



STATE OF WISCONSIN  
Department of Employee Trust Funds  
Robert J. Conlin  
SECRETARY

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## CORRESPONDENCE MEMORANDUM

**DATE:** June 18, 2013  
**TO:** Employee Trust Funds Board  
**FROM:** Tarna Hunter, Legislative Liaison  
**SUBJECT:** Legislative Update

**This memo is for informational purposes only. No Board action is required.**

This memorandum provides information on current pertinent legislative issues to the Employee Trust Funds Board.

The Joint Committee on Finance (JCF) took action on provisions of the Governor's Budget Bill (Assembly Bill 40) regarding the Department of Employee Trust Funds. The JCF is a 16-member standing committee of the Wisconsin Legislature. The Committee's primary responsibility is the review of all state appropriations and revenues. The JCF's recommendations are an important part of the budget-approval process, but please remember that these items may still be amended or removed and are not law until enacted by the Governor.

The JCF voted to provide the necessary resources and flexibility for ETF to continue with the RFP process and the overall initiative of modernizing our business processes and integrating our information technology systems. The JCF included the following budget initiatives impacting ETF in the budget bill:

- **ETF Budget** The JCF provided additional funding and resources for ETF's Transformation, Integration and Modernization (TIM) initiative. The JCF budget provides \$3.5 million in FY 2014 and \$4.3 million in FY 2015 to support this multi-year initiative to modernize our business processes and systems. The JCF removed two new outreach positions that ETF requested, but approved the use of a passive review process for ETF to ask for additional positions and funding to support the TIM initiative over the next 6 years.

Reviewed and approved by Robert Marchant, Deputy Secretary

Electronically Signed 6/19/13

Board	Mtg Date	Item #
ETF	6.20.13	5B

- **Rehired Annuitants** The JCF included the Governor's recommendation to increase the minimum break-in service requirement from 30 to 75 days. Rehired annuitants who are expected to work at least two-thirds of full-time, as defined by ETF, will be required to terminate their annuity and resume WRS contributions as a participating employee. Rehired annuitants who enter into a contract with a WRS employer and are expected to work at least two-thirds of full-time, as defined by ETF, will be required to terminate their annuity until they no longer provide services for a WRS employer. The JCF also adopted a provision proposed by ETF which makes technical changes to the calculation of reestablished accounts. The changes will simplify the administration and calculation of reestablished accounts, as well as provide for a more actuarially sound process.

- **Additional Funding for Actuarial Studies**

Provides an additional \$15,000 GPR in FY 2014 to the Joint Legislative Council's Joint Survey Committee on Retirement System's appropriation used to conduct actuarial studies. This is one-time funding, which increases the amount available for studies on FY 2014 to \$30,000.

- **Eligibility for Employees who were first hired by a WRS Employer before July 1, 2011.**

2011 Wisconsin Act 32 increased the number of hours that an employee must work in order to become a participating employee in the WRS, from one-third of what is considered full-time employment to two-thirds of what is considered full-time employment, as determined by DETF by rule.

Under 2011 Wisconsin Act 32, this change did not apply to those employees who were first hired by a WRS employer before July 1, 2011, regardless of whether they were participating employees before that date. This provision provides that, in order to be exempt from this change, employees must have been participating employees before July 1, 2011.

- **Disclosure of Member Information to Department of Revenue (DOR)**

ETF is permitted, but not required, to disclose member information (including SSNs) concerning the payment of annuities under WRS to DOR for the purposes of administering the payment of state taxes; collecting debts owed to DOR; locating WRS participants, or the assets of WRS participants, who have failed to file tax returns, underreported their taxable income, or who are delinquent debtors; identifying fraudulent tax returns and credit claims; or providing information for tax-related prosecutions.

- **Internal Revenue Code Compliance**

The WRS is a governmental plan and is a tax-qualified retirement plan under s. 401(a) of the IRC. Members of tax-qualified plans enjoy many benefits, including that they do not have to pay income tax on contributions until they withdraw money from the plan. Similarly, contributed amounts are permitted to grow tax deferred. However, statutory changes are occasionally necessary to ensure the qualified status of the WRS and to allow for flexibility in the event of future changes to the IRC.

