H.F. 627
(Kranz)

S.F. 648
(Betzold)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	Teachers Retirement Association
Relevant Provisions of Law:	Minnesota Statutes, Chapter 354
General Nature of Proposal:	Age 65 Normal Retirement Age and "Rule of 90" Benefit Tier Extension to Post-1989 Members
Date of Summary:	April 3, 2008

Specific Proposed Changes

- The proposed legislation extends the "Rule of 90" benefit tier to plan members hired after 1989

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of continuing early normal retirement ages.
2. Appropriateness of reversing the 1989 agreement on phasing out the "Rule of 90" provision.
3. 2007 actuarial cost estimate.
4. Appropriate TRA member and employer contribution increases.
5. Affordability of the various benefit increases.
6. Desirability of gubernatorial input.
7. Lack of uniformity in the various benefit increase proposals.
8. Potential extensions of specific benefit increases.
9. Appropriateness of the implicit change in pension plan purpose.
10. Appropriateness of an early retirement subsidy in light of a broader alternative.
11. Alternative of a supplemental defined contribution plan creation instead of defined benefit plan increase.

Potential Amendments

H0627-1A allocates the actuarial cost of the benefit increase only equally between members and employers.

H0627-2A allocates the actuarial cost of the benefit increase only, with member portion up to 45.5 percent of the total funding requirement and the employer portion of the balance.

H0627-3A allocates the total of the actuarial cost of the benefit increase and the 2006 TRA contribution deficiency equally between members and employers.

H0627-4A allocates the total of the actuarial cost of the benefit increase and the 2006 TRA contribution deficiency, with member portion up to 45.5 percent of the total funding requirement of the plan and with the employer portion of the balance.

H0627-5A makes the same "Rule of 90" benefit tier extension to post-1989 hires to all other applicable Minnesota retirement plans.

State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director LAM

RE: H.F. 627 (Kranz); S.F. 648 (Betzold): TRA; Age 65 Normal Retirement Age and "Rule of 90" Benefit Tier Extension to Post-1989 Members

DATE: April 3, 2008

Summary of H.F. 627 (Kranz); S.F. 648 (Betzold)

H.F. 627 (Kranz); S.F. 648 (Betzold) amends various portions of the Teachers Retirement Association (TRA) law, Minnesota Statutes, Chapter 354, by extending most of the pre-1989 benefit plan provisions to the post-1989 new entrants, making the following changes:

1. Redefines the TRA Normal Retirement Age as Age 65. for person who first became TRA members after June 30, 1989, the normal retirement age for retirement coverage is set at age 65 rather than as the federal full Social Security benefit receipt age, with a maximum of age 66 (Section 1);

2. Extends TRA "Rule of 90" Coverage. Persons who first became TRA members after June 30, 1989, are extended benefit coverage by the "Rule of 90" benefit tier (Section 4); and

3. Increases TRA Member and Employer Contribution Rates. The TRA member contribution and employer contribution rates are increased by unspecified amounts (Sections 2 and 3).

Background Information

Background information is attached for the following applicable topics:

a. 1989 "Rule of 90" Tier Benefit Increase Legislation (Attachment A)
b. Setting Normal Retirement Ages for a Defined Benefit Plan (Attachment B)
c. Benefit Increase Funding (Attachment C)
d. Allocation of Pension Costs between Plan Members and Employing Units (Attachment D)

Analysis and Discussion

H.F. 627 (Kranz); S.F. 648 (Betzold) reverses the 1989 legislative decision to limit the application of the "Rule of 90" early normal retirement age provision and the "Rule of 90" benefit tier to pre-July 1, 1989, hires of the Teachers Retirement Association (TRA) and extends the program to post-June 30, 1989, hires, with an unspecified increases in TRA member and employer contribution rates.

