



H.F. 2725
(Hansen)

S.F. 2467
(Metzen)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-P&F
Relevant Provisions of Law: Special law
General Nature of Proposal: Joint and survivor annuity for ex-spouse of deceased officer
Date of Summary: March 10, 2008

Specific Proposed Changes

- Revise annuity form to provide joint and survivor annuity to ex-spouse following the retirement and death of the retired police officer

Policy Issues Raised by the Proposed Legislation

1. Violates prohibition against annuity form revision.
2. Precedent concerns, leading to revision of annuity forms after commencement of benefit and/after death of retired member.
3. Whether a case can be made that PERA caused harm, providing justification for the proposed treatment.
4. Cost to PERA-P&F of over \$100,000.

Amendments

- H2725-1A Technical amendment.
- H2725-2A Revises the level of the joint and survivor annuity from 50 percent joint-and-survivor to a level to be determined.
- H2725-3A Requires an administrative hearing to determine whether a benefit would be paid.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director **EB**
RE: H.F. 2725 (Hansen); S.F. 2467 (Metzen): PERA-P&F; Revising Annuity to Provide Joint-and-Survivor Coverage to a Divorced Spouse Following Death of Retiree
DATE: February 29, 2008

Summary of H.F. 2725 (Hansen); S.F. 2467 (Metzen)

H.F. 2725 (Hansen); S.F. 2467 (Metzen) would provide a Public Employees Police and Fire Retirement Plan (PERA-P&F) 50 percent joint-and-survivor annuity to the divorced spouse of a deceased South St. Paul police officer retiree, who died in 2006. Benefits are not payable retroactively. To be eligible for a benefit, the divorced surviving spouse must first repay the benefit differential between the single life annuity selected by the deceased retired police officer and a 50 percent joint-and-survivor annuity, with 8.5 percent interest.

Public Pension Problem of Cheryl Kinney

The attached materials indicate that Craig Kinney started working as a South St. Paul police officer in 1966, eventually becoming the police chief, and ended his police service in 1999 when he retired. As a South St. Paul police officer, he was covered by a local police relief association, the South St. Paul Police Relief Association. Mr. Kinney was married to Cheryl Kinney and the couple divorced in 1993.

The benefit provisions of local police and paid fire relief associations generally assumed a family model which seems outmoded today. The police officer or firefighter was presumed to be male and the wife was presumed to be financially dependent. Given those family assumptions, these plans provided automatic survivor coverage to the spouse of a deceased active, deferred, or retired member. However, to qualify for this coverage, these plans generally required that the spouse must be married to the member at the time of death and, if applicable, at the time of retirement. Craig and Cheryl Kinney divorced in 1993, while Mr. Kinney was an active plan member. The 1993 divorce ended Ms. Kinney's eligibility for any survivor benefit from the South St. Paul plan as the plan did not offer any form of joint-and-survivor annuity.

Some of the attached material describes at least portions of the 1993 divorce decree. In part, the divorce decree granted Ms. Kinney a portion of Mr. Kinney's retirement benefit when he retired. The court order required Mr. Kinney to send a portion of each monthly retirement benefit that he received to Ms. Kinney. For much, if not all, of his retirement, Mr. Kinney paid Ms. Kinney the dollar amount required by the divorce settlement assuming that he would retire under local plan benefits. This arrangement placed Ms. Kinney at risk. If Mr. Kinney died, the payments to Ms. Kinney would stop. If sufficient non-pension marital property existed, the courts should have provided Ms. Kinney with a larger share of non-pension assets rather than attempt to divide pension plan retirement rights. Minnesota Statutes, Section 518.58, Division of Marital Property, in subdivision 3, states, "If liquid or readily liquidated marital property other than property representing vested pension benefits or rights is available, the court, so far as possible, shall divide the property representing vested pension benefits or rights by the disposition of an equivalent amount of the liquid or readily liquidated property."

Following the 1993 divorce, the South St. Paul Relief Association consolidated with PERA in 1997, under authority provided in Minnesota Statutes, Chapter 353A. Mr. Kinney was an active police officer at the time of that consolidation. Chapter 353 gives active members of a consolidating plan a choice of benefits. The choice included retaining the benefits provided under the local plan, or selecting PERA-P&F benefits, instead. These elections could occur shortly after consolidating, but most often individuals waited until the time of retirement to make the decision about whether to retire under the local plan or PERA-P&F benefit package. In 1999 Mr. Kinney retired, and he chose to retire under the PERA-P&F plan with a single-life PERA-P&F annuity.

