# Legislative Commission on Pensions and Retirement

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**TO:** Members of the Legislative Commission on Pensions and Retirement

**FROM:** Susan Lenczewski, Executive Director
Rachel Barth, Deputy Director

**DATE:** May 8, 2017

**RE:** LCPR17-038: Pension Benefits and Contributions Bill

## Introduction

Draft bill LCPR17-038 makes changes to current law governing all of the statewide pension plans and the St. Paul Teachers Retirement Fund Association. Generally, the changes can be categorized as follows:

- **Benefit changes:** The bill eliminates augmentation, phases in the elimination of augmentation in the early retirement discount, reduces and defers the commencement of post-retirement adjustments (COLAs), and reduces the rate of interest paid on refunds of employee contributions to former employees. The bill also requires the Pension Commission to conduct a study on the COLA rates and the methodology for determining post-retirement adjustments.
- **Actuarial changes:** The bill reduces the investment rate of return to 7.5% and extends the end of the amortization period to 2047 for all the plans.
- **Contribution increases:** The bill increases the employee and employer contribution rates for most of the plans.
- **Direct state aids:** The bill provides for state aid for the PERA police and fire plan and St. Paul Teachers Retirement Fund Association.
- **Language clean-up changes:** The bill makes a number of clarifying changes to existing provisions, including clarifying combined service annuity and coverage by more than one fund provisions, adds a new interest rate section that sets forth the rates for all the plans, and makes conforming changes to other sections that refer to interest rate.

## Background Information

MSRS, PERA, TRA and St. Paul Teachers proposed contribution rate and COLA changes early in the session. The bills are S.F. 1064 (Rosen); H.F. 1288 (O'Driscoll) for MSRS; S.F. 1066 (Rosen); H.F. 1090 (O'Driscoll) for PERA; S.F. 930 (Rosen); H.F. 722 (Murphy, M.) for TRA; S.F. 992 (Rosen); H.F. 1214 (O'Driscoll) for St. Paul Teachers. The Pension Commission considered these bills and heard testimony at meetings on February 7, 14, and 21.

The Governor proposed contribution rate increases and COLA reductions several weeks ago. The Governor's proposal is set forth in S.F. 2233 (Rosen); H.F. 2486 (O'Driscoll). The Pension Commission considered this bill at its meeting on April 18.

In connection with the consideration of these proposals, the Pension Commission began the process of reviewing the array of benefits offered by the plans to determine whether and to what extent the benefits offered by the plans went beyond the plans' core mission of providing public employees with a secure and sustainable retirement income. The underlying premise of this benefit review is that the pension plans' current shortfall in assets as compared to liabilities (i.e., underfunded status) and ongoing annual contribution deficiency cannot be corrected only by increasing contributions and state funding and reducing COLAs for retirees.

Accordingly, the draft bill presents a combination of benefit changes, COLA reductions, contribution increases and direct state aids.

**Important Terms**

***Augmentation:*** The annual automatic percentage increase to a pension benefit accrued by an individual who leaves public service prior to retirement. For example, under MSRS or TRA, a pension benefit earned by an individual who leaves public service at age 38 is increased by 2% each year, compounded annually, until the former employee applies to receive an annuity at retirement age.

***Early retirement reduction:*** When a member elects early retirement, the pension the member will receive is the normal retirement (age 66) benefit reduced, either using fixed percentages or factors that will result in actuarial equivalence, to reflect early commencement of pension payments. Put another way, the monthly amount a member would have received at normal retirement age is reduced when the member begins to receive the payments earlier, to reflect the fact that the member will receive payments over a longer period.

The plans apply an actuarial or fixed factor reduction, but offset the reduction (so the reduction is less) by augmentation at rates that are higher than regular augmentation rates under the plan. The rate of augmentation for this purpose was not updated when augmentation rates were reduced to 2% or 1% several years ago and are at 2.5% for members who were first employed on or after July 1, 2006, and 3% for members who were first employed before July 1, 2006. This apparent oversight has been highlighted by both MSRS' and PERA's actuary and the Pension Commission's actuary, who have repeatedly recommended that the augmentation rates in the early retirement discount should have been reduced when augmentation generally was reduced. Consistent with the elimination of augmentation, generally, in the bill, the bill also eliminates augmentation as applied in the early retirement reduction, over a five year period.

