State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

Consideration of Possible Pension Plan Benefit Changes

Presentation to the Legislative Commission on Pensions and Retirement

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Ways to Address Pension Plan Funding Shortfalls

- **Two options for addressing a funding shortfall:**
  - **increase** the dollars going into the fund
  - **decrease** the dollars going out of the fund

- **Increased dollars can come from any of three sources:**
  - more **employer contributions** (from employers or direct state aid)
  - more **employee contributions**
  - better investment returns

What Is the Funding Shortfall?

- **Funded status using current 8% (or 8.5% for TRA) investment return assumption**

MSRS-General	PERA-General	TRA	St. Paul Teachers
78.39%	72.42%	72.69%	60.26%

- **Funded status using proposed 7.5% investment return assumption (ignores other changes, such as revised CSA assumptions)**

MSRS-General	PERA-General	TRA	St. Paul Teachers
76.8%	68.8%	65%	57.8%

(Funded status is a % equal to the market value of assets divided by actuarial liabilities.)

Plans' Proposals Request More Contributions

- **MSRS General:**
  - Employer rate will increase from 5.5% to 8.0%
  - Employee rate will increase from 5.5% to 6.0%

	FY18	FY19	FY20	FY21	Total
Employer Increase	1.5%	---	1.0%	---	2.5%
Employee Increase	0.5%	---	---	---	0.5%

- **PERA General:** No increases

- **TRA:**
  - Employer rate will increase from 7.5% to 9.5%
  - Employee rate will remain at 7.5%

	FY18	FY19	FY20	FY21	Total
Employer Increase	0.5%	0.5%	0.5%	0.5%	2.0%

- **St. Paul Teachers:**
  - Employer rate will increase from 6.5% to 9.5%
  - Employee rate will remain at 7.5%
  - Requesting annual direct state aid of $5 million

	FY18	FY19	FY20	FY21	Total
Employer Increase	1.0%	0.75%	0.5%	0.75%	3.0%

Contribution Increases Improve Funding

	FY18		FY19		FY20		FY21	
	Increase over Prior Year	% of Payroll	Increase over Prior Year	% of Payroll	Increase over Prior Year	% of Payroll	Increase over Prior Year	% of Payroll
MSRS-General								
Employer	$43.3M	1.5%	---	---	$28.9M	1%	---	---
Employee	$14.4M	0.5%	---	---	---	---	---	---
PERA-General	---	---	---	---	---	---	---	---
TRA	$24.3M	0.5%	$24.3M	0.5%	$24.3M	0.5%	$24.3M	0.5%
SPTRFA	$2.6M	1%	$1.9M	0.75%	$1.3M	0.5%	$1.9M	0.75%

Benefit Changes Can Reduce Cash Outflow

- **There is an array of benefits that could be modified to reduce the cost of benefits**

- **Benefit modifications can significantly impact a pension plan's funding situation**
  - Depends on the benefit and the extent of the modification
  - The greater the immediate savings, the more significant the impact on long-term funding improvement
  - Not all benefit reductions result in savings because of member behavior in response to the change

Proposed COLA Reductions

- **Currently, under MSRS and TRA, each January 1, retirees' pensions are automatically increased by 2%**
- **The percentage increase compounds annually: the percentage is applied to an ever-increasing base amount**
- **This benefit is referred to in the statutes as the "post-retirement adjustment" or, more commonly, the "COLA"**

Proposed COLA Reductions

	Proposed Change	$/Year	% of Pay
MSRS-General	Reduce COLA from 2% to 1.5% Eliminate COLA trigger	$54.9M	1.9%
PERA-General	No changes proposed (COLA already at 1%)	--	--
TRA	Reduce COLA from 2% to 1% for 5 years, then increase to 1.5% thereafter Eliminate COLA trigger	$120M	2.66%
SPTRFA	Eliminate COLA trigger (COLA already at 1%)	$0.8M	0.31%

Comparison of State's Pension Plans

Includes coordinated members only

	MSRS-General	PERA-General	TRA	St. Paul Teachers
Accrual Rates (multiplied by high-five salary & years of service)	1.7%	1.7%	1.9%	1.9%
Investment Return Assumption	8%	8%	8.5%	8%
Vesting Period	5 years	5 years	3 years	3 years
Active Membership	49,472	148,720	80,526	3,531
Average Salary	$55,463	$37,781	$56,079	$71,943
Retiree Membership	32,241	74,949	54,574	1,749
Deferred Vested Members	17,019	52,516	13,680	2,020
Average Annual Pension	$19,452	$12,230	$22,262	$18,621
Employer Contribution Rate	5.5%	7.5%	7.5%/.2%	6.25%/3.85%
Employee Contribution Rate	5.5%	6.5%	7.5%	7.5%
Post Retirement Increase (COLA)	2%	1%	2%	1%
Augmentation Rate	2%	0%*	2%	2%

**1% for members who terminated before January 1, 2012*

Which Benefits to Change?

