



S.F. 2463
(Rummel)

H.F. 2651
(McFarlane)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-General and PERA-P&F
Relevant Provisions of Law: Special Law Request
General Nature of Proposal: Allow annuity form revision to provide future annuity payments as though Social Security leveling option (accelerated annuities) had not been elected and received
Date of Summary: February 5, 2010

Specific Proposed Changes

- Allow a School District #622 and Ramsey County Sheriff's Department retiree who started receiving PERA annuities in 1994 to rescind his accelerated annuity option annuities from the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) and Public Employees Police and Fire Retirement Plan (PERA-P&F) and to receive prospective payments as though the annuities received to date had not been accelerated.

Policy Issues Raised by the Proposed Legislation

1. Precedent. Would set a precedent by permitting an individual to rescind election of accelerated annuity options many years after benefits had commenced.
2. Lack of any harm to justify the requested treatment.
3. The requested treatment is contrary to Commission's Principles of Pension Policy.
4. Opposition by PERA.
5. Cost.
6. Difficulty of creating any potential expansion for similar individuals without totally undermining pension plan financing.
7. Current depressed actuarial condition of PERA-General and PERA-P&F.

Potential Amendments

There are no proposed amendments.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director *EB*
RE: S.F. 2463 (Rummel); H.F. 2651 (McFarlane): PERA; Revising Social Security Leveling Option to a Single-Life Annuity for a Certain PERA-General Basic Plan and PERA-P&F Retiree
DATE: February 5, 2010

Summary of S.F. 2463 (Rummel); H.F. 2651 (McFarlane)

S.F. 2463 (Rummel); H.F. 2651 (McFarlane) revises the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) basic program and the Public Employees Police and Fire Retirement Plan (PERA-P&F) Social Security leveling option annuity currently being received by William Ziemer, identified in the bill by birth date and various other specific information, to the equivalent of a single-life annuity, to be paid prospectively.

Pension Situation of William Ziemer

William Ziemer began drawing retirement annuities from two PERA plans June 1, 1994, when he was age 56. Mr. Ziemer had five years, six months of service covered by the PERA-General basic program and 21 years, two months of PERA-P&F covered service. Neither the program nor the plan is coordinated with Social Security. For these two annuities, Mr. Ziemer selected an accelerated annuity, also sometimes called a Social Security leveling option, an annuity form under which the plan pays an increased amount prior to the earliest age for receipt of Social Security old age insurance benefits (age 62) and a lower amount thereafter, to compensate for the accelerated early payout. These leveling options are further described later in this memorandum. The PERA annuity application forms included a statement that the individual has read the forms and understands the implications of the annuity form selected. These forms were signed by Mr. Ziemer and notarized.

The selection of a Social Security leveling option is a rather odd selection for Mr. Ziemer, given that his public employment was covered by two plans not coordinated with Social Security. This option is more typically selected by individuals who are in plans which are coordinated with Social Security, and who terminate service and commence drawing an annuity from the Minnesota plan before age 62.

Mr. Ziemer may have chosen the accelerated annuity (Social Security leveling option) simply because he had a preference or need for higher income in the early years of retirement, or he may have had outside employment not covered by the public retirement plan which entitled him to Social Security old age insurance benefits at age 62, or perhaps a spouse had that coverage.

Background Information

1. Coordinated Plans. Currently, nearly all members of PERA-General are coordinated members. Any new PERA-covered employee hired since the early 1970s is required to be coordinated with Social Security. Under a coordinated plan the benefits are relatively low, but so are the contributions needed to support that benefit, because the individual also pays into the Social Security system for that Minnesota employment and will be receiving Social Security benefits in retirement. The Minnesota coordinated plan is designed to provide an adequate benefit in retirement when combined with Social Security old age insurance benefits and distributions from personal savings.
2. PERA-General Basic Program. Before PERA-General became a coordinated program, all of its members were basic members (no Social Security coverage). When PERA coordinated with Social Security, the basic employees were permitted to become coordinated members, but some chose not to do so. The PERA-General basic program provides a higher benefit per year of service (and requires higher contribution rates to support those benefits) than the coordinated program because a basic member is not paying into the Social Security old age insurance program for the Minnesota employment and is assumed to not receive Social Security old age insurance benefits in retirement. The PERA basic benefit must be sufficiently high to permit an individual, who provided many years

of public service, to survive through retirement with a reasonable standard of living on just the PERA basic benefit and distributions from personal savings.

