National Conference of State Legislatures (NCSL)
Fraternal Order of Police (FOP)
American Federation of State, County and Municipal Employees (AFSCME)
National Association of Counties (NACo)
American Federation of Teachers (AFT)
United States Conference of Mayors (USCM)
National League of Cities (NLC)
International Association of Fire Fighters (IAFF)
International City/County Management Association (ICMA)
National Education Association (NEA)
National Association of State Auditors Comptrollers and Treasurers (NASACT)
National Association of Police Organizations (NAPO)
National Association of State Treasurers (NAST)
Government Finance Officers Association (GFOA)
International Public Management Association for Human Resources (IPMA-HR)
National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)
National Conference of State Social Security Administrators (NCSSSA)

April 30, 2008

VIA ELECTRONIC MAIL
Internal Revenue Service
CC:PA:LPD:PR
Room 5203
Ben Franklin Station
Washington, D.C. 20044

Re: Treas. Reg. Section 1.401(a)-1(b)

Dear Sir or Madam:

On behalf of the nineteen national organizations listed above – representing state and local governments and officials, public employee unions, public retirement systems, and more than twenty million working and retired state and local government workers and their beneficiaries—we are writing to request an extension of the effective date of Treasury Regulations Section 1.401(a)-1(b) (the "Final Regulations") for governmental plans.

Organizations representing governmental plans recently submitted a joint comment letter ("Joint Comment Letter," attached) in response to IRS Notice 2007-69, which, among other things, requested comments from sponsors of governmental plans on whether normal retirement age under such plans may be based on years of service. As the Joint Comment Letter outlines, defined benefit plans of state and local governments often define their normal retirement age or normal retirement date as the date or age when participants qualify for normal or unreduced retirement benefits under the plan, and this is often conditioned, in whole or in part, on the completion of a stated number of years of service. Other governmental pension plans do not specifically define normal retirement age.

Prior to the Final Regulations, there was no authority that prohibited such practices for governmental pension plans. Moreover, the Internal Revenue Service has routinely approved service-based normal retirement ages through the determination letter process. Accordingly, the Joint Comment Letter reiterated earlier requests that the IRS refrain from creating standardized definitions for early or normal retirement age with regard to governmental plans, and instead defer to the applicable state or local laws, regulations and policies governing the plan.

Should the Final Regulations require, for the first time, governmental pension plans to specifically define normal retirement age, or redefine normal retirement age so that it is not based wholly or partly on years of service, serious problems will be created for plans, sponsors and plan participants. This is particularly problematic where attainment of normal retirement age entitles participants to rights that are protected by constitutional guarantees.

Any time a State or local retirement system is required to be amended, it generally requires a State legislative initiative or enabling authority. This is because pension plans of States and localities are established by these governments acting in their sovereign capacity and generally are adopted by and subject ultimately to popularly-elected governmental bodies. Benefits are adopted through open political processes or through collective bargaining, and are established by public laws and subject to the oversight of states, localities and the public. The benefits provided by many public employee retirement systems are also subject to state constitutional or statutory provisions that bar public employers from taking back or reducing benefits once they have been established. Furthermore, changing something as fundamental as the age at retirement could additionally have significant financial impacts on the plan and plan sponsor, and would require legislative scoring and appropriation.

Therefore, unless changes to the Final Regulations are made with regard to governmental plans, the IRS will essentially be placing States and localities in the precarious position of either being out of compliance with federal regulation or incurring enormous financial and administrative costs and violating their own constitutional, statutory or case law protections. Furthermore, without the clarifications requested with regard to inappropriate or unclear definitions, it is hard to see how they could reasonably be expected to follow the Final Regulations should they try. Finally, it would additionally be impossible for most elected governmental bodies to amend State or local governing statutes in time to meet the required effective date of the Final Regulations.

Therefore, in order to permit the IRS to fully consider and respond to public sector concerns with the Final Regulations, provide clarification with regard to unsuitable or unclear definitions, provide ample time for State and local governing bodies to respond, and to avoid confusing and potentially harmful actions, we request that the Service provide an extension of the effective date of the Final Regulations for state and local government pension plans.

If you have any questions, please do not hesitate to contact us.

Very truly yours,

Tim Richardson, FOP, (202) 547-8189
Alfred Campos, NEA, (202) 822-7345
Barrie Tabin Berger, GFOA, (202) 393-8020
Barry Kasinitz, IAFF, (202) 737-8484
Bill Cunningham, AFT, (202) 393-6301
Bill Johnson, NAPO, (703) 549-0775
Cornelia Chebinou, NASACT, (202) 624-545
Dan DeSimone, NAST, 202-624-8592
Daria Daniel, NACo, (202) 942-4212
Diana Noel, NCSL, (202) 624-7779
Ed Jayne, AFSCME, (202) 429-1188
Hank Kim, NCPERS, (202) 624-1456
James Driver, NCSSSA, (502) 564-6888
Jeannine Markoe Raymond, NASRA, (202) 624-1417
Larry Jones, USCM, (202) 861-6709
Leigh Snell, NCTR, (703) 684-5236
Neil Bomberg, NLC, (202) 626-3020
Elizabeth Keller, ICMA, (202) 962-3560
Tina Ott Chiappetta, IPMA-HR, (703) 549-7100 x 244

(Attachment)

NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS
NATIONAL COUNCIL ON TEACHER RETIREMENT

December 28, 2007

VIA ELECTRONIC MAIL (notice.comments@irscounsel.treas.gov)
Internal Revenue Service
CC:PA:LPD:PR
Room 5203
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2007-69

Dear Sir or Madam:

We are writing in response to the request for comments under Notice 2007-69 and, more generally, in response to changes under Treas. Reg. Section 1.401(a)-1(b)((the "Final Regulations") that affect governmental plans. In Notice 2007-69, the Tax Exempt and Governmental Entities Division requested comments from sponsors of governmental plans and other plans not subject to the requirements of Section 411 of the Code on whether normal retirement age under such a plan may be based on years of service. More specifically, TE/GE requested comments on whether and how a pension plan with a normal retirement age conditioned on the completion of the stated number of years of service satisfies the requirement in Treas. Reg. Section 1.401(a)-1(b)(1)(i) that a pension plan be maintained primarily to provide for the payment of definitely determinable benefits after retirement or attainment of normal retirement age and how such a plan satisfies the pre-ERISA vesting rules.