- **What is the purpose of a pension plan?**
  - Traditionally, a pension plan is considered one leg of the three-legged stool people depend on in retirement:
    - Individual savings
    - Social Security
    - Employer-sponsored retirement plan
  - Today, for many, there is a fourth leg: part-time employment

Helpful Comparisons

- **How do the plans' benefits compare to benefits provided under other states' pension plans?**
- **How do the benefits compare to private employer pension plans?**
- **How do annual contribution requirements (as determined by the actuary) compare to actual annual contribution payments?**

Balancing Benefit Changes and Contribution Increases

- **To address a funding deficiency:**
  - How much more can employers, employees and the state pay?
  - Can the plans continue to pay the current level of benefits? Is it sustainable?
  - How should decision makers balance changes to contributions versus benefits?
- **If more needs to go into the plan, who should be contributing more?**
  - Employees?
  - Employers?
  - What share of the new and old liabilities are employees and employers responsible for?
- **If the current level of benefits is not sustainable, in what ways should benefits be modified?**

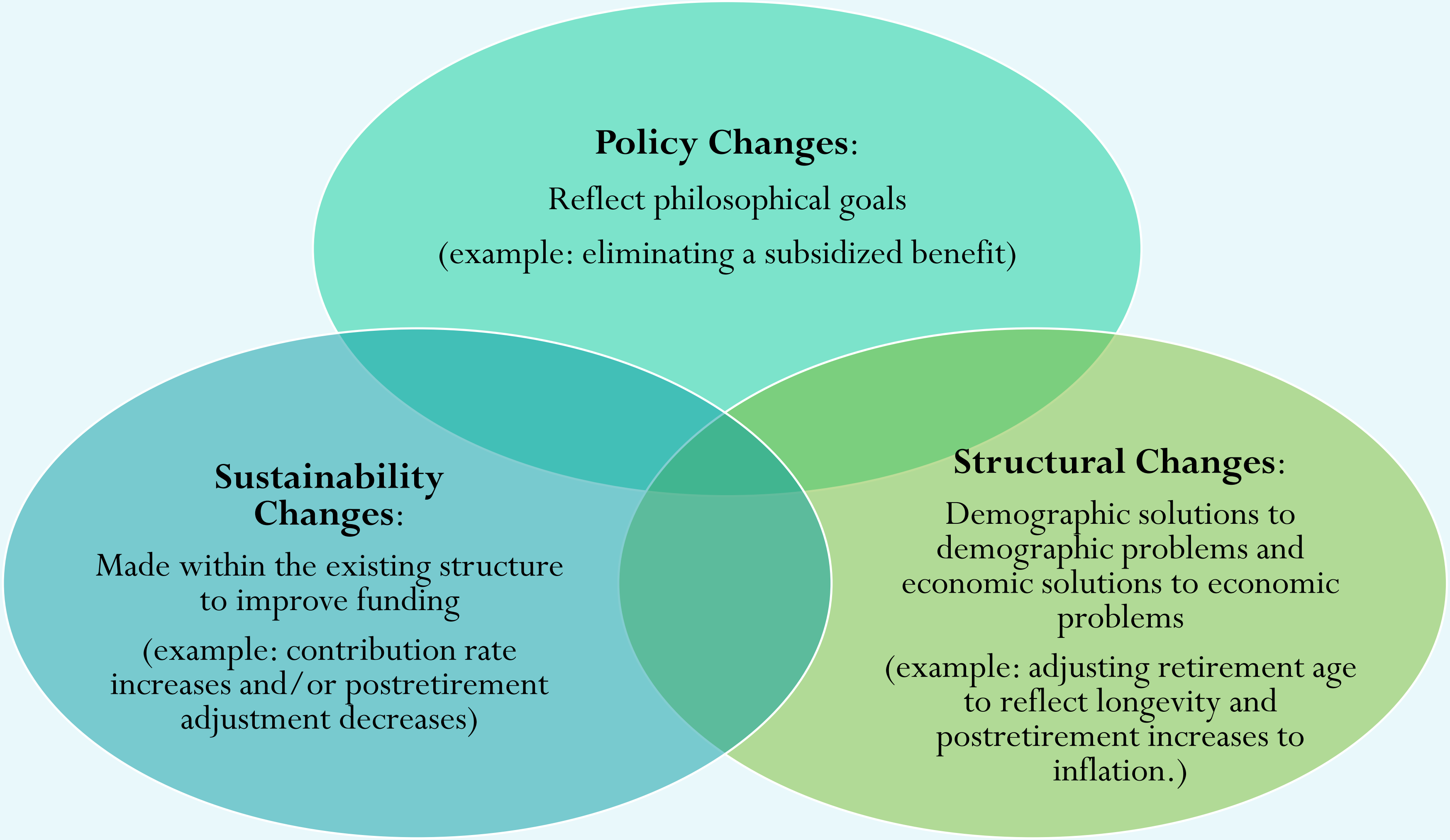
Questions to Ask When Considering Benefit Changes

