



**H.F. 3223**

(Mahoney)

**S.F. 3054**

(Tomassoni)

**H.F. 1331**

(Murphy, M., by request)

**S.F. 920**

(Betzold, by request)

### **Executive Summary of Commission Staff Materials**

*Affected Pension Plan(s):* MSRS-General and MSRS-Unclassified  
*Relevant Provisions of Law:* Minnesota Statutes, Chapter 352D  
*General Nature of Proposal:* Revising coverage options for certain legislators, elected state officials, and judges; permit election of MSRS-General coverage  
*Date of Summary:* March 20, 2008

### **Specific Proposed Changes**

- Revises the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) plan coverage provision to allow legislators, judges, the governor, lieutenant governor, secretary of state, state auditor, and attorney general, within their first year of service, to choose between the MSRS-Unclassified Plan defined contribution plan and the MSRS General State Employees Retirement Plan (MSRS-General) defined benefit plan, rather than being restricted to the Unclassified Program; and
- Revises the transfer to MSRS-General provision to permit these same groups, if they initially select MSRS-Unclassified Plan coverage, to switch to MSRS-General after providing ten years of service.

### **Policy Issues Raised by the Proposed Legislation**

1. Reversal of reforms.
2. Public perception.
3. Implications for coverage by local government elected officials in the Public Employees Defined Contribution plan.
4. Judges issues: different justification, allowing judges to enter another defined benefit plan, funding/contribution issue, support for proposal.
5. Position of executive branch.
6. Adverse impact on MSRS-General.
7. Plan actuarial condition.

### **Potential Amendments**

- H3223-1A adds effective dates to the bill, making the sections effective on July 1, 2008.
- H3223-2A revises the bill so that the treatment of judges is unchanged from current law.
- H3223-3A revises the bill so that the treatment proposed for judges is workable. The election under Section 1 of the bill by a judge would occur within one year of exceeding the 24-year service credit limit in the Judges Plan, and the election under Section 2 of the bill could be made ten years after exceeding that limit. If the judge elects MSRS-General coverage, the judge must pay the sum of the required employee and employer contributions for that plan.
- H3223-4A removes constitutional officers from the bill, leaving their treatment unchanged from current law.
- H3223-5A can be used if judges and constitutional officers remain in the bill, and allows these groups to elect MSRS-General coverage within the first year, but would remove for these groups authority to have a "ten-year" election.
- H3223-6A permits those who did not have a first-year choice of coverage (judges, constitutional officers, and legislators added to the MSRS-Unclassified Plan) to elect MSRS-General coverage through a one-time election.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director *EB*

RE: H.F. 3223 (Mahoney); S.F. 3054 (Tomassoni): MSRS-General and MSRS-Unclassified; Revising Plan Coverage Options for Certain Legislators, Elected State Officials, and Judges; Permitting Election of MSRS-General Plan Coverage

H.F. 1331 (Murphy, M., by request); S.F. 920 (Betzold, by request): MSRS-General and MSRS-Unclassified; Revising Plan Coverage Options for Certain Legislators, Elected State Officials, and Judges; Permitting Election of MSRS-General Plan Coverage

DATE: March 19, 2008

Summary

H.F. 3223 (Mahoney); S.F. 3054 (Tomassoni) revises the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) plan coverage provision (Minnesota Statutes, Section 352D.02, Subdivision 1) to allow legislators, judges, the governor, lieutenant governor, secretary of state, state auditor, and attorney general, within their first year of service, to choose between the MSRS-Unclassified Plan defined contribution plan and the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) defined benefit plan, rather than being restricted to the MSRS-Unclassified Plan; and revises the transfer-to-MSRS-General plan provision (Minnesota Statutes, Section 352D.02, Subdivision 3) to permit these same elected official groups, if they initially select MSRS-Unclassified Plan coverage, to switch to MSRS-General after providing ten years of service.

H.F. 1331 (Murphy, M., by request); S.F. 920 (Betzold, by request) are comparable bills introduced in last year's session. These needed to be redrafted as H.F. 3223 (Mahoney); S.F. 3054 (Tomassoni) because one of the sections amended in the bills was revised in 2007.

Background Information

- Background on plan coverage for judges is found in **Attachment A**.
- Background on Legislators Plan coverage is found in **Attachment B**. All legislators first elected after June 30, 1997, are covered by the MSRS-Unclassified Plan, a defined contribution plan. Many pre-July 1, 1997, legislators also chose to transfer coverage from the Legislators Plan to MSRS-Unclassified plan.
- Information on the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) plan is found in **Attachment C**.
- Information on the Combined Service Annuity provision is found in **Attachment D**.

