



STATE OF WISCONSIN
Department of Employee Trust Funds

Eric O. Stanchfield
SECRETARY

801 W Badger Road
PO Box 7931
Madison WI 53707-7931

1-877-533-5020 (toll free)
Fax (608) 267-4549
TTY (608) 267-0676
<http://etf.wi.gov>

CORRESPONDENCE MEMORANDUM

DATE: August 25, 2004
TO: Employee Trust Funds Board
FROM: Julie Reneau, Administrator, Division of Retirement Services
SUBJECT: Discussion on Establishing a Date Certain for Application and Payment of Lump Sum Benefits

At the June 2004 meeting, the Board requested that staff develop a paper describing the pros and cons of establishing a date certain for lump sum benefits as it relates to the application receipt date and interest crediting. This memo is offered for discussion purposes.

Background Information

Interest crediting is defined by statute. For most lump sum benefits, interest is creditable through the last full month before the "benefit approval date," which is defined in sub. ETF 10.01 (1k) of the Wisconsin Administrative Code. The benefit approval date is the date the Department makes the actual payment. Before this can occur, the Department must receive final termination data from the employer and manually calculate the final benefit amount (including interest).

Once we have received the employer data, timely processing of payments is not an issue during most of the year. However, there can be concerns about the "benefit approval date" when we receive an application near the end of a calendar year and the payment cannot be vouchered until after December 31. By law, a benefit that is not approved before December 31 results in the account being credited with annual effective rate interest for the year just ended.

The date on which a payment is approved becomes especially important when people want to either maximize positive interest crediting or avoid variable fund losses. When a benefit is paid before the end of a calendar year, under Wisconsin Retirement System (WRS) law both fixed and variable balances receive 5% interest, which is prorated for each full month before the payment is approved (the only interest the WRS can credit is annual interest and, when applicable, prorated 5% interest for partial years). Interest crediting becomes of particular concern at the end of the year when the effective rate of annual interest (fixed and/or variable) is less than 4.583% (11/12 of the 5% assumed rate). If an application is received in the current year, but cannot be "approved" until the following year, the participant is at risk of receiving effective rate interest that is lower than 4.583%. Conversely, if the fixed and/or variable interest rate is higher, the participant is advantaged.

A more detailed explanation of current interest crediting procedures and pertinent Wisconsin statutory and administrative code citations governing lump sum payments is attached.

Board	Mtg Date	Item #
ETF	9/17/2004	8

Considerations When Establishing Date Certain for Application Processing and Interest Crediting

An alternative to current process of basing the interest credit on the benefit approval date would be to credit prorated interest for up to 11 months of the year for the year in which the application is received, as long as the participant's termination date was within or prior to that year.

Note: This would require a statutory change.

This approach has some advantages and disadvantages:

PROS

- Participants could control whether the benefit would receive prorated or annual interest.
- Interest crediting would not be dependent on employer reporting or Department workload and backlogs.
- Participants could know the exact benefit amount before applying (if only prorated interest would be credited).

CONS

- Due to potential lengthy delays in employer reporting, we might have to hold up payment for weeks or even months with no additional interest added. Meanwhile, the fund would continue to experience gains or losses on the monies. *Note: There are no employer penalties for late reporting.*
- Participants would put pressure on staff to estimate effective rates so the participants could decide when to apply. This would be especially difficult for fixed rates because of the smoothing feature. If ETF staff "guess wrong" about the effective rates, participants would be unhappy and some would ultimately appeal.
- If a participant applied before the end of the year, but the employer reported that the termination date was after the end of the year, we would need to credit annual interest to the account since the participant isn't eligible for the benefit until after the termination date. In that case, the benefit amount would be different than the participant expected.
- "Gaming" the system is possible, especially in years with extreme losses, since a participant could avoid a loss and get up to 4.58% interest instead, no matter how much the fund lost.

Summary

There is no ideal way to handle the year-end application processing and interest crediting issues. The same rules must be applied consistently each year, and no matter what rules are established, some participants will be advantaged and some will be disadvantaged. Since there is no ideal way to handle the year-end application processing and interest crediting issues, we believe that the current process works fairly well.