Ms. Kinney is also employed in a position with coverage by PERA, although she is covered by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) rather than by PERA-P&F. In 2005, Ms. Kinney was inquiring about benefits to which she would be entitled when she retired from her position. According to the attachments, prior to meeting with PERA

staff in 2005, Ms. Kinney was unaware that the South St. Paul Relief Association had consolidated into PERA, that Mr. Kinney retired with a PERA-P&F pension rather than a local plan pension, that his pension was much greater than expected under the divorce decree, and that PERA-P&F offers joint-and-survivor coverage which could have been used to provide a lifetime benefit for her in the event of Mr. Kinney's death.

In late 2005 or early 2006 Ms. Kinney sought relief through the courts to increase the monthly amount she was receiving to be consistent with Mr. Kinney's election of a PERA-P&F benefit rather than a local plan benefit, to require retroactive payments back to Mr. Kinney's 1999 retirement date, and to require PERA to revise the annuity form from a single-life annuity to a joint-and-survivor annuity. A court order in May 2006 required Mr. Kinney to increase the amounts paid to Ms. Kinney and to make a lump sum payment (\$88,000) covering back shortages, but Mr. Kinney died shortly thereafter, before payments were made. In July 2006, the court concluded that it had no authority to require PERA to revise the annuity form.

Policy on Revising Annuity Forms

Revising annuity forms once an annuity commences is prohibited. The concern is selection against the pension fund, destroying the financial basis of the defined benefit plan. With a properly funded plan, assets are sufficient if all assumptions used to determine necessary financing are satisfied, at least on average. One of those assumptions is life expectancy. Some individuals live longer than expected, with longer benefit payout periods than expected (resulting losses to the fund), but this is balanced by those who do not live as long as predicted (providing offsetting gains). If individuals were allowed to commence receipt of a single-life annuity, and later due to ill health are permitted to revise that choice to cover a second individual, that balance is destroyed, the plan's liabilities are expanded unpredictably and the life expectancies underlying the financing and the benefits are rendered meaningless.

Background Information

- A. Local Police and Paid Fire Plan Consolidations into PERA-P&F. Background information on local police and paid fire plan consolidations into the Public Employees Police and Fire Retirement Plan (PERA-P&F) is found in Attachment A.
- B. Joint-and-Survivor Annuities. Background information on joint-and-survivor annuity forms is found in Attachment B.
- C. Marriage Dissolution, Division of Pension Benefits. Background information on the division of pension benefits as marital property in a marriage dissolution is found in Attachment C.

Discussion and Analysis

H.F. 2725 (Hansen); S.F. 2467 (Metzen) would provide a Public Employees Police and Fire Retirement Plan (PERA-P&F) 50 percent joint-and-survivor annuity to the divorced spouse of a deceased South St. Paul police officer retiree, who died in 2006. Benefits are not payable retroactively. To be eligible for a benefit, the divorced surviving spouse must first repay the benefit differential between the single life annuity selected by the deceased retired police officer and a 50 percent joint-and-survivor annuity, with 8.5 percent interest.

H.F. 2725 (Hansen); S.F. 2467 (Metzen) raises the following pension and related public policy issues for Commission consideration and discussion:

1. General Prohibition against Annuity Form Revision. Revising annuity forms once benefits commence is prohibited. The Legislature and the Commission occasionally receive requests to allow an annuity form to be changed and those requests are rarely, if ever, granted. A recent request occurred in 2004, when the Commission heard H.F. 2180 (Sertich); S.F. 2228 (Tomassoni), which would have permitted a Hibbing school district employee covered by PERA-General who retired in 1978 and elected a single-life annuity to revise his annuity election to instead provide joint-and-survivor coverage for his spouse. The Commission heard the bill on March 10, 2004, but took no action. The current proposal raises more reservations than the 2004 bill, because the current bill would provide a joint-and-survivor annuity commencing after the annuitant, who had elected a single-life annuity, died.
2. Precedent Concerns. Commission staff cannot recall any situation where the Commission and the Legislature chose to allow selection or mandatory payment of a joint-and-survivor annuity well after retirement commenced or after the primary annuitant had died. The Commission may be concerned that H.F. 2725 (Hansen); S.F. 2467 (Metzen) would set a precedent leading to an undermining of the probability structure and financial base of Minnesota public pension funds. To limit impact, the draft

does state that the justification for this unusual action is to address harm caused by PERA. That, in turn, leads to the question of whether PERA did cause harm.

