STATE OF MINNESOTA

MINNESOTA STATE RETIREMENT SYSTEM

EXECUTIVE DIRECTOR

In the matter of the Proposed Amendment and Adoption of Revised Rules Relating to the Minnesota Public Employees Deferred Compensation Plan

STATEMENT OF NEED

The above captioned rules are amendments to existing rules of the Minnesota State Retirement System Deferred Compensation Plan. The last time the rules were amended was December 4, 1980.

A revision of the rules is necessary to implement the provisions of Section 457 of the Internal Revenue Code of 1954 as amended by the Internal Revenue Act of 1978 and final Internal Revenue Service regulations on State and Local Government Deferred Compensation Plans 47FR42335. The Executive Director's specific statutory authority to adopt such rules is set forth in Minnesota Statutes Section 352.96, subdivision 4 (1982).

The Executive Director is charged by Minnesota Statutes Section 352.96 (1982) to establish rules and procedures in such a manner as will qualify the amounts deferred under the plan for benefits afforded under Federal and State tax laws, regulations and rulings. Section 457 of the Internal Revenue Code of 1954, as amended by the Internal Revenue Act of 1978 and final Internal Revenue Service regulations 47FR42335 on State and Local Government Deferred Compensation plans set forth certain conditions and requirements in order for a plan to be an eligible plan, and therefore, afforded favorable tax treatment. The following amendments to the Minnesota State Retirement System Deferred Compensation Plan rules are reasonable and necessary to bring the plan into conformance with the above cited laws, code, and regulations. Without the indicated changes, that plan would not be considered an eligible plan, and therefore, monies deferred by participants may become presently taxable. Additionally, some minor administrative changes are made.

The need for each specific change to the rules is as follows:

2 MCAR S 3.5001. Establishment and purpose of plan

B. Purpose of Plan

Change in language to conform with the terminology used in the Internal Revenue Service code and regulations. No substantive change.

2 MCAR S 3.5002. Definitions

A. Definitions.

4. Change in language to conform with the terminology used in the Internal Revenue Service code and regulations. No substantive change.

6. a. Change to conform to proper name of fund as cited in Minnesota Statutes Chapter 11 A (1982). No substantive change.

6. b. To clarify that there are two investment account options available; a fixed or a variable account, one providing a fixed annuity and the other a variable annuity.

10. Change in language to conform with terminology of Internal Revenue Service code and regulations and to specifically point out the sections of the Internal Revenue Service code which limit the compensation used in determining the maximum amount a participant may defer.

11. To redefine normal retirement age to conform with the requirements of the Internal Revenue Service code and regulations, making clear that "normal retirement" does not mean "early retirement", and that participants may designate any age between the retirement plan's normal retirement age and age 70½ as "normal retirement age".

14. To define pay date as the day a participant receives payment of compensation to differentiate it from the pay period end date.

16. The definition of projected retirement date is deleted because the concept of a projected retirement date is not authorized under the new Internal Revenue Service code and regulations.

17. Defines separation from service for regular employment in conformance with Internal Revenue Service code and regulations. No substantive changes.

19. Defines unforeseeable emergency to conform with the definition in the Internal Revenue Service regulations.

2 MCAR S 3.5004. Participation in the plan

B. Enrollment

Pay period is changed to pay date to indicate more clearly to participants the actual day an application becomes effective.

D. Maximum deferment.

2. To delete reference to "projected retirement date" which is made obsolete by IRS regulations and to change language to conform with the Internal Revenue Service code and regulations, making clear that the "catch up" provision may be used only once whether fully utilized or not, and may be used only in the three taxable years ending before the year in which participant attains normal retirement age under the plan.

E. Modifications to amount deferred.

Pay period is changed to pay date to indicate more clearly to participant the actual day participant realizes the change requested.

F. Revocation of deferral.

Pay period is changed to pay date to indicate more clearly to participant the actual day participant realizes the change requested, and to make clear that employee cannot again defer compensation until next taxable year if he or she revokes all deferral. This is to avoid excessive administrative expense associated with frequent changes.

G. Duration of election to defer compensation language is changed to conform with the terminology used in Internal Revenue Service code and regulations. No substantive change.

H. Deferral adjustments.

4. Maximum deduction. Due to the employer's difficulty in absolutely insuring compliance with the maximum deferral, the rule is changed to insure that employer attempts to make the necessary correction, but that employee is ultimately responsible for the tax owed on salary withheld over the allowed maximum.