One enhancement to the current process would be to make participants' decision-making easier by increased notice of the interest crediting provisions and the deadlines for applying for a lump sum to be paid before the end of a year. Participants would still need to monitor the markets and make their decisions before the actual effective rates for the year were known.

Attachment

INTEREST CREDITING PROCEDURES AFFECTING LUMP SUM PAYMENTS AND RELATED STATUTES AND ADMINISTRATIVE RULES

Interest Crediting

Most lump sum benefits receive prorated 5% interest; these include:

- lump sums from voluntary employee additional contribution
- lump sum retirement benefits
- non-annuitant death benefits (other than a "special death benefit, which is a formula calculation)

There is no prorated interest paid on separation benefits. *Exception: Participants whose final termination was before May 16, 1989, still continue to receive prorated interest for the year in which the separation benefit is paid.*

Annual Effective Rate Interest Credited on Accounts as of December 31*

Effective rate interest is credited to individual participant accounts at the end of each year. Interest is credited on December 31, and is calculated on the prior January 1 balances.* Fixed trust fund balances receive fixed effective rate interest, and if applicable, the variable fund balances receive variable effective rate interest. However, interest rates are based on State of Wisconsin Investment Board (SWIB) investment returns through December 31. Since it takes SWIB time to value all of the assets at year end, there is a built-in delay in determining the effective rates. In most years, the effective interest rates have been available by early February.

Benefits based on account balances, such as separation benefits, non-annuitant death benefits, and retirement benefits may be affected by the annual interest credited on December 31. By law, non-annuitant death benefits (other than "special" death benefits), benefits from voluntary additional contributions and money purchase retirement benefits include the annual interest credited at the end of the year.

** Exception: Inactive participants who first became WRS participants after January 1, 1982, but who have not been active participating employees any time after 1999, continue to receive 5% annual interest crediting on their individual participant accounts.*

Prorated 5% Interest on Some Lump Sum Benefits

Prorated interest is applicable to some benefits as they are calculated throughout a calendar year. This applies to money purchase retirement annuities, lump sums paid in lieu of an annuity calculated under the money purchase method, non-annuitant death benefits, and payments from voluntary additional contributions. Prorated interest is payable for each full month elapsing between January 1 and the month in which the payment is approved. There is no provision in the law for paying prorated interest on separation benefits.

Board	Mtg Date	Item #
ETF	9/17/2004	8

Current Voucher Policies

Weekly lump sum vouchers are completed on Monday to be sent to the Department of Administration and the State Office of the Treasurer for a targeted mailing date of Friday. All lump sum benefits that are ready for voucher are put on the voucher, and prorated 5% interest is credited for partial years. However, when benefit applications received late in a calendar year cannot be approved and vouchered until after December 31, annual effective rate interest for the year just ended must be credited to the account and included in the benefit amount.

Whether or not a payment is on a voucher by the end of a calendar year is dependent on several factors:

- the date a complete and valid application is received
- the employer's report of the participant's final earnings, contributions, creditable service and a termination date is received
- the backlog of work and staffing levels

The last voucher date of the year is established early in the year. Standard procedure is to tell staff the last voucher date and the exact deadlines for processing applications so they can provide this information to participants. For example, in October 2003 the following memo from the manager in charge of lump sum processing was shared with staff:

The last voucher date for lump sum benefits in 2003 will be Monday, December 22, 2003. The cutoff date for this voucher will be Thursday, December 18, 2003. We anticipate that payments from this final voucher for 2003 will be dated on December 30 but we cannot be certain of this date at this time.

The first voucher for lump sum benefits in 2004 will be Monday, January 5, 2004.

We will attempt to process for payment in 2003 all applications for lump sum benefits for which the requirements for payment are complete by the last voucher for the year. To be paid in 2003, a completed benefit application that is in order should be received no later than Friday, December 12. The employer's report of termination must also have been received and loaded to WEBS no later than Thursday, December 18.