The proposed legislation raises several pension and related public policy issues that may merit Commission consideration and discussion, as follows:

1. Appropriateness of Continuing To Emphasize Early Normal Retirement Ages. The policy issue is the appropriateness of the Legislature in emphasizing early normal retirement ages at a time when the age for the receipt of full Social Security benefits is increasing, when the life expectancy of Minnesota retirees is unmatched (except maybe by Hawaii retirees), and when Minnesota is reportedly facing an upcoming teacher shortage. The proposed legislation does this by including additional plan members in the "Rule of 90" early normal retirement benefit tier teachers employed after June 30, 1989. The Commission's Policy Principles, Principle II.C.4, indicate that

> II.C.4. Appropriate Normal Retirement Ages
>
> The normal retirement age should be set in a reasonable relationship to the employability limits of the average public employee and should differentiate between regular public employees and protective and public safety employees.

It is not clear that teachers in Minnesota have reached their expected employability limits five, seven or ten years earlier than teachers who retired two decades ago or three decades ago. With Social Security paying full benefits at later ages and not paying any benefits until age 62, allowing teachers to continue to retire earlier and earlier as this proposed legislation does would appear to work at cross purposes. The trend to earlier retirement for Minnesota teachers with Social Security coverage and its later full benefit receipt ages will likely lead to these teachers demanding greater Minnesota public pension plan benefits in the future to counteract that gap in the receipt of early or full Social Security benefits and to cover the cost of post-retirement health insurance.

2. Appropriateness of Reversing 1989 Agreement on Phasing-Out the "Rule of 90" Provision. The policy issue is the appropriateness of reversing the "Rule of 90" early normal retirement age phase-out that the proponents of the creation of the "Rule of 90" tier committed to in 1989. While the Commission was only indirectly involved in the formulation of the final proposed legislation enacted in 1989, because the Commission never recommended the benefit increases enacted in 1989, the retirement plan administrators did commit, in testimony before the Commission on the proposed 1989 benefit increases, that the early retirement benefit tier would be phased out eventually by limiting its coverage to pre-July 1, 1989, hires and would be eliminated if over-utilized, which was defined as utilization by more than 45 percent of eligible retirees. This commitment has already been broken with the 1993 enactment of a repeal of the "Rule of 90" utilization and termination provision. The 1989 commitment would be totally eliminated if this benefit increase proposal were enacted.

3. Actuarial Cost. The policy issue is the actuarial cost of the proposed legislation. The consulting actuary retained by the Teachers Retirement Association (TRA), has prepared an actuarial cost estimate for this benefit increase (attached), which is summarized as follows:

	TRA 2006		Actuarial Impact of Proposed Legislation		Resulting Actuarial Condition of TRA	
Membership						
Active Members		79,200		--		79,200
Service Retirees		40,973		--		40,973
Disabilitants		630		--		630
Survivors		3,044		--		3,044
Deferred Retirees		11,773		--		11,773
Nonvested Former Members		21,956		--		21,956
Total Membership		157,576		--		157,576
Funded Status						
Accrued Liability		$20,679,110,879		$267,425,000		$20,946,535,879
Current Assets		$19,035,611,839		$0		$19,035,611,839
Unfunded Accrued Liability		$1,643,499,040		$267,425,000		$1,910,924,040
Funding Ratio	92.05%		(1.17%)		90.88%	
Financing Requirements						
Covered Payroll		$3,707,900,584		--		$3,707,900,584
Benefits Payable		$1,224,212,024		--		$1,224,212,024
Normal Cost	9.43%	$349,678,399	0.68%	$25,213,724	10.11%	$374,892,123
Administrative Expenses	0.33%	$12,236,072			0.33%	$12,239,072
Normal Cost & Expense	9.76%	$361,914,471	0.68%	$25,213,724	10.44%	$387,131,195
Normal Cost & Expense	9.76%	$361,914,471	0.68%	$25,213,724	10.44%	$387,131,195
Amortization	2.34%	$86,764,874	0.38%	14,090,022	2.72%	$100,854,896
Total Requirements	12.11%	$448,679,345	1.06%	$39,303,746	13.16%	$487,986,091
Employee Contributions	5.51%	$204,456,479				
Employer Contributions	5.23%	$193,832,020				
Employer Add'l Cont.	0.00%	$0				
Direct State Funding	0.51%	$18,819,110				
Other Govt. Funding	0.07%	$2,500,000				
Administrative Assessment	0.00%	$0				
Total Contributions	11.31%	$419,607,609				
Total Requirements	12.11%	$448,679,345				
Total Contributions	11.31%	$419,607,609				
Deficiency (Surplus)	0.80%	$29,071,736				

The actuarial cost impact estimate was prepared by an actuary employed by Buck Consultants who does not appear to be an approved actuary under Minnesota Statutes, Section 356.215, Subdivision 1, Paragraph (c). TRA apparently did not request an actuarial cost estimate from The Segal Company, the consulting actuary retained jointly by the retirement systems under Minnesota Statutes, Section 356.244.