The Joint Survey Committee on Retirement Systems (JSCRS) held an executive session on the provisions of the budget bill that impact the WRS. Gabriel Roeder Smith & Company provided an actuarial analysis of the budget initiatives to the JSCRS and the Legislative Council provided a report. The JSCRS voted 10-0 that the provisions of the budget bill, as they relate to the WRS, are good public policy. I have attached a copy of the actuarial analysis and Legislative Council report for your information.

The JCF bill was introduced on Monday as 2013 Assembly Substitute Amendment 1 to Assembly Bill 40. The Assembly took up the bill on Tuesday and the Senate will begin consideration when the Assembly finishes its work. The Governor indicated that he would like to sign it by the last day of June.

#### **Other Legislative Items**

- **Special Committee on State-Tribal Relations**

The Committee is looking at the possibility of allowing tribal law enforcement to participate in the WRS. The Committee met on May 20, 2013 in Hayward and discussed next steps in moving forward with the proposal to allow tribal law enforcement to participate in the WRS. We provided the Committee with a memo outlining ETF's preliminary concerns regarding the current legislative draft. The Committee decided to continue studying the proposal and how it may impact the tribes.

- **ETF's Building**

The JCF approved the list of building projects recommended by the Building Commission, including a new Hill Farms State Office Facility that would house all of ETF's operations, however it also deleted \$250 million in bonding authority relating to the building program and directed the Building Commission to find a way to achieve that savings. If passed by the full Legislature, this may mean that the Building Commission will need to revisit and reprioritize the already-approved list of projects. We will keep you updated as more information becomes available.

I will be available at the June 20, 2013, Board meeting to answer questions.

## Record of Committee Proceedings

### Joint Survey Committee on Retirement Systems

#### Assembly Bill 40

Relating to: state finances and appropriations, constituting the executive budget act of the 2013 legislature.

By joint committee on Finance., by request of Governor Scott Walker

February 20, 2013 Referred to Joint Survey Committee on Retirement Systems

June 18, 2013 **Executive Session Held**

Present: (10) Senator Schultz; Representative Stroebel; Senators Farrow and Hansen; Representatives Severson and Berceau; Commissioner of Insurance Nickel; Assistant Attorney General Gibson; Secretary, ETF Conlin; Public Member Pederson.

Absent: (0) None.

Excused: (0) None.

Moved by Representative Severson, seconded by Senator Schultz that **Assembly Bill 40** be recommended for Adoption of Report stating the WRS provisions in AB 40 are good public policy..

Ayes: (10) Senator Schultz; Representative Stroebel; Senators Farrow and Hansen; Representatives Severson and Berceau; Commissioner of Insurance Nickel; Assistant Attorney General Gibson; Secretary, ETF Conlin; Public Member Pederson.

Noes: (0) None.

ADOPTION OF REPORT STATING THE WRS PROVISIONS IN AB 40 ARE GOOD PUBLIC POLICY. RECOMMENDED, Ayes 10, Noes 0

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John Soper  
Committee Clerk

STATE OF WISCONSIN

APPENDIX TO 2013 Assembly Substitute Amendment 1 to Assembly Bill 40

REPORT OF JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS

(Introduced by the Joint Committee on Finance by request of Governor Scott Walker.)

An Act relating to: state finances and appropriations, constituting the executive budget act of the 2013 Legislature.

**PROVISIONS OF THE AMENDMENT THAT ARE THE SUBJECT OF THIS REPORT**

Section 13.50 (6) (a), Stats., requires that the Joint Survey Committee on Retirement Systems prepare a report on those provisions of any bill, and any amendments to the bill, that modify the system for, or make any provision for, the retirement of or payment of pensions to public officers or employees. The provisions of this amendment that are the subject of this report are the following:

1. Internal Revenue Code (IRC) Compliance. [SECTIONS 696-698, 701-704, 707-710, 712, 717-718, 720-725, 732, 734-736, 739-745, 750-752 and 754-758 of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40.]