These comments are being submitted on behalf of the National Association of State Retirement Administrators ("NASRA") and the National Council on Teacher Retirement ("NCTR"). Representatives of NASRA, NCTR and systems that are part of their membership, such as the Public Employees Retirement System of Idaho ("PERSI"), among others, had the opportunity to meet with Martin L. Pippins, William Bortz, James P. Flannery and Janet Laufer on November 8, 2007. We greatly appreciate their insights on these issues. The meeting was most helpful to us in refining and directing

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NCTR – 112 SOUTH PITT STREET – ALEXANDRIA, VA 22314 – 703.684.5236

our comments. We also appreciate Mr. Bortz's courtesy in allowing us additional time to finalize our comments.

<u>Description of NASRA and NCTR</u>

NASRA is a non-profit association whose members are the directors of the nation's state, territory, and largest statewide public employee retirement systems. NCTR's membership consists of 77 state, territory, local and university retirement systems that include teachers and other public employees. The retirement systems represented by our organizations collectively serve nearly 19 million working and retired state and local government workers and oversee roughly $2.5 trillion in assets.

Five years ago, our organizations individually submitted comments to the Service in response to IRS Notice 2002-43 and identified a list of principles for phased retirement. Among them, the comments specifically noted there was strong consensus among our members that the IRS should not attempt to create standardized definitions for early or normal retirement age, but instead should defer to the applicable state or local laws, regulations and policies governing a particular plan:

> "IRS should clarify ***the definition of such terms as normal retirement age***, early retirement age, minimum retirement age and final or highest average compensation (or whatever term is used in a particular jurisdiction) ***should be whatever appears in the applicable state or local laws, regulations, case law, and policies governing the retirement system. Such clarification serves to recognize that state and local governments have different ways of defining these terms.***"

(Emphasis added.) Unlike the private sector, any time a State or teacher retirement system is required to be amended, it generally requires a State legislative initiative. This is because pension plans of States and localities are established by these governments acting in their sovereign capacity and generally are adopted by and subject ultimately to popularly-elected governmental bodies. The benefits provided by many public employee retirement systems are also subject to state constitutional or statutory provisions that bar public employers from taking back or reducing benefits once they have been established. Benefits are adopted through open political processes or through collective bargaining, and are established by public laws and subject to the oversight of states, localities and the public.

The request that the definitions in these plans defer to the applicable state or local laws, regulations and policies governing a particular plan seems in line with comments made by the Treasury Benefits Tax Counsel before the Ways and Means Committee earlier this year. In his testimony on Retirement Plan Fees and Expenses, he stated "The exception from ERISA of governmental plans…was a conscious decision by

Congress in enacting ERISA. State and local legislative bodies have been left to regulate these plans…"

An Overview of Normal Retirement Age in Governmental Pension Plans

Nearly all defined benefit plans of state and local governments condition the receipt of normal (*i.e.*, unreduced) retirement benefits, in whole or in part, on the completion of a stated number of years of service. Many such plans define their normal retirement age or normal retirement date[1] as the time or times when participants qualify for normal retirement benefits under the plan. For these plans, the normal retirement age is based wholly or partly on years of service. Other governmental pension plans do not specifically define normal retirement age. Many sponsors of governmental pension plans with normal retirement ages conditioned on service as well as sponsors of governmental pension plans that do not employ either term have received a series of favorable determination letters with respect to their plans.

Under many governmental pension plans, a participant can reach normal retirement age by satisfying one of several age and service combinations. For example, a large municipal teachers plan defines normal retirement age as the earliest of (1) the date the participant reaches age 65 with 5 years of service, (2) the date the participant reaches age 55 with 25 years of service, and (3) the date the participant reaches age 50 with 30 years of service. It is also common for governmental pension plans to include among the alternative ways a participant may reach normal retirement age, the satisfaction of an age plus service combination, such as the "rule of 85,"[2] or the satisfaction of a reasonable service requirement at any age. In addition, normal retirement age may be different for different subgroups of employees covered by the same plan, depending on their date of hire.

While many governmental pension systems have separate plans for their teachers, public safety employees and other employee groups, this approach is not universal. Governmental pension plans often provide multiple benefit structures and cover multiple employee groups. Some states and local governments find such an approach more efficient than maintaining dozens of smaller plans with separate benefit structures or separate employee groups. Thus, the definition of normal retirement age in a governmental pension plan can be very complex, particularly if the plan covers

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[1] Some governmental plans use the term "normal retirement age" while others use the term "normal retirement date." There does not appear to be any difference in meaning between the two terms. In these comments, we will use the term normal retirement age to cover both terms. We understand that there is a distinction between the terms as they are applied to private employer plans. *See*, for example, Rev. Rul. 81-211 1981-2 C.B. 98 (plan that provides for non-forfeitable benefits on normal retirement date, defined as a date that occurs after normal retirement age, will not satisfy the requirements of Section 411(a)). The distinction is not meaningful for a plan that is not subject to Section 411(a).