3. Public Employees Police and Fire Retirement Plan (PERA-P&F). PERA-P&F is a public safety retirement plan, providing coverage to most police officers and paid firefighters in the state. The program provides generous benefits per year of service because the plan is not coordinated with Social Security and because individuals providing police and fire service need to be relatively young, given the dangerous and rigorous nature of the employment. The plan has a low normal retirement age, age 55. Currently, PERA-P&F provides a benefit of three percent of the high-five average salary per year of service. The high-five average salary is the average salary during the five years that provide the highest average. These are typically the years just prior to retirement or termination of service. Given that three percent accrual rate, an individual with 30 years of PERA-P&F service would receive an annual benefit equal to 90 percent of the high-five average salary.
4. Social Security Leveling Options. Social Security leveling options were added to several pension plan systems decades ago to address the gap that can occur between the time that an individual may retire from a state or local pension plan and the age at which the individual will be able to receive Social Security old age insurance benefits. In general employee plans, individuals typically may terminate service and begin drawing an annuity as early as age 55, but are not eligible to commence receipt of a Social Security old age insurance benefit until age 62. The Minnesota State Retirement System (MSRS) leveling option provision is Section 352.116, Subdivision 3; PERA's provision is Section 353.29, Subdivision 6; the Teachers Retirement Association (TRA) provision is Section 354.35; and the corresponding first class city teacher plan provision is Section 354A.33. Social Security leveling options are rather heavily used in TRA, and more than likely also in the first class city teacher plans. The provisions allow retiring members to make an election which will increase the monthly annuity benefit amount from the retirement plan during the early years of retirement. Later, when Social Security benefits commence, the benefit from the Minnesota public retirement plan is reduced below that which would otherwise occur, so that the monthly Social Security benefit plus the monthly Minnesota plan benefit is approximately equal to the benefit the individual received earlier from the Minnesota plan alone. This provides a fairly seamless transition. The applicable Minnesota laws further provide that the total lifetime annuity value expected to be paid to an annuitant who elects a Social Security leveling option must be no greater than that of a comparable individual who does not elect this provision. Thus, if benefits in the earlier years are increased above what would otherwise occur, the monthly benefits in later years after Social Security benefits commence must be sizably reduced to compensate.

While the Social Security leveling provisions in the various Minnesota plans are similar, they are not identical. For example, the MSRS and PERA provisions would permit accelerated benefits to be paid only to age 62, which is the age at which any individual can begin commencement of a reduced Social Security old age insurance benefit. In contrast, the current law TRA benefit permits acceleration until age 65.

Discussion and Analysis

Mr. Ziemer's Approximate Benefit Amount Assuming Single-Life Annuity. At the time Mr. Ziemer retired, the benefit per year of service in PERA-P&F was 2.65 percent of the high-five per year of service rather than 3.0 percent as found in more recent statute. The applicable percentage for PERA-General basic is likely to have been 2.0 percent. With five years of basic service, Mr. Ziemer would have received a benefit of 10 percent of the high-five salary as a result of the PERA-General basic service, although that benefit amount would have been reduced due to early receipt because he started drawing that benefit at age 56, well before the normal retirement age for that plan, which is age 65. For the approximately 21 years of PERA-P&F service he would receive an annual benefit of 56 percent of the high-five average salary (2.65 percent x 21 years = 55.6 percent). So the combined annual benefit from the two plans, if received as single-life annuities without acceleration, would have been slightly over 60 percent of the high-five average salary. This would be increased over time by post-retirement adjustments. These adjustments were very generous in the late 1990s. Over the years since the benefit commenced in 1994 to the present time, the benefit amount would have doubled, to an annual amount which is approximately 120 percent of the salary amount he received near retirement (120 percent of his high-five average salary). Over that same period, the cost of living increased by only 39 percent, so the annuity payout from a single-life annuity commencing in 1994 would have increased considerably in real terms. In real terms, the current annual benefit would be equivalent to 89 percent of the high-five salary, considerably higher than the 60 percent of the high-five average salary he received at the time of his retirement.