2. Wisconsin Retirement System (WRS) Eligibility Requirements. [SECTIONS 737-738 of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40.]

3. WRS Employee Separation Requirements. [SECTIONS 716b., 716d., 716f., 716h., 716j., 733m., 737m., 738d., 738p., 746m., 747, 748b., 748d., 748f., 748h., 748j., 748l., 749, 745m., 9112 (3L) and 9312 (2L) of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40.]

These provisions are described below.

**1. IRC Compliance**

***a. Description***

This provision of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40 modifies the language of current WRS administration and benefits to ensure compliance with the IRC.

Under **current law**, no WRS benefit plan may be administered in a manner that violates a provision of the IRC that authorizes or regulates the benefit plan or that would cause an otherwise tax-exempt benefit to become taxable under the IRC.

**2013 Assembly Substitute Amendment 1 to Assembly Bill 40** updates and ensures the conformity of a number of provisions governing WRS benefits and the administration of the WRS to the IRC.

***b. Actuarial Effect***

No material actuarial effect to the WRS is expected.

***c. Probable Costs***

The provision is not expected to significantly increase costs to the WRS.

**2. WRS Eligibility Requirements**

***a. Description***

This provision of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40 alters which employees are eligible to participate in the WRS prior to July 1, 2011.

**Current law** requires that an individual must work for a covered employer at least two-thirds of what is considered full-time employment as determined by the Department of Employee Trust Funds (ETF). 2011 Wisconsin Act 32 increased the number of hours that an employee must work in order to become a WRS participating employee from one-third to two-thirds of what is considered full-time employment. Under 2011 Wisconsin Act 32, this change in law did not apply to those employees who were first hired by a WRS employer before July 1, 2011, regardless of whether they were participating employees before that date.

**2013 Assembly Substitute Amendment 1 to Assembly Bill 40** provides that in order to be exempt from this change in law, an employee must have been a participating employee before July 1, 2011.

***b. Actuarial Effect***

No material actuarial effect to the WRS is expected.

***c. Probable Costs***

This provision is not expected to significantly increase costs to the WRS.

**3. WRS Employee Separation Requirements**

***a. Description***

This provision of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40 requires a WRS participant to remain separated from WRS-covered employment for at least 75 days prior to being eligible to return to WRS-covered employment as a rehired annuitant. In addition, rehired annuitants who are expected to work at least two-thirds of full-time employment must cease receiving their annuities until they terminate covered employment.

**Under current law**, a WRS participant who has applied to receive an annuity must wait at least 30 days between terminating WRS-covered employment and returning to WRS-covered

employment as a participating employee, or the participant is not eligible to receive a WRS retirement annuity.

**2013 Assembly Substitute Amendment 1 to Assembly Bill 40** provides that the participant must remain separated from WRS-covered employment for at least 75 days to be eligible for an annuity.

The amendment requires that a participant receiving a retirement annuity, or a disability annuitant who has attained his or her normal retirement date, employed in a position in WRS-covered employment in which he or she is expected to work at least two-thirds of what is considered full-time employment by ETF (one-third time is currently defined by ETF as 600 hours per year for non-teachers and 440 hours per year for teachers), the annuity would be suspended, including any amount provided by additional contributions, and no annuity payment would be payable after the month in which the participant files with ETF a written election to be included within the provisions of the WRS as a participating employee.

In addition, if a participant receiving a retirement annuity, or a disability annuitant who has attained his or her normal retirement date, enters into a *contract* to provide employee services with a participating employer and he or she is expected to work at least two-thirds of what is considered full-time employment by ETF, as determined by rule, the participant's annuity must be similarly suspended.

