

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 1057 (Pogemiller); H.F. 1120 (Powell): MSRS; Early Retirement Incentives and Voluntary Unpaid Leave Options

S.F. 1845 (Larson); H.F. 1953 (Cornish): MSRS; Post-Retirement Employment Option and Voluntary Hours Reduction Plan

DATE: April 4, 2005

Summary of the First Engrossment of S.F. 1057 (Pogemiller); H.F. 1120 (Powell)

The first engrossment of S.F. 1057 (Pogemiller); H.F. 1120 (Powell) contains uncoded early retirement and voluntary leave provisions, as follows:

- a. Temporary Targeted Early Retirement Incentive. A temporary targeted early retirement incentive program would be established, applicable to the period following final enactment to September 1, 2005, for a State employee who has at least five years of service, who is immediately eligible to a retirement annuity upon retirement, who terminates State service between final enactment and September 1, 2005, and who is offered the incentive by the State employee's employing unit. The incentive is a dollar amount up to \$17,000, which may be used only as follows:
  - (1) if the employee retires before July 15, 2005, the amount is for deposit in the employee's healthcare savings plan under Minnesota Statutes, Section 352.98;
  - (2) if the employee retires between July 15, 2005, and September 1, 2005, the amount is for the purchase of allowable service credit for future unperformed employment sufficient in combination with proceeds from the person's deferred compensation program account to qualify for the "Rule of 90" early normal retirement age provision if employment terminates after July 15, 2005, or the amount is for the purchase of an additional annuity under the Minnesota State Retirement System Unclassified State Employees Retirement Program (MSRS-Unclassified).
- b. Phased Retirement/Reduced Employment and Retirement Annuity Receipt. Additionally, a State employee covered under the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the State Correctional Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Correctional), or the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) who is employed for at least half time, who agrees to a reduction of 25 percent in their regularly scheduled work hours, and who is eligible for an immediate unreduced retirement annuity from the applicable plan is permitted to continue active employment as agreed, without earning additional service credit, and to receive a retirement annuity without any reemployed retirement annuity limitation. The employee would be eligible for health insurance coverage as collectively bargained for State employees. Severance pay is not payable until the person actually terminates State employment. The assignment of work hours would be an employer determination. Once the phased retirement position is vacated by the termination of the employee, the employer cannot continue the position as part-time employment. The phased retirement option is exclusive of all other options.
- c. Reduction in Employment to Half-Time. Also, a State employee is permitted to reduce their work hours to half-time and continue to make full member contributions to a state retirement plan, have full employer contributions made on their behalf to a State retirement plan, and receive full allowable service from a State retirement plan.
- d. 1,040 Hour Voluntary Leave. In addition, a State government employer may allow State employees to take a voluntary leave of 1,040 hours during the fiscal years 2006-2007 biennium and continue to make the balance of full member and employer contributions during the leave.

Summary of S.F. 1845 (Larson); H.F. 1953 (Cornish)

S.F. 1845 (Larson); H.F. 1953 (Cornish) contains an option for post-retirement reduced hours employment by a State employee in the executive branch, the Minnesota State Retirement System (MSRS), or the Office of the Legislative Auditor who retires after at least five years of state employment from a half-time or greater position and is eligible for a retirement annuity from the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), for a one-year period and renewable five times and authority to reduce employment hours to no more than half time, with full-time state employee retirement coverage, but not more than three years in total.