4. Appropriate TRA Member and Employer Contribution Increases. The policy issue is the appropriate amount of the Teachers Retirement Association (TRA) member and employer contribution rate increases to accompany the proposed benefit increase. A contribution deficiency of 0.80 percent of covered pay currently exists within TRA and the proposed benefit increase would increase that deficiency to 1.86 if no contribution rate increase accompanies the proposed benefit increase. If the Commission desires to increase the TRA contribution rates, the following amendments provide a variety of potential increases:

Benefit Increase Cost Only

• Equal Allocation of Impact	Amendment H0627-1A
• Member Allocation Up to 45.5 percent* of Total Contributions, with Employer Rate Increased Based on Balance	Amendment H0627-2A

Benefit Increase Cost and Current Deficiency

• Equal Allocation of Total	Amendment H0627-3A
• Member Allocation Up to 45.5 percent * of Total Cost, with Employer Rate Increased Based on Balance	Amendment H0627-4A

**In July 1, 2006, TRA actuarial valuation, members contribute 45.5 percent of TRA current full actuarial cost*

5. Affordability of Various Benefit Increases. The policy issue is the affordability of the various proposed benefit increases. The policy issue is a corollary to the issue of the actuarial cost of the proposed benefit increases. The benefit increase depends on employer contribution increases by for their future financing to some degree and employer budgets may be unable to absorb any contribution increases. The proposed legislation does not propose any increase in state education aid to school districts, so for most Teachers Retirement Association (TRA) employers, the cost will be borne from existing sources.

6. Desirability of Gubernatorial Input. The policy issue is the potential desirability of receiving input from the Governor, the Department of Finance, and other relevant Executive Branch sources on the proposed benefit increase. While in Minnesota, historically, public pension policy has largely become the purview of the Legislative Branch by default or design, most public policy issues reflect a considerable interplay between the Executive Branch and the Legislative Branch. When considering public pension policy proposals as significant as some of the proposed benefit increase, it may be advisable to provide the Governor and the Executive Branch with an opportunity to weigh in on these proposals and to consider any input provided.

7. Lack of Uniformity in the Various Benefit Increase Proposals. The policy issue is the impact of the various benefit increase proposal on the uniformity of the benefit coverage between various types of Minnesota public pension plans. In 1997, the package of benefit increases was argued by its proponents as being necessary to achieve uniformity among the various Minnesota public retirement plans. Benefit uniformity became the stated goal of the 1997 legislation to such an extent that it functioned as the shorthand title for the legislation as it progressed. The proposed benefit increase further strays from uniformity between the various retirement plans and makes the 2006 TRA benefit accrual rate increase departure from uniformity worse.

8. Potential Extensions of Specific Benefit Increases. The policy issue is the appropriateness of pursuing a specific pension benefit increase proposal without considering likely or probable demands for their extension to other plans. Currently, the "Rule of 90" benefit tier is limited to pre-1989 hires for the Teachers Retirement Association (TRA) and four other retirement plans, the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), the Duluth Teachers Retirement Fund Association (DTRFA), and the St. Paul Teachers Retirement Fund Association (SPTRFA). If the "Rule of 90" tier is extended to post-1989 hires of TRA, uniformity concerns or plan membership demands may lead to the same extension for the remaining plans. If the Commission desires to make the extension to all applicable plans, Amendment H0627-5A provides for that extension.

