



H.F. 3415
(Pelowski)

S.F. 3531
(Larson, D.)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): TRA and First Class City Teacher Plans
Relevant Provisions of Law: Minnesota Statutes, Sections 354.05, 354.44, 354A.31, and New Coding
General Nature of Proposal: Increases TRA, DTRFA, and SPTRFA exempt reemployment income amounts to \$46,000; creates new TRA "phased retirement program"
Date of Summary: March 10, 2008

Specific Proposed Changes

- Increases the Teachers Retirement Association (TRA), the Duluth Teachers Retirement Fund Association (DTRFA), and the St. Paul Teachers Retirement Fund Association (SPTRFA) exempt reemployment income amounts to \$46,000 rather than the maximum exempt income amounts for a given age as specified by the Social Security Administration.
- Creates a new TRA program, called the phased retirement program, permitting active teachers at least age 62 to enter into an agreement to continue providing teaching service after retirement, on any terms agreed to by the teacher and district.
- Changes TRA's definition of termination of teaching service, permitting in-service distribution to those at least age 62 despite a contract to return to employment, and to younger teachers if there is an oral rather than written contract to return to teaching service following submission of a resignation.

Policy Issues Raised by the Proposed Legislation

1. In-service distribution problem, those under age 62.
2. In-service distribution issues, those over age 62.
3. Inconsistency with the general policy against double-dipping.
4. Similar provision in other bills.
5. Lack of any phased retirement restrictions in proposed phased retirement program.
6. Issues raised by section 1, in conjunction with the section 3 phased retirement program.
7. Cost implications.
8. Issue of whether defined benefit pension plans should continue to be offered.
9. Need for new phased retirement program.
10. Unclear actual need for relaxation of limits; potential misunderstanding of current reemployed annuitant limits.
11. Willingness of legislature to make further changes.
12. Erosion of contribution base.
13. Loss of gain on account assets.
14. Scope.
15. Further design questions.
16. Study.

Potential Amendments

- H3415-1A** is a technical amendment.
H3415-2A deletes Section 1.
H3415-3A can be used if section 1 remains in the bill. It prohibits all pre-retirement return-to-employment contracts after retirement by those under age 62, not just those which are written, and removes reference to different treatment if individuals are age 62 or over.
H3415-4A deletes Sections 2, 4, and 5.

- H3415-5A** revises TRA and first class city teacher exempt income limit provisions from the proposed \$46,000 to an amount to be set by the Commission, either higher or lower than \$46,000.
- H3415-6A** can be used if the Commission retains the TRA and first class city teacher plan reemployed annuity provisions, either with the proposed \$46,000 exempt income limit or some other dollar limit. This amendment would provide similar changes to the MSRS and PERA reemployed annuitant provisions.
- H3415-7A** deletes Section 3.
- H3415-8A** adds additional qualification requirements similar to those applicable to the Minnesota State Colleges and Universities System (MnSCU) programs.
- H3415-9A** can be used if Sections 2, 4, and 5 remain in the bill and the Commission wishes to limit the reemployment exempt income limit for younger reemployed annuitants.
- H3415-10A** can be used to insert a section requiring TRA employing units to make employer contributions to the plan on behalf of reemployed annuitants.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director *EB*
RE: H.F. 3415 (Pelowski); S.F. 3531 (Larson, D.): TRA and First Class City Teacher Plans; Providing for Phased Retirement from Teaching
DATE: March 10, 2008

General Summary

H.F. 3415 (Pelowski); S.F. 3531 (Larson, D.) does the following:

- increases the Teachers Retirement Association (TRA), the Duluth Teachers Retirement Fund Association (DTRFA), and the St. Paul Teachers Retirement Fund Association (SPTRFA) exempt reemployment income amounts to \$46,000 rather than the maximum exempt income amounts for a given age as specified by the Social Security Administration;
- creates a new TRA program, called the phased retirement program, permitting active teachers at least age 62 to enter into an agreement to continue providing teaching service after retirement, on any terms agreed to by the teacher and district; and
- changes TRA's definition of termination of teaching service, permitting in-service distribution to those at least age 62 despite a contract to return to employment, and to younger teachers if there is an oral rather than written contract to return to teaching service following submission of a resignation.

Background Information

Background information is attached as follows:

- Reemployment earnings limitations as found in the Social Security System and various Minnesota public plans is found in **Attachment A**.
- The current bill establishes a new program that has some similarity to the existing State Employee Post Retirement Option Program. Background on that program is found in **Attachment B**.
- Background on the Minnesota State Colleges and Universities System (MnSCU) phased retirement program is found in **Attachment C**.

Discussion and Analysis

The Legislative Commission on Pensions and Retirement's Principles of Pension Policy states the following as the purpose of Minnesota public pension plans:

II.A. Purpose of Minnesota Public Pension Plans

1. 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 out-transitioning 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.