***Postretirement adjustment:*** Also referred to as the **"COLA."** The annual automatic percentage increase in the annuity amount being paid monthly to a retiree, survivor, or member receiving a disability annuity. It is not to be confused with "augmentation," which is an annual increase credited to the pension benefit of an individual who is no longer in public employment and is not yet receiving an annuity from one of the pension plans.

**Section-by-Section Summary**

**Article 1. Minnesota State Retirement System**

Section 1: Eliminates augmentation for all members of the Legislators plan after December 31, 2017, but does not make any change to augmentation credited to the member's pension benefit up to December 31, 2017.

Section 2: Eliminates augmentation as applied in calculating early retirement benefits for MSRS General. See the definition of "early retirement reduction" on page 2 of this memo for additional explanation. The phase in is over a five year period starting July 1, 2018. Beginning July 1, 2023, an early retirement benefit will be a straight actuarial equivalence to a normal retirement benefit.

Section 3: Lowers the rate of interest rate paid on refunds of employee contributions if a former employee elects to take a refund, from 4% to 3%.

Section 4: Adds clarification regarding the repayment of a refund by a member of an MSRS plan.

Section 5: Corrects a cross-reference.

Section 6: Eliminates augmentation for all members of the MSRS-General and MSRS-Correctional plans after December 31, 2017, but does not make any change to augmentation credited to the member's pension benefit up to December 31, 2017.

Section 7: Eliminates augmentation for all members of the State Patrol plan after December 31, 2017, but does not make any change to augmentation credited to the member's pension benefit up to December 31, 2017.

Sections 8-10: Corrects several cross-references.

Section 11: Repeals the following statutes:

- Sections 3A.12 (Legislators Plan), 352.72 (MSRS General and Correctional Plans), and 352B.30 (State Patrol Plan): "Coverage by More than One Fund" statutes. Each of the systems have similar statutes and they are all being repealed and a single statute that will cover all the plans is being added as new section 356.311.
- Section 352.045 (MSRS Plans): "Contribution stabilizer" statute. The statute permits the MSRS Board of Directors to increase employer and employee contributions, if specified contribution deficiency levels are reached, without a legislative change to the contribution rate statutes. The changes must be reported to the Pension Commission, which can allow them to take effect or recommend against the changes or modify the changes.

**Article 2: Public Employees Retirement Association**

Section 1: Eliminates augmentation as applied in calculating early retirement benefits for PERA General. See the definition of "early retirement reduction" on page 2 of this memo for additional explanation. The phase in is over a five year period starting July 1, 2018. Beginning July 1, 2023, an early retirement benefit will be a straight actuarial equivalence to a normal retirement benefit.

Section 2: Lowers the rate of interest rate paid on refunds of employee contributions if a former employee elects to take a refund, from 4% to 3%.

Section 3: Eliminates augmentation for all members of PERA after December 31, 2017, but does not make any change to augmentation credited to the member's pension benefit up to December 31, 2017.

Section 4: Repeals the following statutes:

- Section 353.71: "Coverage by More than One Fund" statute. Each of the systems have similar statutes and they are all being repealed and a single statute that will cover all the plans is being added as new section 356.311.
- Section 353.27: "Contribution stabilizer" statute. The statute permits the PERA Board of Trustees to increase employer and employee contributions, if specified contribution deficiency levels are reached, without a legislative change to the contribution rate statutes. The changes must be reported to the Pension Commission, which can allow them to take effect or recommend against the changes or modify the changes.

**Article 3: Teachers Retirement Association**

Section 1: Removes the reference to the contribution stabilizer provision in Section 354.42, which is being repealed.

Section 2: Eliminates augmentation as applied in calculating early retirement benefits for TRA. See the definition of "early retirement reduction" on page 2 of this memo for additional explanation. The phase in is over a five year period starting July 1, 2018. Beginning July 1, 2023, an early retirement benefit will be reduced by a flat 4% per year for ages 55 through 59 and 7% per year for ages 60 to the normal retirement age of 66.
*(This provision does not impact members who retire under the "62/30" rule.)*

Section 3: Lowers the rate of interest rate paid on refunds of employee contributions if a former employee elects to take a refund, from 4% to 3%.