Following suspension of an annuity under either of these provisions, the retirement account of the participant whose annuity is suspended would be established on the following basis: (1) the amount of the annuity payments that would have been paid under the suspended annuity, from the original annuity suspension date to the subsequent retirement date, would be credited to a memorandum account; and (2) upon becoming a participating employee, a subsequent retirement account would be established and would include the memorandum account amounts specified above (the suspended annuity payments), interest, and any contributions made, and creditable service earned, during the subsequent participating employment.

Upon the subsequent retirement and application for an annuity, the suspended annuity would be reinstated and the subsequent annuity of a former annuitant would be computed as an original annuity, based upon the participant's attained age on the effective date of the subsequent annuity, in an optional form as elected by the participant. The subsequent annuity would be initiated at the same time the suspended annuity is reinstated.

The substitute amendment repeals current statutes relating to the termination of annuity payments, reestablishment of retirement accounts, and recomputed annuities for rehired annuitants that are inconsistent with these alternative provisions.

These provisions would first apply to annuitants who return to employment as participating employees in the WRS on the effective date of the act.

***b. Actuarial Effect***

This provision has a number of effects which may result in a savings to the WRS. A longer waiting period tends to discourage the rehiring of retired annuitants and often resulting in the reduction of payroll costs by encouraging the hiring of new, lower paid employees. New employees also tend to increase turnover gains to the WRS by terminating employment prior to getting an employer provided benefits. In addition, some members may be expected to delay retirement in response to the provision, thereby delaying annuity payments and increasing employee and employer payments to the WRS. Finally, this provision may reduce costs to the WRS by eliminating the potential for the abuse of the WRS by allowing participants to return at a substantially higher salary for a short period of time and significantly increase annuities without increased contributions over an extended time period to reduce costs.

The consulting actuaries note that there is an additional instance under which this provision may result in an increase in cost to the WRS. The section of the amendment that provides that a returning annuitant's account is suspended, but may accumulate payments to the annuity for distribution at a later date of retirement, may result in increased costs if the waiting period and termination requirements are not carefully administered.

For more information on the potential costs or savings generated by this provision, see the full actuarial report attached to this report.

***c. Probable Costs***

The effect of this provision may result in a cost or a savings, depending upon its effect on the decision-making processes of participants and annuitants. The expected cost or savings generated by this provision is approximately 0.03% or \$3.6 million per year in today's dollars.

**POLICY RECOMMENDATION**

The Joint Survey Committee on Retirement Systems finds that the provisions of 2013 Assembly Substitute Amendment 1 to Assembly Bill 40, as they relate to the WRS, are good public policy.



June 14, 2013

Mr. Terry C. Anderson  
Director, Joint Legislative Council  
1 East Main St., 401  
Madison, Wisconsin 53703

**Re: 2013 Assembly Bill 40 including Joint Committee on Finance Amendments**

Dear Mr. Anderson:

On June 10, 2013 you contacted us on behalf of the President of the Wisconsin Senate, asking that we provide an actuarial analysis of the provisions of 2013 Assembly Bill 40, the Executive Budget Bill, that relate to rehired annuitants and changes to Wisconsin Retirement System (WRS) eligibility. The Wisconsin Department of Employee Trust Funds (DETF) has given us permission to do this work and this letter is being copied to DETF. Our analysis relates only to the WRS. We did not consider Group Insurance Benefits, the Accumulated Sick Leave Conversion Credit (ASLCC) program, the effect on the employer's salary structure, or anything else not directly related to the operation of WRS.

The following chart compares provisions in current statute with those that are being proposed.

	<b>Provision</b>	<b>Current Law</b>	<b>Proposed AB 40</b>
1.	Break in service requirement prior to rehire.	30 Days	75 days
2.	Rehired annuitant participates in WRS?	Annuitant may choose. Annuity is suspended if annuitant chooses participation.	Must participate if expected to work at least two-thirds of full time, in which case annuity is suspended. .
3.	Recalculation of Annuity upon re-retirement if rehired annuitant participated in WRS.	Annuity benefit is recalculated based upon total of original service credit and new service credit and final average compensation that reflects earnings during reemployment, along with certain adjustments for benefits previously paid.	Original annuity resumes, including dividends and negative adjustments that would have accrued during the suspension period. The total amounts that would have been paid during the period of reemployment are annuitized and added to the benefit. Finally, an additional benefit is paid based on the service during reemployment, and the compensation earned.
4.	Recalculation of Annuity upon re-retirement if rehired annuitant did not participate in WRS.	Original benefit and dividends continues to be paid.	No change.

