

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)
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)
Service Employees International Union (SEIU)

November 1, 2007

The Honorable Charles Rangel
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

RE: Request for Public Comment on H.R. 3361, a bill to make technical corrections to the
“Pension Protection Act of 2006”

Dear Mr. Chairman:

On behalf of the twenty 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 strongly urge the Committee to include language in the Pension Protection Technical Corrections Act of 2007 (H.R. 3361) to ensure restrictions aimed at plan conversions and design issues in the ERISA plan setting do not adversely impact the benefits that are provided to employees in governmental defined benefit plans. Specifically, we strongly support a needed statutory clarification to ensure rates of interest provided by a State or local government defined benefit plan in accordance with a statute, ordinance, administrative procedure, collective bargaining agreement or other public process, are treated as permissible methods of crediting interest. We are forwarding language to provide a needed technical correction to ensure this, and hope you will give it strong consideration for inclusion in your legislation.

At issue is a requirement in the Pension Protection Act of 2006, which stipulates 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 may actually conflict with State and local benefit guarantees and 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.

Thus, we strongly urge you to include a statutory clarification in the Pension Protection Technical Corrections Act of 2007 (H.R. 3361) to ensure rates of interest guaranteed under State or local governmental plans are not in conflict with new federal requirements. Attached is a one-page summary of the issue along with suggested legislative language we hope will be included in legislation soon to come before your Committee. 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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Susan White, NAGDCA, (703) 683-2573
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Attachments (2)

(c) AMENDMENTS TO AGE DISCRIMINATION IN EMPLOYMENT

ACT.—Section 4(i) of the Age Discrimination in Employment Act of 1967 (29 U.S.C. 623(i)) is amended by adding at the end the following new paragraph:

“(10) SPECIAL RULES RELATING TO AGE.—

“(A) COMPARISON TO SIMILARLY SITUATED YOUNGER INDIVIDUAL.—

“(i) IN GENERAL.—A plan shall not be treated as failing to meet the requirements of paragraph (1) if a participant’s accrued benefit, as determined as of any date under the terms of the plan, would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant.

“(ii) SIMILARLY SITUATED.—For purposes of this subparagraph, a participant is similarly situated to any other individual if such participant is identical to such other individual in every respect (including period of service, compensation, position, date of hire, work history, and any other respect) except for age.

“(iii) DISREGARD OF SUBSIDIZED EARLY RETIREMENT BENEFITS.—In determining the accrued benefit as of any date for purposes of this clause, the subsidized portion of any early retirement benefit or retirementtype subsidy shall be disregarded.

“(iv) ACCRUED BENEFIT.—For purposes of this subparagraph, the accrued benefit may, under the terms of the plan, be expressed as an annuity payable at normal retirement age, the balance of a hypothetical account, or the current value of the accumulated percentage of the employee’s final average compensation.

“(B) APPLICABLE DEFINED BENEFIT PLANS.—

“(i) INTEREST CREDITS.—

“(I) IN GENERAL.—An applicable defined benefit Plan shall be treated as failing to meet the requirements of paragraph (1) unless the terms of the plan provide that any interest credit (or an equivalent amount) for any plan year shall be at a rate which is not greater than a market rate of return. A plan shall not be treated as failing to meet the requirements of this subclause merely because the plan provides for a reasonable minimum guaranteed rate of return or for a rate of return that is equal to the greater of a fixed or variable rate of return.

“(II) PRESERVATION OF CAPITAL.—An interest credit (or an equivalent amount) of less than zero shall in no event result in the account balance or similar amount being less than the aggregate amount of contributions credited to the account.

“(III) MARKET RATE OF RETURN.—The Secretary of the Treasury may provide by regulation for rules governing the calculation of a market rate of return for purposes of subclause (I) and for permissible methods of crediting interest to the account (including fixed or variable interest rates) resulting in effective rates of return meeting the requirements of subclause (I). For governmental plans as defined in the first sentence of Section 414(d) of the Internal Revenue Code, rates of interest that are established by or in accordance with a statute, ordinance, administrative procedure, collective bargaining agreement or other public process, shall be treated as market rates of return calculated pursuant to a permissible method of crediting interest under this clause.

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

Existing State and local protections of pension benefit accruals generally do not permit converting public employees' benefits from one plan design to another. However, restrictions in the Pension Protection Act (PPA) of 2006 aimed at such conversions and design issues in the ERISA plan setting could adversely impact many employees in governmental plans by limiting the amount of interest credit that may be provided in all defined benefit plans.

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 not only cash balance conversions, but also numerous traditional DB plans with features and options that provide interest crediting. Treasury has indicated this would likely apply to long-standing public hybrid plans not subject to interest rate requirements under ERISA, as well as 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 to 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.