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CORRESPONDENCE MEMORANDUM

DATE: September 7, 2006

TO: Employee Trust Funds Board
Teachers Retirement Board
Wisconsin Retirement Board

FROM: Bob Conlin, Director of Legislation, Communications and Planning
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SUBJECT: Federal Legislative Report

Pension Protection Act of 2006

On August 17, 2006, President Bush signed into law the much-anticipated pension reform legislation that had been working its way through Congress for more than a year. The Pension Protection Act of 2006 (PPA), which was signed into law as Public Law 109-280, makes numerous changes in federal laws governing pensions. Although the Act primarily addresses private sector pensions, it also includes a number of provisions that will have an effect on public plans. Some of the more significant of those changes are summarized below:

- EGTRRA Permanency. The Economic Growth and Tax Reconciliation Relief Act of 2001 (EGTRRA) contained a number of provisions that were geared towards enhancing retirement savings for Americans. For example, EGTRRA increased the limits on contributions, benefits, and compensation under qualified retirement plans, tax-sheltered annuities, and deferred compensation plans. It also contained provisions for "catch up" contributions for those nearing retirement, hardship withdrawals, and purchase of service credit under governmental pension plans. When EGTRRA passed, it contained a sunset provision required by federal budgeting rules. Under that sunset provision, the majority of EGTRRA's enhanced pension and savings provisions were set to expire at the end of 2010.

  The PPA repealed the sunset provision, effectively making these enhanced provisions of EGTRRA permanent.

- Removal of Early Distribution Penalty for Public Safety Employees. Prior to enactment of the PPA, a distribution from a qualified retirement plan prior to age 59 ½, death, or disability, was subjected to a 10% early withdrawal penalty. This penalty was imposed unless certain exceptions were met. For example, the penalty does not apply to persons who separate from service after the age of 55, or to distributions in the form of periodic payments.

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The PPA provides that the 10% early withdrawal penalty additionally does not apply to distributions from public pension plans that are made to “public safety employees” separating from service after age 50. For purposes of this provision, a public safety employee is considered an employee of a state or political subdivision of a state if the employee provides police protection, firefighting services, or emergency medical services within the state or political subdivision.

- Public Safety Officer Withdrawals for Health and Long Term Care. Prior to the PPA, distributions from a qualified government pension plan, a 403(b) plan, and a 457 plan were included in income for federal tax purposes in the year in which the distributions were made.

  The PPA provides that deductions from distributions from such plans to pay for health or long term care insurance premiums for eligible retired public safety officers are excludable from income, up to $3,000 per year. Under the PPA, an eligible retired public safety officer is a law enforcement officer, a firefighter, a chaplain, or a member of a rescue squad or ambulance crew who, by reason of disability or attainment of normal retirement age, separated from service as a public safety officer. This provision becomes effective January 1, 2007.

- Tribal Pension Plans. Prior to adoption of the PPA, tribal pension plans had been considered to be governmental plans by the Internal Revenue Service (IRS). Recently, the IRS began reconsidering its position on tribal plans. Loss of governmental plan status would have subjected tribal plans to the federal pension requirements of the Employee Retirement Income Security Act (ERISA).

  The PPA provides that pension plans established and maintained by tribal governments are considered to be governmental plans and, therefore, not subject to ERISA. Qualified employees of these plans are those who perform “essential governmental services”, not commercial activities.

- Minimum Distribution Rules. Prior to adoption of the PPA, qualified pension plans had to meet certain minimum distribution requirements. Proposed Treasury regulations interpreting these requirements would have jeopardized certain post-retirement adjustments made to pension payments, like the post-retirement increases based on investment returns used by the Wisconsin Retirement System (WRS).

  The PPA requires the Secretary of the Treasury to issue regulations, under which a governmental plan is treated as complying with the minimum distribution requirements, if the plan complies with a reasonable, good faith interpretation of the statutory requirements. The intent of the PPA was for these regulations to apply for periods before the date of enactment of the PPA. This provision will allow the WRS to maintain its post-retirement, investment-based adjustments.

Additional Federal Scrutiny of Public Pension Plans

As negotiations on the PPA were winding down, two prominent U.S. Senators, Charles Grassley (R-Iowa) and Max Baucus (D-Montana), the Chair and Ranking Member of the Senate Finance Committee, sent a letter to the Government Accountability Office (GAO). The letter noted that public pension systems lack federal oversight, have no back-up source for guaranteed benefit payments, and are underfunded. The letter requested that the GAO study the fiscal and other challenges facing state and local public pension plans. Among other things, the request specifically asked the GAO to look at the following:

- The general financial health of state and local government defined benefit pension plans and how it has changed over the last decade.

- The prevalence of retiree health benefits by state and local government employers, the cost of that coverage, and the funded status of such retiree health plans.

- The effect recent accounting changes will have on the funding and transparency of these plans.

- The implications for state and local government employee retirement security based on these pension and other benefit funding trends.

In response to this request, a number of national groups, like the National Association of State Retirement Administrators (NASRA), the National Council on Teachers Retirement (NCTR), and the National Conference on Public Employee Retirement Systems (NCPERS), sent letters to the Senators challenging many of the underlying assumptions cited in the GAO study request and encouraging the GAO to take a fair and unbiased look at public pension systems. The Department of Employee Trust Funds (ETF) also sent a letter to the Senators. A copy of that letter is attached.

It is likely that the GAO study will focus additional public attention on public pension plans and public employees and retiree benefits around the country. It may also encourage Congress to become more involved in the regulation of state and local public pension plans. ETF will keep you posted on any developments in this area.

National Education Campaign

To help educate the public and lawmakers at the national level about the importance and vitality of public pensions, NASRA, NCTR, and the Council of Institutional Investors have embarked on an organized national education campaign. To help with this project, the organizations have hired Kelly Kenneally, an experienced communications and public relations professional with more than 15 years of experience in the field. The stated goal of this project is to proactively and strategically communicate with key national audiences to build broad awareness and understanding of the facts and benefits of public and private sector defined benefit pension plans. This effort will also be a valuable resource for state and local pension plans to use as they create and refine their own educational efforts at the state and local levels.

Attachment