Board's 1st Annual Municipal Securities Regulator Summit, former SEC Commissioner Daniel Gallagher (R) said public pension disclosures were a "serious threat hidden from investors" and called for a common disclosure baseline using the risk-free discount rate. A joint response was coordinated from national organizations raising serious concerns with the Commissioner's remarks. Gallagher left the Commission in October of 2015.

Recently, the SEC has taken an increased interest in private equity and other private fund fees, with growing concern over expenses charged to portfolio companies and investors. During 2014 and 2015, several enforcement actions were brought by the SEC concerning misallocation of fees and expenses, and SEC Enforcement Director Andrew Ceresney has said in a statement last fall in connection with one such case that "Our clear message to the entire private-equity industry is that this is an area of great risk, and that whatever the success of the fund over time, hidden or inadequately disclosed fees will not be tolerated regardless of the size of the adviser."

Furthermore, in July of 2015, thirteen state and municipal treasurers and comptrollers representing $1 trillion in public pension fund assets sent a letter to SEC Chairwoman Mary Jo White calling for an industry-wide standard from the SEC that would provide private equity limited partners more transparent and frequent information on fees and expenses. The officials, from the District of Columbia, California, New York, Virginia, Wyoming, North Carolina, South Carolina Rhode Island, Vermont, Nebraska, Oregon and Missouri, said that a lack of transparency regarding fees has "led to a culture in which management fees reported by state pension funds often do not reflect total management fees accrued by private equity firms." They said that "increased disclosure transparency will provide limited partners with a stronger negotiating position, ultimately resulting in more efficient investment options."

Governmental retirement systems' investment fees are increasingly the focus of plan attention, participant concern, media scrutiny, and SEC enforcement actions, particularly the costs associated with private equity. Transparency is a very real issue, and a lack of common reporting standards further exacerbates the problem.

Last April, CEM Benchmarking, an independent global benchmarking and research organization, issued an influential "White Paper," finding that less than one-half of private equity costs incurred by U.S. pension funds are currently being disclosed. CEM called for standardized total cost disclosure for private equity. In response to these challenges, the Institutional Limited Partners Association (ILPA), a global organization dedicated to the interests of institutional limited partners (LPs) in private equity, released a new "Fee Reporting Template" in January of this year, designed to encourage increased uniformity in fee disclosures. Their goal is to both provide LPs with an improved baseline of information that permits more streamlined analysis and informed internal decision making, as well as reduce the compliance burden on general partners (GPs), who often face a wide variety of non-uniform reporting formats.

Such industry self-policing may demonstrate to the SEC that a formal rulemaking in this area is unnecessary, but much will depend upon the extent to which both LPs and GPs embrace the new ILPA tool.

Another area of particular interest to Federal regulators has been the role of the Federal government in assisting governmental jurisdictions that are in financial distress. Help in coordinating such assistance was one of the reasons why, in April, 2014, the U.S. Treasury announced the creation of the Office of State and Local Finance (OSLF) to serve as the Department's liaison to state and municipal officials and associations. While OSLF has no regulatory powers, it can convene those within Treasury as well as other federal agencies that do have authority.

In addition, the OSLF is assigned to monitor developments in municipal bond markets; support policies to improve the management of public pensions and other liabilities; and develop potential federal policy responses to issues that emerge in municipal financing markets. At the outset, OSLF held numerous meetings with state and local officials and associations to share the purpose of the new unit and to gather information to assist in its work, including the role of public pensions.

However, early on, OSLF became very interested in the recent bankruptcies of Jefferson County, Alabama, as well as several California local governments and Detroit. As the OSLF Director Kent Hiteshew told one of his early audiences, "These events have increased attention and focus on the municipal market, particularly in the regulatory community." He also said the Obama administration had helped Detroit by channeling $50 million to revitalize neighborhoods and, with other federal agencies, helped improve Detroit's governing capacity.

Furthermore, the fast-deteriorating situation in Puerto Rico was another early focus, and OSLF has worked to coordinate the Federal response in an effort to try to stabilize the Commonwealth's finances. Hiteshew has compared Puerto Rico and Detroit in this regard, explaining that his new Treasury office has worked "to develop remedies to assist communities in distress."