In 2004, the last voucher date will be December 20, 2004, with a mailing date target of December 27, 2004 (Friday of that week is a holiday).

Index to the Statutory (and Administrative Code) Provisions

Assumed benefit rate is 5%.....	§ 40.02 (6)
Effective rate (fixed and variable) defined.....	§ 40.02 (23)
Actuarial effect of interest payment experience.....	§ 40.03 (5) (b)
Annual "variable" interest on participant account.....	§ 40.04 (4) (a) 2
Annual "fixed" interest on participant account.....	§ 40.04 (4) (a) 2g
Prorated interest 1/1 to benefit approval date.....	§ 40.04 (4) (b) and (bm)
Uncredited interest goes to employer reserve.....	§ 40.04 (5) (b)
Death benefit includes interest that was credited to the deceased participant accounts...	§ 40.73 (1) (a) and (am)
Date on voucher is date benefit approved.....	§ ETF 10.01 (1k)

Statutes

Wis. Stat. § 40.02 (6)

"**Assumed benefit rate**" means a rate of 5%. The assumed benefit rate shall be used for ... determining the amount of lump-sum death benefits payable from the portion of an annuity based on additional deposits and crediting interest to employee required contribution accumulations under s. 40.04(4)(a)2.

Wis. Stat. § 40.02 (23)

"**Effective rate**" means:

(a) For the fixed annuity division, the rate, disregarding fractions of less than one-tenth of one percent, determined by dividing the remaining fixed annuity division investment earnings for the calendar year or part of the calendar year, after making provision for any necessary reserves **and after deducting prorated interest and the administrative costs of the fixed annuity division for the year**, by the fixed annuity division balance at the beginning of the calendar year as adjusted for benefit payments and refunds paid during the year excluding prorated interest.

(b) For the variable annuity division, the rate, disregarding fractions less than one percent, which will distribute the net gain or loss of the variable annuity division to the respective variable annuity balances and reserves using the same procedure as provided in par. (a) for the fixed annuity division.

Wis. Stat. § 40.03 (5) (intro.) and (b) [Interest payment experience may affect actuarial assumptions]

(5) Actuary. The actuary or actuarial firm retained under sub. (1)(d):

(b) Shall make a general investigation at least once every 3 years of the experience of the Wisconsin retirement system relating to mortality, disability, retirement, separation, interest, employee earnings rates and of any other factors deemed pertinent and to certify, as a result of each investigation, the actuarial assumptions to be used for computing employer contribution rates, the assumed rate and the tables to be used for computing annuities and benefits, provided the tables shall not provide different benefits on the basis of sex for participants or beneficiaries similarly situated. If the assumed rate changes, the actuary shall at the same time adjust the assumptions for future changes in employee earnings rates to be consistent with the new assumed rate. The recommended actuarial assumptions shall be based on the system's own experience as identified in the general investigations unless lack of adequate information or unusual circumstances are specifically identified and fully described which require use of other groups' experience and such other experience is not inconsistent with the system's own experience. When considering or implementing new or changed benefit provisions and areas of risk, the assumptions may be based solely on the experience of other groups until 5 years of the system's own experience is available for use as long as such other experience is not inconsistent with the system's own experience.

Wis. Stat. § 40.04 (4) (a) (intro.), 2. [variable division] and 2g. [fixed division]

(a) An employee accumulation reserve, within which a separate account shall be maintained for each participant, shall be maintained within the fund and:

2. Credited as of each December 31 with interest on the prior year's closing balance at the effective rate on all employee required contribution accumulations in the variable annuity

division, on all employee required contributions in the fixed annuity division on December 31, 1984, on all employee required contributions in the fixed annuity division of participants who are not participating employees after December 31, 1984, and on all employee and employer additional contribution accumulations and with interest on the prior year's closing balance at the assumed benefit rate on all employee required contribution accumulations in the fixed annuity division for participants who are participating employees after December 31, 1984, but who terminated covered employment before December 30, 1999.