Discussion and Analysis

The existing law language (found on page 1.8 to 1.17 of the bill) allows employees other than judges and elected officials to choose between the MSRS-Unclassified Plan, a defined contribution plan, and MSRS-General, a defined benefit plan. Elected officials (legislators, judges for service in excess of 24 years, the governor, lieutenant governor, secretary of state, state auditor, and attorney general) do not have an option. They are to be covered by the MSRS-Unclassified Plan.

1. Treatment Of Employees Other Than Judges, Legislators, Elected State Officers. The existing law reflects the policy that non-elected employees should be permitted to decide for themselves what type of coverage is best. If an employee expects to be short-term, MSRS-Unclassified is clearly the best option because the assets in the individual's MSRS-Unclassified Plan account are fully portable. If

the individual terminates he or she retains the employee contributions, the employer contributions, and the investment earnings on the employee and employer contributions. In contrast, if the individual had chosen MSRS-General coverage and terminated after a few years, the individual may not have vested for any deferred annuity from the plan, and even if he or she did vest, the value of that benefit may be less than the value of a refund as permitted under that plan, which is the employee contributions plus six percent interest. Also, existing law allows non-elected employees in the Unclassified Plan to exercise a second election any time after providing ten years of covered service, and before one month after terminating service. They can transfer the MSRS-Unclassified Plan account value to MSRS-General, and when they retire they will receive an annuity based on the individual's high-five average salary, service credit, and accrual rate in MSRS-General rather than upon the account's value. Thus, if the individual does provide long service, and if the annuity value would be greater under MSRS-General than the value of the individual's MSRS-Unclassified Plan account, it is in the individual's financial interest to transfer plan coverage.

Both the first-year election of coverage and the ten-year transfer feature can negatively impact MSRS-General. Individuals who intend to stay and provide long service will elect MSRS-General coverage, while those who intend to leave early will not. Compared to other employees in MSRS-General, this lessens plan turnover which will put upward pressure on plan cost. The ten-year transfer provision also allows individuals to add liability on MSRS-General without providing sufficient assets to fully cover that liability, by choosing that transfer when the value of an MSRS-General benefit exceeds that of their Unclassified Plan account value. Information on liabilities placed on MSRS-General and the normal cost of MSRS-Unclassified members compared to MSRS-General members appears in Attachment C. In the past, MSRS has proposed ending the ten-year transfer provision, at least for new hires, but that has not been passed by the Legislature.

2. Treatment Of Judges, Legislators, Elected State Officers. Existing law does not give post-June 30, 1997, legislators, judges for service in excess of 24 years, the governor, lieutenant governor, the secretary of state, the state auditor, and the attorney general any first year election. These individuals are covered by the MSRS-Unclassified Plan. These reflect a decision by past Legislatures that the appropriate coverage for these groups is defined contribution plan coverage.
  - a. Legislators. The Legislators Plan, which was closed to new entrants in 1997, is a defined benefit plan which was a basic plan, meaning that individuals did not contribute to Social Security based on that employment, and therefore did not accrue old age Social Security benefits. In part to permit Social Security coverage, all new legislators first elected after June 30, 1997, and any legislators first elected earlier who wanted to transfer coverage, were placed in the MSRS-Unclassified Plan, which is coordinated with Social Security. That legislative decision may also reflect a conclusion that defined contribution plan coverage is more appropriate for legislators. Most legislators have employment other than the legislature, and most do not serve as legislators for more than a few sessions. Given the incidental nature of this employment and the short service, defined contribution plan coverage makes sense. The Legislature may also have been reacting to windfalls that could occur when coverage was provided by the defined benefit Legislators Plan, which is a plan included under the Combined Service Annuity provision (Minnesota Statutes, Section 356.30). If, after providing legislative service, an individual becomes employed in the judiciary or as a commissioner or in some other highly paid position, the high-five average salary established in the high-paying position can be applied to compute the legislative annuity, rather than basing the Legislators Plan annuity on the low pay the individual received as a legislator. This can result in an annuity from the Legislators Plan which is much larger than expected, placing an unexpectedly large liability on taxpayers.
  - b. Elected State Officers. For elected state officers (governor, lieutenant governor, the secretary of state, the state auditor, and the attorney general), the issues are similar. Many of these individuals provide short service, and high pay in some of these positions can create problems if coverage was provided by a defined benefit plan included in the Combined Service Annuity provision. There used to be an Elected State Officers Plan, which was a defined benefit plan very similar to the Legislators Plan. This plan was closed to new entrants in 1997, the same year in which similar action was taken in the Legislators Plan. The Elected State Officers Plan, while it existed, was included in the Combined Service Annuity provision.