[2] Under the rule of 85, a participant will reach his normal retirement age when the sum of his age and service equals 85. The rule of 80 and the rule of 90 are also common.

multiple groups and sub-groups of employees and, like the municipal teachers plan described above, includes alternative combinations of age and service in the definition of normal retirement age.

As discussed above, for most governmental pension plans that define normal retirement age, normal retirement age is the time when participants qualify for unreduced benefits under the plan.[3] However, normal retirement age in some governmental pension plans triggers different rights, such as eligibility for deferred vested benefits, eligibility for in-service distributions or vesting. For example, some governmental pension plans permit groups of employees to begin taking in-service distributions, typically at a date that is on or after the date the participant has satisfied the conditions for normal retirement. Thus, normal retirement age, in the context of in-service distributions, typically has a service component.

Although governmental pension plans are not subject to the anti-cutback rules of Section 411(d)(6) of the Code, the provisions of most governmental plans are guaranteed in the state's constitution. Many states have constitutional provisions protecting against diminishing, impairing, encumbering or diverting public sector retirement funds for any reason or purpose whatsoever.[4] As a result, the sponsors of governmental pension plans often lack the ability to change key terms in the plan, such as the plan's normal retirement age. Thus, to the extent that the Service's interpretation of recent changes to the Final Regulations affects or impairs the guaranteed contractual rights of retirement fund members, the states or funds would be subject to numerous suits by retirees or future retirees for impairment of these contractual rights. Even when constitutional protections and collective bargaining agreements do not impact the ability of the sponsor to amend a plan, changes can typically be made to a governmental plan only with the approval of elected governmental bodies, such as through official action of the state legislature or the city or county council.

In sum, the Service is unnecessarily creating a plan qualification issue for a substantial number of plans covering millions of employees that would require elected

[3] Defining normal retirement age as the date the participant has a right to unreduced benefits is consistent with the pre-ERISA definition of normal retirement age in Rev. Rul 71-24, 1971-1 C.B. 114 . It is also consistent with the definition under the Section 457 regulations, which are applicable to governmental plans. Reg. § 1.457-4(c)(3)(v) defines normal retirement age as an age that is on or after the earlier of age 65 or the date when the participant may retire and receive unreduced benefits under the basic defined benefit pension plan or money purchase pension plan.

[4] Based on a recent survey, approximately 25 states have some form of constitutional provisions protecting these public retirement funds or such protections have been otherwise legislatively or judicially created. *See*, for example, Michigan Constitution, Article 9, Sections 19 and 24; New Mexico Constitution, Article XX, Section 22; South Carolina Constitution, Article X, Section 16. Likewise, many states consider membership in a state employee retirement system as a contractual relationship subject to statutory and constitutional protections which may be judicially enforced. *See*, for example, Alaska Constitution, Article 12, Section 7; Arizona Constitution, Article 29, Section 1; Michigan Constitution, Article 9, Section 19.

governmental bodies to take action. In the case of our members, it would nearly universally require a State legislative initiative.

Summary of General Concerns

Notice 2007-69 and the Final Regulations have caused significant concern among sponsors of governmental pension plans. Some concerns relate to the interplay between normal retirement age and in-service distributions, but some more fundamental concerns relate solely to the definition of normal retirement age. The chief concerns are:

1. Many governmental pension plans (including those whose sponsors have relied for decades on favorable determination letters) have never defined normal retirement age. The sponsors of such plans are concerned that the Final Regulations will require, for the first time, that governmental pension plans specifically define normal retirement age. Introducing a new term with uncertain legal consequences is likely to confuse their members and may impact constitutionally protected features of their plans.

2. Among governmental pension plans that define normal retirement age, many have definitions that do not completely coincide with the views expressed in Notice 2007-69. Nearly all include a service component and many reflect a normal retirement age that is based on service alone. Sponsors of such plans are deeply concerned about the implications of redefining their normal retirement ages. The concerns are heightened where attainment of normal retirement age entitles participants to rights that are protected by constitutional guarantees.

3. Sponsors of plans that currently permit participants to receive in-service distributions when the participants become eligible for normal (i.e., unreduced) retirement benefits have concerns that a regulation that does not permit in-service distributions when participants satisfy the service requirements for normal retirement benefits will interfere with rights that are protected by constitutional guarantees.

4. Sponsors, whose participating employers would like to retain valuable employees by offering them the opportunity to begin receiving unreduced retirement benefits while remaining employed are concerned that, without the ability to provide in-service retirement payments at the time when the employees first become eligible for normal retirement benefits, they will lose their most valued employees.

5. Under many governmental pension plans, a participant can reach normal retirement age by satisfying one of several age and service combinations. Sponsors of such plans would find it very difficult to select a single age to be the plan's normal retirement age. Selecting an age that is higher than the lowest age would likely impair the constitutionally protected rights of the participants. Selecting an age that is lower than the highest age could impact the actuarial cost of the plan.

6. Governmental pension plans often provide multiple benefit structures and cover multiple employee groups. The use of the term "plan" under the Final Regulations raises the concern that the Internal Revenue Service may apply the general rule and the safe harbors very narrowly in the case of governmental pension plans.

7. Sponsors of plans that cover both public safety employees and non-public safety employees, with separate benefit structures for each group, are concerned that the age-50 safe harbor in Treas. Reg. Section 1.401(a)-1(b)(2)(v) will not be available to their public safety employees because substantially all of the plan participants are not qualified public safety employees.

8. Sponsors of plans covering public safety employees are concerned that a restrictive interpretation of "normal retirement age" as used in Section 402(l) will prevent most public safety retirees from benefitting from the $3,000 tax exclusion for distributions for health insurance and long-term care premiums.

