



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Rachel Barth, Deputy Director

RE: Summary of the 2015 PERA Report on a Proposal to Increase Benefits to Certain Individuals Receiving Benefits from the PERA Police and Fire Plan

DATE: February 17, 2016

## Introduction

This memorandum is a summary of a report prepared by the Public Employees Retirement Association (PERA), dated January 16, 2015, at the request of the Pension Commission after consideration of proposed bill H.F. 1800/S.F. 1620, introduced in the 2013 session. The report provides background information on local police and fire relief association consolidations with the PERA Police and Fire Plan (P&F Plan) and the opportunities members had at various times to elect (i) the plan in which they wished to participate, (ii) the post-retirement adjustment (COLA) they wished to receive, and (iii) the benefits their surviving spouse would receive. The report provides statistical information and cost estimates for proposed benefit increases, which would be paid to certain retirees and survivors who had chosen to maintain their local police and fire plan benefits and.

## The Report

### Local Plan Consolidations

Local pension plans for paid police and fireman, called relief associations, were administered by the respective city and provided benefits based on each association's articles of incorporation and bylaws. Beginning in 1980, all newly hired paid police and fireman were required to be enrolled in the P&F plan. Due to administrative burdens and the improving P&F benefits, many relief associations wanted to consolidate with the P&F plan. Chapter 353A was enacted in 1987 that established a process for consolidation and the benefit options relief association members were able to choose from. Consolidation merely shifted the plan's administration to PERA, the city still had to provide funding to ensure all promised benefits were paid.

Benefit costs of a consolidation varied based on the benefit option choice each relief association participant made. So, to determine the consolidation costs to ensure that the city provided the appropriate funding, the actuary generated the cost as if each participant elected the benefit provisions that would provide the highest benefit payable, using the applicable PERA assumptions. Cities were required to make an initial annual contribution based on that cost estimate and future annual contributions thereafter, depending on various actuarial experiences.

If a consolidation occurred, active and former members of the relief association were authorized to make benefit choices. Active members had the option between the local plan's benefit and the P&F

coverage in its entirety. Former members, which included retirees, disability benefit recipients, surviving spouse benefit recipients, and deferred members, were required to retain the benefits paid to them on the date of consolidation, but they were able to choose how to receive their future annual post-retirement adjustments (COLA). The option was either to maintain the local plan increases, which were tied to wage increases negotiated for active members of a defined rank, or receive the P&F COLA, which was determined by the Minnesota Post Retirement Investment Fund (Post Fund) investment returns. Future surviving spouses of these benefit recipients were tied to the COLA choice made by the member spouse. The law also required that at the time the member passed away, PERA must use the applicable relief association bylaws to calculate the survivor benefit and apply the COLA choice the member made. So, if a member chose to receive the P&F COLA and received the COLA increases of the 1990s, which were significant, the eventual survivor benefit would be smaller than the member's benefit because the survivor benefit would not include those COLA increases.

Local plan benefits differed from P&F benefits. Local plan benefits were calculated as a percentage and allocated units of "base pay" upon which contributions had been paid with benefits commencing at age 50. Local plans provided for automatic survivor benefits that were paid from the plan so that the member did not have to take a lower benefit to provide a future benefit to the spouse. P&F benefits were calculated using the salary high-five with benefits being reduced if taken before the member reached age 55. The benefit was also reduced if the member chose a survivor benefit option.

Plans that had consolidated into PERA became increasingly more complex to administer due to the fewer numbers of members electing and paying into the local plan. The annual required calculation local plans with unfunded liabilities had to pay fluctuated every year, which put a strain on city budgets. P&F benefits were also improved three separate times. Each city had to approve the improvements before they could be extended to the members who had chosen P&F coverage because the improvements had to be funded by the city. Some cities were able to adopt the improvements while other cities were not, leading to benefit differences between what P&F members would receive. The desired result of consolidation was to achieve uniformity, which was no longer occurring among those who had or could elect P&F benefits.

### Merger of Local Plans

The volatility of city contributions on behalf of the consolidated accounts and the differences in benefit levels among P&F members led to the eventual full merger of the consolidated relief associations. Cities that had unfunded liabilities were required to fully fund their benefit obligations and were given a specified amount and time frame to do so. The merger law provided a second election to benefit recipients who had chosen to retain the local plan COLA to instead choose the P&F COLA prospectively. Local plan participants who had elected to retain local plan benefits, were also given a second election to choose P&F COLAs, prospectively.

Participants who had been retired at the time of consolidation and had chosen P&F COLAs began to realize that their spouses' benefits would be lower due to the requirement that PERA calculate the spousal benefit using the local plan provisions, which did not recognize prior COLA increases. In 2000, legislation was enacted that allowed local plan retirees to elect either a 15% or 25% joint and survivor option. Selecting either option meant that the retiree's benefit would immediately be reduced by the respective percentage and provide for 15% or 25% of the current benefit to be paid to the spouse in addition to the local plan survivor benefit. This new option did not provide a "bounce back" feature like

the one in the P&F plan, which allows the member's benefit to "bounce back" to 100% if the member outlives the spouse. The cost of the "bounce back" feature is incorporated into the P&F retirement cost included in determining the contributions required to the fund plan. However, the local plan retirees had chosen the P&F COLAs after already retiring and therefore had not made any contributions to fund a "bounce back" feature. So, if a local plan retiree chose the new joint and survivor option but they outlived their spouse, their benefit would remain at the reduced rate.

### Proposed Legislation to Increase Benefits

In 2013 legislation was proposed to increase the benefits of all retired persons who retained benefits under the relief association laws to \$38,000 annually or 20%, whichever was less. It also directed that all survivors receiving benefits based on local plan bylaws were to receive an increase to \$30,000 annually or 20%, whichever was less. The bill did not have a provision to provide funding for those benefit increases.

PERA testified in opposition to the 2013 bill stating that it would violate PERA's fiduciary duty to use assets from the P&F plan to pay for increased benefits to a select group of members. PERA also raised concerns that other benefit recipients of the plan who were not formerly part of a relief association, but who were receiving similar benefit amounts to those identified in the bill, were not included. In 2014, PERA analyzed the accounts of those local plan benefit recipients who were former participants in the local plans that consolidated and ultimately merged into the P&F plan and released a report on January 16, 2015 to the LCPR.

### PERA Report Results

PERA found that 970 retired members of the local plans were receiving benefits in 2014, 498 of whom were retired when their relief association consolidated or merged with P&F. Only 3 of those members chose to retain local plan COLA increases. PERA also found that of the 472 former local plan members who were deferred or still working when their relief association consolidated, 417 chose P&F benefits and 55 chose to retain their local plan benefits. Only 1 of those 55 members chose to retain local plan COLA increases when given the second election in 1999.

At the time PERA conducted the study, 83 individuals were receiving benefits that were below the proposed legislation's threshold of \$38,000. Of those 83, 58 were retired before consolidation and 25 retired after consolidation and retained local plan benefits. PERA found that the cost of increasing only the benefits was a present value of \$2,386,819 in 2014. PERA also found that 288 local plan survivors were below the proposed legislation's threshold of \$30,000. The cost of increasing the survivors' benefits was a present value of \$6,083,262 in 2014.

PERA also found that there were individuals who were receiving P&F benefits who also fell below the proposed legislation's thresholds. 7 individuals who retired after consolidation and chose P&F benefits fell below the \$38,000 threshold. PERA found that there were 418 survivors receiving P&F survivor benefits that below the \$30,000 threshold. If those 418 benefits were increased, the present value cost was \$9,697,738 in 2014.