2 MCAR S 3.5005. Participants' accounts, investments and distributions

A. Deferred compensation accounts and valuation.

1. Participants' accounts. To indicate the specific sections of the rules that refer to distributions of accounts.

2. Financial responsibility of the employer. To indicate the specific sections of the rules that refer to distributions of accounts.

4. To reduce the administration charge for moneys deferred and invested in the Supplemental Investment Account from 2% to 1½%. Such change was warranted by favorable experience of the System and approved by the Legislative Auditor.

C. Investment of funds.

1. To make clear that since moneys deferred under the plan are remitted to the Executive Director by the employer, the director, not the employer, is responsible for the investments.

2. Investment options. To clarify that the fixed and the variable accounts are two separate accounts and to provide that the participant may invest with the State and/or with only one of the companies approved by the Investment Board at any one time due to significant administrative difficulties and payroll expense involved.

3. Investment preference requests for future compensation. To increase the number of times the participant may change his investment preference for future deferrals from once to twice a year.

4. Investment preference requests for past deferred compensation. To conform with above change in frequency and to establish a minimum amount which can be transferred or be a remainder. This limit is needed to avoid excessive administrative expense connected with transfers of small amounts, and also clarifies the kinds of transfers that are allowed. (See C (2), above.)

D. Distribution events.

All changes are made in order to comply with the requirements of Internal Revenue Service code 457 and the regulations, which limit the scope of authorized distributions.

E. Methods of distribution. To provide a standard form for use in making distribution elections.

1. To provide a method of distribution in the event no election is made by participant in the supplemental investment account. Under present rule if no election is made, the distribution is a lump sum, taxable in the year of distribution. Under the proposed rule, if no election is made, payment is spread out, and taxable, over a five (5) year, sixty (60) month period.

1. b. To limit the purchase of an annuity to one of the companies to curtail excessive administrative expense.

1. c. This limit in the distribution period, where no annuity is purchased, is needed to conform to Internal Revenue Service code and rules. The rule also provides a method of distribution of minimal amounts. This latter provision is needed to curtail administrative expense associated with distributions of small amounts.

2. To establish a date for making the elections and to provide a method of payment in the event no election is made by a participant in the fixed and/or variable annuity account.

2. b. To limit the period over which a period certain annuity may be paid to conform to Internal Revenue Service code and rules.

2. c. To conform to Internal Revenue Service code and rules by limiting joint annuities to spouses. Providing that if no election is made, the account will be paid out over five years to avoid having it all taxed in one year. To make specific the time when small accounts will be paid.

F. Date of distribution.

Under the present rule participants and beneficiaries have rather broad flexibility in designating and changing the time of distribution of assets. The IRS regulations greatly restrict the flexibility, and this change is made to conform to Internal Revenue Service code and rules.

1. To conform to Internal Revenue Service code and rules, this provision specifies the time periods after separation from service during which a participant must make an irrevocable election of distribution.

2. To conform to Internal Revenue Service code and rules, this provision designates the events and time period authorized for a distribution to a beneficiary.

3. To conform to Internal Revenue Service code and rules, this provision states that once payment starts, the time and method of distribution cannot be changed, except for unforeseen emergencies.

4. Language is changed to conform to Internal Revenue Service code and rules. No substantive change.

5. To conform to Internal Revenue Service code and rules, this rule states the time of distribution if the time has not been elected prior to separation from service.

G. Unforeseeable emergency.

This rule makes two clarifications as follows:

1. The insurance company annuity contracts provide that once distribution begins, only monthly payments are payable. This is now also stated in the rule so that participants will not be confused.

2. To conform to Internal Revenue Service code and rules, this rule requires that when a participant seeks an emergency distribution, his or her deferrals automatically stop.

H. Designation of beneficiary.

To clarify that as to participants with funds in the fixed or the variable annuity accounts, more than one beneficiary may be named and that a change of beneficiary is allowed.

I. Leave of absence.

Language is changed to conform with the terminology used in the Internal Revenue Service code and regulations. No substantive change.

J. Separation from service by independent contractor

Provides the conditions constituting separation from service by independent contractors in conformance with Internal Revenue Service code and regulations by adopting the language of the regulation.