Background on Early Retirement Incentive Programs

Minnesota has utilized several early retirement incentives in connection with its public employee workforce over the past several years. Prior to 1982, there was little systematic legislative experience with early retirement incentives for Minnesota public employees other than the teacher mobility provisions of the mid-1970s. Since 1982, the following early retirement incentives have been enacted to apply to Minnesota public employees:

<b>Year</b>	<b>Citation</b>	<b>Coverage Group(s)</b>	<b>Retirement Plan Based Early Retirement Incentive</b>	<b>Other Employment Benefit Early Retirement Incentive</b>
1982	Laws 1982, Chapter 522, Sections 1 and 2	State employees and University of Minnesota employees	None	Pre-age 65 state paid health insurance coverage
1984-1987	Minnesota Statutes, Section 356.70	Members of MSRS-General, PERA-General, TRA, 1 <sup>st</sup> Class Teachers	Full accrued benefit without reduction when "Rule of 85" reached	N/A
1990	Laws 1990, Chapter 591, Article 2, Section 6	MSRS-General, MSRS-Correctional, State Patrol	N/A	Pre-age 65 state paid health insurance coverage
1991	Laws 1991, Chapter 345, Article 1, Section 112	Various state and retirement plan employees	N/A	Pre-age 65 state paid health insurance coverage
1992	Laws 1992, Chapter 499, Article 7, Sections 12 and 13	Teachers	N/A	Pre-age 65 employer paid health insurance coverage
1992	Laws 1992, Chapter 513, Article 4, Sections 58 and 59	Various state, retirement plan, and public employees, teachers	N/A	Pre-age 65 employer paid health insurance coverage
1993	Laws 1993, Chapter 192, Section 108	Members of MSRS-General, PERA-General, or MERF	Additional benefit of 0.25 percent of final average salary for each year of service up to 30 years	Alternative benefit of pre-age 65 employer-paid health insurance coverage
1993	Laws 1993, Chapter 224, Article 8, Sections 17 and 18	Members of TRA or 1 <sup>st</sup> Class City Teachers	Additional benefit of 0.10 percent of final average salary for each year of service up to 30 years	Additional benefit of pre-age 65 employer-paid health insurance coverage
1994	Minnesota Statutes, Section 122.23, Subdivision 20	Teachers in consolidating school districts	Purchase of up to five additional years of service credit	Pre-age 65 employer-paid health insurance coverage, extended leaves of absence, or severance payment
1994	Laws 1994, Chapter 518	Various local government employees	Same as Laws 1993, Chapter 192, Section 108	Same as Laws 1993, Chapter 192, Section 108
1994	Laws 1994, Chapter 572, Section 3	Displaced higher education employees	Purchase of up to two additional years of service credit	Pre-age 65 employer-paid health insurance coverage

<b>Year</b>	<b>Citation</b>	<b>Coverage Group(s)</b>	<b>Retirement Plan Based Early Retirement Incentive</b>	<b>Other Employment Benefit Early Retirement Incentive</b>
1995	Laws 1995, Chapter 262, Article 1, Sections 17 through 25	Metropolitan Council employees; Minnesota Historical Society employees	Additional benefit of 0.25 percent of final average salary for each year of service up to 30 years for MSRS-General, PERA-General, or MERF members and additional benefit of 0.10 percent of final average salary for each year of service up to 30 years for TRA or first class city teacher retirement fund associations' members	Alternative benefit of pre-age 65 employer-paid health insurance coverage
1999	Laws 1999, Chapter 222, Article 7	Employees of the Metropolitan Council	Additional benefit of 0.25 percent of final average salary for each year of service up to 30 years	None
2002	Laws 2002, Chapter 392, Article 14, Section 1	State employees	N/A	Permits voluntary leaves up to 320 hours of leave without losing seniority rights, insurance, and pension and other benefits for the period ending June 30, 2003
2003	Laws 2003, First Special Session, Chapter 1, Article 2, Section 130	State employees	N/A	State government appointing authorities may allow employees to take leaves without pay for up to 1040 hours prior to June 30, 2005. Vacation, sick leave, seniority, and health care benefits continue to accrue during the leave period in the applicable pension plan; employee and employer contributions must be made to the applicable plan. An appointing authority may, at its discretion, pay the employee contributions on behalf of the employee
2003	Laws 2003, First Special Session, Chapter 12, Article 1	PERA-General, PERA-P&F, PERA-Correctional	N/A	Public employees who previously worked at least half time may enter into an agreement with the employer to reduce work hour to less than half time. Contributions may be made to the applicable PERA plan as though the individual had not reduced hours. Thus, the employment reduction does not harm the individual's eventual retirement annuity. The second program involves voluntary leaves. If the individual makes the employee contribution to the applicable retirement plan during the leave, the employer must make the applicable employer contribution. Under both programs, all other benefits including health care coverage as provided under the collective bargaining agreement are retained. The programs apply to the period ending June 30, 2005. Inclusion in either program requires an agreement between the employee and employer, and the employer is authorized to designate job classifications or positions that qualify for each option