9. Appropriateness of the Implicit Change in Pension Plan Purpose. The policy issue is the appropriateness of the implicit change brought on by the proposed legislation in the purposes for which a public pension plan exists. The emphasis on earlier and earlier normal or subsidized retirements at a time when there are lengthening lifetimes, improved retiree health, and a growing labor shortage means implicitly that pension plans are being viewed by participants as the economic

underwriters of second or third careers. The Commission, in its policy principles, reflects a traditional view of pension plan purposes, indicating in Principle II.A.1. that:

> II. A.1. Purpose of Minnesota Public Pension Plans
>
> Minnesota public pension plans exist to augment the Minnesota public employer's personnel and compensation system by assisting in the recruitment of new qualified public employees, the retention of existing qualified public employees, and the systematic outtransitioning of existing public employees at the normally expected conclusion of their working careers by providing, in combination with federal Social Security coverage, personal savings and other relevant financial sources, retirement income that is adequate and affordable.

If this second or third career subsidization is an appropriate goal for Minnesota public pension plans, it should be reflected in the Commission's policy principles and, perhaps, it should be better targeted and designed.

10. Appropriateness of Early Retirement Subsidy In Light of Broader Alternative. The policy issue is the appropriateness of giving that portion of the membership of the four teacher retirement plans who want to retire early greater benefits while providing no benefit increase to the remainder. Early retirees could be provided with larger dollar amount benefits by an increase in the "Level Benefit" benefit tier benefit accrual retirement formula rate, applicable to all plan members, and that alternative should be considered.

11. Alternative Supplemental Defined Contribution Plan Creation/Increase Instead of Defined Benefit Plan Increase. The policy issue is the advisability of the Commission establishing an alternative practice to further defined benefit plan increases by creating or augmenting a supplemental defined contribution plan. At some moment in time, the combination of Social Security coverage and the applicable defined benefit retirement plan coverage will provide a sufficient retirement base for a majority of public employees and the provision of supplemental defined contribution coverage will provide an enhancement and a flexibility to those public employees that is impossible in the blunt policy instrument that is the State's current defined benefit plans. Additionally, redirecting benefit increase demands into defined contribution retirement coverage avoids the uncertain future actuarial accrued liabilities always present in defined benefit plan benefit increases.

Attachment A

Background Information on the 1989 "Rule of 90" Tier Benefit Increase Legislation

a. Distinction Between Defined Benefit Plans and Defined Contribution Plans. Most Minnesota public pension plans are defined benefit plans rather than defined contribution plans. Defined benefit plans establish a mechanism or formula by which the eventual retirement annuity amount would be determined, generally as a service related percentage of a final average salary base, and leave the pension funding obligation variable. The annual actuarial valuations required of defined benefit Minnesota public pension plans are needed to determine that variable funding obligation. Defined contribution plans set the pension funding obligation as a fixed amount, percentage, or mechanism, and leave the ultimate retirement annuity amounts to be determined based on the amount of amassed contributions and accrued investment earnings and actuarial assumptions as to post retirement interest and mortality.

b. Normal Retirement Age in Defined Benefit Plans. In a defined benefit plan, the normal retirement age provision or provisions establish the point or points during a pension plan participant's lifetime where a retirement annuity has the maximum actuarial liability for the pension plan and greatest actuarial value for the participant becomes payable. Historically, the normal retirement age is intended to mark the end of a plan participant's generally expected working career and the beginning of the person's years outside of the regular full time workforce. Pension plans have usually been viewed as an adjunct to the personnel and compensation system of an employer to encourage the recruitment of new employees, the retention of existing productive personnel, and the systematic predictable out-transitioning of senior employees at the logical conclusion of their working careers by providing an adequate level of pension coverage.

At the normal retirement age or ages, a Minnesota public pension plan typically pays a single life annuity that is equal to the full amount of the retirement annuity calculated using the defined benefit plan formula. Typically, a Minnesota public pension plan will pay a retirement annuity at an earlier age, frequently referred to as the early retirement age or early reduced retirement age, with the single life annuity amount reduced to account in whole or in part for the actuarial impact of providing a retirement annuity before the normal retirement age or ages. If the reduction is equal to the whole actuarial impact of the earlier age for benefit payment, the reduction is referred to as an actuarially equivalent reduction. If the reduction is less than the whole actuarial impact of the likely extension in the person's retired lifetime, the early retirement annuity is considered to have been subsidized.