Currently, Mr. Hiteshew has been one of the "point men" in explaining the Administration's policy recommendations concerning the Commonwealth, including a Federal bankruptcy regime that, as he puts it, is "necessary to provide an orderly framework for restructuring the Commonwealth's large, complex and intertwined debt stock." He stresses that a "court-supervised process would provide the most effective framework for untangling the Commonwealth's eighteen separate, but interdependent, credits and three different public pension systems, given the reality that Puerto Rico lacks the resources to make full and timely repayment on all of its existing debt."

Hiteshew has also underscored that the Administration's bankruptcy proposal for Puerto Rico has been carefully tailored; that under the U.S. Constitution, "territories and states have different legal relationships with the federal government;" that the Administration's proposal "is limited to the territories;" and that "states would remain ineligible to file for bankruptcy under this or any other bankruptcy regime."

While one of OSLF's primary focus at the present appears to be to find remedies to assist communities currently in financial distress, another office, the Financial Stability Oversight Council (FSOC), is tasked with helping to avoid such circumstances in the first place by, among other things, identifying risks to the nation's financial stability from the financial distress or failure, or ongoing activities, of large, interconnected bank holding companies and nonbank financial companies, and to respond to emerging threats to the stability of the U.S. financial system.

Public pension financial conditions have generally been included in annual reports of FSOC, particularly concerning the fiscal position of state and local governments and projected stability of the public sector. For example, in the FSOC 2015 annual report, it was noted that "States, municipalities, and territories may face important constraints in improving strained fiscal conditions while addressing pension funding shortfalls.

In 2015, FSOC released a notice (and later an extension) seeking public comment regarding potential risks to U.S. financial stability from asset management products and activities. The notice indicated that while the FSOC had not reached any conclusions regarding the potential financial stability threats posed by the asset management industry, it was seeking input from the public about potential risks associated with liquidity and redemptions, leverage, operational functions, and resolution in the asset management industry. At its September 2015 meeting, the FSOC indicated that it was still engaged in an ongoing process of evaluating the asset management industry.

Finally, the Municipal Securities Rulemaking Board (MSRB) is yet another Federal agency with an interest in public finance and its intersect with public pensions. Its mission was expanded by the 2010 Dodd-Frank Act to include the protection of state and local governments and other municipal entities**,** including state and local government pension plans. MSRB's jurisdiction was also expanded to include the regulation of municipal advisors, including advisors to public pension plans.

The MSRB has convened roundtables regarding state and local government pension funding and disclosures, and the MSRB Chair has stated their interest in public pension advisors as well as adequate disclosures of public pension obligations. Continued interest is expected, particularly surrounding pension disclosures in

Official Statements of municipal issuers.

INFRASTRUCTURE INVESTMENTS

There continues to be interest on Capitol Hill, in the Administration, and within organizations such as the U.S. Chamber of Commerce regarding infrastructure investments, particularly public-private partnerships that include institutional investors such as pension funds. For example, the White House launched an Infrastructure Investment Initiative and the National Economic Council, Department of Transportation and Treasury Department held an Infrastructure Investment Summit in September of 2014.

In addition, in 2015, Federal agencies continued to take steps to encourage private investment in infrastructure, such as roads, bridges, broadband networks, drinking water and sewer networks, including Federal grants to attract more private capital into projects and promote models of public private collaboration; identification of opportunities for investment in projects and connecting them with investors; attracting investors for U.S. projects from around the world through the SelectUSA Program; and the creation of a new Qualified Public Infrastructure Bond (QPIB) for municipalities seeking public/private partnerships**.**

Senator Ron Wyden (D-OR) and Senator John Hoeven (R-ND) have also sponsored the "Move America Act," S. 1186, to encourage the broader use of public-private partnerships by creating a new type of tax-exempt bond that requires 95% or more of its net proceeds to be used for infrastructure projects, including airports; docks and wharves; mass commuting facilities; railroads; any surface transportation project eligible for federal assistance, a project for an international bridge or tunnel, or a facility for the transfer of freight from truck to rail or rail to truck; flood diversions; or inland waterways. An issuer can use such bonds to finance a project even if the economic owner of the property is not a state or local government entity (so long as the project is available for use by the general public).