Year	Citation	Coverage Group(s)	Retirement Plan Based Early Retirement Incentive	Other Employment Benefit Early Retirement Incentive
2003	Laws 2003, First Special Session, Chapter 12, Article 3	TRA; 1 <sup>st</sup> Class City Teacher Retirement Fund Associations	For TRA-covered districts only, the employer may enter into agreements with the exclusive bargaining representative of the teachers in the district to cover, for specific individual teachers, all or a portion of the employee contribution to the retirement plan while the teacher is on an extended leave of absence.	School districts may enter into agreements with the exclusive bargaining representative of the teachers in the district to cover, for specific individual teachers, all or a portion of health care coverage premiums while the teacher is on an extended leave of absence
--	Collective Bargaining Agreement	Patrol, BCA, Conservation Officers	N/A	Employer-paid health and dental insurance premiums
--	Collective Bargaining Agreement	State University Faculty	N/A	Severance payment; employer-paid health insurance premium for one year
--	Collective Bargaining Agreement	State University Administrative Personnel	N/A	Severance payment; employer-paid health insurance premium for one year
--	Collective Bargaining Agreement	Community College Faculty	N/A	Severance payment; employer-paid health insurance premium for one year
--	Personnel Policy	Displaced Higher Ed Board Excluded Administrators	N/A	Severance payment
--	Personnel Policy	Community College Unrepresented Administrators	N/A	Severance payment; employer-paid health insurance premium for one year

The various early retirement incentives have been enacted or implemented for a variety of reasons. Most of the early retirement incentives were apparently implemented to assist in resolving State budget difficulties by encouraging retirements instead of layoffs or other involuntary terminations. Those early retirement incentives were enacted not primarily to benefit public employees, but to use a potentially advantageous benefit to induce higher-paid, longer-service employees to terminate active public employment at an earlier age than they otherwise would retire. The savings that potentially will accrue to the public employer in this circumstance are dependent on the employer not filling the employment position with another employee or on the employer filling the employment position with another employee at a much smaller salary.

When a public pension plan provides an early retirement incentive, the public pension plan is fulfilling its prescribed function within the overall personnel compensation and benefit system. Public employee pension plans exist primarily to assist the public employer's personnel system by aiding in the recruitment of new public employees, the retention of existing trained and productive public employees, and the predictable systematic out-transitioning of public employees who have reached the end of their regularly expected productive working career. This is done by adopting a retirement plan that provides a sufficient post-retirement income (adequate based on pre-retirement earnings) and that is competitive with other potential employers. In providing an early retirement incentive, the public employee pension plan is emphasizing the out-transitioning function and is attempting to speed up its timing. Other employment benefit coverage, such as severance pay or employer-paid early retirement health insurance premiums, can also assist in this out-transitioning function.

#### Discussion and Analysis

The first engrossment of S.F. 1057 (Pogemiller); H.F. 1120 (Powell) creates four early retirement incentive or related programs, as follows:

1. Early Retirement Incentive. An executive or legislative branch employing unit may offer up to \$17,000 to an employee who is immediately eligible to retire, who has at least five years of Minnesota public pension plan coverage, and who retires before September 1, 2005, for deposit into the person's post-retirement healthcare savings account if the person retires before July 15, 2005, or used to

purchase enough service credit to qualify for the “Rule of 90,” or used to purchase an annuity from the Unclassified State Employees Retirement Program (MSRS-Unclassified);

