



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.

In 1990, TRA sought to address the question of when the bounceback should occur if TRA is not notified of the death until long after the death occurred. Through Laws 1990, Chapter 570, Article 12, Section 32, the TRA bounceback was limited to approximately one year prior to TRA's receipt of the notification. Specifically, the following paragraph was added to TRA's provision:

(c) The restoration of the normal single life annuity under this subdivision will take effect on the first of the month following the date of death of the designated optional annuity beneficiary or on the first of the month following one year before the date on which a certified copy of the death certificate of the designated optional annuity beneficiary is received in the office of the teachers retirement association, whichever date is later.

The provision remained unchanged until 2006, when the bounceback provisions of all the plans were revised for simplicity and to remove obsolete language. The 2006 revision to TRA's bounceback provision was found in Laws 2006, Chapter 271, Article 3, Section 37, and that revision inadvertently removed the one-year limitation. The effective date provision for that article included a statement that the revisions to the bounceback provisions of the various plans are "not intended to increase, modify, impair, or diminish the benefit entitlements" specified in the applicable sections of law and if the executive director of any of the applicable plans determines that revised language had that effect, the executive director was required to provide remedial legislation.

By striking language specifying a maximum of approximately one year's retroactivity in the date of the bounceback when there is a long delay in notifying TRA, last year's bill did impact the bounceback date in some circumstances, which could create a larger lifetime benefit for some individuals. The drafting of Section 4 is TRA's effort to fulfill its responsibility to recommend remedial legislation.

Policy issues raised by Section 4 are:

1. Need for the Change. As discussed above, this section is needed to correct an unintended substantive change that occurred last year to TRA's bounceback annuity provision.
2. Other Plans. TRA was the only plan that had the one year after notification of death language. Staff does not believe that the bounceback provisions for other plans need remedial revision.

Section 5 amends Section 354.48, Subdivision 3, TRA disability benefit computation provision, by clarifying in formula annuity situations that the laws to be used for purposes of computing the disability annuity will be the laws in effect on the last day for which salary is paid, and by specifying in money purchase annuity cases that the applicable laws will be the laws in effect on the last day for which salary is paid, rather than the date on which the disability application is received.

Most of the changes in this provision are for clarification. The one area where there may be some debate is in money-purchase disability situations. In that situation, the current law language of this subdivision states that the benefit will be computed under the law in effect "when the disability application is received," rather than on the last day for which salary is paid. It is possible that these dates and the laws deemed applicable could differ because under TRA law, an individual can make a disability application up to 18 months following termination of service.

Basing the applicable law on the law in effect on the last day for which salary is paid seems consistent with the general convention of basing any annuity computation on the law in effect when the public employee terminated service, and seems consistent with Subdivision 2 of this section (copy attached), which can be interpreted as requiring that a disability benefit application cannot be filed until service has terminated.

Policy issues raised by Section 5 are:

1. Nature of the Change. The first issue is whether the proposed change regarding the date of laws applicable for money purchase annuity disability benefit computations is properly viewed as a technical correction rather than a policy change. The proposed change might be viewed as a technical revision to make the section as a whole more internally consistent. The Commission may wish to hear testimony from TRA on this matter.
2. Possible Complaints. If the proposed change is adopted, there could be complaints from TRA members who become disabled and who are eligible for a money purchase disability annuity computation if some favorable change in law occurred after they left service but before they applied for a disability benefit. They may contend that the proposed change amounted to a benefit takeaway.

Section 6 is a proposed new section (Section 354.471, Account Termination, Restoration), stating that if an active or a deferred TRA member dies and there is no surviving spouse or other beneficiary, or these individuals cannot be located within five years after the death, any assets relating to the deceased employee belong to the TRA fund. However, if a surviving spouse or other beneficiary later contacts TRA and establishes a right to a survivor annuity, death refund, or other benefit, that benefit will be paid.

The policy issue raised by Section 6 is:

1. Need for Change. The issue is whether the proposed provision is needed. The provision seems to specify a self-evident treatment that would be followed even if this provision did not become law. Also, the drafting of the provision suggests a defined contribution plan rather than a defined benefit plan, since the language suggests that all the accumulated contributions and all investment earnings related to a member are kept in a separate account and only become "part of the retirement fund" when amounts are forfeited following death. TRA has indicated it wants this provision for accounting or financial compliance purposes. The Commission may wish to request testimony from TRA.