5.	Contract Employees	No Provision	Annuity is terminated for contract employees who are expected to work at least two thirds of full time. They do not participate in the system during re-employment. Upon termination of the contract, original annuity resumes, including dividends that would have accrued during the suspension period. The total amounts that would have been paid during the period of reemployment are annuitized and added to the benefit.
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Please review the above to ensure that our understanding of the proposed provisions is correct. If you have reason to believe that we misunderstood the Bill, or have omitted important provisions, please let us know. Also, please be aware, that in such case, the analysis in this letter cannot and must not be relied upon.

We have not received final language of the bill, but have relied on preliminary information as described in Sections 11 and 12 of Fiscal Bureau summary of ETF-related provisions in AB 40 provided by ETF staff.

If there are other important documents that you believe we should review, please let us know, and do not rely on the results of this study in that instance until we have completed such review and informed you thereof.

We will now discuss these provisions one at a time.

**Break in Service**

If an annuitant returns to work before the end of the break in service period, the annuity is cancelled, benefit payments the annuitant received, if any, must be repaid, and the individual again becomes a participant in the system. Provisions such as this are designed to ensure that the retirement is bona fide. We have seen 30 day periods among our Public retirement clients, and have seen cases where the period is being lengthened -- in one teacher plan, for example, the period was recently lengthened to 180 days. According to the Legislative Audit Bureau Study in December of 2012 (LAB Study), a significant number (30-40%) of rehired annuitants are currently re-hired between 30 and 90 days following retirement. The longer the waiting period, the more likely it is that the retirement is, in fact bona fide. A longer waiting period will tend to discourage rehiring retirees, and therefore encourage hiring new people. Hiring new people is good for the Retirement System because it will tend to produce a larger payroll that will help control percent of payroll costs. Also, in many cases, new hires will terminate employment without getting an employer provided benefit, thereby producing turnover gains for the System. The LAB Study indicated that ETF has oversight authority over retirement and conducts investigations to determine whether or not good faith terminations of employment have in fact occurred

prior to retirement. It does not have access to payroll systems that would allow a robust monitoring of employers and employees, so it initiates investigations only when it has reason to believe that pension laws may have been violated. Out of 19 investigations that ETF conducted between August 2009 and June 2012, ETF determined that in 4 cases, good faith terminations had not occurred. It is likely, that in fact, there were more than 4 such cases out of the many thousands of retirements that occurred during that period, and that existing procedures were simply not able to detect them. However, the proportion of rehired retirees working more than two-thirds of full time is relatively small. More than two-thirds of annuitants hired into local governments were expected to work less than 20 hours per week, for example. Extending the waiting period to 75 days from 30 days should make it more difficult for an employer and employee to agree to a rehire prior to retirement, since the employer would have to go without the person for 75 days. This is a benefit to the WRS because some members will simply defer retirement (rather than separating from service and rehiring), which will tend to delay payment of annuities, and increase the time period during which the WRS receives participant and employer contributions on behalf of the person.

### **Rehired Annuitants Participating in WRS**

Present statutes allow rehired annuitants a choice regarding whether or not to participate in WRS following reemployment. Many rehired annuitants are working part time (the LAB study noted that only 17% work full time) or earning less than their previous earnings rate and decline participation in WRS. For example, of 2783 annuitants hired by the UW System and other State Agencies between January, 2007 and March, 2012, only 26 people elected to suspend their annuities and to participate in WRS. We note that GRS performs only 35-40 credit reestablishment calculations per year for the entire WRS. As a general rule, when people are offered a choice, they will attempt to select the choice that is best for them, and therefore they will tend to select against the system. It is a reasonable presumption, although we do not have hard evidence to support it, that all or most of the 26 individuals mentioned above improved their pensions, including the past service portion, by returning to work and electing to participate in WRS. The proposed provisions restrict the choice and require the participation of any rehired annuitant who is expected to work at least two-thirds of full time, in alignment with participation requirements for newly hired employees. By restricting the choice, selection against the System will, in the long term, be reduced, and cost savings may occur.