<u>Analysis of Issues Raised by the Final Regulations and Notice 2007-69</u>

Governmental Plans Are Not Required to Define "Normal Retirement Age"

Qualified plans that are subject to Section 411(a) of the Code are required to provide that an employee's right to his normal retirement benefit (as defined in Section 411(a)(9)) is non-forfeitable on attainment of normal retirement age (as defined in Section 411(a)(8)). Thus, plans sponsored by private employers are required to state a normal retirement age that is no later than the time the participant reaches age 65 or the 5th anniversary of his participation in the plan, if later. In addition, normal retirement age in private employer plans has a very specific meaning -- it is the date when normal retirement benefits are required to be vested.

By contrast, Section 411(a), with its requirement to state a normal retirement age, is not applicable to a governmental plan. Section 411(e) of the Code provides that governmental plans satisfy the requirements of Section 411 if they meet the vesting requirements resulting from the application of Section 401(a)(4) and Section 401(a)(7) as in effect on September 1, 1974. We will refer to these requirements as the "pre-ERISA vesting rules."

Section 401(a)(7), as in effect on September 1, 1974, required 100% vesting on plan termination or upon the complete discontinuance of employer contributions. Clearly, pre-ERISA Section 401(a)(7) did not require a plan to specify a normal retirement age.

Pre-ERISA Section 401(a)(4) required that contributions or benefits provided under a qualified plan may not discriminate in favor of "employees who are officers, shareholders, [supervisors], or highly-compensated employees." The requirements of Section 401(a)(4) were made inapplicable to state and local governmental plans by the Taxpayer Relief Act of 1997.[5] *See* Section 401(a)(5)(G). Section 401(a)(5)(G) does not provide an exception for the application of pre-ERISA Section 401(a)(4) to governmental plans.

Because Section 411(a) does not apply to governmental plans, and because there is no other requirement under the qualification rules for governmental plans to define normal retirement age, it is clear that governmental plans are not required to define normal retirement age. This conclusion is supported by the Internal Revenue Service's regulatory practice. Many governmental plans that do not define normal retirement age have consistently received favorable determination letters for decades.[6]

Normal Retirement Age in a Governmental Plan May Have a Service Component

The Internal Revenue Service and Treasury requested comments on whether and how a governmental pension plan with a normal retirement age conditioned on the completion of service satisfies the "pre-ERISA vesting rules" and the "definitely determinable benefits rule". We do not believe that either requirement prevents a governmental pension plan from having a normal retirement age that either includes a service component or is based entirely on the completion of service.

<u>Pre-ERISA Vesting Rules</u>

The pre-ERISA vesting rules do not preclude a governmental pension plan from having a normal retirement age that is conditioned on the completion of the stated number of years of service. We understand, based on discussions during our

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[5] Section 1505(d)(2) of the Taxpayer Relief Act of 1997 further provided that a state or local governmental plan will be treated as satisfying the requirements of Section 401(a)(4) for all taxable years beginning before the date of enactment.

[6] The regulations under Section 411 confirm that, prior to ERISA, a qualified plan is not required to state a normal retirement age. *See* Reg. §1.411(a)-7(b)(2). Example (2).

November 8, 2007 meeting, that some representatives of the Treasury and the Internal Revenue Service believe that the vesting requirements resulting from the application of Section 401(a)(4) include the rule described in Part 5(c) of Revenue Ruling 69-421 and that Part 5(c) prohibits governmental pension plans from having a normal retirement age that can be triggered by the completion of a service requirement. As explained above, we believe that Section 411(e)(2) of the Code does not require governmental pension plans to comply with Part 5(c) of Revenue Ruling 69-421. Even if Part 5(c) of Revenue Ruling 69-421 applies to governmental plans despite Section 401(a)(5)(G), Part 5(c) does not preclude a plan from having a normal retirement age conditioned on the completion of service. Revenue Ruling 69-421, Part 5(c)(2) provides as follows:

> *Vesting on Retirement.* -- A plan will be held not to qualify if it fails to provide that an employee who has reached the normal retirement age (in the case of a pension or annuity plan) . . . ***and has satisfied any reasonable and uniformly applicable requirements as to length of service or participation***, is vested in the contributions made or benefits payable under the plan. *See* Rev. Rul. 66-11, C.B. 1966-1, 71 and Rev. Rul. 68-302.

(Emphasis added.) Part 5(c) clearly permits full vesting on a date that is the later of the attainment of a stated age and the satisfaction of reasonable service requirements. There is no requirement that a normal retirement age be based solely on the participant's date of birth, without reference to service or participation requirements.[7]

While some governmental pension plans have normal retirement ages that are expressed as **the later of** a specified age and fulfillment of service conditions, most governmental pension plans use other combinations, including (1) a requirement that age plus service equals a certain number (*e.g.*, the rule of 90), (2) a normal retirement age expressed as **the earlier of** the attainment of a specified age and the satisfaction of specified service requirements, or (3) a normal retirement age expressed solely in terms of the completion of specified service. We believe that a normal retirement age expressed in any of these manners satisfies the requirements of Part 5(c) of Revenue Ruling 69-421.

A normal retirement age based on age plus service, such as the rule of 90, is the functional equivalent of a normal retirement age that is the later of the stated age and the satisfaction of service or participation requirements. For example, a participant

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[7] Even the definition of normal retirement age in Section 411(a)(8), which is not applicable to governmental plans, permits normal retirement age to be expressed as the later of age 65 and the fifth anniversary of participation.

reaches normal retirement age under the rule of 90 on reaching age 60 only if the participant has 30 years of service. Age plus service requirements for normal retirement are squarely within the contemplation of Part 5(c) of Revenue Ruling 69-421 which requires vesting on reaching a specified age and satisfying specified service conditions. The rule of 90 and similar rules are merely a series of age plus service combinations, each of which satisfies Part 5(c) of Revenue Ruling 69-421.