2. Phased Retirement Option. An MSRS-General State Employees Retirement Plan (MSRS-General) member who is employed on a half-time basis or more, agrees to a reduced work schedule of 25 percent down to no more than half-time, and qualifies for an immediate unreduced MSRS-General annuity may receive the annuity without any reemployed annuitant earnings limitation reduction or suspension;
3. Voluntary Hour Reduction Plan. A State employee who is employed on at least a half-time basis and who is covered by a pension plan administered by MSRS may reduce work hours to half-time or less and may receive full pension plan allowable service credit with the payment of full member contributions and with the employing unit would pay the full employer contributions; and
4. Voluntary Unpaid Leave of Absence. A State employing unit may allow an employee to take an unpaid leave of absence for up to 1,040 hours during the fiscal years 2006-2007 biennium, with the employee eligible to pay the member and employer contributions during the leave period.

S.F. 1845 (Larson); H.F. 1953 (Cornish) contains an option for a pre-retirement agreement for post-retirement half-time reemployment in one-year increments, renewable five times, for state executive branch, Minnesota State Retirement System (MSRS), or Office of the Legislative Auditor employees who have at least five years of service and qualify for an immediate retirement annuity and the option to reduce the person’s employment hours with the continuation of full-time retirement contributions.

The proposed legislation raises several pension and related public policy issues that the Commission may wish to discuss and consider, as follows:

1. S.F. 1057 (Pogemiller); H.F. 1120 (Powell): Ambiguity in Specifying Agencies Allowed to Offer Incentive. The policy issue is the ambiguity in the provision in specifying the State agencies that would be permitted to offer the early retirement incentive. It is unclear whether all MSRS employers, such as the Minnesota State Colleges and Universities System (MnSCU), the University of Minnesota, the Minnesota State Retirement System (MSRS), the Minnesota Historical Society, the Legislature, or the Court System can use this incentive. The incentive program would benefit from a more careful delineation of the employing entities that the provision is intended to cover.
2. S.F. 1845 (Larson); H.F. 1953 (Cornish): Appropriateness of Restricting Options to the Executive Branch, MSRS, and the Office of the Legislative Auditor. The policy issue is the appropriateness of targeting the options solely to the executive branch, the Minnesota State Retirement System (MSRS), and the Office of the Legislative Auditor. Targeting is intended to insure that there are budgetary savings among agencies with budgetary pressures. While there are budgetary pressures in some executive branch agencies funded from the General Fund and in the Office of the Legislative Auditor, it is unclear what budgetary pressures are borne by MSRS, which is not funded from the General Fund. There are no restrictions that appear to limit the options to executive agencies with budgetary pressures that are funded from the General Fund. Also, it is unclear whether or not the Minnesota State Colleges and Universities System (MnSCU) is in the executive branch and covered by the options.
3. S.F. 1057 (Pogemiller); H.F. 1120 (Powell) and S.F. 1845 (Larson); H.F. 1953 (Cornish): No Monitoring of or Final Approval Over the Designation of Which Employees are to be Offered an Incentive or Option as a Check on its Fiscal Impact. The policy issue is the lack of any mention of a mechanism for the monitoring of or granting final approval over agency designation of employees to be offered an early retirement incentive or post-retirement option in order to insure that there is an actual fiscal savings and in order to minimize any potential discrimination or other impropriety in making the designations and offers. While the up-front cost to the employing unit of up to \$17,000 in offering an early retirement incentive under S.F. 1057 (Pogemiller); H.F. 1120 (Powell) should insure that the early retirement incentive program in each agency is actually targeted and well considered, inadvertent mistakes are still possible that could be avoided if some review or approval process is utilized, and some mischief could occur where State employees with political, social, or family connections are inappropriately included in the early retirement incentive offer, but could be avoided with the existence of a “second look” review or approval process. The post-retirement options under S.F. 1845 (Larson); H.F. 1953 (Cornish) only require the use of Department of Employee Relations (DOER) forms, leaving each employing unit full discretion to offer options.