Finally, the Senate Finance Committee's bipartisan Working Group on Community Development & Infrastructure, co-chaired by Senators Dean Heller (R-NV) and Michael Bennet (D-CO), examined the tax expenditures related to economic and community development, including those that help state, local and tribal governments build infrastructure such as roads, bridges and airports. It was not able to reach bipartisan recommendations involving infrastructure financing in its report, other than options to provide a funding alternative for the Highway Trust Fund, but it did provide a comprehensive discussion of the background and present law concerning bonds and public-private partnerships.

SAME-SEX MARRIAGE

On June 26, 2015, the U.S. Supreme Court struck down state laws that prohibit same-sex marriage in *Obergefell v. Hodges*, holding that the Fourteenth Amendment requires a State to license a marriage between two people of the same sex, and that it also requires a State to recognize a same-sex marriage licensed and performed in another State that recognizes that right. This decision followed on the heels of the U.S. Supreme Court's decision in *United States v. Windsor* (June 26, 2013), invalidating a key provision of the 1996 Defense of Marriage Act (DOMA) and requiring that same sex couples are to be treated as married for all Federal tax purposes, including income and gift and estate taxes.

Subsequent to the *Windsor* decision, the Internal Revenue Service (IRS) issued a Revenue Ruling 2013-17 addressing the status of individuals of the same sex who are lawfully married under the laws of a state that recognizes such marriages. It states that such individuals will be considered to be lawfully married under the Internal Revenue Code as long as they were married in a state whose laws authorize the marriage of two individuals of the same sex, even if they are domiciled in a state that does not recognize the validity of same-sex marriages.

Then, in April of 2014, the IRS issued Notice 2014-19, which included a set of "Frequently Asked Questions," clarifying certain retroactive retirement plan implications of the *Windsor* ruling. The Notice expressly provided that qualified retirement plan operations must reflect the outcome of *Windsor* as of June 26, 2013, meaning that there would not be retroactive application before the date of the *Windsor* ruling itself, and that a retirement plan will not be subject to disqualification merely because it did not recognize the same-sex spouse of a participant as a spouse before that date.

Despite the *Obergefell* ruling, as of January 20, 2016, eleven counties in Alabama are reported to issue no marriage licenses at all rather than supply them to same-sex couples. In Kentucky, several counties are refusing to comply with the decision, and at least one county in Texas is also refusing to issue marriage licenses to same-sex couples.

Other complications remain. For example, domestic partnerships, civil unions, or other relationships that are not treated as a "marriage" under state law are not required to be recognized by a retirement plan, and plan sponsors may be able to stop recognizing domestic partners since they may now marry in all states. With regard to health benefits, while the Affordable Care Act (ACA) does not require that employers must offer or subsidize health care coverage for spouses, and ERISA does not require coverage of spouses under employer health plans, what about the impact of *Obergefell* on courts who may be asked to find that discrimination based on sexual orientation is a violation of Title VII of the Civil Rights Act of 1964? Will it be easier administratively and safer legally for employers to simply provide uniform benefits to all employees and their spouses rather than covering opposite-sex spouses but not same-sex spouses?

Finally, state income tax laws in those states that do not recognize same-sex marriages will have to conform to Federal income tax laws, and this could take time to accomplish, with attendant impacts. For example, some states previously required that state income taxes apply to the benefits provided to a same-sex spouse, even though such benefits were tax-free for opposite-sex spouses. As state income tax laws change, employers should no longer be required to impute income for state income tax purposes for same-sex spouses. Since Federal law already recognizes same-sex spouses, additional guidance from the IRS is unlikely.

ACCESS 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 in 2011 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). 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.

Congress passed further restrictions on access to the DMF as part of the Bipartisan Budget Act of 2013, which would effectively limit access within 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 instituted by the Commerce Department for persons who are found 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.

Public pension plans are clearly permitted access to the DMF under the NTIS proposal. However, 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.

Legislation (HR 2720, 113th Congress) introduced last Congress would allow state and local retirement systems access to the full unredacted DMF, but attempts by staff to include this in the 2013 budget deal were not successful and it has received no further action. Some staff have indicated the issue should be resolved at the state level, as state and territory vital records juridictions have legal authority for the records and data, and state laws govern what information may be shared, by whom, and under what circumstances.