Part 5(c) of Revenue Ruling 69-421 should also be read as approving a normal retirement age that is **the earlier of** a stated age or the satisfaction of specified service requirements. Part 5(c) does not specifically address a normal retirement age that is the earlier of a stated age or satisfaction of service or participation requirements. The proper inference from the failure to address the "earlier of" option is that it is permissible. Part 5(c) is arguably applicable to governmental plans only because it arose from the pre-ERISA non-discrimination rules. Part 5(c) addressed the specific concern that employers would use vesting rules to discriminate in favor of officers, shareholders, supervisors or highly-compensated employees. *See* Part 5(c)(1). Normal retirement ages that are the earlier of a stated age or the satisfaction of a service requirement are axiomatically more inclusive and less likely to be discriminatory than normal retirement ages that are the later of a stated age and the satisfaction of the same service requirement. Thus, if a normal retirement age expressed as the later of attaining a specified age and satisfying a service requirement does not violate pre-ERISA Section 401(a)(4), a normal retirement age that is the earlier of stated age or satisfaction of the same service requirement will not violate pre-ERISA Section 401(a)(4).[8]

By the same token, Part 5(c) of Revenue Ruling 69-421 should be read to permit a normal retirement age that is expressed as the time when the participant completes a service requirement. Such a provision will always be more inclusive, and less likely to be discriminatory than a requirement to complete the same service requirement and reach a specified age.

Definitely Determinable Benefits Rule

The definitely determinable benefits rule does not preclude a qualified plan from having a normal retirement age that is conditioned on the completion of a stated number of years of service. Treas. Reg. Section 1.401(a)-1(b)(1)(i) provides in relevant part that:

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[8] The recent case of *Fry v. Exelon Corporation Cash Balance Plan,* No. 06-C-3723 (N.D. Ill., Mem. Op. Order), concluded that ERISA permits a definition of normal retirement age that is based on the earlier of attaining a stated age and completing a service requirement. The *Fry* case involved an interpretation of Section 3(24) of ERISA, 29 U.S.C. § 1002(24) which is not applicable to governmental plans. Nevertheless, we believe that conclusion that normal retirement age is not synonymous with a chronological age should be followed by the Internal Revenue Service.

> In order for a pension plan to be a qualified plan under section 401(a), the plan must be established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to its employees over a period of years, usually for life, after retirement or attainment of normal retirement age (subject to paragraph (b)(2) of this section). A plan does not fail to satisfy this paragraph (b)(1)(i) merely because the plan provides, in accordance with Section 401(a)(36), that a distribution may be made from the plan to an employee who has attained age 62 and who has not separated from employment at the time of such distribution.

Treas. Reg. Section 1.401(a)-1(b)(1)(i), by its terms, requires benefits to be definitely determinable "after retirement ***or*** attainment of normal retirement age." (Emphasis added.) However, nothing in the regulation suggests that normal retirement age must be determined with reference to the employee's date of birth. Revenue Ruling 71-24, 1971-1 C.B. 114 further explains the requirements of Treas. Reg. § 1.401-1(b)(1)(i) as follows:

> The normal retirement age is the ***time*** from which definitely determinable benefits under a pension plan become fixed and payable. An employee who has reached such age ***and has fulfilled the service requirement*** and other universally applicable provisions of the plan must be permitted to retire and to commence receiving the benefits payable thereunder.

(Emphasis added.) Revenue Ruling 71-24 clarifies that the requirement for definitely determinable benefits at normal retirement age refers to a time when the plan's age and service requirements for normal retirement are satisfied.[9]

Meaning of "Plan" under the Final Regulations

The general rule for determining normal retirement under the Final Regulations provides that "[t]he normal retirement age under a ***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." (Emphasis added.) Treas. Reg. Section 1.401(a)-1(b)(2)(i). The regulations also provide an age 50 safe harbor for qualified public safety employees stating that

[9] The "definitely determinable benefits" rule is also satisfied if the plan provides for definitely determinable benefits at retirement. There is no requirement that the plan provide for definitely determinable benefits at normal retirement age and at retirement.

> A normal retirement age under a ***plan*** that is age 50 or later is deemed to be 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 if substantially all of the participants in the plan are qualified public safety employees (within the meaning of section 72(t)(10)(B)).

(Emphasis added.) Treasury Regulation § 1.401(a)-1(b)(2)(v). The age 62 safe harbor also is stated in terms of a normal retirement age under a "plan." See Treasury Regulation § 1.401(a)-1(b)(2)(ii).

The use of the term "plan" under the Final Regulations raises the concern that the Internal Revenue Service may apply the general rule and the safe harbors very narrowly in the case of governmental pension plans. For example, the general rule might be applied to require a single normal retirement age under a governmental pension plan that has multiple benefit structures or that covers multiple employee groups.[10] In addition, the age 62 safe harbor might be applied to limit relief to a "single plan" (within the meaning of Section 414(l) of the Code and the regulations thereunder) that has a single normal retirement age of 62 or later. Moreover, the age 50 safe harbor for qualified public safety employees might be applied to limit relief to a "single plan" (within the meaning of Section 414(l) of the Code and the regulations thereunder) in which substantially all of the participants are qualified public safety employees.[11] We urge the Internal Revenue Service and Treasury to (a) recognize that governmental pension plans often provide multiple benefit structures and have different rules for different employee groups and (b) interpret the Final Regulations in a manner that is consistent with that reality. A narrow interpretation of the Final Regulations would require the enormous undertaking of going through state and local governing bodies to unnecessarily fracture governmental pension systems into several smaller "plans" in order to have multiple normal retirement ages or take advantage of the safe harbor relief provided under the Final Regulations. Such action would require immense legislative and administrative efforts and only serve to increase the costs and

[10] Although not applicable to governmental plans, it is worth noting that the regulations under Section 401(a)(4) contemplate multiple normal retirement ages in a single plan. See, e.g., the definition of "testing age" under Treas. Reg. Section 1.401(a)(4)-12.