Section 7 amends Section 356.46, Subdivision 3, a subdivision requiring notice to a retiring member's spouse regarding optional annuities, to allow TRA to send the notice "before or upon" the member's election of an annuity form, rather than before that election.

Minnesota Statutes, Section 356.46, is a statutory provision applying to all Minnesota public retirement plans which provide joint and survivor annuities as an option (the provision was enacted in 1981 and recodified in 2002 as Section 356.46). Subdivision 2 requires the pension plan to provide the member, as part of the annuity application form, with a written statement summarizing all optional annuity types offered by the plan. That information must include a general discussion of the consequences of selecting any of these options, a calculation of any reduction in the monthly annuity amount that would occur if the option is selected, and where the individual can obtain more detailed information.

Subdivision 3 requires that the pension plan administration send that same information to the member's spouse before the member elects an annuity form. Then, following the election by the member, the plan must send notice to the spouse of the form of annuity that the member selected. A signed acknowledgement is required from the spouse confirming receipt of a copy of the completed retirement annuity form.

This provision in law ensures that both the spouse and member receive information needed to allow the family unit to discuss the best annuity under the specific circumstances of the couple. This procedure also helps to minimize requests to the Legislature to provide continuing income to a survivor spouse, in situations where the member elected a single life annuity and predeceases the spouse, and legislative requests to allow individuals to revise the annuity option many months or years after the annuity commenced. These elections are irrevocable. Allowing individuals to revise annuity options long after the annuity commences would increase plan costs. An individual might elect the single life annuity option, but when informed during retirement of a terminal illness, that individual might want to change the annuity form to provide continuing coverage to the spouse.

A single life annuity covers only the retired public employee. When he or she dies, benefit payments end, whether or not the spouse survives the retired member. A joint and survivor annuity, however, would provide continuing income to the survivor, in an amount dependent upon the specific joint and survivor annuity elected. A 50 percent joint and survivor annuity would provide monthly income to the survivor equal to half the monthly amount paid to the deceased member just prior to death, while a 100 percent joint and survivor annuity would pay the same monthly amount as that received prior to death. A reduction must be made in the monthly amount paid to the retiree in order to provide this coverage, to keep the annuity's actuarial value comparable to a single life annuity.

TRA is proposing to amend this provision to provide an exception for TRA. Rather than requiring the first notification to the spouse when the member requests a retirement application (and before any annuity is elected), that notification can occur "before or upon the member's election of an optional annuity" (see page 6, lines 4 to 6).

The request is being made because in recent years TRA has engaged in a major reengineering of its systems, including providing considerable benefit information to its members online and permitting members to apply for retirement through the TRA website. Those systems apparently allow members to view retirement application forms and apply for an annuity in a single transaction. This is inconsistent with Section 356.46, because it allows an annuity to be selected before any of the required spousal notification has occurred. Before the computer system was developed, TRA should have performed a careful review of the legal requirements under which it operates, and planned its computer systems and operating systems accordingly.

TRA contends that that its practice is compatible with the spirit of spousal notification requirements, if not the exact requirements. TRA has an administrative practice of permitting annuity forms to be changed during the first two months following the initial scheduled payment date. If the spousal notification requirements of Section 356.46 have not been satisfied prior to that scheduled payment date, TRA does not process the payment. As support for this practice, TRA cites an application for retirement statute, Section 354.44, Subdivision 3, stating that a retirement application is not complete until the executive director receives all necessary supporting documents. The spousal notification and reply required by Section 356.46, Subdivision 3, is viewed by TRA to be a necessary supporting document. By withholding payment until the spousal notifications have occurred, it is possible for an annuitant who initially applied for an annuity online to revise that annuity, because an annuity form can be revised provided that the annuity payments have not commenced.

Policy issues raised by Section 7 are:

1. Possible Undermining of the Intent of Existing Law. The issue is whether TRA's proposal erodes or undermines the apparent intention of the existing law. The law seems to be a mechanism to assure that members of the family unit receive important information about the implications of single life versus joint and survivor annuities, so that informed discussion within the family can occur before an annuity form is selected. The signed notification to the spouse regarding the form of annuity that has been selected allows the individual and family to plan accordingly.