Recently enacted legislation (Public Law 114-109) that addresses improper federal payments, authorized the judicial and legislative branches, as well as state government agencies that manage federal programs, to use the Treasury Department's Do Not Pay (DNP) Program, which includes access to the restricted and redacted DMF as well as other data sources.

GASB

There have been several recent actions by the Governmental Accounting Standards Board (GASB) that are of interest and importance to public pensions. Most recently, GASB has moved quickly to change the definition of "covered-employee payroll" contained in GASB Statements No. 67 and 68. As originally approved, these statements defined this term as the payroll of employees who are provided with pensions through the pension plan, meaning gross payroll rather than pensionable payroll.

In May of 2015, NASRA, NCTR, NCPERS, the Public Pension Financial Forum (P2F2), and the Government Finance Officers Association (GFOA) wrote a letter to GASB explaining the serious problems that were presented for both plans as well as their sponsors by requiring the use of gross payroll. The letter asked the Board to consider issuing guidance which would redefine "covered employee payroll" using the definition for covered payroll in GASB Statement No. 25, which provided that the term meant all elements included in compensation paid to active employees on which contributions to a pension plan are based.

In response to this and other public pension community requests, GASB subsequently issued an "Exposure Draft" on December 22, 2015, entitled *Pension Issues*, which dealt with this problem as well as the classification of payments made by employers to satisfy employee (plan member) contribution requirements. In a comment letter dated February 10, 2016, the same five national organizations expressed strong support for GASB's proposed changes, stating that "passage of these amendments will address the concerns and questions surrounding the affected Statements on these pension issues" that they had previously pointed out to GASB.

As the new comment letter explained, serious operational, cost, and feasibility concerns were raised due to the way in which covered payroll was defined in Statements 67 and 68 originally, and the organizations therefore strongly concurred with the Exposure Draft's proposed amendment that would instead require the presentation of covered payroll as being the portion of compensation paid to active employees on which contributions to a pension plan are based. The February 2016 comment letter also addressed the GASB Exposure Draft's response to some interpretations of how member contributions would be treated under the new standards, particularly those that were made under an Internal Revenue Code Section 414(h)(2) "pickup" arrangement.

Noting that these employer-paid member contribution arrangements vary considerably throughout the country, the comment letter expressed support for the proposed amendment that would clarify that such payments made by an employer to satisfy contribution requirements identified by terms of the pension plan as plan member contribution requirements should be classified as plan member contributions for purposes of Statement 67 and as employee contributions for purposes of Statement 68. Furthermore, the letter said that if these amounts are included in pensionable compensation, then no further disclosure should be required to account for these contributions as a salary expense.

In 2015, GASB also approved two new Statements in June dealing with the accounting and financial reporting by state and local governments for postemployment benefits other than pensions (OPEB), primarily retiree health insurance. GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, addresses reporting by OPEB plans that administer benefits on behalf of governments, and replaces GASB Statement No. 43. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, addresses reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments, and replaces GASB Statement No. 45. Statement 74 is effective for fiscal years beginning after June 15, 2016, while Statement 75 is effective for fiscal years beginning after June 15, 2017.

The new OPEB standards parallel the pension standards issued in 2012 (GASB Statements No. 67 and 68). For example, the unfunded liability will become a balance sheet item rather than a note disclosure. Also, certain implementation guidance issued relative to the pension standards will apply equally to Statements 74 and 75. However, GASB recognizes that other issues specific to OPEB warrant additional implementation guidance, and is currently working on Implementation Guides for the new Statements; the target date for issuance of the Statement 74 Guide is February of 2017, while the Guide for Statement 75 is not expected until November of that year.

six years, the hourly rate charged by the consulting actuary has increased by 12%. In addition, recent changes in the Actuarial Standards of Practice (APA) and the Government Accounting Standards Board (GASB) rules governing pension plans have substantially increased the number of hours needed to prepare the required actuarial analyses. In order to continue to utilize these essential services to the extent necessary to properly fund the retirement systems while ensuring the long-term fiscal integrity and sustainability of the pension funds, we are requesting a recurring appropriation of $750,000 to offset the increased costs of these services.