- **When considering benefit changes:**
  - How should benefits reflect changes in actual experience, such as people living longer and retiring later?
  - What is the purpose of a COLA? Should the COLA fluctuate or remain stable? Should the COLA be tied to the actual rate of inflation?
  - What level of benefits should be available to members who leave active service mid-career?
  - What level of benefits should be available to members who retire early?
  - Should benefits incentivize members to retire early? Should benefits incentivize members to continue working to normal retirement age?

How to Assess Proposed Benefit Changes?

- **Considerations when assessing benefit changes:**
  - What are core benefits?
  - Should benefit changes be driven solely by cost savings?
  - What are the policy considerations?
  - How important are pensions to attracting and retaining employees?
  - How important is uniformity of pension benefits among Minnesota public employees?
  - How much does a proposed change impact the value of the benefit?
  - How are other states changing benefits? Should we care?
  - Should the LCPR Principles of Pension Policy be updated to provide guidance for future benefit adjustments?

Another Way to View Benefit Changes



Suggestions for Benefit Changes to Consider

- **Staff prepared "Benefit Analysis and Possible Cost Savings Changes" chart**
  - The chart summarizes and compares benefit features provided by MSRS General, PERA General and TRA
  - Offers options for possible cost saving changes
  - Each of the following descriptions of benefit changes includes a reference to the corresponding page on the chart
- **LCPR Chair and Vice Chair selected several benefit changes for further review and to obtain an assessment of the cost savings for each**
- **MSRS, PERA, TRA and St. Paul Teachers provided actuarial cost savings estimates for each possible change selected for evaluation**

Benefit Change I(a)

see chart page 1

- **Benefit: Automatic annual 2% increase on the pension amount for members no longer working in public employment ("augmentation")**
- **Change: Reduce rate to 1% effective for deferral years beginning on and after January 1, 2018, for all deferred members**

Cost Savings	MSRS	PERA	TRA	SPTRFA
% of total payroll	0.1%	N/A	0.02%	0.1%
Annual $ amount	$2,889,433	N/A	$900,000	$260,000

Benefit Change I(b)

see chart page 1

- **Benefit: Automatic annual 2% increase on the pension amount for members no longer working in public employment ("augmentation")**
- **Change: Reduce rate to 1% for all employment terminations on or after January 1, 2018**

Cost Savings	MSRS	PERA	TRA	SPTRFA
% of total payroll	0.1%	N/A	Less than 0.02%	0.1%
Annual $ amount	$2,889,433	N/A	Less than $900,000	$260,000

Benefit Change 1(c)

see chart page 1

- **Benefit: Automatic annual 2% increase on the pension amount for members no longer working in public employment ("augmentation")**
- **Change: Reduce rate to 0% effective for deferral years beginning on and after January 1, 2018, for all deferred members**

Cost Savings	MSRS	PERA*	TRA	SPTRFA
% of total payroll	0.1%	0.1%	Less than 0.11%	0.1%
Annual $ amount	$2,889,433	$5,906,821	Less than $4,970,000	$260,000

***PERA will have cost savings only if the COLA trigger is also eliminated.**

Benefit Change 1(d)

see chart page 1

- **Benefit: Automatic annual 2% increase on the pension amount for members no longer working in public employment ("augmentation")**

- **Change: Reduce rate to 0% for all employment terminations on or after January 1, 2018**

Cost Savings	MSRS	PERA	TRA	SPTRFA
% of total payroll	0.1%	N/A	0.11%	0.1%
Annual $ amount	$2,889,433	N/A	$4,970,000	$260,000

Benefit Change 2(a)

see chart page 2

- **Benefit: For TRA and St. Paul Teachers, the service times salary pension formula applies a 1.9% multiplier, whereas MSRS and PERA apply a 1.7% multiplier**
- **Change: For TRA and St. Paul Teachers, reduce the multiplier from 1.9% to 1.7% for all years of service after June 30, 2017 (TRA effective date would be June 30, 2018)**

