



Memorandum

CITY OF HENDERSON
240 Water Street
P.O. Box 95050
Henderson, NV 89009-5050

CITY MANAGER'S OFFICE
Mary Kay Peck, City Manager
702-267-2080
fax 702-267-2081

TO: Terri Barber, Intergovernmental Relations Director

FROM: Santana Garcia, Intergovernmental Relations Specialist

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SUBJECT: IRS Final Regulation on Definition of Normal Retirement Age – UPDATED

This is a briefing paper describing the IRS's final regulation to *amend the definition of normal retirement age*, which significantly affects Nevada's Public Employees' Retirement System (PERS). I've written this to be basic and easy to digest; it does not contain all of the nuances such a regulation evokes. The City's financial consultant, Marvin Leavitt, has reviewed this paper and provided some additional insight on the topic.

What is "Treasury Regulations Section 1.401(a)-1(b)(the "Final Regulations")?"

This is the IRS's final regulation that basically redefines "normal retirement age" when a participant (or retiree) is eligible to receive retirement pay within plans in state and local governments. They went into effect May 22, 2007 and are supposed to begin affecting plans July 1, 2008 or January 1, 2009, depending upon the plan.

How does the City of Henderson/PERS define "normal retirement age?"

The City/PERS currently defines normal retirement age as the earlier of a fixed age or the completion of a lengthy period of service. In other words, a retiree is eligible for unreduced retirement benefits as follows:

Eligibility for Monthly Unreduced Retirement Benefits for Regular Members

Years of Service	Age
5	65
10	60
30	Any age

Eligibility for Monthly Unreduced Retirement Benefits for Police and Fire Members

Years of Service	Age
5	65
10	55
20	50
25	Any age
30	Any age

How exactly does this regulation affect the City of Henderson?

Firstly, it doesn't affect just Henderson, but every local jurisdiction that participates in PERS, including the State. What this regulation does is effectively erase the tables you see above and would require retirement benefits be given to retirees based on age only; *length of service no longer applies*. Basically, the IRS wants retirees to receive benefits between the ages of 55 to 62. A plan completely complies with the IRS regulations if retirees don't receive benefits until they reach age 62. But if you want participants to receive benefits before they reach age 62, and no earlier than age 55, the plan administrator must prove that such an age range is reasonably representative of the industry in which the covered workforce is employed.

What is the IRS's impetus for such a change?

The short answer is: the IRS believes that normal retirement age less than age 55 is not reasonable. For the past couple of years, the IRS has researched this issue and most plan administrators across the country have asserted that normal retirement age under their plans is the typical retirement age for the industry in which the covered workforce is employed, even though it is possible for participants to attain the normal retirement age as early as age 47 (i.e. 30 years of service beginning at the job at age 17). Some in Nevada speculate that this irks the IRS because such a scenario, when multiplied out by many employees, could harm the solvency of such plans down the road. There is also speculation that the IRS is irked by what are known as "Drop Plans." These are plans that allow a participant to continue working beyond the stated retirement age of their plan, say 55, and, upon retiring at say 60, a participant expects to not only collect all the contributions made on their behalf after age 55, but also the income earned on those contributions – all in a lump sum payment. So this is viewed as an unwarranted windfall. But Drop Plans do not exist in Nevada.

When was this regulation first contemplated and what did Nevada PERS think?

The IRS began this regulation about two or three years ago. For that entire time, PERS has been vehemently opposing it in conjunction with national groups across the country as follows:

- 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)

What are PERS and these groups doing about this right now?

As stated earlier, everyone has been fighting such regulation since it was first discussed. A letter dated April 30, 2008 was sent to the IRS from the groups listed above requesting an extension of the effective date of the 2007 regulation, which is currently July 1, 2008. Specifically, the letter contends that "...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." In short, the letter asks the IRS to delay the implementation until many difficult questions can be answered and give state and local governments time to respond (e.g. preparing tiered plans or something similar) so as to avoid the precarious position of being out of compliance with the IRS or, risk the financial liabilities from violating their own state statutes or protections from court cases, etc. Several years ago, the Nevada Legislature made some changes to PERS. The changes were challenged in federal court and the State lost. The ruling said that you can't make changes to a retirement plan that can have a detrimental effect on plan participants – the Nevada Legislature basically violated the Contracts Clause. In other words, the moment an employee comes into the PERS system, a contract is entered into and the employee has a guaranteed right to benefits and you can't suddenly diminish them. As far as we know, the IRS to date has not officially responded to the April 30 letter even though they seem determined to move forward with this regulation.

What else is being done about this?

Nevada PERS administrators have indicated that the list of national groups are seeking Congressional action from the leadership of the tax writing committees in both the House and the Senate, which have jurisdiction over the IRS. Letters are being drafted to the Secretary of the Treasury and the head of IRS accusing the IRS of overstepping its bounds, indicating that Congress never intended to give the IRS such authority, and asking the IRS to pull back these regulations. When Congress returns from recess on September 8 these letters will be circulated for Members to sign on. We will want to seek the participation of the whole Nevada delegation.