This request also addresses a considerable staffing issue with which the Division is currently faced. Contractors and other temporary employees play an essential and ongoing role in supporting the operations of the North Carolina Retirement Systems: temporary staffing affords RSD the human resource flexibility to operate reliably and consistently in spite of unpredictable circumstances. Inadequate staffing threatens the stability and reliability of the many operational functions RSD must perform in order to meet its obligations and ensure that its statutorily mandated benefit programs are equitably and consistently administered. Seasonal fluctuations in workload demands, activities associated with compliance requirements, technological enhancements and maintenance, and implementing legislative mandates are the principal elements fueling RSD's continual need for temporary workers and contractor services in meeting its human resource needs. This request provides a funding pool for temporary services and contractors to facilitate these activities and ensure seamless operations throughout the year.

Request #3: Contributory Death Benefit Open Enrollment

Recurring	$ 0
Nonrecurring	$ 175,000 (Receipt Supported)
Positions	0

Because of former statutory restrictions regarding beneficiary designations that have now been repealed by the General Assembly, RSD believes that many retirees in previous years were discouraged from enrolling in the CDB plan. As a result of a recent statutory change allowing much greater flexibility in designating beneficiaries, there is considerable demand for the opportunity to enroll in the plan among current retirees. RSD is requesting a non-recurring appropriation of $175,000 to offset the administration costs as well as the communications and marketing collateral needed to offer an Open Enrollment period for the Retirees' Contributory Death Benefit Plan (CDB). This request also requires statutory authority to charge a one-time administrative fee to fully offset any costs resulting from the open enrollment period.

Based on the new actuarial analyses released in January 2016, a persistent funding deficit for the CDB will soon increase from $30.7 million to $59 million -- the largest funding deficit the plan has seen in the past six years. Moreover, retiring members in the past, if they had chosen to participate, would have had very little flexibility to name or modify the beneficiary of this benefit. As a result, RSD believes that many retirees may have elected not to participate in the plan due to inflexibility in beneficiary-naming regulations. In 2014, however, the General Assembly changed the law governing CDB participants' choice of beneficiary to allow for much greater flexibility. RSD believes that implementing an open enrollment period would allow retirees who previously elected not to participate in the plan to take advantage of this new beneficiary-naming flexibility, which would increase participation. According to RSD's projections, an additional 10,000 new enrollees in the plan would partially address the plan's current deficit. An open enrollment period is likely the most cost-effective and expeditious manner of achieving this much-needed increase in plan participation.

Request #4: Achieving a Better Life Experience Program – Implementation Funding

Recurring	$ 0
Nonrecurring	$ 225,000 (General Fund)
Positions	0

DST is requesting funding to offset the costs associated with ensuring optimal accessibility of all marketing, communications, and other essential informational materials produced and distributed by the Department among the target population served by the NC ABLE Program Trust. This funding request will enable the Department to promptly and effectively reach out to potentially eligible individuals with disabilities within North Carolina and beyond in order to increase awareness of the NC ABLE Program Trust and attract sufficient participation and total assets to begin sustaining operations and administration costs through fees charged directly to participants.

Services such as closed captioning, simultaneous broadcasting of webinars and other presentations in American Sign Language, web design capabilities designed for the visually impaired, and other accommodations will all be necessary if the program is to effectively and equitably reach its intended audience.

Effective communications materials will reduce confusion regarding the program's rules and limitations, eligibility requirements, and other important information that, if not properly communicated, could lead to income tax consequences, suspension of means-tested federal benefits, and other adverse consequences for the participant. Collateral for market research and materials will enhance the Department's ability to identify those individuals who may be eligible to participate and encourage sufficient enrollment to accumulate enough assets to make the plan affordable, sustainable, attractive to potential participants, and valuable to participating individuals.

Request #5: Supplemental Retirement Plan 403(b) Operations Funding

Recurring	$ 0
Nonrecurring	$ 300,000 (General Fund)
Positions	0

The NC 403(b) Program was initially funded by a start-up loan from the Qualified Excess Benefits Arrangement to keep costs low and fees competitive until enough participants have joined the program and sufficient assets are accumulated to sustain ongoing operations and administration costs through fees charged directly to the participants. Thus, this request provides funding to pay off the initial start-up loan to prevent further accrual of interest as well as maintain operations and keep fees low while the program continues to grow.

