**S.F. xxx****H.F. 2588**
(Dittrich)**Executive Summary of Commission Staff Materials**

Affected Pension Plan(s): PERA-General
Relevant Provisions of Law: Special Law Provision
General Nature of Proposal: Reopening Retirement Annuity Form Election
Date of Summary: January 27, 2006

Specific Proposed Changes

- Permits Stephen Schoch to elect a joint and survivor optional annuity form instead of the single life annuity form initially elected

Policy Issues Raised by the Proposed Legislation

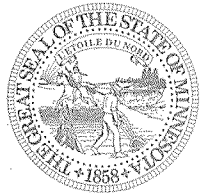
1. Appropriateness of the proposed special authority as contrary to general commission policy.
2. Equitable considerations favoring or disfavoring the requested optional annuity change.
3. Appropriateness of the proposed special authority in the light of an available alternative.
4. Appropriate manner of recouping the benefit amount differential.
5. Lack of specificity on the optional annuity form for the spouse.
6. Lack of any expiration date on the special legislation.
7. Precedent.

Potential Amendments

LCPR-H2588-A1 Makes various clarifications and stylistic revisions (Technical)

LCPR-H2588-A2 Requires joint and survivor optional annuity election to cover the spouse. (Substantive)

LCPR-H2588-A3 Provides an expiration date for the special legislation. (Substantive)



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director *jam*

RE: S.F. xxx; H.F. 2588 (Dittrich): PERA-General; Authorizing a Post-Retirement Optional Retirement Annuity Election

DATE: January 27, 2006

Summary of S.F. xxx; H.F. 2588 (Dittrich)

S.F. xxx; H.F. 2588 (Dittrich) would permit Stephen Schoch, described as the sole intended member of a class, to reverse his prior election of a single life annuity from the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) and to select a joint and survivor optional annuity form upon the payment of the difference between the single life annuity amount from December 2004 to date and the joint and survivor annuity amount from December 2004 to date. The election must be made within 60 days of the effective date of the provision.

Public Pension Problem of Stephen Schoch

Stephen Schoch of Champlin, Minnesota, was a Human Services Representative II employed by Hennepin County for 24 years who took a General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) disability benefit on September 1, 2004, suffering from Stage III congestive heart failure. When Mr. Schoch terminated his employment on account of his heart condition, he also applied for a Social Security disability benefit. Mr. Schoch's Social Security disability benefit application was not processed when he applied for his PERA-General disability benefit. Mr. Schoch elected to take a single life annuity from PERA-General on December 1, 2004.

Mr. Schoch indicates that he would have taken a joint and survivor optional annuity form from PERA-General, covering his wife, who suffers from a traumatic brain injury, if he had known that his Social Security disability benefit application was approved, which occurred on January 15, 2005, after his PERA-General disability benefit began.

Based on the extenuating circumstances that surrounded his original decision, Mr. Schoch is requesting the special authority to reverse his original single life annuity election and to now select a joint and survivor optional annuity form, presumably with his wife as the second covered life.

Background Information on Minnesota Public Pension Plan Optional Retirement Annuity Forms

Background information on optional retirement annuity forms provided by Minnesota public pension plans is set forth in Attachment A.

Discussion and Analysis

S.F. xxx; H.F. 2588 (Dittrich) permits Stephen Schoch, as the sole intended member of a described class, to revoke his election of a single life annuity form of a disability benefit from the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) and to elect a PERA-General joint and survivor optional annuity.

The potential proposed legislation raises several pension and related public policy issues for possible consideration and discussion by the Legislative Commission on Pensions and Retirement, as follows:

1. Appropriateness of the Proposed Special Authority as Contrary to General Commission Policy. The policy issue is the appropriateness of the proposed special optional annuity election modification authority in light of the Commission's general policy principle against optional annuity changes. Principle II.C.13 of the Commission's Principles of Pension Policy, last substantively revised in 1995-1996, indicates that "[r]eopenings of optional annuity elections should not be permitted." Optional annuity elections generally involve actuarial liabilities and legal rights created in another person. The optional annuity form is calculated to have the same actuarial present value (i.e., pension liability) as the single life annuity payable to the plan participant on the effective date of retirement, using the pension plan's post-retirement interest rate actuarial assumption and mortality table, and conveys entitlement to a benefit payout for life or for a period of years upon the death of the plan participant to another person. A change in an optional annuity

form at a later date involves a different present value situation and risk situation and can involve a change in the pension with the eventual benefit entitlement. The Schoch request does involve the present value consideration, occurring after the initial optional annuity selection, but does not involve a third party entitlement consideration, since the change is from a single life annuity, Stephen Schoch's entitlement, to the provision of a portion of that value to another person, his wife. Thus, the impact of the proposal is somewhat less problematic and somewhat less disruptive than the prior optional annuity change proposals that undoubtedly gave rise to the blanket prohibition to optional annuity changes in the policy principle.