4. S.F. 1057 (Pogemiller); H.F. 1120 (Powell) and S.F. 1845 (Larson); H.F. 1953 (Cornish): Using Pension Plan Service Credit Does Not Necessarily Target Long-Term, Higher-Paid State Employees. The policy issue is the appropriateness of using a minimum of five years of service credit as a suitable measure for selecting eligible State employees. The usual rationale for an early retirement incentive program is that inducing early retirements by long-service employees who are higher on the salary ladder and who are closer to retirement produces a more positive budget balancing impact than layoffs, which target the least senior and least well-paid employees. However, the proposed legislative conditions the incentive on a minimum of five years of service credit, presumably in any of Minnesota's statewide or major local pension plans. Thus, someone with four years of teaching service in the Duluth Teachers Retirement Fund Association (DTRFA) who may have changed careers (or may even have retired from DTRFA) and now has an additional year of State employment could qualify for the \$17,000 incentive under S.F. 1057 (Pogemiller); H.F. 1120 (Powell), which could cost more than a layoff. A better measure to limit the program to long-term State employees would be to focus the qualifications to the length of State employment. The Department of Employee Relations (DOER) maintains records of State employment for seniority, vacation leave accrual, and sick leave accrual purposes and could be used as an appropriate mechanism for verifying the employment duration requirement.
5. S.F. 1057 (Pogemiller); H.F. 1120 (Powell) and S.F. 1845 (Larson); H.F. 1953 (Cornish): Retirement Incentive Could Include Reemployed Annuitants Rather than Career State Employees. The policy issue is the appropriateness of potentially including public pension plan annuitants who have become reemployed in State employment and are unlikely to produce the type of salary savings that are needed to offset a \$17,000 expenditure over the remainder of this or the next biennium under S.F. 1057 (Pogemiller); H.F. 1120 (Powell) or to make the post-retirement option successful under S.F. 1845 (Larson); H.F. 1953 (Cornish). Many local police and paid firefighter relief associations permitted retirements at age 50 and those retirees may have sought second careers in State employment and would now qualify for the incentive. State Patrol Retirement Plan retirees, who typically retire at age 55, are not covered by any reemployed annuitant earnings limitations, and routinely are reemployed in State employment that potentially could qualify for the incentive. These State employees are unlikely to be a good target group for the salary savings presumably hoped to be gained by the incentive or post-retirement option. Disallowing employees who have already retired from another Minnesota public pension plan will avoid second career reemployed annuitants from eligibility, thereby maintaining the targeting on long-term career State employees.
6. S.F. 1057 (Pogemiller); H.F. 1120 (Powell) and S.F. 1845 (Larson); H.F. 1953 (Cornish): Retirement Incentive or Post-Retirement Option Eligibility Has No Upper Age Limit. The policy issue is the appropriateness of attempting to provide an early retirement incentive or post-retirement option for employees who are older than the generally applicable normal retirement age. The proposed legislation, in effect, sets a minimum age of 55 by requiring immediate retirement eligibility, but has no upper-end age limitation or surrogate condition. If a State employee already is eligible to receive an unreduced normal retirement annuity, their continuation in employment likely has some other rationale and they consequently would be less likely or unlikely to utilize the incentive. Any incentive under S.F. 1057 (Pogemiller); H.F. 1120 (Powell) applied to these State employees could simply become a windfall for them, especially if the change in working conditions and workload following a budget balancing effort could easily lead them to retire without an incentive.
7. S.F. 1057 (Pogemiller); H.F. 1120 (Powell): Incentive Needs Clear Election Process. The policy issue is the need for a clear manner in which an eligible State employee in a designated employment position elects to take the incentive. Acceptance of the early retirement incentive offer simply by terminating State employment should be avoided. While that action is a perfectly acceptable manner to indicate agreement to some offers, retirement is a very serious life-changing event and utilizing a written acceptance process rather than acceptance through employment termination would provide more clarity in the process.
8. S.F. 1057 (Pogemiller); H.F. 1120 (Powell): The Incentive is Unclear on the Nature of the Annuity to be Purchased. The policy issue is the need to more clearly specify what kind of annuity is available to be purchased. Most annuities in public retirement plans are single life annuities. Optional annuity forms include term certain and for life annuities. Term certain annuities not for life may be more appropriate than term certain and for life annuities. Using a term certain annuity that is also not payable for life as part of the incentive, with a consequent shorter average payout period, will permit the incentive annuity to be used as a bridging device between employment and a regular retirement annuity at a later age. If the term certain annuity is the usual term certain annuity currently provided by Minnesota public pension plans (i.e., for a period of years and for life) the \$17,000 incentive