Given the recent legislative changes to expand the program to allow community colleges to offer the program to their teachers and employees, we anticipate accelerated growth in the number of participants and total assets in the coming years. We are requesting an appropriation of $300,000 to repay the initial start-up loan to avoid accruing additional interest, to reimburse Departmental staff involved in the ongoing monitoring of program assets (currently performed internally by the Investment Management Division (IMD)), and to fund ongoing operations and administration costs in order to keep the plan competitive until it becomes fully sustainable and financially self-sufficient.

This appropriation will allow the Department to maintain the current level of highly competitive fees, which promises to increase participation and total plan assets until it can support itself financially from administrative and other fees charged to participants.

Request #6: A Study of Retirement Compensation of State & Local Government Employees

Recurring	$ 0
Nonrecurring	$ 400,000 (General Fund)
Positions	0

Requested funding would pay for a study of compensation of state and local government employees – to be conducted by the Department of State Treasurer. The study would engage national experts to study the total compensation packages provided to state and local government employees in North Carolina. In conducting this study, the Department of State Treasurer could expend resources to conduct actuarial studies and human resources analyses. The study will examine the future of retirement benefits for N.C. public servants. The Department would seek a professional facilitator to lead a bi-partisan group of legislators and stakeholders, including the Office of State Human Resources. The study will examine all relevant data, including overall compensation and benefits packages, to assess and recommend a retirement benefit structure that balances recruiting and retention needs against economic and fiscal realities.

The Public Employee Pension Transparency Act (PEPTA)/H.R. 4822

The Public Employee Pension Transparency Act (PETPA) (H.R. 4822) was reintroduced in the U.S House of Representatives by Rep. Devin Nunes of California on March 21, 2016. PEPTA has been introduced each Congress since 2010. The bill would require public pension funds to produce and submit to the Internal Revenue Service an additional set of financial reports that, if not properly and timely reported, would result in the loss of tax-exempt status for certain state-issued bonds.

Nearly identical provisions aimed at state and local pension reporting requirements included in PEPTA are also included in the Puerto Rico Assistance Act of 2015 (PRAA) (S. 2381) which was introduced in December 2015. Both PEPTA and a nearly identical provision included in the PRAA would impose many onerous and costly pension reporting requirements on state and local governments, including additional reporting requirements of the following plan-specific data which are largely already reported as part of the stringent reporting regime required by the Governmental Accounting Standards Board (GASB):

- The plan's schedule of funding status, including current liability, the amount of plan assets available to meet that liability, the amount of any unfunded liability, and the funding percentage of the plan;

- A schedule of contributions by the plan sponsor for the plan year;

- Alternative projections for the subsequent plan years to be specified by the IRS of cash flows associated with the current liability and a statement of assumptions used to determine such projections;

- The plan's actuarial assumptions for the plan year, including the investment rate of return of plan assets and the plan's investment returns, including the rate of return, for the plan year and the five preceding plan years;

- Plan participant data describing active and retired members' service and status with regard to receipt of benefits;

- A Statement as to the degree and manner in which the plan sponsor expects to eliminate any unfunded current liability that may exist for the plan year and the extent to which the plan sponsor has followed the plan's funding policy for each of the five preceding plan years;

- A statement as to the amount of pension obligation bonds outstanding; and a statement of the current cost of the plan for the plan year.

The Retirement Systems Division is already in the process of implementing the comprehensive accounting and financial reporting requirements promulgated by GASB and which were effective beginning in 2013. These new GASB requirements include improved financial reporting through the use of enhanced disclosures and schedules of required supplementary information, including updated year-to-year liabilities and rates of return. Enhanced GASB reporting requirements have changed how governments calculate and report the costs and obligations associated with pension liabilities with a focus on increased transparency and added disclosure, including much of the same information required under PEPTA/PRAA.

Summary: Department of Labor Finalizes Rule to Address Fiduciary Standards and Conflicts of Interest in Retirement Advice for ERISA-covered plans

Excerpted from the U.S. Department of Labor Fact Sheet accessible online at http://www.dol.gov/ebsa/newsroom/fs-conflict-of-interest.html.