### **Recalculation of Annuity upon Re-Retirement if Rehired Annuitant Participated in WRS**

Under present law, the entire benefit is recalculated based upon original and additional service credit and potentially a new higher final average salary. While the final average salary may, in fact, not change, depending on circumstance, it is possible for the new final average salary to be higher than the one upon which the original benefit was based, and in some cases it may be much higher. It is also possible for the Money Purchase portion of the benefit to create a much higher benefit as well. When either event happens, there can be a significant loss to the WRS and a windfall to the individual, because the WRS does not receive additional contributions to account for the improvement in the past service benefit, which could be very large. The proposed AB 40 provision removes the potential for loss by applying the new final average salary only to the marginal new benefit created from the new service and also removes potential windfalls due to the operation of the Money Purchase benefits for annuitants who rehire for a very short period of time and re-retire with a much higher benefit. In order to get a full understanding of the effect of the recalculation, we need to compare the case of a person who would

have chosen participation under current law, with the same person under proposed law. Individuals who would choose participation under present law would do so for various reasons, including an expectation of getting a retirement benefit enhancement that exceeds the value of the annuity payments they would forfeit. If the benefit is enhanced solely because of additional service, and final average compensation is not affected, then the AB40 provision is likely to be more expensive than the current statute because with the current statute, at least part of the suspended annuity payments are forever lost, but with AB40, their value is preserved. If the enhanced benefit is due largely to enhanced final average salary, then the current statute could result in a benefit that is much more valuable than the proposed provisions in AB 40 would produce. Various possibilities and our judgments of the relative costs for the System are summarized in the table below. Absolute dollars could not be assigned to each scenario due to the complexity of the current calculation methodology. Even within each scenario, individual circumstances could produce a net gain or loss due to a variety of factors including age, service, money purchase plan balance, length of time retired, length of time rehired, etc. The proposed calculation method under AB40 should greatly simplify the calculation methodology, administration and reduce the potential for large unexpected costs to the WRS or windfalls to members.

	<b>Present Statute</b>	<b>AB40</b>
Member working more than two thirds and would have chosen participation anyway		
Benefit enhancement mostly due to extra service	Less expensive	More expensive
Benefit enhancement mostly due to higher pay	Much more expensive	Much less expensive
Benefit enhancement due to short rehire periods and/or Money Purchase increases	Much more expensive	Much less expensive
Member working more than two thirds and would not have chosen participation	Less expensive	More expensive
Member working less than two thirds and would have chosen participation	Less expensive	More expensive
Member working less than two thirds and would not have chosen participation	About same as AB40	About same as present

We do not have data sufficient to judge the relative value of the tradeoff indicated in the table. While this table represents the relative impact on the System, the impact on the member should be relatively neutral as the intent is to eliminate a potential for dramatic abuse in the return to work process. Current statute would permit a long service person with a relatively low final average salary to return to work at a much higher paying job for a few years and greatly enhance the total retirement package and in other cases provides large benefit windfalls for those annuitants who rehire for very short periods expecting to receive a higher recalculated retirement benefit. AB 40 removes that ability. While it does eliminate a significant potential for abuse, this provision gives the person the ability to accumulate the suspended

annuity for payment at a later date, in addition to the original pension and the additional layer of pension that accrues while reemployed. Assuming tight administration of the 75 day waiting period, and a high level of compliance with the bona fide termination of employment rule, we judge that the cost of this portion of AB40 may be mostly or more than offset by the reduction in the potential for abuse that exists in current statute.