[11] The regulations under Section 414(l) specifically do not apply to governmental plans within the meaning of Section 414(d). See Treas. Reg. Section 1.414(l)-1(a)(1). In addition, the policy behind Section 414(l) – protecting against benefit reductions in the event of plan mergers – is not relevant to determinations of when a participant should be able to draw retirement benefits. Accordingly, the regulations under Section 414(l) should not be used as a basis for interpreting the term "plan" under the Final Regulations. For example, the regulations under Section 414(l) would treat "several distinct benefit structures" as a single plan if assets related to employees under one distinct benefit structure are available to pay benefits to employees covered by other distinct benefit structures. See Treas. Reg. Section 1.414(l)-1(b)(1). We are requesting that the opposite approach be taken in interpreting the term "plan" under the Final Regulations, and that distinct benefit structures be recognized as separate plans.

complexity of administering governmental pension plans while doing little to promote sound tax administration.

We request that clarification be provided in the form of a revised regulation or other guidance of general applicability. This request would not appear to be controversial. Certainly it was not the intent of the Internal Revenue Service and Treasury, for example, to exclude from the age 50 safe harbor hundreds of thousands of safety employees who are covered by distinct benefit structures merely because the safety employees participate in statewide plans that also cover non-safety employees under different benefit structures.

Normal Retirement Age in the Context of Section 402(l)

Section 402(l) of the Code provides that up to $3,000 in annual distributions from governmental pension plans for health or long-term care insurance for "eligible retired public safety officers" is excludible from taxable income. Section 402(l)(4) defines an eligible retired public safety officer as an individual who was separated from service by reason of disability or attainment of normal retirement age. We believe that normal retirement age for purposes of Section 402(l) is the date that a public safety officer qualifies under the plan for normal, or unreduced, retirement benefits.

This approach is consistent with normal retirement age, as used in other contexts relevant to governmental pension plans. Prior to ERISA, normal retirement age in a pension plan was defined as the lowest age specified in the plan at which the participant has the right to retire without the consent of the employer and receive unreduced benefits, based on service earned. *See* Revenue Ruling 71-147, 1971-1 C.B. 116. *See also* Part 5(e) of Revenue Ruling 69-421. Treas. Reg. Section 1.457-4(c)(3)(v), which is applicable to eligible deferred compensation plans sponsored by governmental employers, defines normal retirement age as an age that is on or after the earlier of age 65 or the date when the participant may retire and receive unreduced benefits under the basic defined benefit pension plan or money purchase pension plan. Thus, the link between normal retirement age and unreduced benefits has been established for many years.

We suggest that the Internal Revenue Service should look at the definition of normal retirement age for purposes of Section 402(l) in this context. The legislative history of Section 402(l) does not suggest that the $3,000 tax exclusion was to be available only to participants who reached a specified age. In fact, 402(l) was enacted prior to the changes to the Final Regulations).

Needed Changes to the Final Regulations for Governmental Plans

Based on the general concerns expressed on pages 5 and 6 above and the analysis of the legal issues raised by the Final Regulations at pages 6 through 12 above, we believe that the following changes should be made for purposes of the application of the Final Regulations to governmental pension plans.

1. Governmental plans are not required to define normal retirement age. Accordingly, Treas. Reg. Section 1.401(a)-1(b) should make clear that the limitations imposed on normal retirement age in subsection 1.401(a)-1(b)(2) do not require a governmental pension plan to define normal retirement age and do not limit a governmental plan's ability to define normal retirement age for purposes of eligibility for unreduced benefits, eligibility for terminated-vested benefits, or for any purpose other than in-service distributions.

2. Governmental pension plans typically have normal retirement ages that include a service component or are exclusively service-based. Accordingly, Treas. Reg. Section 1.401(a)-1(b)(2) should make clear that a governmental pension plan may permit in-service distributions at a time that is no earlier than the earliest time that is reasonably representative of the typical retirement date for the employee group. If employees typically retire after completing 20, 25 or 30 years of service, in-service distributions should be permitted at that point, regardless of the employee's age.

3. Governmental pension plans often provide multiple benefit structures and cover multiple employee groups. Accordingly, the term "plan" under the Final Regulations should be interpreted to permit treatment as a separate "plan" (a) each benefit structure under a governmental pension plan that results from differences in the formula for determining the amount of retirement benefits, the time at which retirement benefits may commence, or reductions imposed for early retirement and (b) each classification of employees identified under the terms of a governmental pension plan as having rights or benefits that differ from other employees covered under the governmental pension plan.