Note: The final rule applies to ERISA plans, not governmental plans, and relates to investment advice which the N.C. Retirement Systems do not provide. As such, the defined benefit retirement plans overseen by the TSERS and LGERS Boards of Trustees are not subject to the final rule. However, in light of the wide reporting on this issue and the change from a "suitability" standard to a "fiduciary" standard applicable to investment advice provided by intermediaries subject to ERISA, this summary is provided to the Board for informational purposes.

Since 1974, when Congress enacted the Employee Retirement Income Security Act (ERISA), the Department of Labor ('DOL' or 'Department') has worked to protect America's tax-preferred retirement savings. In the ensuing decades, there has been a dramatic shift in the retirement savings marketplace from employer-sponsored defined benefit plans to participant-directed 401(k) plans, coupled with the widespread growth in assets in Individual Retirement Accounts and Annuities (IRAs). When the basic rules governing retirement investment advice were created in 1975, 401(k) plans did not exist and IRAs had just been authorized. These rules have not been meaningfully changed since 1975.

The changes in the retirement landscape over the last 40 years have increased the importance of sound investment advice for workers and their families. While many advisers do act in their customers' best interest, not everyone is legally obligated to do so. Many investment professionals, consultants, brokers, insurance agents and other advisers operate within compensation structures that are misaligned with their customers' interests and often create strong incentives to steer customers into particular investment products. These conflicts of interest do not always have to be disclosed and advisers have limited liability under federal pension law for any harms resulting from the advice they provide to plan sponsors and retirement investors. These harms include the loss of billions of dollars a year for retirement investors in the form of eroded plan and IRA investment results, often after rollovers out of ERISA-protected plans and into IRAs.

The new conflict of interest final rule and related exemptions will protect investors by requiring all who provide retirement investment advice to plans and IRAs to abide by a "fiduciary" standard—putting their clients' best interest before their own profits. This final rulemaking fulfills the Department of Labor's mission to protect, educate, and empower retirement investors as they face important choices in saving for retirement in their IRAs and employee benefit plans.

North Carolina
Department of State Treasurer

N.C. DEPARTMENT OF STATE TREASURER
RETIREMENT SYSTEMS DIVISION

JANET COWELL
TREASURER

STEVE TOOLE
RETIREMENT SYSTEMS DIRECTOR

April 13, 2016

Mr. Andrew T. Heath
State Budget Director
Office of Budget and Management
Administration Building
Raleigh, North Carolina

Mr. Mark Trogdon
Director, Fiscal Research Division
North Carolina General Assembly
619 Legislative Office Building
Raleigh, North Carolina

Re: Estimated State & Local Government Payrolls for Retirement Appropriations Purposes as of July 1, 2016

Mr. Heath and Mr. Trogdon:

Based on the agreement reached among the Legislative Fiscal Research Division, the Office of State Budget and Management and the Department of State Treasurer, we have prepared and attached a schedule of estimated covered members' payrolls for purposes of retirement system appropriations for the 2016 Session of the General Assembly.

Sincerely,

Steve Toole
Director, Retirement Systems Division

ST/sw

Enclosure

3200 ATLANTIC AVENUE, RALEIGH, NORTH CAROLINA 27604
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Estimated State Payrolls for Retirement Appropriations Purposes for the 2016 Session of the North Carolina General Assembly

Retirement System	General Fund	Highway Fund	Receipts/ Other Funds	Total
Teachers' and State Employees' System	* $9,865,000,000	$ 303,000,000	$ 4,456,109,000	$ 14,624,109,000
University Optional Plan	$1,136,000,000	N/A	$ 514,000,000	$ 1,650,000,000
Consolidated Judicial	$70,000,000	N/A	N/A	$ 70,000,000
Legislative System	$3,620,000	N/A	N/A	$ 3,620,000
TOTAL	**$11,074,620,000**	**$ 303,000,000**	**$ 4,970,109,000**	**$ 16,347,729,000**

*Includes $190 million for law enforcement officers

	General Employees	Law Officers	Firefighters	Total
Local Governmental Employees' System	***$ 4,404,690,000**	**$1,102,678,000**	**$510,894,000**	**$6,018,262,000**

* Includes $6,714,000 for Registers of Deeds.