Consistent with that principle, historically Minnesota public plans strongly discourage individuals to leave covered employment prior to the conclusion of their working careers by containing strong penalties if the individual became reemployed within the same retirement system and earned more than very modest income. In some cases, if a minimal reemployment income threshold was exceeded, the annuity for the year was forfeited, while in other plans a portion of the annuity was forfeited. Over time, the Legislature made some modification to these provisions, by either modestly increasing the exempt income thresholds

or by reducing the portion of the annuity forfeited. Although these changes reduced penalties, the provisions still could be viewed as strongly encouraging public employees to continue until the end of their productive years, rather than retiring but then returning as reemployed annuitants.

While the Commission has not substantively altered the policy statement quoted above, a fundamental shift in policy as reflected in law occurred in 2000 (Laws 2000, Chapter 461, Article 2). Due to strong pressure from teachers, in that chapter the Legislature passed provisions changing retirement plan reemployed annuitant laws for teachers and other public employees. The punitive forfeitures, of all or a portion of the annual annuity if substantial reemployment income occurred, was replaced with a requirement that these amounts, rather than being forfeited, would instead be deposited in a savings account for the individual payable with six percent interest. The account can be accessed at age 65 or approximately one year after ceasing the reemployment, whichever is later. This transformed the plan provisions from a punitive penalty for reemployment to a forced savings plan. Perhaps the deferral requirement has some impact in encouraging individuals nearing retirement age to remain in full employment and to not terminate from their employers. For those who do terminate, but who are not ready to fully withdraw from the labor force, the provisions at least serve to partially withhold retirement annuity payments until the individual has fully retired, so that assets intended to support the individual in retirement are actually used for that purpose.

The existing reemployed income limit laws can be questioned regarding their scope and design. Regarding scope, the provisions that appear in these plans apply, at most, to reemployment in a position covered by the same retirement system. Thus, a Teachers Retirement Association (TRA) retiree becoming reemployed in a position normally covered by TRA is subject to the TRA reemployed annuitant provision, while a similar TRA retired teacher who took a position in the private sector, or a position covered by a first class city teacher plan, or by any other public plan, would not be subject to the provision. The administrators for the various plans have long supported the combined service annuity provision (Minnesota Statutes, Section 356.30) which, for purposes of computing the annuity at the time of retirement, allows individuals who have service in more than one Minnesota public defined benefit plan or system to have that service treated as though it was provided within a single retirement system. However, the plan administrators have not supported any effort to amend reemployed annuitant laws to have a similar scope.

Part of the current proposal appears to be an effort to create, for all TRA and first class city teacher plan retirees, an exempt income limit which matches that found in provisions specific to Minnesota State Colleges and Universities System (MnSCU) retirees with Minnesota State Retirement System (MSRS), TRA, or first class city teacher plan annuities. Those provisions in current law are Minnesota Statutes, Sections 352.1155, 354.445 and 354A.31, Subdivision 3a, respectively.

While the current proposal would use the same exempt income limit as the MnSCU provisions, \$46,000, the proposal lacks many of the restrictions found in the MnSCU provisions. To be eligible for the MnSCU program, the individual must:

- (1) have ten years of service credit from a public pension plan in which MnSCU is a participating employer;
- (2) be employed prior to retirement on a full-time basis as a MnSCU faculty member or as a MnSCU administrator in the unclassified service;
- (3) retire from the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), or from TRA, or from a first class city teacher plan; and
- (4) return to employment by MnSCU on at least one-third of full time and not more than two-thirds of full time under an agreement between the employee and employer under which the individual will not earn salary in excess of \$46,000 per calendar year.

In contrast, under the TRA proposal that would apply to all K-12 teachers and administrators, there is no length of prior service requirement, no requirement that the individual work full time prior to termination and rehire, and no requirement that the reemployment be a reduction from prior employment. Individuals will be permitted to commence receipt of full retirement benefits while remaining fully employed.

The proposed program also does not prohibit entering into reemployment agreements while the individual remains an active employee. In general, this would raise the issue of whether the federal government would view these as sham terminations, creating a distribution of retirement plan assets to the applicable individual (an in-service distribution) without a true separation from service. The current bill seeks to avoid that federal compliance problem by restricting the proposed program to those who are at least age

62, an exemption from in-service distribution prohibitions provided in recent 2006 federal legislation. However, this is uncharted ground for Minnesota public plans. The Legislature has never knowingly permitted in-service distributions. The Commission may wish to carefully consider the implications of permitting these distributions. If they are permitted under any circumstances, it may not be possible to restrict them to one or two specific programs, and may have unforeseen cost implications for the plans.