- c. Judges. Judges are covered by the Judges Retirement Plan, a defined benefit plan specified in Minnesota Statutes, Chapter 490, for the first 24 years of service. It is assumed that an individual will be appointed as a judge at an age which is much later than a typical new entrant in other plans. To allow a reasonable benefit to accrue, the Judges Plan uses a very high accrual rate, 3.2 percent per year for service after June 30, 1980. This created a problem when the individual did not fit the expected norm. When individuals are appointed at a relatively young age and provide long service, this high accrual rate could create a benefit deemed to be excessive. To address this concern, statute placed a cap on the pension as a percentage of salary (70 percent); then in 2000 this was replaced with a service credit cap wherein a judge could accrue no more than 24 years of service credit. If the individual continued to serve after 24 years, an account is established in the MSRS-Unclassified Plan funded by the employee contribution that would otherwise be paid to the Judges fund.

Given the likely reasons why legislators, elected state officers, and judges for service in excess of 24 years were placed in MSRS-Unclassified, it might be assumed that these groups would not be permitted to transfer to MSRS-General coverage after ten years, but one can debate whether there is a prohibition in law. The language is less than clear. MSRS interprets the existing law language to prohibit individuals in these groups from transferring coverage. MSRS argues that Minnesota Statutes, Section 352.D.02, Subdivision 1, (the existing law version Section 1 of the bill) divides the broad coverage group into two subgroups: (1) a group referred to as “employees” or “enumerated employees,” and (2) a second group referred to as “referenced persons.” The “referenced persons” group is composed of legislators, the elected state officers, and judges with more than 24 years of service. Under Subdivision 1, it is “employees” or “enumerated employees” who have the right to choose between MSRS-General and MSRS-Unclassified coverage, while “referenced persons” are restricted to MSRS-Unclassified.

Regarding the ten-year transfer provision, under the existing law language of Minnesota Statutes, Section 352D.02, Subdivision 3 (the existing law version of Section 2 of the bill), an individual who has a transfer right (page 3.17 to 3.19) is “An employee credited with employee shares in the unclassified program, after acquiring credit for ten years of allowable service....” MSRS contends that if the Legislature intended that legislators, elected state officers, and judges with more than 24 years of service could transfer after ten years of service, the Legislature would have stated, “An employee or referenced person” rather than just “An employee” on page 3.17. One could also argue that if a transfer right for judges was intended, then this subdivision would have been revised in 2000 when judges with more than 24 years of service were placed in the MSRS-Unclassified Plan chapter. It is not clear how to apply this ten-year requirement when a judge will already have 24 years of service before this chapter of law is relevant to that judge’s situation.

H.F. 3223 (Mahoney); S.F. 3054 (Tomassoni) is an effort to revise law to permit legislators, elected state officers, and judges with more than 24 years of service to have a choice in the first year between MSRS-Unclassified coverage and MSRS-General coverage; and to have a right to transfer from MSRS-Unclassified coverage to MSRS-General after ten or more years of service.

### Pension Policy Issues

The proposed legislation raises several pension and related public policy issues for potential Commission consideration and discussion, as follows:

1. Reversal of Reforms. The policy issue is that the proposal seems to reverse actions by prior Legislatures to reform the pension systems, by eliminating opportunities for windfalls which can occur when elected officials are covered by defined benefit plans included in the Combined Service Annuity provision. The Commission may wish to establish, through testimony, whether there is sufficient merit or equity concerns to outweigh drawbacks of again permitting defined benefit coverage.
2. Public Perception. The Legislative Commission on Pensions and Retirement and the Legislature may wish to consider that the general public may react negatively to any attempt to revise pension coverage for legislators and other elected officials. The current proposal is, in part, a natural response to recent market events which have caused a large decrease in the value of any MSRS-Unclassified Plan account invested in whole or part in stocks. The Commission may wish to consider that most private sector pension plans are defined contribution plans. The bill may be viewed as an effort by legislators

to shield themselves from the impact of the very bad recent markets, while the general public has no similar protection.