2. Equitable Considerations Favoring or Disfavoring the Requested Optional Annuity Change. The policy issue is how compelling any equitable considerations are either favoring or disfavoring the optional annuity change requested by Stephen Schoch. The primary equitable considerations appear to be Mr. and Mrs. Schoch's health problems (Stage III congestive heart failure and traumatic brain injury), the limited financial resources of the Schoch family, and the timing differential between decisions on the existence of Mr. Schoch's disability by PERA and by the federal Old Age, Survivors, and Disability Insurance Program (Social Security). Reportedly, Mr. Schoch's medical condition required that he terminate Hennepin County employment, financial need required that he access disability benefits at an early date and maximize his monthly income, and the longer processing period for his Social Security disability benefit meant that Mr. Schoch had incomplete knowledge when deciding whether or not to take a single life annuity General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) disability benefit. The sole potential disfavoring equitable consideration that the Commission staff can identify is a potential delay by Mr. Schoch in pursuing his Social Security disability benefit. If Mr. Schoch was not as timely as possible in pursuing a Social Security disability benefit, a delay by Social Security in processing his disability benefit application should not be viewed as a favorable equitable consideration. Testimony from Mr. Schoch would clarify the situation.
3. Appropriateness of the Proposed Special Authority in the Light of an Available Alternative. The policy issue is the appropriateness of granting special legislation authority to modify a past optional annuity election if an alternative solution to the problem exists. Stephen Schoch has concerns about his wife's financial situation following his probable early death, since she suffers from a traumatic brain injury, is relatively young, but is unable to be regularly employed. This survivor concern could be addressed by the purchase of term life insurance. The cost of the term life insurance could be competitive with the reduction in the monthly benefit amount from a single life annuity that would be required to take an optional annuity form from the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), depending on the level of the survivor coverage desired. It is unclear whether Mr. Schoch has pursued this line of inquiry. The problem with a potential purchase of term life insurance by Mr. Schoch is the health problems he has and his wife have, which may disqualify him for affordable life insurance. In general, term life insurance, even if affordable, has the administrative disadvantage that it requires prompt and consistent payment of insurance premiums, with any interruption causing a loss of insurance coverage.
4. Appropriate Manner of Recouping the Benefit Amount Differential. The policy issue is the appropriate manner in which the difference between the single life annuity amount and the new optional annuity amount is to be recovered. The potential proposed legislation provides that Stephen Schoch must pay that differential, up front, in a lump sum, when he elects the optional annuity from PERA. Alternatively, the differential amount could be recouped by withholding the benefit for a period of time or by further reducing the benefit amount to recoup the differential amount. PERA may have a preference about the manner in which the differential amount is recouped.
5. Lack of Specificity on the Optional Annuity Form for the Spouse. The policy issue is the appropriateness of the potential special legislation in not limiting any joint and survivor optional annuity to be elected by Mr. Schoch to cover his wife. If the compelling equitable considerations relate to concerns about survivor coverage for Mr. Schoch's wife, it may be appropriate to insure that she is the ultimate beneficiary of any special legislation. **Amendment LCPR-H2588-A2** would limit any authority for Mr. Schoch to elect a joint and survivor optional annuity form to a form that made his wife the second covered life.
6. Lack of Any Expiration Date on the Special Legislation. The policy issue is the appropriateness of not specifying any expiration date on the proposed special legislation. The actuarial liability associated with Mr. Schoch under the special legislation will be the closest to the liability associated with Mr. Schoch on the day he retired, December 1, 2004, the earlier Mr. Schoch utilizes the authority granted under the special legislation. An expiration date would speed the process up. **Amendment LCPR-H2588-A3** would set an expiration date for the special legislation or a date to be determined by the Commission.