Cost Savings	TRA	SPTRFA
% of total payroll	0.77%	0.8%
Annual $ amount	$34,000,000	$2,000,000

Benefit Change 2(b)

see chart page 2

- **Benefit: For TRA and St. Paul Teachers, the service times salary pension formula applies a 1.9% multiplier, whereas MSRS and PERA apply a 1.7% multiplier**
- **Change: For TRA and St. Paul Teachers, reduce the multiplier from 1.9% to 1.7% for new hires after June 30, 2017**
- **Cost savings:**
  - TRA: Minimal immediate cost savings, but eventually this change will reduce normal cost by 0.92% of pay
  - SPTRFA: 0.8% of pay, $2,000,000 annually

Benefit Change 3

see chart page 3

- **Benefit: Normal retirement age is currently 66 for MSRS, PERA, TRA, St. Paul members hired after June 30, 1989**
- **Change: Raise normal retirement age to 67 for new hires after June 30, 2017**
- **Cost savings: Minimal immediate cost savings**
- **Future cost savings: Eventually this change will reduce normal cost:**
  - MSRS: 0.5% pay, from 8.1% to 7.6%
  - PERA: 0.4% of pay, from 7.5% to 7.1%
  - TRA: 0.56% of pay, $25,300,000
  - SPTRFA: 0.3% of pay

Benefit Changes 4 & 5

see chart page 3

- **Benefit: Early retirement age is currently 55 for MSRS, PERA, TRA, St. Paul members**
- **Change 4: Raise early retirement age to 62 for new hires after June 30, 2017**
  - This would achieve no measurable cost savings
- **Change 5: Raise early retirement age to 57 for all early retirements after June 30, 2017**
  - This would achieve no measurable cost savings and was cost neutral

Benefit Change 6

see chart page 4

- **Benefit: MSRS and TRA provide a 2% annual COLA to retirees, whereas PERA and St. Paul Teachers provide a 1% annual COLA to retirees**
- **Change: For MSRS and TRA, lower the COLA from 2% to 1%, effective January 1, 2018**

Cost Savings	MSRS	TRA
% of total payroll	3.8%	4.27%
Annual $ amount	$108,000,000	$192,800,000

Benefit Change 7

see chart page 4

- **Benefit: Members who retire early receive a full annual COLA beginning 18 months after retirement**
- **Change: Postpone starting COLA increases for early retirees until retiree reaches normal retirement age**

Cost Savings	MSRS	PERA	TRA	SPTRFA
% of total payroll	0.3%	0.3%	0.36%	0.3%
Annual $ amount	$8,668,299	$17,720,463	$16,300,000	$780,000

Benefit Change 8(a)

see chart page 5

- **Benefit: Early retirement benefits are reduced by certain factors but are then augmented by 2.5% or 3%, depending on the plan. Intent is to be actuarially equivalent to a deferred benefit, but augmentation rates for calculating early retirement benefits are higher than augmentation rates for members who do not take early retirement.**

- **Change: Eliminate augmentation from the calculation of the early retirement benefit, effective for early retirements on or after July 1, 2017**

Cost Savings	MSRS	PERA	TRA	SPTRFA
% of total payroll	0.6%	0.6%	1.27%	0.7%
Annual $ amount	$17,336,598	$35,440,926	$57,300,000	$1,800,000

Benefit Change 8(b)

see chart page 5

- **Benefit: Early retirement benefits are reduced by certain factors but are then augmented by 2.5% or 3%, depending on the plan. Intent is to be actuarially equivalent to a deferred benefit, but augmentation rates for calculating early retirement benefits are higher than augmentation rates for members who do not take early retirement.**
- **Change: Reduce augmentation to match current augmentation rates of 1% or 2%, effective for early retirements on or after July 1, 2020**

Cost Savings	MSRS	PERA	TRA	SPTRFA
% of total payroll	0.2%	0.6%	Less than 1.27%	0.2%
Annual $ amount	$5,778,866	$35,440,926	Less than $57,300,000	$520,000

Note on Cost Savings Estimates

- **It may be helpful to determine the impact on each plan's funding ratio at the end of the 30-year amortization period for each proposed change**
  - For example, TRA reported that reducing the COLA (annual post-retirement adjustment) from the current 2% to 1% (see slide 25), effective January 1, 2018, can be expected to improve TRA's funding ratio in 2047 from 37% to 74% (assuming no other changes)
- **If more than one change is proposed, the cost savings of all proposed changes taken together should be evaluated because one change can impact the cost savings of another change.**