3. Implications for Coverage by Local Government Elected Officials in the PEDC. The issue is that any action to again permit defined benefit plan coverage for legislators and constitutional officers will lead to requests for similar treatment for local government officials. In recent years the Commission and the Legislature have revised Public Employees Retirement Association (PERA) law to prohibit coverage of local elected officials by PERA's general employee defined benefit plan, PERA-General. The only coverage permitted for newly elected or appointed local government officials is by PERA's defined contribution plan, the Public Employees Defined Contribution (PEDC) plan.
4. Judges Issues. There are a few issues specific to judges, as follows:
  - a. Different justification. Judges were added to the MSRS-Unclassified Plan coverage provisions for reasons quite different than those applicable to legislators and elected state officers, and the proposed framework does not work for that group. Section 2 of the bill would authorize all groups to switch to defined benefit coverage after ten years, but it is unclear how to apply that to judges, since a judge would have 24 years of service before being referred to MSRS-Unclassified for further coverage. Similarly, Section 1 of the bill with its first-year election needs modification to clarify how it is to apply to judges.
  - b. Allowing judges to enter another defined benefit plan. Judges are referred to MSRS-Unclassified because they have exceeded the years of service deemed reasonable under the Judges Plan, given the high accrual rate of that defined benefit plan. It is not clear why they should be permitted to enter another defined benefit plan, MSRS-General, rather than MSRS-Unclassified. If they are to be permitted defined benefit plan coverage, that could be done by leaving them in the Judges Plan but with a reduced accrual rate for service in excess of 24 years.
  - c. Funding/contribution issue. When a judge is referred to MSRS-Unclassified for further coverage, the employee contribution, eight percent of pay that would otherwise be made to the Judges Plan, is instead made to the individual's account in MSRS-Unclassified. However, the employer contribution, 20.5 percent of pay, continues to be made to the Judges Plan fund. (These requirements are specified in Minnesota Statutes, Section 490.123, Subdivisions 1a and 1b.) If the judge is instead permitted to enter MSRS-General, some additional drafting is necessary because it is not clear how MSRS-General will receive the full employee and employer contribution required by law for that plan. The eight percent of pay contribution currently made by a judge in MSRS-Unclassified is considerably more than the employee contribution required under MSRS-General, but less than the sum of the required employee/employer contributions, which currently total 8.5 percent of pay, but which will escalate in 2010 to ten percent of pay. The Commission and Legislature could require the judge to pay the full required MSRS-General amount, which would be larger than the eight percent contribution currently made, or the Commission and Legislature could require some of the current 20.5 percent of pay the employer is currently contributing to the Judges Plan to instead be paid to MSRS-General to cover the required MSRS-General employer contribution. That, however, would harm the Judges Plan fund.
  - d. Support for proposal. The issue is whether this proposal, as it applies to judges, is supported by the judicial branch and by individual judges.
5. Position of Executive Branch. Since this bill impacts the elected state officers, the issue is whether the executive branch and these elected officials support this proposal.
6. Adverse Impact on MSRS-General. The issue is the adverse impact on MSRS-General. As noted above, the first-year and ten-year elections adversely impact MSRS-General. This bill expands the group that can make those elections, which will add to that adverse impact.

7. Plan Actuarial Condition. The issue is the actuarial condition of MSRS-General and the Judges Plan. MSRS-General has unfunded liability and a 2.11 percent of pay contribution deficiency. Although total contributions are scheduled to be increased to ten percent of pay, that may still leave a deficiency. The elections proposed by the bill will have a further negative effect on the fund.

The Judges Plan is 75 percent funded and has a 3.54 percent of pay contribution deficiency. If the bill was amended to require some of the employer contributions to this plan to be redirected to MSRS-General, this would worsen the condition of the Judges Plan.