3. Question of Harm by PERA. Any payment from PERA-P&F required by H.F. 2725 (Hansen); S.F. 2467 (Metzen) as drafted is an additional liability to that pension fund, without a sufficient offsetting injection of assets. That action can be justified if PERA caused harm to Ms. Kinney, harm worthy of financial compensation. The Commission may determine whether or not PERA caused harm by reviewing the attached documents or any other documents provided to the Commission on this matter, and through testimony.
4. Commission Acting as a Judicial Body. To weigh the merits of the proposal and the issue of harm, the Commission would need to act as a judicial body rather than a legislative body, a role for which the Commission is not ideally equipped. The Commission may consider referring this matter to a Hearing Examiner, with the proposed benefit payable if the conclusion is that PERA had an obligation to keep the divorced spouse of a consolidation account member informed about his pension options when he retired, that PERA failed in fulfilling that obligation, and that a court is likely to have required that Mr. Kinney select PERA-P&F benefits with a joint-and-survivor annuity, naming his ex-spouse as the beneficiary in the event of his death, if a request for action had been brought to the courts..
5. Divorce Decree Issue. An issue is whether the court erred in trying to divide rights to pension benefits rather than providing a larger allocation of non-pension assets to Ms. Kinney. Given Minnesota Statutes, Section 518, Subdivision 3, the court should have taken the approach it did only if other assets were insufficient. The Commission may seek to determine through testimony whether other assets were insufficient, whether the court properly considered this matter, and whether Ms. Kinney's lawyer in that divorce case does not have some blame for the current situation.
6. PERA's Opposition to the Proposal. The issue is that PERA opposes the bill.
7. Cost to PERA-P&F. The issue is the cost that providing the annuity required by the draft legislation will impose on PERA-P&F. PERA recently estimated that the bill would cost PERA P&F \$103,961. That cost would be higher if the Commission were to amend the bills to provide greater than a 50 percent joint-and-survivor annuity.
8. Actuarial Condition of PERA-P&F. The issue is the ability of PERA-P&F to take on additional unfunded liability. Based on the most recent actuarial study for the plan (July 1, 2007), PERA-P&F has \$287 million in unfunded liability and has a 95 percent funding ratio. The required contributions to the plan, as determined by the actuary, to cover normal cost, plan expenses, and to retire the unfunded liability by the plan's full funding date, is 5.6 percent of payroll (\$38.9 million) more than the contributions being made to plan given the contribution rates in law. Contribution rate increases are being phased in over the next few years in an effort to address this contribution deficiency problem.

		2007
<u>Membership</u>		
Active Members		10,720
Service Retirees		4,938
Disabilitants		803
Survivors		1,291
Deferred Retirees		1,200
Nonvested Former Members		814
Total Membership		19,766
<u>Funded Status</u>		
Accrued Liability		\$5,669,346,646
Current Assets		<u>\$5,382,707,345</u>
Unfunded Accrued Liability		\$286,639,301
Funding Ratio	94.94%	
<u>Financing Requirements</u>		
Covered Payroll		\$699,841,244
Benefits Payable		\$280,266,868
Normal Cost	22.19%	\$155,328,501
Administrative Expenses	<u>0.10%</u>	<u>\$699,841</u>
Normal Cost & Expense	22.29%	\$156,028,342
Normal Cost & Expense	22.29%	\$156,028,342
Amortization	<u>3.77%</u>	<u>\$26,384,015</u>
Total Requirements	26.06%	\$182,412,357

	2007	
Employee Contributions	8.20%	\$57,386,982
Employer Contributions	12.30%	\$86,080,473
Employer Add'l Cont.	0.00%	\$0
Direct State Funding	0.00%	\$0
Other Govt. Funding	0.00%	\$0
Administrative Assessment	<u>0.00%</u>	<u>\$0</u>
Total Contributions	20.50%	\$143,467,455
Total Requirements	26.06%	\$182,412,357
Total Contributions	<u>20.50%</u>	<u>\$143,467,455</u>
Deficiency (Surplus)	5.56%	\$38,944,902