c. "Rule of 90" Normal Retirement Age. Historically, it has been Commission policy to set an age 65 normal retirement age for general (non-public safety) employees and an age 55 normal retirement age for public safety employees. While age 65 or age 55 normal retirement ages remain a common requirement, different normal retirement ages have been established over time. For the oldest programs of the first class city plans and local police and salaried firefighter relief associations, younger normal retirement ages have long existed before 1989, as follows:

Plan	Age or Ages
Duluth Teachers Retirement Fund Association (DTRFA) Old Law Program	Age 60
Minneapolis Teachers Retirement Fund Association (MTRFA) Basic Program	Age 60 or any age with 30 years of service
St. Paul Teachers Retirement Fund Association (SPTRFA) Basic Program	Age 60 with 25 years of service
Minneapolis Employees Retirement Fund (MERF)	Age 60 or any age with 30 years of service
Most local police or salaried firefighter relief associations	Age 50

In 1973, the Commission and the Legislature initially recognized long service as a qualification for an earlier normal retirement age for the statewide general employee pension plans, with the enactment of the age 62 with 30 years of service normal retirement age provision.

In 1982, after several sessions of considering proposed legislation to create earlier normal retirement ages, the Legislature enacted the "Rule of 90" for the Public Employees Retirement Association (PERA), in lieu of the PERA age 62 with 30 years of service provision. The "Rule of 90" provision allows a person to retire with an unreduced retirement annuity when the person's combined age and service total at least 90.

In 1989 (Laws 1989, Chapter 319, Article 13), the Legislature extended this "Rule of 90" early normal retirement provision to the Minnesota State Retirement System (MSRS), Teachers Retirement Association (TRA), and the three first class city teacher plans as part of a major benefit improvement. That benefit increase was added as a House of Representatives floor amendment to proposed legislation relating to teachers' salaries in Independent School District No. 709 (Duluth), without a favorable recommendation by the Legislative Commission on Pensions and Retirement. The "Rule of 90" provision is part of the Tier I benefit package, which consists of an earlier retirement age, a lower benefit accrual rate for the initial ten years of service (1.0 percent rather than 1.5 percent for Tier II Coordinated Programs, and 2.0 percent rather than 2.5 percent for Tier II Basic Programs), and a subsidized early retirement reduction amount.

During the 1989 Session, several Senate members of the Legislative Commission on Pensions and Retirement supported a general benefit accrual rate increase at age 65 while several House of Representatives members of the Commission supported the "Rule of 90" early normal retirement age provision. The 1989 benefit increase legislation, an amendment derived from 1989 Session S.F. 1329 (Pogemiller); H.F. 1302 (Simoneau), ultimately was enacted.

Specifically, the 1989 benefit increases related to the "Rule of 90" and "Level Benefit" benefit tiers are as follows:

1. Level Benefit Tier. All plan members are eligible to receive a retirement annuity using a level benefit accrual formula rate of 1.5 percent credit for all years of service, rather than the current one percent of each of the first ten years of service, followed by 1.5 percent thereafter. If the individual retires before the normal retirement age, the benefit is actuarially reduced. The normal retirement age for new employees will be automatically changed to correspond to the Social Security retirement age, as that age changes over time. The normal retirement age is age 65.

2. "Rule of 90" Benefit Tier. Plan members first hired before July 1, 1989, if their age plus years of service total the sum of 90, are eligible to receive a benefit accrual formula rate of one percent for each of the first ten years of service, followed by 1.5 percent per year thereafter, with no early retirement reduction. If the member does not meet the "Rule of 90" eligibility requirement, with a benefit accrual rate of one percent for each of the first ten years and 1.5 percent thereafter, the early retirement reduction rate is three percent per year.

The 1989 benefit accrual rates were increased in 1997 (see Laws 1997, Chapter 233, Article 1).

The argument made by the proponents for the "Rule of 90" benefit tier was that the benefit program would be restricted to then current plan members (pre-July 1, 1989 hires) and that the Legislature reserved the right to eliminate the provision if its utilization exceeded 45 percent of eligible retirees. The "Rule of 90" report requirement and elimination provision was repealed in 1993 (see Laws 1993, Chapter 280), at the request of the various major general employee retirement plan administrators when the Teachers Retirement Association (TRA) utilization approached the triggering level.