7. Precedent. The policy issue is the existence of any past precedent for the requested special legislation and the potential for the requested special legislation, if enacted, to become a binding precedent for further special legislation requests. There is limited prior precedent for special legislation authorizing the change in a joint and survivor optional annuity form, with one special law not recommended by the Legislative Commission on Pensions and Retirement (Laws 1987, Chapter 157, Section 20, relating to the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), allowing a retired member to return to a single life annuity following a divorce) and one special law recommended by the Commission (Laws 1994, chapter 526, relating to PERA-General, allowing a retired member to return to a single life annuity following a divorce where the joint annuitant waived any benefit right). Neither prior special law involved an annuitant who took a single life annuity and who then sought to select an optional annuity form, as the request by Mr. Schoch entails, but both did involve the authorization of the annuity form change. More recently, in 2004 (2004 H.F. 1795 (Swenson); S.F. xxx), requested special legislation for a PERA-General annuitant who sought to change the designated joint annuitant on a joint and survivor optional annuitant following a marriage dissolution. Also, in 2004 (2004 H.F. 2179 (Sertich); S.F. 2229 (Tomassoni) and 2004 H.F. 2178 (Sertich); S.F. 2228 (Tomassoni)), the Commission declined to recommend requests to permit the surviving spouse of a PERA-General annuitant who took a single life annuitant to elect a posthumous optional joint and survivor annuity. The authorization requested by Mr. Schoch, in effect, marries those two failed 2004 bills. Since the Commission has only once recommended this type of special legislation and has not done so since 1994, and more recently rejected special legislation requests that combined both a reversal of an annuity election and the shift from a single life annuity form to a joint and survivor optional annuity form, the recent precedents do not favor the request. The Schoch request, if recommended by the Commission, will likely be a precedent for future annuity form election requests by other individuals.

Technical Amendment LCPR-H2588-A1

Amendment LCPR-H2588-A1 revises the language and style of the potential proposed legislation, adds the appropriate references to the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) optional annuity statute, and clarifies that any elected joint and survivor optional annuity form must be the actuarial equivalent of the single life annuity payable immediately prior to the election.

Background Information on Optional Annuity Forms

Most statewide and major local Minnesota public pension plans provide a retirement annuity in the form of a single life annuity. This means that the retirement annuity is payable solely for the duration of the retired lifetime of the annuitant. To accommodate the needs and desires of annuitants, most major and statewide Minnesota public pension plans have established optional annuity forms.

An optional annuity form allows the annuitant to potentially extend the time period over which an annuity will be paid and to potentially include other recipients. The recipients must be natural persons, rather than legal persons (trusts or corporations), so that there is an actual lifetime over which the value can be predicted. The optional annuity form is typically provided on an actuarial equivalent basis, so the longer period of potential payment or the inclusion of additional recipients is accounted for by a reduced annuity amount. The most typical optional annuity forms are joint and survivor optional annuities or term-certain optional annuities. A joint and survivor optional annuity pays a reduced annuity amount to the annuitant, but upon the death of the primary annuitant, all or a portion of the prior monthly benefit continues to be paid for the remaining life of the designated survivor. Joint and survivor annuities are often elected by married couples to ensure continued income for the surviving spouse. The amount of the reduction is a function of the actuarial life expectancy of the annuitant, the actuarial life expectancy of the potential survivor, and the extent of increased benefit payment duration caused by the differences in the ages. A term-certain optional annuity pays a reduced annuity amount to the annuitant, and if the annuitant dies before a designated period of time of receipt has elapsed, an equal annuity amount to the annuitant's survivors or estate for the remaining unelapsed period of time. The amount of the reduction is a function of the actuarial life expectancy of the annuitant and the length of the period of guaranteed annuity payments. An accelerated annuity (or Social Security leveling optional annuity) provides a benefit in a greater amount during the initial years of retirement, followed by a lower benefit amount for the remainder of the retired lifetime, typically intended to assist public employees who retire at ages earlier than when Social Security benefits are payable (earliest is age 62) or when full Social Security benefits are payable (age 65 if born earlier than 1938, increasing to age 67 if born later than 1959).

Optional annuity forms are likely elected by retirees or disabilitants for a number of potential motivations. The most clear motivation is a concern about the financial situation of a potential survivor (spouse, child, or other survivor) that underlies the selection of joint and survivor optional annuity forms. The motivation for the pre-age 62 accelerated optional annuity form is presumed to be an equalization of total benefit payouts to account for the delay in eligibility for Social Security benefits until age 62. The motivation for selecting term certain optional annuity forms is unclear. Because of its time limitations, the term certain optional annuity forms are not generally considered to be survivor benefits, although some term certain optional annuity forms may be utilized for specialized survivor coverage concerns.