### **Recalculation of Annuity upon Re-Retirement if Rehired Annuitant Did Not Participate in WRS**

There is no recalculation in this instance. Current statute and AB40 do not differ, so there is no cost or savings associated with AB40. However, readers of this report should note that rehiring annuitants who do not participate in WRS leads to smaller payroll, because the rehired annuitants take the place of people who would otherwise participate in WRS and make contributions. A smaller payroll can make plan costs appear higher than otherwise when expressed as a percentage of that payroll.

### **Contract Employees**

In this case, current statute and AB40 will provide approximately the same value.

### **Eligibility for New Hires**

Under the current statute, employees initially employed by a WRS employer prior to July 1, 2011 are exempt from the two-thirds requirement needed for WRS eligibility even if they were not a participating employee. The proposed provision clarifies that this applies to a participating employee before July 1, 2011. This provision will limit the amount of grandfathering into the System and provide a small savings to the System, but will not be material enough to impact plan contribution rates.

### **Actuarial Statement**

The extension of the break in service period to 75 days, and the eventual elimination of anti-selection that is inherent in allowing rehired annuitants to choose whether or not to participate in WRS are cost saving elements of this bill. We also think that the change in calculation method on re-retirement will eliminate a potential for significant unintended and perhaps even abusive results. However, the provision under AB40 where suspended payments are accumulated and ultimately returned to the member in an annuity at a later date prevents us from giving a definitive statement on the cost or savings from the Bill. This Bill will generate either a long term cost or a long term saving depending on the extent to which the effect of the change in the recalculation method does or does not offset the unintended windfall benefits that can occur with the current statute. To the extent that a cost is generated, it will be partially or perhaps mostly covered by participant and employer contributions on behalf of affected individuals, so we do not expect any significant effect on percent of pay costs. In any case, the effect, whatever it is, will emerge gradually over time, and will likely not be detectable in an actuarial valuation. To the extent that this provision is carefully administered and monitored, the cost or savings impact on the System of the benefit provision change is anticipated to be small, roughly +/- 3 basis points, or \$3.6 million per year in today's dollars. However, the provisions of AB40 will greatly reduce the potential for certain types of windfalls that can occur to individuals in return to work situations.

## Recommendations

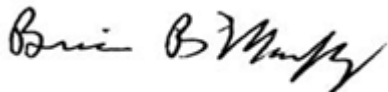
In general, we expect that the proposed changes will help simplify plan administration and complexity while enhancing equity among members. We recommend that the enforcement of the 75 day waiting period be carefully monitored to ensure that there is, in fact, a bona fide separation from service. We are particularly concerned about the case of teachers for whom 75 days might be the length of the summer break. If it begins to appear that a significant number of retirements are being followed by reemployment at the two thirds or greater level, the banking of suspended benefits in the re-calculation method should be reconsidered. We also recommend that suspended annuities be credited with a low rate of interest, or a zero % interest rate for purposes of the benefit recalculation. It will be necessary to develop administrative rules to deal with a variety of situations. For example, an individual may be expected to work two-thirds of full time but may not actually do so, or an individual may not be expected to work two-thirds of full time, but might do so.

The actuaries submitting this statement are Members of the American Academy of Actuaries (MAAA) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

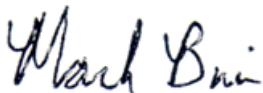
Circular 230 Notice: Pursuant to regulations issued by the IRS, to the extent this communication (or any attachment) concerns tax matters, it is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) marketing or recommending to another party any tax-related matter addressed within. Each taxpayer should seek advice based on the individual's circumstances from an independent tax advisor.

This communication shall not be construed to provide tax advice, legal advice or investment advice.

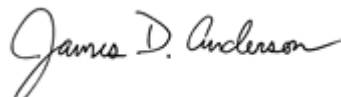
Sincerely,



Brian B. Murphy, FSA, EA, FCA, MAAA.  
Senior Consultant



Mark Buis, FSA, EA, MAAA  
Senior Consultant



James D. Anderson, FSA, EA, MAAA  
Senior Consultant

BBM/sc

cc: Mr. Robert Conlin