



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director EB
RE: H.F. 79 (Thissen); S.F. 56 (Betzold): TRA; Administrative Provisions
DATE: February 9, 2007

General Summary of H.F. 79 (Thissen); S.F. 56 (Betzold)

H.F. 79 (Thissen); S.F. 56 (Betzold) makes changes generally of an administrative nature; proposes procedures to be used when making payments to Teachers Retirement Association (TRA) using pre-tax transfers; revises optional accelerated annuity procedures to recognize normal retirement ages older than age 65; corrects the bounceback annuity provision; clarifies applicable law for certain disability annuities; proposes account termination, restoration procedures; revises spousal notification procedures when member applies for a benefit; and repeals an inactive account small balance procedure.

Section-by-Section Summary and Analysis

Section 1 amends Section 354.094, Subdivision 1, the TRA extended leave of absence service credit contribution provision, by clarifying the provision and by striking language to be moved to a new provision in Section 2.

Section 2 (proposed new Section 354.105) would apply when individuals make payment to TRA to receive service credit under any provision of law (TRA law, special law, or Chapter 356, Retirement Systems, Generally), when payment is by transfer of pre-tax assets through a third party administrator. Under this section, payment to TRA can occur up to 90 days after the due date, providing the authorization for the asset transfer has been received by the applicable third party administrator by the due date, and providing that the payment includes interest at 0.708 percent per month from the due date through the end of the month in which TRA receives payment.

Section 2 has the effect of creating a general treatment to be followed whenever any individual with a right to purchase service credit in TRA is making the purchase using pre-tax assets transferred through a third party administrator. These situations commonly arise when an individual seeks to obtain service credit by repaying a refund previously taken, or by making the payments required under a leave-of-absence provision to obtain service credit for the leave period, or when making a service credit purchase payment authorized by special law. The individual may seek to transfer the money to TRA from a tax-sheltered annuity or tax-deferred account, such as a 401(a), 401(k), 403(b), or 457 plan, or from an Individual Retirement Account (IRA). To keep the transfer from becoming a taxable event, the transfer is made using a direct agency-to-agency transfer.

The proposed treatment currently exists in TRA law, but only for extended leave of absence contribution payments. The mechanism was added to TRA law in 2005, as part of a solution devised by the Commission to address the pension problem of an Anoka-Hennepin teacher on an extended leave, who intended to make payments using a transfer from a third party administrator, but the transfer did not occur by the deadline then in law. The original 2005 bill was H.F. 1648 (Abeler); S.F. 1758 (Jungbauer). That language in the extended leave of absence provision (Section 1), is being stricken and replaced by similar language proposed for Section 2, to be applied in all TRA service credit purchase situations (refund repayments, leave of absence contributions, and special or general law service credit purchase provisions).

Policy issues raised by Section 2 are:

1. Sufficient Need for Change. The issue is whether there is sufficient need to make the proposed change. An argument for the change is that agency-to-agency transfers are not uncommon and are likely to become even more widely used in the future. The procedure may help to avoid problems and special legislation requests in cases where a teacher instructs an IRA, a tax-sheltered annuity, or a deferred compensation plan custodian to transfer assets to TRA, in situations where the transfer request was made before the deadline but the transfer did not occur until after the deadline.
2. Extension of Deadlines; Harm to the Fund. The provision could extend the deadline for TRA to receive payment by up to 90 days whenever payment is made by agency-to-agency transfer. While this might raise some concern, the provision does require interest payments to protect TRA financially. Under the proposed revision, the third party administrator must receive the transfer request by the deadline in applicable law, and interest must be paid for any delay in transferring those funds beyond the due date, not to exceed 90 days. In general, this interest requirement should

adequately protect the pension fund. The rate is equivalent to the 8.5 percent annual investment return assumption used in the plan's actuarial work, except that it is expressed in monthly returns. In some cases, the interest to be received will actually exceed the equivalent of an 8.5 percent annual rate, because, although the payment might occur in early or mid month, the interest must be computed to the end of the month in which TRA receives the payment. On average, this should compensate TRA for the delay in receiving these assets, with some additional margin, and should provide an incentive to the teacher to pay earlier rather than later.

3. Scope. If the Commission concludes that the proposed procedure for TRA has sufficient merit, the Commission may wish to consider extending the proposal to all or most pension funds.

Section 3 revises TRA's optional accelerated annuity provision, Section 354.35, by modifying the provision to recognize that normal retirement age for Social Security purposes will differ from age 65 for many teachers.

Accelerated annuity options are found in several pension plans. These options are sometimes called "Social Security leveling options," because they may be used by individuals who retire early to provide a larger income in the initial years before Social Security is payable, to provide an income more similar to that which will later be provided by the Minnesota public pension and Social Security combined. Because these options pay out a larger amount in the early years, the amount paid in later years after Social Security payments commence must be reduced below what would otherwise be paid, to keep the expected value of the annuity comparable to that of a single life annuity.

The age for full receipt of Social Security benefits depends on the individual's date of birth. For those born in 1937 or earlier, the age is age 65. For those born after 1937 through 1954, that age gradually increases to age 66. For those born in 1955 through 1960, that age gradually increases to age 67, and is age 67 for all those born after 1960.

The financial health of defined benefit pension plans is partly dependent upon accurate assumptions of mortality and many other economic and demographic assumptions. Some people live longer than predicted by the plan's mortality assumptions, and receive benefits for more years than expected. In part, this is balanced by those who do not live to the expected age. Those who draw benefits for fewer years than expected balance, to a degree, those who live longer than expected.

The nature of this balance is impacted or at least is complicated when an accelerated annuity system is put in place. Those who use this option and who die quite early in retirement received larger payouts than would otherwise be the case. Thus, they do not balance, to the extent that they previously did, those who live longer than expected. However, the lifetime value of the annuity to a member of the long-lived group will be impacted by the lower payouts provided once Social Security commences.

TRA law has a limitation to the annuity reserves that can be used accelerate annuities. For each year that the individual is under normal retirement age, five percent of the annuity value may be used to accelerate the annuity (see page 3, lines 11 to 13). This places a constraint on the difference between the pre-Social Security age amount and the post-Social Security age payments, lessening any surprise that a retiree may have when that flip date occurs. It may also serve to lessen risk to the fund, in the form of unexpected impacts on plan funding due to these procedures.

A policy issue raised by Section 3 is:

1. Cost Impact to the Fund. Allowing the acceleration phase of an accelerated annuity to extend beyond age 65 will alter the amount of annual payouts to those using this revised option. The issue is whether TRA has received guidance from its actuary on this issue, and whether this proposed change is expected to have any impact on TRA cost. The Commission may wish to hear testimony on this matter.

Section 4 amends Section 354.45, Subdivision 1a, the TRA bounceback annuity provision by reinstating a requirement that had been deleted last year, which had addressed situations where there is a long delay between the death of the designated optional annuity beneficiary and the date that TRA is notified of that date. The reinstated requirement is that if the death occurred more than one year ago, the bounceback will not occur earlier than the first of the month following one year before the date on which TRA received notice of the death.

Unsubsidized joint and survivor provisions in most major plans were revised in 1989 to provide a subsidized bounceback (Laws 1989, Chapter 319, Article 13). Under those revised laws, if the designated beneficiary under a joint and survivor annuity dies before the primary annuitant, the former employee's annuity automatically bounces back to the single life annuity level, and no charge in the form of any additional reduction in the monthly annuity amount is to be made for this feature.