What does the Finance Department think?

Per Carol Turner:

"Finance has reviewed the IRS Final regulation and contacted PERS for its position. Finance believes the City needs to actively support the requests to delay the implementation of the

regulation. Finance has prepared the following two paragraphs to summarize its position (dated July 21, 2008):

The City of Henderson supports PERS, National League of Cities, NACO, etc. in asking the IRS to delay implementation so that more discussions can take place reference the impact of the IRS Final Regulation on government pension plans. At issue is the IRS requirement for government pension plans to set a Normal Retirement Age that does not include years of service in the calculation.

At this time, Nevada PERS members are allowed to retire with unreduced benefits at age 60 with 10 years of service or any age with 30 years of service. Neither of these calculations would meet the "safe harbor" of a normal retirement age of 62 established by the IRS. The City takes the same issue with the City's public safety retirement calculations not meeting the "safe harbor" of age 50. At this time, PERS believes the pension plan and its members will be impacted, but the fiscal impact is not yet known.

Here is some more information on how the regulation may impact the PERS retirement calculations. An email from PERS Executive Officer states that PERS has not determined the full impact the implementation would have or how PERS would respond. It is not easy for the City to estimate what the impacts may be but Finance wanted to reflect some alternatives so that the City could better understand the impact of a "normal retirement age":

- Option one, PERS may be able to "justify" to the IRS a lower than 62 normal retirement age, but the fact that people can retire as young as 43 (25 years of service with 5 purchased years) means some City employees would still be impacted.
- A second alternative would be to not make any calculation changes which will require all members to work until age 62 for unreduced benefits. Members reaching the 75% maximum calculation younger than age 62 would then need to decide whether to continue to work with a PERS entity for no additional credit or to take a reduced retirement amount (4% reduction for each year younger than 62).
- A third alternative would be to allow all employees to work until 62 and to earn an unlimited amount of credit.

These are not the only options available to PERS but it reflects that many of the options will have fiscal impacts on the plan as well as greatly impact the retirement decisions of our employees."

What does the City Attorney's Office think?

Per Andrew J. Urban, Esq:

"The regulation has a delayed effective date for local government pension plans. Initially I agreed with Marvin and you that the delayed effective date was January 1, 2009. However, I

have reread the effective date language several times and I have come to the conclusion that the effective date for NV PERS is not January 1, 2009 but July 1, 2009. This would allow the state legislature to make plan revisions so the plan comes into compliance with the new regulations.

Here is the language on Effective Dates. I have highlighted the sentence that I think supports the July 1, 2009 date:

Effective Dates

These regulations are generally applicable May 22, 2007. **In the case of a governmental plan (as defined in section 414(d)), these regulations apply with respect to plan years beginning on or after January 1, 2009.** In the case of a plan maintained pursuant to one or more collective bargaining agreements that have been ratified and are in effect on May 22, 2007, these regulations do not apply before the first plan year that begins after the last of the agreements terminates determined without regard to any extension thereof (or, if earlier, May 24, 2010).

Based on a review of NRS Chapter 286 it appears that the PERS plan year starts on July 1st and runs to June 30th (our fiscal year not a calendar year). I did not find anything specific in the statutes to support this but all changes in benefits go into effect on July 1st and PERS credits service to member accounts on a fiscal year basis. I assume a call to PERS would confirm this.

As I write this we are in plan/fiscal year 2009. Therefore based on the plain language of the above section the effective date of this new regulation for NV is the start of the next plan year after January 1, 2009 which I contend is July 1, 2009.

This will give employees that are planning to retire using the 30 year and any age provision additional time to determine their options, purchase additional time if necessary or just to firm up their retire plan.”

So what happens next?

When the Congress returns the week of September 8, letters will circulate in both the House and the Senate asking IRS to pull back these regulations. We will ask the Members of the Nevada delegation to sign on to these letters and do whatever else they can to stop this regulation from being implemented in January 2009. During the current recess this issue should be discussed in any meetings with legislators or their staffs. At the state level, legislatively-speaking, we need to keep abreast of any changes PERS is contemplating to propose during the 2009 Session. Should the congressional appeal not succeed, or the April 30 letter asking for an extension not succeed as well, I'm sure PERS will have to prepare BDRs to come into compliance. Also, if PERS must choose between several options, we'll definitely want to have a seat at that table. We could also begin talks with the unions to see where they are on this.

It's also important to note that since this regulation was adopted on May 22, 2007, PERS had no realistic chance to submit a BDR in the 2007 Session since the issue was still well up in the air. So it would make sense that the IRS regulation would take into consideration those states whose legislatures don't meet every year – but they don't.

Again, I've attempted to condense this topic down. Rather than weigh it down with lengthy attachments, please contact me if you would like the background materials.

SG