Legislative Actions Prior to Mr. Ziemer's Retirement. Mr. Ziemer's 1994 retirement was at an advantageous time. Two benefit improvements occurred just prior to his retirement which increased the value of his annuities. Because he retired so soon after these improvements occurred, his contributions toward paying for these improvements were minimal. In 1993 (Laws 1993, Chapter 352, Section 4), the accrual rate (percentage of the high-five average salary received per year of service) was increased in PERA-P&F from 2.5 percent to 2.65 percent per year of service. Then in 1994 (Laws 1994, Chapter 528, Article 2, Section 14) the combined service annuity provision was revised to permit use of the new 2.65 percent accrual rate, rather than 2.5 percent, in a combined service annuity calculation. It is likely that he used that provision at the time he retired, and it is likely to have increased the value of Mr. Ziemer's PERA-General basic program annuity.

Impact of the Leveling Option on Mr. Ziemer. Since Mr. Ziemer chose an accelerated annuity rather than a normal single-life annuity, his payout would differ from that previously described. For the six years before he reached age 62, the annuity amount would have been larger than it would have been with a non-accelerated single-life annuity. In 2000, when he reached age 62, it would have reverted to a much lower level. Part of that reduction was simply because, even without any post-retirement increases, the annual benefit level would need to be reduced substantially to keep actuarial equivalence over the expected lifetime with a non-accelerated single-life annuity. In Mr. Ziemer's case the decrease may have been particularly noticeable. The plan provided large post-retirement increases in the late 1990s. When his annuity was decreased, part of the decrease represented the loss of the increases on the accelerated portion of the annuity.

S.F. 2463 (Rummel); H.F. 2651 (McFarlane) raises the following pension and related public policy issues:

1. Precedent. If enacted, the bill would set a precedent by permitting an individual who had been receiving an accelerated annuity to revert to a single-life annuity amount, as though the acceleration phase and the additional benefits received during that phase had not occurred. If this were to pass, it is likely to lead to many more similar requests in PERA and in other plans which have similar acceleration provisions. This could seriously undermine the financial structure of the plan. There is no currently apparent justification for providing the requested treatment to Mr. Ziemer without extending it to others who used Social Security leveling options.
2. Proposed Action Contrary to Commission Policy. The requested action is a revision of an optional annuity form. Revising annuity forms after benefits have commenced is contrary to the Commission's Principles of Pension Policy, which state under Substantive Principle II.C.13. that "Reopenings of optional annuity elections should not be permitted." This principle exists to protect the financial integrity of the pension funds.
3. Lack of Harm. The issue is the lack of justification for the change, given that no apparent harm occurred. Mr. Ziemer selected an accelerated annuity which provided a higher amount compared to a non-accelerated single-life annuity in the retirement years before age 62, and lower amounts thereafter, in order to keep the lifetime value of the annuity the same as a non-accelerated annuity. Receiving an annuity with the same lifetime value as that of a comparable individual who chose not to accelerate the annuity is not harm, but fairness. Providing the treatment in the bill would grant Mr. Ziemer a windfall.
4. Possible Contention of PERA Error. Mr. Ziemer may contend that he was in some way misled by PERA. However, it may be difficult to argue that he was uninformed or misled by PERA, causing him to select an annuity form which did not fit his personal needs or that of his family. He signed a notarized form stating that he had read the form and understood the implications of the annuity form he selected. In any event, even if he had been misled or was uninformed, there is no financial harm. He simply received more benefits early in exchange for fewer benefits later, without any loss in net value.
5. Opposition by PERA. PERA will strongly oppose this legislation.
6. Cost. The issue is the cost to the PERA plans of the benefit provided by the bill. Presumably, PERA can provide an estimate of these amounts.
7. Harm to PERA and Other Plans. The issue is the harm to PERA and to other pension funds given the additional requests that will come for comparable treatment. An accelerated annuity is intended to be actuarially equivalent (have the same value) as a non-accelerated single-life annuity. If this bill leads to many accelerated annuity recipients receiving a boost in annuity amounts received after age 62, as though an early period of higher benefit payments never occurred, this will considerably increase plan