amount likely will produce too small a monthly amount (about \$100 per month at age 65, about \$95 per month at age 60, and about \$90 per month at age 58) to permit this bridging.

9. S.F. 1057 (Pogemiller); H.F. 1120 (Powell): \$17,000 Incentive May Have Limited Appeal. The policy issue is the potential disparity between the expectations for the success of this proposed incentive in encouraging large salary savings accruing to the State general fund through the accelerated or premature retirement of numerous senior high-paid State employees and its actual performance. In a retirement setting, \$17,000 is less significant than it might initially appear. For all retirees from the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the present value of their retirement benefits is in excess of \$150,000. The present value of the retirement benefit of a new retiree at age 60, with 30 years of service credit, and a \$50,000 highest five successive years average salary approaches \$300,000. Thus, an additional \$17,000 in value is not a large percentage increase in retirement value. For State employees contemplating retirement at a relatively early age (at age 55 or thereabouts) and with an average life expectancy of at least 78 years, the \$17,000 incentive value may be spread very thin, meaning that fewer State employees will be induced to prematurely terminate State employment than may have been expected by the designers of the incentive.
10. S.F. 1057 (Pogemiller); H.F. 1120 (Powell): Incentive May Provide a Windfall to Some Retirees. The policy issue is the potential that the proposed early retirement incentive may be offered to some State employees who would have terminated State employment before September 1, 2005, anyway, without the incentive, thereby providing them with a windfall and reducing the actual net savings that the State would receive. The windfall potential can only be countered by careful targeting by affected agencies, where the State agency has a good sense of the future plans of its employees who will retire before September 1, 2005, anyway, induced by increasing workloads or other post-budget reduction employment conditions, and its employees for whom up to \$17,000 would provide the necessary nudge into a premature retirement and adjusts accordingly.
11. S.F. 1057 (Pogemiller); H.F. 1120 (Powell): Incentive Will be Futile if Substantial Rehiring Occur. The policy issue is the futility potentially involved with the proposed early retirement incentive if State employees who take the incentive are reemployed by the State or retained as a consultant by the State in the near term following retirement. The incentive will produce the most salary savings if the position of the retiring employee is not filled and if total State employment is reduced on balance by the incentive. One way to insure that maximum savings is to prohibit the retiree receiving the incentive from being reemployed by the State or from being retained as a consultant by the State for a period of years after retirement.
12. S.F. 1845 (Larson); H.F. 1953 (Cornish): Appropriateness of Permanent Post-Retirement options and Reduced Hour/Full Retirement Coverage Option. The policy issue is the appropriateness of having the proposed post-retirement employment options and the part-time state employment/full-time retirement coverage option become permanent provisions. The somewhat narrow specification of covered employing units may be appropriate at this time, but it may not be appropriate or useful in the future. The post-retirement employment option excludes the person from the application of the reemployed annuitant earnings limitations, but does not amend or add a crossreference to the appropriate General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) provisions, which a permanent provision should do. Similarly, the reduced employment hours/full-time retirement coverage provision is permanent, but contains no amendment in or crossreference added to the appropriate MSRS-General provisions.