9. Possible Responsibility of Ms. Kinney. An issue is whether Ms. Kinney was sufficiently attentive, and whether she should have been aware of the consolidation of the local relief association with PERA as it occurred in 1997, or soon after, rather than in 2005. Perhaps earlier action through the courts may have avoided the current situation. A related issue is whether it is reasonable to create an annuity for Ms. Kinney in PERA-P&F despite Ms. Kinney's forfeiture of any right to a survivor annuity under the local South St. Paul Relief Association plan, the plan from which it was assumed that Mr. Kinney would eventually retire, when the divorce occurred. Through that action and the court decree which provided her with a monthly amount out of her husband's pension, it was understood that the benefit to Ms. Kinney would stop if Mr. Kinney died. Following the divorce, Mr. Kinney had the good fortune of having the relief association in which he was a member consolidate into PERA, which led to enhanced pension benefits beyond that envisioned at the time of the 1993 divorce. The Commission may wish to decide if it is proper to extend Mr. Kinney's good financial fortune after the divorce occurred to his divorced wife, through the request made through the draft legislation, creating a lifetime annuity for Ms. Kinney in PERA-P&F despite the forfeiture of any direct survivor benefit right in the local plan as a result of the divorce.

Potential Amendments for Commission Consideration

1. Amendment H2725-1A is a technical amendment to correct a drafting error.
2. Amendment H2725-2A is substantive, revising the optional annuity from a 50 percent joint-and-survivor option to a different option to be determined by the Commission. PERA-P&F offers 25 percent, 50 percent, 75 percent, and 100 percent joint-and-survivor options. A 75 percent or 100 percent joint-and-survivor option will provide a larger benefit to Ms. Kinney, but it would increase the amount she must pay to PERA-P&F to commence receipt of the annuity, and increase the net cost to PERA-P&F.
3. Amendment H2725-3A is also substantive and can be used with the prior amendments. This amendment would make payment to Ms. Kinney contingent upon a review by a Hearings Examiner, and a finding that PERA had an obligation to keep the divorced spouse of a consolidation account member informed about his pension options when he retired, that PERA failed in fulfilling that obligation, and that a court is likely to have required that Mr. Kinney select PERA-P&F benefits with a joint-and-survivor annuity, naming his ex-spouse as the beneficiary in the event of his death, if a request for court action had been brought to it. As drafted, Ms. Kinney must cover the cost of the hearing.

Attachment A

Background Information on Local Public Safety Pension Plan Consolidations with PERA-P&F

Minnesota Statutes, Chapter 353A, enacted in 1987, authorizes local police or paid fire relief associations to undertake an administrative consolidation of the relief association with the Public Employees Police and Fire Retirement Plan (PERA-P&F) and authorizes the active members of a consolidated local relief association to elect between the local relief association benefit plan coverage and that of PERA-P&F. Individuals who were deferred members or benefit recipients as of the date of consolidation have a more limited option. The PERA-P&F provision available to individuals who were retired, deferred, or disabled on the effective date of the consolidation is limited to an option to have the post-retirement adjustment determined under the PERA-P&F procedure rather than those applicable to the local plan. Except for that limited option, the benefit provisions of the local plan apply.

A local relief association consolidation with PERA-P&F is a voluntary action on the part of the relief association membership and the applicable municipality. The consolidation action is initiated by a petition signed by a minimum proportion of the relief association membership (either 10 percent or 30 percent of the relief association, depending on support or opposition of the relief association to the 1987 consolidation legislation). If the petition is sufficient in the number of signatures and verified, the consolidation question is subject to a membership referendum subject to a majority vote (either a majority of those voting or a majority of all members voting or not voting).

If the referendum prevails, the governing body of the applicable city must act upon the proposed action. If the governing body grants preliminary approval, an actuarial assessment of the possible liability impact of the benefit plan coverage option is prepared. The governing body then considers final approval after receipt of the consolidation actuarial work to effect the consolidation. If the consolidation is approved on final municipal approval, the local relief association ceases to exist as a pension fund and all administrative duties relating to the local plan shift to PERA, and the State Board of Investment (SBI) invests the assets of the prior relief association.

Following the consolidation, members can retain their current benefit coverage or elect all or portions of the PERA-P&F benefit plan, as applicable given the status of the individual at the time of the consolidation. Individuals who are active members at the time of the consolidation are authorized under law to retain all rights under the local plan or to elect the PERA-P&F plan in its entirety. For individuals who at the time of the consolidation are disabilitants, deferred retirees, retirees, or survivors, the election is limited to the manner in which prospective post-retirement adjustments are calculated. For these deferred members or benefit recipients, the benefit continues as it was specified in the local plan, including any post-retirement increases paid to date. From the date of consolidation forward, the individual elects whether to continue adjustments under the provisions of the local plan or to have adjustments computed from that date forward under the system applicable to PERA-P&F. The retirees, deferred retirees, disabilitants, and survivors were given a period of time following the consolidation to make an election. If no election was made, the individual automatically retained all local plan benefits. The period of time for making this election presumably was a period of a few months. The statute authorizes PERA's board to set the length of the period following the consolidation, sufficient in length to provide adequate time to counsel the members.