Section 4: Eliminates augmentation for all TRA members after December 31, 2017, but does not make any change to augmentation credited to the member's pension benefit up to December 31, 2017.

Section 5: Repeals the following statutes:

- Section 354.60: "Coverage by More than One Fund" statute. Each of the systems have similar statutes and they are all being repealed and a single statute that will cover all the plans is being added as new section 356.311.
- Section 354.42: "Contribution stabilizer" statute. The statute permits the TRA Board of Trustees to increase employer and employee contributions, if specified contribution deficiency levels are reached, without a legislative change to the contribution rate statutes. The changes must be reported to the Pension Commission, which can allow them to take effect or recommend against the changes or modify the changes.

**Article 4: St. Paul Teachers Retirement Fund Association**

Section 1: Updates a reference to the investment return assumption.

Section 2: Revises the COLA in the following ways:

- There will be no COLA for any members on January 1, 2018 and January 1, 2019;
- For retirements on or after January 1, 2020, a retiree is not eligible to receive a COLA until the retiree reaches normal retirement age. *(This provision does not apply to members who retire under the Rule of 90, are receiving disability benefits, or receive survivor's benefits)*

Section 3: Eliminates augmentation as applied in calculating early retirement benefits for TRA. See the definition of "early retirement reduction" on page 2 of this memo for additional explanation. The phase in is over a five year period starting July 1, 2018. Beginning July 1, 2023, an early retirement benefit will be reduced by a flat 4% per year for ages 55 through 59 and 7% per year for ages 60 to the normal retirement age. *(This provision does not impact members who retire under the "62/30" rule.)*

Section 4: Eliminates augmentation for all SPTRFA members after December 31, 2017, but does not make any change to augmentation credited to the member's pension benefit up to December 31, 2017.

Section 5: Lowers the rate of interest rate paid on refunds of employee contributions if a former employee elects to take a refund, from 4% to 3%.

Section 6: Repeals the following statutes:

- Section 354A.39: "Coverage by More than One Fund" statute. Each of the systems have similar statutes and they are all being repealed and a single statute that will cover all the plans is being added as new section 356.311.
- Section 354A.29: "COLA trigger" statute. Removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met.

**Article 5: Postretirement Adjustments for Statewide Plans and General Provisions**

Section 1: Lowers the investment return assumption to 7.5% for all MSRS plans, PERA plans, TRA, and SPTRFA, effective July 1, 2017.

Section 2: Permits more flexibility in the adoption of mortality improvement scales by the pension plans and makes conforming changes to the section of the statutes that governs the adoption of actuarial assumptions other than the assumptions set forth in the statutes. The revisions permit the use of recent changes in the methodology for determining the appropriate mortality assumption.

Section 3: Resets the 30-year amortization period to 2047 for MSRS plans, PERA plans, TRA, and St. Paul Teachers.

Section 4: Clarifies the Combined Service Annuity provision and adds a conforming change to reflect the elimination of augmentation, generally.

Section 5: Combines each plan's Coverage by More than One Plan provision for a comprehensive and uniform provision.

Section 6: Modifies the COLA for **MSRS-General, MSRS-Unclassified**, and the **Legislators plans** in the following ways:

- Removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met;
- Lowers the COLA from 2% to 1% for five years, and 1.5% thereafter; and
- For retirements on or after January 1, 2018, a retiree is not eligible to receive a COLA until the retiree reaches normal retirement age. When the retiree reaches normal retirement age, the retiree will receive a full COLA increase if the retiree has been receiving at least 12 months of pension payments as of the prior June 30. If the retiree has fewer than 12 months, the retiree will receive a fraction of the COLA based on the number of months of payments received or, if fewer than 6 months, the retiree must wait a year to receive a full COLA. *(This provision does not apply to members who retire under the Rule of 90, are receiving disability benefits, or receive survivor's benefits)*

Section 7: This section modifies the COLA for **MSRS-Correctional** in the following ways:

- Removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met; and
- Lowers the COLA from 2% to 1.5%.