liabilities. That will inevitably lead to groups who selected normal (non-accelerated) annuities to want a corresponding increase in the value of their annuities, leading to an even larger increase in plan liabilities.

8. Difficulty of Creating Alternative Solutions. An alternative draft could be created which extends the proposed treatment to all PERA plan members who elected an accelerated option (or to members in any Minnesota public employee plan with a similar accelerated option). This would be fairer to others with an accelerated option, but it would greatly increase the cost of the proposal. Also, it would be most unfair to the majority of plan members, those who do not use acceleration options. Despite comparable salary and service, these individuals would have annuities of lesser value than those who chose an accelerated option and then reverted to a normal annuity when the acceleration phase ends.
9. Actuarial Condition of the Plans. The issue is the actuarial condition of the pension funds involved, those of PERA-General and PERA-P&F. Currently, these plans have considerable liabilities in excess of their assets (unfunded liabilities). The actuarial condition of these plans is presented below. Both plans have contribution requirements considerably in excess of current contribution levels. Also, the assets stated in the asset information below is the actuarial value of assets, rather than the actual market value, and the actuarial value of assets has not recognized much of the losses that occurred due to the current recession. If the following were based on market values, the unfunded liability amounts would be greater and the contribution shortfalls would also be greater.

	PERA-General 2009		PERA-P&F 2009	
<u>Membership</u>				
Active Members		142,097		11,035
Service Retirees		56,948		5,213
Disabilitants		2,075		838
Survivors		7,036		1,380
Deferred Retirees		43,645		1,280
Nonvested Former Members		<u>122,434</u>		<u>911</u>
Total Membership		374,235		20,657
<u>Funded Status</u>				
Accrued Liability		\$18,799,416,000		\$6,296,274,000
Current Assets		<u>\$13,158,490,000</u>		<u>\$5,239,855,000</u>
Unfunded Accrued Liability		\$5,640,926,000		\$1,056,419,000
Funding Ratio	69.99%		83.22%	
<u>Financing Requirements</u>				
Covered Payroll		\$5,130,307,000		\$786,887,000
Benefits Payable		\$863,910,000		\$310,099,000
Normal Cost	7.82%	\$400,956,000	22.07%	\$173,703,000
Administrative Expenses	0.20%	\$10,261,000	0.13%	\$1,023,000
Amortization	<u>7.53%</u>	<u>\$386,312,000</u>	<u>7.79%</u>	<u>\$61,298,000</u>
Total Requirements	7.53%	\$386,312,000	7.79%	\$61,298,000
Employee Contributions	6.00%	\$307,819,000	9.40%	\$73,967,000
Employer Contributions	<u>6.88%</u>	<u>\$352,965,000</u>	<u>14.10%</u>	<u>\$110,951,000</u>
Total Contributions	12.88%	\$660,784,000	23.50%	\$184,918,000
Total Requirements	7.53%	\$386,312,000	7.79%	\$61,298,000
Total Contributions	<u>12.88%</u>	<u>\$660,784,000</u>	<u>23.50%</u>	<u>\$184,918,000</u>
Deficiency (Surplus)	(5.35%)	(\$274,472,000)	(15.71%)	(\$123,620,000)

From: Kitty Musty
To: Carol McFarlane
Date: 6/5/2008 12:11 PM
Caller: Bill Ziemer
Company: [REDACTED]
Phone: [REDACTED]

Telephoned Please call
 Will call again Returned your call
 Wants to see you Came to see you
 Urgent

PERA: Pre 62 retirement clause allowed him to draw an extra \$200.00 per month. The info he received at time of retirement didn't indicate it would be a lifetime payback commitment. He has repaid thousands of dollars in excess of what he drew out + interest. He feels it is very unfair.