The TRA proposal would allow it to provide information to the spouse after an election has already occurred, because TRA's computer systems permit members to review annuity information and to apply for an annuity in a single session at TRA's internet site. TRA has created a procedure that may be compatible, at least in spirit, with existing law, by not allowing the selected annuity to commence until the spouse has been notified and acknowledgement of the selected annuity form has been received. The Commission may wish to consider whether this process is sufficient. One risk is that individuals may apply for an annuity and elect an annuity form online, and may later conclude that they did not make the best election given the needs of the family unit. If TRA does not make it clear that the annuity form can be revised up to the time that the spousal notification requirements have occurred and the annuity commences, there will be problems. Legislators may be concerned that they will receive requests to revise annuity forms after TRA annuities commenced, under an argument that the retiring TRA member was not properly informed that annuity forms can be revised provided that the benefit has not commenced.

2. Drafting Issue in Existing Law. Section 356.46 in existing statutes seems misdrafted. As written, spousal notification about annuity forms is required before an annuity election is made only if the member eventually elects a joint and survivor annuity (optional annuity). Since that decision cannot be known in advance, it suggests that notification is intended before the individual elects any form of annuity.

Section 8 repeals Minnesota Statutes, Section 354.49, Subdivision 5, a provision in TRA law that allows forfeiture to the fund if a teacher has stopped providing teaching service and does not apply for a refund within five years and the amount contributed to the fund is under \$500, but if the teacher returns to service and the forfeited amount exceeded \$5, the amount would be restored. The section seems antiquated and obsolete, and may not be consistent with the Combined Service Annuity provision and various other provisions of law.

Potential Amendments

Amendment H0079-2A extends the pre-tax payment transfer procedure in Section 2 to apply to all plans rather than just to TRA. The amendment removes the proposed TRA new section and replaces it with a comparable provision to be coded in Chapter 356, to apply to virtually all plans, including local police and fire plans.

Amendment H0079-3A clarifies TRA's authority to delay the commencement of annuity payments until spousal notification is complete. If the Commission is not comfortable with the approach TRA suggests, the Commission could instead remove section 7 by verbal amendment.

Amendment H0079-4A clarifies the notification requirements in Section 356.46 by indicating that spousal notification is required in all cases, not just those where a joint and survivor annuity is ultimately selected. It is impossible to know beforehand which type of annuity will be selected.

1.1 moves to amend H.F. No. 79; S.F. No. 56, as follows:

1.2 Page 2, delete section 2

1.3 Page 5, after line 20, insert:

1.4 "Sec. 6. **[356.445] PAYMENTS USING PRETAX TRANSFERS.**

1.5 If a current or past member of a plan specified in section 356.20, subdivision 2, is
1.6 making a payment to the applicable plan to receive service credit under a provision of
1.7 law applicable to the plan, and this payment is to be made by a transfer of pretax assets
1.8 authorized under section 356.441, payment is authorized after the due date, but not to
1.9 exceed 90 days, providing the authorization for the asset transfer has been received by the
1.10 applicable third party administrator by the due date, and the payment includes interest at a
1.11 rate of .708 percent per month from the due date through the end of the month in which
1.12 the plan receives the payment."

1.13 Page 6, line 10, delete ", 2," and delete "4" and insert "3"

1.14 Page 6, line 11, delete "3" and insert "2"

1.15 Renumber the sections in sequence and correct the internal references

1.16 Amend the title accordingly

1.1 moves to amend H.F. No. 79; S.F. No. 56, as follows:

1.2 Page 3, after line 23, insert:

1.3 "Sec. 4. Minnesota Statutes 2006, section 354.44, subdivision 3, is amended to read:

1.4 Subd. 3. **Application for retirement.** (a) A member or a person authorized to act on
1.5 behalf of the member may make application for retirement provided the age and service
1.6 requirements under subdivision 1 are satisfied on or before the member's retirement
1.7 annuity accrual date under subdivision 4. The application may be made no earlier than 120
1.8 days before the termination of teaching service. The application must be made on a form
1.9 prescribed by the executive director and is not complete until all necessary supporting
1.10 documents are received by the executive director.

1.11 (b) The notification and documentation requirements under section 356.46 are
1.12 necessary supporting documents under this subdivision."

1.13 Page 6, line 10, delete "8" and insert "9"

1.14 Renumber the sections in sequence and correct the internal references

1.15 Amend the title accordingly

- 1.1 moves to amend H.F. No. 79; S.F. No. 56, as follows:
- 1.2 Page 5, line 27, strike "an optional" and insert "a"
- 1.3 Page 6, line 6, delete "optional"