4. Treas. Reg. Section 1.401(a)-1(b)(2) should be revised to include additional presumptions and safe harbors for governmental pension plans. We suggest the following:

a. The time at which an employee is qualified for an unreduced retirement benefit under a governmental pension plan should be presumed to satisfy the requirement that in-service distributions be no earlier than the earliest age that is reasonably representative of the typical retirement age in the industry in which the covered workforce is employed for purposes of Treas. Reg. Section 1.401(a)-1(b)(2).

b. For non-public safety employees, a normal retirement age that is no earlier than age 55 or the date the participant has earned a minimum of 25 years of service (regardless of age) should be deemed to satisfy the requirement that in-service distributions be no earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

c. For public safety employees, a normal retirement age that is no earlier than age 50 or the date the participant has earned a minimum of 20 years of service (regardless of age) should be deemed to satisfy the requirement that in-service distributions be no earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed.

d. Governmental pension plans that currently define normal retirement age or normal retirement date, whether expressed in terms of age alone, service alone, a combination of age and service, or a series of alternate age and service combinations, may allow in-service distributions at their earliest current normal retirement age or date.

In addition, we believe that normal retirement age for purposes of Section 402(l) should be the date that a public safety officer qualifies under the plan for unreduced retirement benefits.

Conclusion

State and local government retirement systems are established through public laws by governments acting in their sovereign capacity and subject ultimately to the oversight of popularly-elected governmental bodies and the public. The benefits provided by many public employee retirement systems are also subject to state constitutional or statutory provisions that bar public employers from taking back or reducing system benefits, once they have been established. We believe, therefore, it was not unreasonable for our organizations to request the IRS not attempt to create standardized definitions for early or normal retirement age with regard to governmental plans, but instead defer to the applicable state or local laws, regulations and policies governing the plan.

Governmental pension plan sponsors have, for many decades, conditioned eligibility for normal retirement benefits on the completion of a stated number of years of service. Many such plans have defined normal retirement age as the time the participant becomes eligible for normal retirement. Prior to the Final Regulations, there was no authority that prohibited such a practice, at least for governmental pension plans. Moreover, the Internal Revenue Service has routinely approved service-based normal retirement ages through the determination letter process. Governmental pension plan sponsors have, in turn, relied on favorable determination letters, and the participants' rights attendant on the satisfaction of service-based normal retirement ages have become protected by constitutional guarantees.

Clearly, prohibiting service-based normal retirement ages in governmental pension plans will require plan amendments that, in many cases, will conflict with constitutional guarantees. Even changes that do not impact such guarantees will require action by state legislators and other public officials.

We appreciate the opportunity to provide comments on this very significant issue. If you have any questions, please do not hesitate to contact us.

Very truly yours,

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National Conference of State Legislatures (NCSL)
American Federation of State, County and Municipal Employees (AFSCME)
National Association of Counties (NACo)
American Federation of Teachers (AFT)
United States Conference of Mayors (USCM)
Fraternal Order of Police (FOP)
International Brotherhood of Teamsters (IBT)
National League of Cities (NLC)
International Association of Fire Fighters (IAFF)
International City/County Management Association (ICMA)
National Education Association (NEA)
National Association of State Auditors Comptrollers and Treasurers (NASACT)
National Association of Police Organizations (NAPO)
National Association of State Treasurers (NAST)
Government Finance Officers Association (GFOA)
International Public Management Association for Human Resources (IPMA-HR)
National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)
National Association of Government Defined Contribution Administrators (NAGDCA)
National Public Employer Labor Relations Association (NPELRA)
National Conference of State Social Security Administrators (NCSSSA)
Service Employees International Union (SEIU)

February 22, 2008

The Honorable George Miller
Chairman, Committee on Education & Labor
U.S. House of Representatives
Washington, DC 20515

RE: Needed Technical Correction for Public Employee Pensions

Dear Mr. Chairman:

On behalf of the twenty-one national organizations listed above—representing state and local governments and officials, public employee unions, public retirement systems, and more than 20 million state and local government employees, retirees, and their beneficiaries—we are writing to request your assistance in making a needed technical correction to the Pension Protection Act (PPA) of 2006 to ensure restrictions aimed at issues in the ERISA plan setting do not impose benefit cuts on employees in governmental defined benefit plans. Specifically, we strongly support a needed statutory clarification to ensure rates of interest established by or in accordance with State or local laws are treated as permissible methods of crediting interest.

At issue is a requirement in the PPA stipulating that in order to comply with age discrimination laws the rate of interest used by a defined benefit plan can be **no greater** than a "market rate of return." This cap is aimed at issues that arise under ERISA. In the public plan setting – where benefit protections and plan designs are quite different – the application of an interest rate cap would cut employee benefits, may actually conflict with State and local benefit guarantees, and also undermine efforts to preserve underlying defined benefit features.

Most governmental pension plans credit interest in some fashion, whether on refunds of contributions, deferred retirement option plans (DROPs), survivor benefits, or other optional forms of benefit common in public sector plans. These plan features are set through public law to achieve different objectives. In some cases, the structure was designed to protect public plan participants from the ravages of inflation or downside investment risk, in others to allow members to share in the investment gains of the plan. Many apply solely to optional ancillary provisions added to provide flexibility or accommodate the needs of short-service employees while safeguarding the traditional pension as the primary plan benefit. Nevertheless, State statutes and/or local ordinances guaranteeing numerous types of interest credit, including set, underlying or minimum rates of return, could be in excess of a new federal limitation in any particular year.

It is our understanding that PPA technical corrections legislation may soon be considered. We strongly urge your support of including a statutory clarification to ensure rates of interest guaranteed under State and local governmental plans are not in conflict with new federal requirements.

