

## Executive Director Update

February 10, 2012

### Cash Balance Accounts Established!

On behalf of the ATRS Board of Trustees, I am pleased to announce to the members of ATRS that the ATRS Board is establishing a **new and innovative plan** to help members who are retiring from T-DROP and want all or part of their T-DROP account balance in an account with **HIGHLY** competitive interest rates with **PROTECTION** of principal by ATRS! The ATRS Board met on Monday, February 6, 2012, and began a rule-making process that establishes a **cash balance account** for ATRS members **retiring** from T-DROP. The CBA program should be available for members retiring from T-DROP on **July 1, 2012**. ATRS will call this account the "**CBA**" for **T-DROP Cash Balance Account**. The member's CBA principal and the interest paid by ATRS on the CBA are tax-deferred until the member makes a withdrawal. The ATRS Board is excited to provide ATRS members with this new option for their T-DROP balances when the member is ready to retire and must decide how to distribute the balance in their T-DROP account.

### Background on T-DROP

Before I discuss CBAs, it may be important to give a brief explanation on how a T-DROP account works. T-DROP is a program available to members with 28 or more years of service and can be entered without an early entry penalty at 30 years of service. T-DROP is an elective program and must be entered by filing an application with ATRS. ATRS has only one entry date a year for T-DROP, July 1<sup>st</sup>. ATRS must have an application by May 31<sup>st</sup> to begin on July 1<sup>st</sup>.

When a member enters into T-DROP, ATRS begins accruing a T-DROP balance for the member through monthly deposits into a member's account while the member is still working and earning a salary at an ATRS employer. The monthly deposit is usually between 60% and 70% of what the member's retirement check would have been if the member had simply retired instead of entering T-DROP. The member cannot spend or obtain T-DROP balances until the member actually retires.

One time a year, on June 30, a member in T-DROP is provided between 2% and 6% interest on the balance in their T-DROP account, depending upon the investment returns of ATRS for the prior year. For 2011, ATRS members' T-DROP balances received 6% interest on the weighted balance in their T-DROP accounts. For June 30<sup>th</sup> 2012, the rate is again 6%. When a member is ready to retire, the member's T-DROP account often

contains a sizeable amount of money. Accounts sometimes have \$200,000, \$300,000 or more if the member stays in T-DROP for the allowed 10 years. When a member retires, he or she must decide how the balance in the T-DROP account is going to be distributed. This is where the CBA becomes a great option for the member!

## **Old Options**

Previously, ATRS offered only two alternatives to distribute the T-DROP balances at retirement. **Those options are both still available.** One option is to "cash out" the account by rolling the balance out to another retirement administrator to manage the balance on behalf of the member. Another way to "cash out" the account is for ATRS to send a check to the member as immediately taxable income and withhold taxes.

A second option is for the member to annuitize the T-DROP balance with ATRS and receive a higher monthly benefit from ATRS for the rest of the member's life. This option lets the member get the value of the T-DROP account over time through monthly payments that is added to the regular retirement check. If the member dies before the T-DROP balance is exhausted, then the balance left is paid by residual balance payment to the member's beneficiary.

Beginning July 1, 2011, ATRS has allowed members to split their account balance between the two options explained above by allowing the member to roll out a percentage and also annuitize the rest with ATRS. Thanks to the ATRS Board's focus on giving more options to members, members now can annuitize 100%, 75%, 50%, or 25% and roll the balance out to another plan administrator. The ATRS Board heard the members and provided an option to members that allowed a division of the T-DROP balances between annuitizing and rollout to better serve members.

## **The ATRS Board's Latest Innovation: CBAs**

The ATRS Board's latest innovation is to offer CBAs. The benefit of a CBA is that upon retirement, a member will be allowed to leave their T-DROP account balance **with** ATRS in one of two ways. First, a member will still be allowed to annuitize all or part of their T-DROP balance. Second, the member can also put all or part of their T-DROP balance in a CBA. The member may also split the account balance between annuitizing part of the account and leaving the rest in a CBA with ATRS. The CBA will pay annual interest with **very competitive interest rates** for members and provide the safety of ATRS protecting the principal for the member!