2g. Credited as of each December 31, with interest on the prior year's closing balance at the effective rate on all employee required contribution accumulations in the fixed annuity division for participants who are participating employees on or after December 30, 1999.

Wis. Stat. § 40.04 (4) (b) and (bm)

(b) Whenever a payment under [s. 40.25 \(4\)](#),¹ an annuity or a death benefit is computed, the prior year's closing balance of all employee contribution accumulations and any accounts maintained for individual participants shall be credited with interest for each full month elapsing between the first day of the calendar year and the annuity effective date or the month in which the payment of a benefit under [s. 40.25 \(4\)](#) is approved at one-twelfth of the assumed benefit rate. The interest so credited shall be charged to the interest earnings for the current year and shall be paid out or transferred with the amount to which it was so credited.

(bm) Whenever a payment under [s. 40.25\(1\)](#)² is computed under [s. 40.23\(3\)](#),³ the prior year's closing balance of all employee and employer contribution accumulations and any accounts maintained for individual participants shall be credited with interest for each full month elapsing between the first day of the calendar year and the month in which the payment under [s. 40.25\(1\)](#) is approved at one-twelfth of the assumed benefit rate. The interest so credited shall be charged to the interest earnings for the current year and shall be paid out or transferred with the amount to which it was so credited.

Wis. Stat. § 40.04 (5) (intro.) and (b)

(5) An employer accumulation reserve shall be maintained within the fund to which, without regard to the identity of the individual employer, shall be:

(b) Credited, as of each December 31, all fixed annuity division interest not credited to other accounts and reserves under this section.

Wis. Stat. § 40.08 (6) (e)

(6) Refunds. (e) No interest may be credited to any money refunded under this subsection.

Wis. Stat. § 40.73 (1) (a) [*Inactive death benefit*] and (am) [*Participating employee death benefit*]

(1) The amount of the Wisconsin retirement system death benefit shall be:

(a) Upon the death of a participant, other than an annuitant or a participating employee, the sum of the additional and employee required contribution accumulations credited to the participant's

¹ Lump sum payment of additional contributions.

² Lump sum in lieu of a retirement annuity, because monthly annuity below thresholds.

³ The money purchase guarantee of 200% of required contributions plus additional contributions.

account on the beneficiary annuity effective date or, in the case of a lump sum payment, the first day of the month in which the death benefit is approved. In addition:

1. For teacher participants who were members of the state teachers retirement system or the Milwaukee teachers retirement fund on June 30, 1966, the amount shall be increased by the employer contribution accumulation credited to the participant's account on or prior to June 30, 1973, plus interest at the effective rate subsequently credited to the accumulations.

2. For participants who were participants of the Wisconsin retirement fund on or prior to December 31, 1965, the amount shall be increased by the employer contribution accumulation credited to the participant's account on December 31, 1965, plus interest at the effective rate subsequently credited to the accumulations.

(am) Upon the death of a participating employee, except as otherwise provided by par. (c), the sum of the additional contribution and twice the employee required contribution accumulations credited, including any interest credited to the accumulations, to the participant's account on the beneficiary annuity effective date or, in the case of a lump sum payment, the first day of the month in which the death benefit is approved.

Administrative Rules

Wis. Admin. Code § ETF 10.01 (1k)

(1k) "Benefit approval date" is the date on which an application for a separation benefit, lump sum retirement benefit, or the payment of additional contributions, death benefit, or remaining guaranteed annuity payments in a lump sum, is finally approved for payment by the department. The date of final approval is the date recorded by the department in the voucher box on the "Single Sum Benefit Data," form ET-7102, or the electronic equivalent, associated with the benefit payment in question.

Note: See "benefit approval date" in [s. ETF 20.19 \(2\) \(a\)](#), "date the application for a separation benefit is approved" in [s. 40.25 \(2\), Stats.](#), and reference to the month in which the payment of a benefit is approved in [ss.40.04 \(4\) \(b\) and \(bm\) and 40.73 \(1\) \(a\) and \(2\) \(a\), Stats.](#)