MSRS-GENERAL			JUDGES PLAN		
	2007			2007	
<u>Membership</u>			<u>Membership</u>		
Active Members		48,379	Active Members		308
Service Retirees		20,880	Service Retirees		171
Disabilitants		1,547	Disabilitants		9
Survivors		2,919	Survivors		83
Deferred Retirees		14,751	Deferred Retirees		18
Nonvested Former Members		<u>7,007</u>	Nonvested Former Members		<u>0</u>
Total Membership		95,483	Total Membership		589
<u>Funded Status</u>			<u>Funded Status</u>		
Accrued Liability		\$9,627,304,704	Accrued Liability		\$214,296,973
Current Assets		<u>\$9,171,066,094</u>	Current Assets		<u>\$161,749,693</u>
Unfunded Accrued Liability		\$456,238,610	Unfunded Accrued Liability		\$52,547,280
Funding Ratio	95.26%		Funding Ratio	75.48%	
<u>Financing Requirements</u>			<u>Financing Requirements</u>		
Covered Payroll		\$2,241,738,286	Covered Payroll		\$37,974,474
Benefits Payable		\$392,058,387	Benefits Payable		\$14,516,203
Normal Cost	8.40%	\$188,716,922	Normal Cost	18.03%	\$6,848,676
Administrative Expenses	<u>0.23%</u>	<u>\$5,155,998</u>	Administrative Expenses	<u>0.14%</u>	<u>\$53,164</u>
Normal Cost & Expense	8.63%	\$193,872,920	Normal Cost & Expense	18.17%	\$6,901,840
Normal Cost & Expense	8.63%	\$193,872,920	Normal Cost & Expense	18.17%	\$6,901,840
Amortization	<u>1.98%</u>	<u>\$44,386,418</u>	Amortization	<u>13.44%</u>	<u>\$5,103,780</u>
Total Requirements	10.61%	\$238,259,338	Total Requirements	31.61%	\$12,005,620
Employee Contributions	4.25%	\$95,273,877	Employee Contributions	8.00%	\$2,874,882
Employer Contributions	4.25%	\$95,273,877	Employer Contributions	20.50%	\$7,784,783
Employer Add'l Cont.	0.00%	\$0	Employer Add'l Cont.	0.00%	\$0
Direct State Funding	0.00%	\$0	Direct State Funding	0.00%	\$0
Other Govt. Funding	0.00%	\$0	Other Govt. Funding	0.00%	\$0
Administrative Assessment	<u>0.00%</u>	<u>\$0</u>	Administrative Assessment	<u>0.00%</u>	<u>\$0</u>
Total Contributions	8.50%	\$190,547,754	Total Contributions	28.07%	\$10,659,665
Total Requirements	10.61%	\$238,259,338	Total Requirements	31.61%	\$12,005,620
Total Contributions	<u>8.50%</u>	<u>\$190,547,754</u>	Total Contributions	<u>28.07%</u>	<u>\$10,659,665</u>
Deficiency (Surplus)	2.11%	\$47,711,584	Deficiency (Surplus)	3.54%	\$1,345,955

8. Request for Elections by Current MSRS-Unclassified Plan Members. The issue is the likelihood that existing legislators, who did not have an option to elect MSRS-General rather than MSRS-Unclassified coverage during their first year, will want a special election to make that coverage change. The bill as drafted does not include that election.

9. Requests by Members of the Legislators Plan to Shift Coverage. The issue is whether members of the Legislators Plan will want an election to shift coverage to MSRS-General if this bill were to pass. Individuals who remain in the basic Legislators Plan may want another opportunity to get Social Security coverage. Individuals who are members of the Coordinated Legislators Plan, created in 2002, were able to retain coverage by the Legislators Plan provided the legislator agreed to pay both the employee and employer Social Security contributions. MSRS-General is also a coordinated plan, but with lesser accrual rates than that used in the Legislators Plan. There may be legislators interested in shifting to MSRS-General if the requirements for paying the Social Security employer contribution on behalf of legislators were revisited.

### Potential Amendments for Commission Consideration

- **Amendment H3223-1A** adds effective dates to the bill, making the sections effective on July 1, 2008.
- **Amendment H3223-2A** revises the bill so that the treatment of judges is unchanged from current law.
- **Amendment H3223-3A** revises the bill so that the treatment proposed for judges is workable. The election under Section 1 of the bill by a judge would occur within one year of exceeding the 24-year service credit limit in the Judges Plan, and the election under Section 2 of the bill could be made ten years after exceeding that limit. If the judge elects MSRS-General coverage, the judge must pay the sum of the required employee and employer contributions for that plan.
- **Amendment H3223-4A** removes constitutional officers from the bill, leaving their treatment unchanged from current law.
- **Amendment H3223-5A**, which can be used if judges and constitutional officers remain in the bill, allows these groups to elect MSRS-General coverage within the first year, but would remove for these groups authority to have a “ten-year” election.
- **Amendment H3223-6A** permits those who did not have a first-year choice of coverage (judges, constitutional officers, and legislators added to the MSRS-Unclassified Plan) to elect MSRS-General coverage through a one-time election. As drafted, this amendment would be appropriate for all individuals who currently have Social Security coverage.