Attached is a one-page summary of the issue. If you have any questions or need additional information, please do not hesitate to contact the legislative representatives of our organizations:

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Allison Reardon, SEIU, 202-898-3200

Impact of PPA's Interest Credit Limitations on Public Employee Plans

Restrictions in the Pension Protection Act (PPA) of 2006, Aimed at ERISA Plan Issues, Could Conflict with State and Local Government Employee Benefit Guarantees and Protections

Most Public DB Plans Credit Interest in Some Fashion. The current statutory definition of an "applicable defined benefit plan" subject to the limitations set forth in the PPA is being interpreted to cover numerous traditional DB plans with features and options that provide interest crediting. Treasury has indicated this would likely apply to long-standing public pension plan designs not subject to interest rate requirements under ERISA, including the vast majority of traditional public DB plans that credit interest on **refunds of contributions,** provide interest-bearing deferred retirement option plans **(DROPs), survivor benefits,** or other **optional forms of benefit** common in public sector plans that make these arrangements more attractive to public workers. These plan features have been adopted in open public legislative processes that included significant employee participation and in many cases were promoted by the employee groups themselves.

Cap on Interest Rates Could Conflict with State Guarantees and Efforts to Preserve Underlying Defined Benefit Features. The PPA stipulates that in order comply with age discrimination laws the rate of interest used by an applicable defined benefit plan must be ***no greater*** than a "market rate of return." State statutes and/or local ordinances guarantee numerous types of interest credit, including set, underlying or minimum rates of return that could be in excess of this new federal limitation in any particular year. State and local interest rate structures are set through public law to achieve different objectives. In some cases, the structure was designed to protect public plan participants from the ravages of inflation or downside investment risk, in others to allow members to share in the investment gains of the plan. Many apply solely to optional ancillary provisions added to provide flexibility or accommodate the needs of short-service employees while safeguarding the traditional pension as the primary plan benefit.

State and Local Protections Already Exist. State and local government constitutional, statutory, contractual and/or case law would generally prohibit conversions of traditional DB plans to cash balance or any other plan design, as most public employees are not only guaranteed what they have earned to date, but their future accruals are safeguarded as well. Such protections mean that any changes in the pension design are prospective only – applying solely to the way benefits will be provided to future employees.

Cross-Reference to Inapplicable Federal Laws Presents a Catch-22. Most of the cash balance and hybrid plan provisions of the PPA amend parts of the Internal Revenue Code (IRC) and ERISA from which governmental plans are exempt. The legislation's modification to the Age Discrimination in Employment Act (ADEA), however, applies to private and public sector plans alike yet cross-references definitions in ERISA and parts of the IRC inapplicable to public sector plans. Because public plans are not subject to these cross-referenced sections of the Code and ERISA, Treasury's conforming regulations to these sections cannot make special accommodations for the specific designs and protections inherent in State and local government plans. Furthermore, since the Equal Employment Opportunity Commission (EEOC), which implements ADEA, is required by law to use the IRC definitions, this agency also cannot provide such relief. In short, even if Treasury or EEOC were to agree that a problem exists, neither agency appears to believe it has regulatory authority to deal with it.

Clarification Needed. The unique protections and plan designs inherent in State and local government retirement systems cannot be accommodated in regulations written for parts of the IRC and ERISA inapplicable to the public sector. A statutory clarification is needed to ensure rates of interest provided by State or local governmental plans in accordance with a statute, ordinance, administrative procedure, collective bargaining agreement or other public process, are treated as permissible methods of crediting interest under the PPA.

Code Section 415 Compliance for Governmental Plans

An ongoing audit of the Missouri State Employees' Retirement System (MOSERS) was initiated by the Internal Revenue Service in July 2006. After spending hundreds of hours of staff time and thousands of dollars in retirement system legal fees (not to mention the time and expense incurred by the IRS), their findings have boiled down to one issue regarding which they are at an impasse. Specifically, it has to do with the application of section 415 of the Internal Revenue Code (IRC) to State and local government retirement systems.

Ironically, in the unlikely event that MOSERS were to agree with the position of the IRS, the only thing that would happen would be substantial complications to their accounting system. There would be no change in the amount of the benefits they pay, no change in the tax status of the benefits they pay, and no change in the taxes collected by the Federal government on those benefits. In other words, this protracted exercise and use of retirement system resources and Federal taxpayer money has resulted in no discernable benefit to any party. (It is also worth noting that of the 27,000 plus benefit recipients of MOSERS, only one case was identified in which the IRS maintains MOSERS is not in compliance and MOSERS disagrees with that finding.)

Based on observations at an April 22, 2008 meeting hosted by the IRS to address their new interest in public employee retirement system issues, there is the distinct impression that, left unchecked, the MOSERS' experience will be repeated at governmental plans throughout the country.

IRS regulations pertaining to traditional pension programs were generally developed to keep corporate executives from constructing unreasonable tax shelters. The application of Section 415 in the public plan environment is a tough fit at best and just one example among many regarding lack of information available from the IRS with regard to how Federal tax code requirements should be specifically applied in the public plan setting. Thus, it is quite unsettling that the IRS is attempting to increase enforcement actions in this area without first soliciting input on and developing needed guidance.

During the April 22nd meeting with representatives of the IRS, it was noted that there are many provisions of the IRC which are obviously in need of clarification regarding their application to governmental pension plans. It was further suggested that a working group of plan representatives be established to cooperate with the IRS to identify these areas and needed guidance or modifications. A lead spokesperson for the IRS at the meeting stated that these are matters of policy and they do not get involved with policy.

Accordingly, assistance is likely needed from Congressional policymakers in ensuring the taxpayers of Missouri, whose State pension plan is being audited by federal regulators absent appropriate guidance, will not be penalized beyond the enormous expenditures already incurred. Furthermore, the IRS should delay further enforcement actions against State and local retirement systems until compliance guidance specific to governmental plans is developed with proper input from State and local legislative bodies and executive agencies, as well as public plan participant groups. Finally, where guidance cannot be developed absent corrective amendments to the IRC, Congressional assistance may be needed on legislative changes to make the Internal Revenue Code more workable for governmental plans.