Before January 1, 1999, 44 local relief associations consolidated with PERA-P&F. No local relief association has consolidated with PERA-P&F since January 1, 1999. The various relief associations with completed consolidations are as follows:

Consolidated Relief Associations

Police				Fire		
Albert Lea	Columbia Heights	Mankato	St. Louis Park	Albert Lea	Hibbing	St. Cloud
Anoka	Crookston	New Ulm	St. Paul	Austin	Mankato	St. Louis Park
Austin	Crystal	Red Wing	Virginia	Chisholm	Red Wing	St. Paul
Bloomington	Duluth	Richfield	West St. Paul	Columbia Heights	Richfield	South St. Paul
Brainerd	Faribault	Rochester	Winona	Crookston	Rochester	West St. Paul
Buhl	Fridley	South St. Paul		Duluth	South St. Paul	Winona
Chisholm	Hibbing	St. Cloud		Faribault		

Only four police or paid fire relief associations remain freestanding – the Fairmont Police Relief Association, the Minneapolis Fire Department Relief Association, Minneapolis Police Relief Association, and the Virginia Fire Department Relief Association.

Attachment B

Background Information on Joint-and-Survivor Annuity Forms

1. Joint-and-Survivor Annuities, In General. For general public employee and statewide public safety plans, the total value of the retirement benefit is a function of the individual's salary near retirement and total years of service, and an individual may choose to take that benefit in a variety of forms. A single-life (or straight-life) annuity covers only the retiree's life. A joint-and-survivor annuity is an annuity form that provides coverage to another individual in addition to the retired or disabled employee. The other individual is often a spouse, but it could also be another adult or a child, unless specifically restricted under the laws or bylaws governing a particular plan. With a joint-and-survivor annuity, the intent is to provide continuing income to the other individual for life, following the death of the primary annuitant. With a few exceptions, any of these annuities must have the same value whether it covers only the retired member, or the retired member and spouse, or some other individual or individuals. One of these exceptions is a subsidized bounce-back feature on joint-and-survivor annuities, which is discussed later.

To achieve this benefit equivalence requirement, when a joint-and-survivor annuity is selected the monthly benefit received by the primary annuitant must be reduced in order to finance the continuing coverage to the survivor. Otherwise, the total value received would be higher than that received by a comparable single individual, or a comparable married individual who decides not to take a joint-and-survivor annuity. The amount of the reduction is a function of the ages of the annuitant and designated beneficiary. If the retiree is male and the joint-and-survivor annuity provides coverage to a wife who is much younger than the primary annuitant, the amount of the monthly reduction can be quite large, due to the likelihood that the female will outlive the male by many years.

The amount of the reduction also depends upon the extent of the continuing coverage. Plans typically permit several different joint-and-survivor annuities. Under a 100 percent joint-and-survivor option, the designated beneficiary receives the same monthly benefit as before the death of the primary annuitant occurred. Because of the level of this continuing coverage, a 100 percent joint-and-survivor annuity requires a larger monthly reduction than options offering lesser continuing coverage. With a 50 percent joint-and-survivor option, the designated beneficiary would receive a monthly benefit that is half that previously received. Fifty percent, 75 percent, and 100 percent joint-and-survivor annuities are the most common joint-and-survivor offerings, but others also exist.

2. Plans with Subsidized Bounce-Back Feature on Joint-and-Survivor Annuities. There is a provision in many of the larger Minnesota state retirement plans (PERA plans, the Teachers Retirement Association (TRA), the first class city teacher plans, and most Minnesota State Retirement System (MSRS) plans) which slightly modifies the general actuarial equivalence requirement. In 1989, bounce-back provisions were added to the joint-and-survivor annuity laws in these plans. Under this modification, if the individual to receive the second half of the joint-and-survivor annuity predeceases the primary annuitant, the monthly benefit is restored (bounces back) to the monthly benefit level that would have been received if the individual had selected a single life annuity. In the plans with a subsidized feature, this bounce-back is provided without any further reduction in the monthly benefits to cover the cost of the bounce-back. The bounce-back cost is shifted to all employers and employees who fund the plan through their contributions.