The "bounce-back" in a joint and survivor annuity means that the annuity amount returns from the joint and survivor actuarially reduced amount back to the single life annuity amount if the intended survivor predeceases the annuitant. The bounce-back is subsidized because no additional actuarial reduction in the retiree's retirement annuity amount is required for the feature beyond the joint and survivor optional annuity form actuarial equivalence reduction. The bounce-back feature has not been included as part of term-certain or other optional annuity forms.

Under Minnesota Statutes, Section 356.46, enacted in 1981 and reenacted in 2002, there is a procedure that must be followed in electing an optional retirement annuity. Public pension plans are required to provide the retiree and the retiree's spouse before retirement with a summary of all optional retirement annuity forms with the retirement application, a calculation of the benefit reduction required to take each option, and the procedure to be used to gain more information on optional forms, and to provide the retiree and the retiree's spouse with a post-election notification to the spouse of actual retirement election.

Since optional annuity forms are established to be the actuarial equivalent of a single life annuity at the time of retirement, any reopening of an optional election form will threaten to disrupt the actuarial situation under which the option was calculated. Also, since the optional annuity form election frequently establishes rights to a potential eventual retirement benefit in other people, any reopening of or any modifications in the optional annuity form will affect their rights and, consequently, would be inappropriate.

1.1 moves to amend S.F. No.; H.F. No. 2588, as follows:

1.2 Page 1, line 7, before "JOINT" insert "PERA-GENERAL;" and delete "BENEFIT"
1.3 and insert "ANNUITY ELECTION"

1.4 Page 1, line 7, delete "benefit" and insert "optional annuity under Minnesota
1.5 Statutes, section 353.30, subdivision 3," and before "Public" insert "general employees
1.6 retirement plan of the"

1.7 Page 1, line 10, after "irrevocable." insert "The optional annuity must be the actuarial
1.8 equivalent of the single life benefit payable to the eligible person on the first day of the
1.9 month next following the date on which the election is filed with the Public Employees
1.10 Retirement Association."

1.11 Page 1, line 11, after "pay" insert "to the general employees retirement fund of"

1.12 Page 1, lines 13 and 15, delete "benefit" and insert "annuity"

1.13 Page 1, line 20, before "Public" insert "general employees retirement plan of the"

1.14 Amend the title as follows:

1.15 Page 1, line 4, before "Public" insert "general employees retirement plan of the"

- 1.1 moves to amend S.F. No.; H.F. No. 2588, as follows:
- 1.2 Page 1, line 7, after "benefit" insert "covering the spouse of the eligible person"

- 1.1 moves to amend S.F. No.; H.F. No. 2588, as follows:
- 1.2 Page 2, line 1, after "DATE" insert "; EXPIRATION DATE" and before "Section"
- 1.3 insert "(a)"
- 1.4 Page 2, after line 1, insert:
- 1.5 "(b) Section 1 expires on"

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State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-FOURTH
SESSION

HOUSE FILE No. **2588**

January 19, 2006

Authored by Dittrich

Unofficially referred to the Committee on Governmental Operations and Veterans Affairs

- 1.1 A bill for an act
1.2 relating to retirement; allowing certain persons to select a joint and survivor
1.3 benefit from the Public Employees Retirement Association.
1.4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

1.5 Section 1. **JOINT AND SURVIVOR BENEFIT.**

- 1.6 (a) Notwithstanding any law to the contrary, an eligible person may elect to receive a
1.7 joint and survivor benefit from the Public Employees Retirement Association. An eligible
1.8 person must make this election within 60 days of the effective date of this act, in a manner
1.9 specified by the executive director of the Public Employees Retirement Association. An
1.10 election under this section is irrevocable. At the time of making an election to receive
1.11 a joint and survivor benefit under this section, an eligible person must pay the Public
1.12 Employees Retirement Association the difference between:

- 1.13 (1) the amount of the single-life benefit the person received from December 2004
1.14 until making an election under this section; and

- 1.15 (2) the amount of the joint and survivor benefit the person would have received if the
1.16 person had been receiving a joint and survivor benefit since December 2004.

- 1.17 (b) For purposes of this section, an eligible person is a person who:

- 1.18 (1) was employed by Hennepin County as a human services representative until
1.19 September 1, 2004;

- 1.20 (2) began receiving a disability benefit from the Public Employees Retirement
1.21 Association in December 2004; and

- 1.22 (3) was notified in January 2005 that the person was approved to receive Social
1.23 Security disability benefits.

2.1 Sec. 2. EFFECTIVE DATE.

2.2 Section 1 is effective the day following final enactment.