Section 8: This section modifies the COLA for **PERA-General** in the following ways:

- Removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met; and
- For retirements on or after January 1, 2018, a retiree is not eligible to receive a COLA until the retiree reaches normal retirement age. When the retiree reaches normal retirement age, the retiree will receive a full COLA increase if the retiree has been

receiving at least 12 months of pension payments as of the prior June 30. If the retiree has fewer than 12 months, the retiree will receive a fraction of the COLA based on the number of months of payments received or, if fewer than 6 months, the retiree must wait a year to receive a full COLA. *(This provision does not apply to members who retire under the Rule of 90, are receiving disability benefits, or receive survivor's benefits)*

<u>Section 9</u>: This section removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met for **PERA-P&F**.

<u>Section 10</u>: This section modifies the COLA for **TRA** in the following ways:

- Removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met;
- Lowers the COLA from 2% to 1%; and
- For retirements on or after January 1, 2018, a retiree is not eligible to receive a COLA until the retiree reaches normal retirement age. When the retiree reaches normal retirement age, the retiree will receive a full COLA increase if the retiree has been receiving at least 12 months of pension payments as of the prior June 30. If the retiree has fewer than 12 months, the retiree will receive a fraction of the COLA based on the number of months of payments received or, if fewer than 6 months, the retiree must wait a year to receive a full COLA. (*This provision does not apply to members who retire under the Rule of 90, are receiving disability benefits, or receive survivor's benefits)*

<u>Section 11</u>: This section removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met for the **State Patrol** plan.

<u>Section 12</u>: This section adds language to maintain the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met for the **Judges** plan.

<u>Section 13</u>: This section modifies the COLA for **PERA-Correctional** in the following ways:

- Removes the provisions requiring automatic increases in the COLA, up to a maximum of 2.5%, when specified funding ratios are met; and
- Lowers the COLA from 2.5% to 1.5%.

<u>Section 14</u>: This section requires the Pension Commission to conduct a study before December 31, 2020, on the COLA rates for all the pension plans and make recommendations regarding any modification to the rates and methodology for determining the rates. The Pension Commission is to act on the recommendations during the 2021 legislative session.

**Article 6. Interest Rate Conforming Changes**

<u>Sections 1 – 43</u>: All the plans pay interest or are paid interest on many different types of payments. Payments on which interest is paid include payments made by rehired members when they repay a previous refund, payments by the employer when it fails to deduct enough from an employee's paycheck, payments by an employee for missed employee contributions during certain leaves of absence, and late payment of employer

contributions by an employer. The rate of interest is tied, in most cases, to the investment rate of return assumption.

With the lowering of that assumption to 7.5% many statutory references to interest rates had to be revised. Rather than make that change in numerous places throughout the statutes, a reference to a new section, Minnesota Statute § 356.59, has been inserted to replace specific rates of interest. The new statute is added by Section 40 of Article 6 of the bill, and is a compilation of all the interest rates over different time periods for each of the plans.

MSRS, PERA, TRA, and St. Paul Teachers drop their interest rate to 7.5% effective July 1, 2017.

**Article 7. Contribution Rates**

**Note:** "FY18" means the fiscal year July 1, 2017, to June 30, 2018
"FY19" means the fiscal year July 1, 2018, to June 30, 2019
"FY20" means the fiscal year July 1, 2019, to June 30, 2020
"FY21" means the fiscal year July 1, 2020, to June 30, 2021

Section 1:

| **MSRS GENERAL EMPLOYEE CONTRIBUTION RATE INCREASES** | | | |
|---|---|---|---|
| | **FY18** | **FY19** | **TOTAL** |
| % Increase | 0.25% | 0.25% | **0.5%** |
| Rate | 5.75% | 6% | **6%** |

Section 2:

| **MSRS GENERAL EMPLOYER CONTRIBUTION RATE INCREASES** | | | |
|---|---|---|---|
| | **FY18** | **FY19** | **TOTAL** |
| % Increase | 0.375% | 0.375% | **0.75%** |
| Rate | 5.875% | 6.25% | **6.25%** |

Section 3: **MSRS-Correctional employee** contribution rate increased by **0.5% in FY18** (from 9.1% to 9.6% of salary).

Section 4: **MSRS-Correctional** regular **employer** contribution rate increased by **1.55% in FY18** (from 12.85% to 14.4% of salary).

Section 5: New **MSRS-Correctional supplemental employer** contribution, as follows:

- 1.45% of salary in FY19;
- 2.95% of salary in FY20; and
- **4.45% of salary in FY21**, which remains in effect until the market value of assets equals or exceeds actuarial accrued liability.