The ATRS CBAs are designed to preserve principal, while paying very competitive interest rates. It is also designed to reward members who leave a CBA over the years with ATRS by interest rates that rise over time to 4% annual interest! The rates that apply when a member enters the CBA program **are not subject to reduction** but may be increased on an ad hoc basis.

### **CBA Provisions**

If a member retires and leaves all or part of their T-DROP balance in a CBA, then the member may make quarterly withdrawals of money from the CBA that the member may need in retirement. (No withdrawal may be made in the first quarter that a member enters the CBA program.) However, if a member has already made a withdrawal in a quarter and an emergency occurs, ATRS will allow a hardship withdrawal if the member proves hardship even though the member has already made a quarterly withdrawal.

Members are allowed, but not required, to make quarterly withdrawals. Once a member reaches 70 ½ years of age, certain annual withdrawals are required by federal law. For all money left in the account over an entire fiscal year, ATRS will pay 2% interest for that first fiscal year. If withdrawals are made, ATRS will use a weighted average balance to apply interest. (ATRS cannot allow money to be rolled back into ATRS for those who have already retired from T-DROP due to federal law restrictions.) All money that stays in the CBA account for two fiscal years will draw interest at 2.25% with the interest increasing over time to 4%. The interest schedule is listed below.

After one (1) complete fiscal year:	2.00% interest
After two (2) complete fiscal years:	2.25% interest
After three (3) complete fiscal years:	2.50% interest
After four (4) complete fiscal years:	2.75% interest
After five (5) complete fiscal years:	3.00% interest
After six (6) complete fiscal years:	3.25% interest
After seven (7) complete fiscal years:	3.50% interest
After eight (8) or more complete fiscal years:	4.00% interest

The rule being adopted provides that this is a minimum interest rate that will not be reduced over time. This means that members entering the cash balance account on July 1, 2012, are guaranteed these rates are minimum rates that will never be reduced. However, the ATRS Board has made it possible within the rules that if investment market conditions change or ATRS has good returns in the market, the interest rates may be increased on an ad hoc basis. At the same time, the interest rates that are in place when a member enters the CBA program will never be reduced below the floor for the interest

rates that are being set between 2% and 4% as explained above. For instance, once a member's CBA has been in place 8 fiscal years, the member will always get **at least 4%** interest on the account balance!

Because of how ATRS rules are adopted, it is expected that as ATRS develops these rules, the ATRS staff will be preparing forms for members to use. However, until the rules are in final form and fully adopted through the Administrative Procedures Act, ATRS will not be providing members forms for official use. Based upon the notice periods and steps that must be taken for standard rules to be adopted, the ATRS Board will schedule a special meeting in late March or early April to speed up the rule making process to make the CBA rule an emergency rule so members will be guaranteed to have the CBA rule in place by July 1, 2012. In fact, the ATRS Board took a **unanimous straw vote** by show of hands on Monday, February 6, 2012 of the Board's willingness to adopt the CBA as an emergency rule to implement CBAs. The straw vote was to assure members that the ATRS Board is unanimous in its commitment to adopt an emergency rule in late March or early April to allow T-DROP participants who are retiring on or after July 1, 2012, to have the cash balance account as an option by July 1<sup>st</sup>.

As soon as the emergency rules are adopted, ATRS staff will send out revised forms to all members in T-DROP who have filed a retirement application for July 1, 2012, or later, and will inform members who have already elected a different option of this new opportunity. Members who have already made a decision on how their T-DROP balance will be distributed can adjust it to take advantage of the cash balance account. Even at this time, since the rule has already been positively approved by the ATRS Board, ATRS staff will begin responding to questions from members and providing information about the cash balance account and how it will work for members.

The ATRS Board continues to look for innovative ways to assist members in retirement planning and to protect members' assets. The ATRS Board is working hard to enhance the ability of ATRS employers to **Recruit, Retain and Reward** career educators (**The Three "Rs" of the Arkansas Teacher Retirement System**). I hope that members in T-DROP and members who are considering entering T-DROP will find this new innovation by the ATRS Board to be a great new option that provides members the safety and security of protecting their T-DROP principal, while at the same time, providing competitive interest rates that should catch the attention of members who would like to take advantage of this special opportunity that is now becoming an option for ATRS participants.