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ADDITIONAL INFORMATION REGARDING PROPOSED ERB RULE 5.16 - TERMINATION OF PLAN; ACCRUED RIGHTS OF MEMBERS PUBLIC COMMENT PERIOD

February 21, 2013 through March 23, 2013

The Educational Retirement Board (the "ERB") has received a number of inquiries regarding: (1) whether the proposed Rule 5.16 indicates either an intention to terminate the ERB defined benefit plan (a/k/a, the "regular plan") or for employees and employers to cease making contributions to the plan and (2) why adoption of proposed Rule 5.16 is required.

The ERB wants to reiterate that there is <u>no</u> current plan or intention to either terminate the ERB defined benefit plan or for employees and employers to cease making contributions to the plan. As stated in the notice on the ERB web site, the proposed rule does not imply that the ERB or the New Mexico Legislature are considering terminating the ERB defined benefit plan or completely discontinuing contributions to it.

The ERB is proposing the draft rule for adoption in order to comply with IRS requirements governing public pension plans such as the ERB defined benefit plan. The IRS requires public pension plans to include the proposed language in order for the IRS to issue a "determination letter" stating that the plan meets federal tax requirements.

Although the ERB defined benefit plan is a state pension plan, the plan must comply with IRS requirements in order to maintain its tax-favored status. The ERB's tax-favored status is what allows member contributions to the defined benefit plan to be exempt from taxation. Instead of paying taxes on contributions, a member pays taxes only on the annuity that the member receives after retirement or if the member takes a refund[1] of contributions after terminating employment. The defined benefit plan's tax-favored status also allows the investments of the educational retirement fund to grow without being subject to taxation. It is the growth of the fund through

[1] A refund occurs when a former member asks the ERB to pay that member's contributions directly to the member rather than "rolling" the contributions over to another tax-favored retirement fund or to an Individual Retirement Account ("IRA").

investment earnings, together with member and employer contributions, that allows the ERB to pay retirement annuities to the members and their beneficiaries.

Treasury Regulation 26 CFR 1.401-6 establishes a framework for public pension plans to follow in vesting employees who were not vested if a defined benefit pension plan is ever terminated or if all contributions to the plan were halted. The proposed ERB Rule 5.16, and through the proposed rule, the Treasury Regulation, would not apply to members of a pension plan who were vested at the time that the plan was terminated or all contributions to the plan were halted, if such events were to occur.

In the ERB's case, the extent of funding on the date of termination would be determined by a process of allocating plan assets (i.e., the assets of the educational retirement fund at that date) to accrued benefits. The Treasury Regulation does not set out a method of allocating plan assets to accrued benefits. Other IRS guidance, however, indicates that an allocation method that satisfies ERISA[2] requirements may be used to allocate assets in a partial termination. ERISA is the federal statute which sets out minimum requirements or standards for actions taken by private industry pension plans. ERISA requirements or standards are frequently used as guidance or references for public sector defined benefit plans. In response to some of the comments received, the ERB is providing the following example drawn from ERISA-based requirements of how a distribution of plan assets could be carried out if there ever were a plan termination or cessation of contributions.

Under a distribution plan based on ERISA requirements, assets would be allocated first to benefits attributable to employee contributions, then second to certain benefits of participants who had retired or could have retired as of the first day of a three year period that would end on the date that the plan actually had been terminated.[3] After the first and second distributions, assets would then be distributed to all other vested benefits. Fourth and finally, assets would be distributed to all remaining benefits under the plan. Under this allocation method, non-vested benefits would be in this final distribution category. In other words, vesting "to the extent funded" generally means that only if there were assets remaining after assets were used to support the benefits of all the members already vested at the time the plan was terminated would the remaining assets be distributed to members who were not vested at the time the plan was terminated, if such an event ever were to happen.

It is important to note again that the proposed rule is not being proposed to address a planned or proposed termination of the plan or cessation of contributions. The New Mexico legislature is not currently considering any proposals to terminate the defined benefit plan nor is it considering any proposals to stop employee or employer contributions from being made to the plan. As noted above, the IRS has required the ERB to adopt the proposed rule as a condition of the IRS issuing the ERB a favorable determination letter. Again, as outlined above, that determination letter allows the ERB to maintain its tax-favor status, a status that benefits all members, both active and retired, of the ERB defined benefit plan. The ERB is proposing to adopt the rule solely to comply

[2] Employee Retirement Income Security Act of 1974, Public Law No. 93-406, codified in part at 29 USCS § 1002 *et seq.*

[3] This example omits a distribution that a private industry pension plan would have to make to the Pension Benefit Guaranty Corporation, which provides a partial guaranty or 'insurance' of certain private pension plan benefits.

with IRS requirements concerning language that must be in the plan to maintain the plan’s tax-favored status.