Section 6:

| STATE PATROL EMPLOYEE CONTRIBUTION RATE INCREASES | | | |
|---|---|---|---|
| | **FY18** | **FY20** | **TOTAL** |
| % Increase | 0.5% | 0.5% | **1%** |
| Rate | 14.9% | 15.4% | **15.4%** |

Section 7:

| STATE PATROL REGULAR EMPLOYER CONTRIBUTION RATE INCREASES | | | |
|---|---|---|---|
| | **FY18** | **FY19** | **TOTAL** |
| % Increase | 0.75% | 0.75% | **1.5%** |
| Rate | 22.35% | 23.1% | **23.1%** |

New **supplemental employer** contribution rates are as follows:

- 1.75% of salary in FY18;
- 3% of salary in FY19;
- 5% of salary in FY20; and
- **7% of salary in FY21**, which remains in effect until the market value of assets equals or exceeds actuarial accrued liability.

Section 8: Deletes the language which ties the employee contribution rate under the **MSRS Unclassified Plan** to the employee contribution rate under the MSRS General Plan and inserts the current **employee** contribution rate of 5.5%.

The employee contribution rate under the MSRS Unclassified Plan will be 0.5% lower than the rate under the MSRS General Plan, after the employee contribution increases for the General Plan are fully effective.

Section 9:

| PERA P&F EMPLOYEE CONTRIBUTION RATE INCREASES | | | |
|---|---|---|---|
| | **2018** | **2019** | **TOTAL** |
| % Increase | 0.5% | 0.5% | **1%** |
| Rate | 11.3% | 11.8% | **11.8%** |

Section 10:

| PERA P&F EMPLOYER CONTRIBUTION RATE INCREASES | | | |
|---|---|---|---|
| | **2018** | **2019** | **TOTAL** |
| % Increase | 0.75% | 0.75% | **1.5%** |
| Rate | 16.95% | 17.7% | **17.7%** |

Section 11:

| TRA EMPLOYEE CONTRIBUTION RATE INCREASES | | | | | |
|---|---|---|---|---|---|
| | **FY18** | **FY19** | **FY20** | **FY21** | **TOTAL** |
| % Increase | 0.1875% | 0.1875% | 0.1875% | 0.1875% | **0.75%** |
| Rate | 7.69% | 7.88% | 8.06% | 8.25% | **8.25%** |

The contribution rate each year is rounded to hundredths. The TRA basic member employee contribution increase is also increased by 0.75% over four years (from 11% to 11.75% of salary).

Section 12:

| TRA EMPLOYER CONTRIBTUION RATE INCREASES | | | | | |
|---|---|---|---|---|---|
| | **FY18** | **FY19** | **FY20** | **FY21** | **TOTAL** |
| % Increase | 0.25% | 0.25% | 0.25% | 0.25% | **1%** |
| Rate | 7.75% | 8% | 8.25% | 8.5% | **8.5%** |

The TRA employer contribution rate for basic members is also increased by 1% over four years (from 11.5% to 12.5% of salary).

Section 13: **STPRFA employee** contribution rate increased by **0.25% in FY22**

- from 7.5% to 7.75% of salary for coordinated members
- from 10% to 10.25% of salary for basic members.

Section 14:

| SPTRFA EMPLOYER CONTRIBTUION RATE INCREASES | | | | | |
|---|---|---|---|---|---|
| | **FY18** | **FY19** | **FY20** | **FY21** | **TOTAL** |
| % Increase | 0.5% | 0.75% | 0.5% | 0.75% | **2.5%** |
| Rate | 7% | 7.75% | 8.25% | 9% | **9%** |

The SPTRFA employer contribution rate for basic members is also increased by 2.5% over four years (from 10.5% to 12.5% of salary).

**Article 8: Direct State Aid**

Section 1: This section requires annual direct state aid payments to **PERA P&F**, as follows:

- $4.5 million on October 1, 2018;
- $4.5 million on October 1, 2019;
- $9 million on October 1, 2020;
- $9 million on October 1, 2021 and annually thereafter

Section 2: This section requires annual direct state aid payments to the **SPTRFA** in the amount of $5 million each October 1. This amount is in addition to a total of $9,827,000 in annual direct state aid payments being made to SPTRFA.