If you want me to have research look into it let me know

LCPR MAR 13 2009

From: Kitty Musty
To: Carol McFarlane
Date: 6/19/2008 3:52 PM
Subject: Bill Zeimer

MARY VAN ELS

Carol,
I called PERA and asked them to call Mr. Zeimer. Alan Eldridge from PERA called him and talked to him about the Pre-62 contract he signed when he retired in 1994. Mr. Eldridge said those provisions are in law and would need legislative action to change them.

Mr. Zeimer also called to say he had talked to Mr. Eldridge at PERA. He wants the legislature to change the law to stop the decrease in payments after a certain point, or cap the decrease.

I then asked Bob Shipman for advice. He said to talk to Lisa Diesslin or Peggy Orren at the Pension Commission. They can walk you through what needs to be done. Bob said let the Pension Commission decide about the merits of his case and draw up legislation. Bob said it will be good for you to learn the process of pension bills, but you won't need to do all the work, just let the pension commission take care of it. Pension Commission #: 651-296-2750. Larry Martin is the director of Legislative Commission on Pensions & Retirement.

Kitty

Senator Rummel introduced—

S.F. No. 2463: Referred to the Committee on State and Local Government Operations and Oversight.

A bill for an act

relating to retirement; general employees retirement plan of the Public Employees Retirement Association police and fire plan; increasing annuity of an accelerated annuity recipient.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. PERA; ACCELERATED ANNUITY RECIPIENT BENEFIT PAYMENT INCREASE.

(a) Notwithstanding any law to the contrary, the Public Employees Retirement Association general plan basic program and the Public Employees Retirement Association police and fire plan must provide a revised retirement annuity to an eligible person under paragraph (b). The revised annuity begins on the first of the month after the executive director receives an application and determines eligibility under this section. The revised annuity must be computed as though the eligible person had not elected accelerated annuities under Minnesota Statutes, section 353.29, subdivision 6.

(b) An eligible person is a person who:

(1) was born on February 9, 1938;

(2) was employed by Independent School District No. 622, North St. Paul, Maplewood, Oakdale, with coverage by the Public Employees Retirement Association general plan basic program, and was later employed by the Ramsey County Sheriff's Department with coverage by the Public Employees Retirement Association police and fire plan;

(3) commenced receiving retirement annuities from the Public Employees Retirement Association general plan basic program and the Public Employees Retirement Association police and fire plan on June 1, 1994; and

2.1 (4) had both annuities accelerated under Minnesota Statutes, section 353.29,
2.2 subdivision 6, and computed using the combined service annuity provision, Minnesota
2.3 Statutes, section 356.30.

2.4 (c) To determine the monthly benefit amounts payable starting on the commencement
2.5 date specified in paragraph (a), the executive director of the Public Employees Retirement
2.6 Association shall determine the monthly benefit amounts which would have been paid as of
2.7 June 1, 1994, if acceleration had not been elected, and shall escalate those benefit amounts
2.8 by the postretirement adjustments that would have applied through the commencement
2.9 date of the revised annuities. An annuity revised under this section is eligible for future
2.10 postretirement increases under the same procedures applicable to other retirement
2.11 annuitants from these pension plans. Payments of prior annuities to the eligible person
2.12 terminate when payment of the revised annuity commences. Annuities revised under this
2.13 section are prospective; no retroactive payments are permitted. If the original annuities
2.14 included joint and survivor coverage, that same coverage shall apply to the revised annuity.

2.15 (d) The executive director of the Public Employees Retirement Association
2.16 is authorized to require an eligible person described in paragraph (b) to provide
2.17 documentation or information deemed necessary by the executive director to determine
2.18 application and eligibility under this section.

2.19 **EFFECTIVE DATE.** This section is effective the day following final enactment.