Policy Issues

H.F. 3415 (Pelowski); S.F. 3531 (Larson, D.) does the following:

- increases the Teachers Retirement Association (TRA), the Duluth Teachers Retirement Fund Association (DTRFA), and the St. Paul Teachers Retirement Fund Association (SPTRFA) exempt reemployment income amounts to \$46,000 rather than the maximum exempt income amounts for a given age as specified by the Social Security Administration;
- creates a new TRA program, called the phased retirement program, permitting teachers at least age 62 to enter into an agreement while still active teachers to continue providing teaching service after retirement, on any terms agreed to by the teacher and district; and,
- changes TRA's definition of termination of teaching service, permitting in-service distribution to those at least age 62 despite a contract to return to employment, and to younger teachers if there is an oral rather than written contract to return to teaching service following submission of a resignation.

The bill raises numerous policy issues for Commission consideration, as follows:

1. In-Service Distribution Problem, Those Under Age 62. The issue is whether section 1 as drafted is consistent with federal law in-service distribution requirements applicable for those under age 62. By adding "written" on page 1, line 12, the implication is that oral contracts to return to work are permissible, since the termination of service is only invalid under this revision if the contract is written. TRA may have wanted to add "written" because of TRA's limited ability to be aware of any oral contract. However, the addition of "written" validates, for purposes of this Minnesota law, use of oral contracts between the employee and employer to return to employment following commencement of retirement. That increases the chance that Minnesota law could be found to violate the federal prohibition against in-service distributions. In contrast, PERA in its administrative provisions is proposing to add "written or oral" to its termination of service provision. The suggested PERA wording is a stronger effort to be consistent with federal in-service distribution prohibitions.
2. In-Service Distribution Issues, Those Over Age 62. The issue is whether the Commission and Legislature want to knowingly permit in-service distributions to those who are at least age 62. Although in-service distributions may be permitted under federal law for the age 62 and older age group, the Commission may wish to address the question of whether this reflects good pension policy. This is not a subject that the Commission has previously addressed. Permitting in-service distributions is contrary to a core concept that retirement plan benefits should be used to support individuals who are truly retired. Permitting in-service distributions to any individuals in any plan is likely to create pressure to permit this treatment for similar individuals in all Minnesota public pension plans. Over the longer term this policy is likely to lead to more costly pension plans and more administrative burden. Retirees who are providing service comparable to their younger, active member follow employees will eventually push for some form of additional pension coverage for this service. There may also be lawsuits arguing that the lack of further retirement plan accrual for this additional service violates equal protection requirements or constitutes age discrimination. Eventually, the plans may need to recompute annuities each year, revising the annuity being paid each year to reflect the additional service, similar to the current treatment of Social Security benefits, which can be increased if the individual continues to provide employment following commencement of the original benefit.
3. Inconsistency with the General Policy Against Double-Dipping. The proposal is inconsistent with the generalized public policy against individuals receiving both a full retirement annuity and a full active member salary at the same time, frequently referred to as "double-dipping." In a well constructed retirement plan, where retirement benefits are not accessible until the generally expected conclusion of a public employee's working lifetime is reached and the person's termination of regular gainful employment occurred, meaning that few, if any, retirees should be receiving an income from substantial regular employment while also receiving a retirement annuity. Allowing some modest post-retirement employment can be handled by imposing some reemployed earnings limitation at an amount that is greater than zero. Double-dipping can occur when retirement is permitted or

encouraged at ages earlier than normal employability limits and when the reemployed annuitant earnings exempt income limitations are set at a very high level. Based on a 50-state teacher retirement system survey conducted by the Commission staff, as specified in current law Minnesota teacher retirement plans are among the least restrictive in limiting post-retirement employment with the continued receipt of unaffected retirement benefits. The proposed loosening of restrictions on reemployment by retired teachers permits, and may encourage, further “double-dipping” practices.

4. Similar Provision in Other Bills. The Commission may choose to be aware that sections 1 and 2 of this bill is also found in H.F. xxxx; S.F. 3324 (Betzold), (MSRS, TRA, and PERA administrative provisions), although these proposed changes are not administrative. The first class city teacher plan reemployed annuitant exempt earnings provision, which is revised in Section 4 of this bill, is also treated in H.F. 2194 (Kahn); S.F. 2006 (Pappas) (various plans; reemployed annuitant earnings limits; actuarial services; state aid). In that bill, the first class city teacher reemployed annuitant earnings limit provision would be repealed.
5. Lack of Any Phased Retirement Restrictions in Proposed Phased Retirement Program. The issue is that Section 3, as drafted, claims to be a new TRA phased retirement program, but lacks any provisions requiring the program to be used to phase into retirement, other than the requirement that the individual must be at least age 62. The basic requirements typically found in a transition-to-retirement program are missing. There is no requirement that the employee be a full-time employee prior to entering the program, that reemployment under the program be restricted to part-time or less-than-full year employment, that the employment under this program represents a reduction from the level of service provided prior to entering the program, or that the reemployment be for a limited period rather than an unspecified, indefinite period. As drafted, this program can be used to allow individuals to simply continue in full-time employment without any break in service while simultaneously drawing their full retirement annuity. If enacted as specified, the program will be abused, particularly by those with power and influence.
6. Issues Raised by Section 1, in Conjunction with the Section 3 Phased Retirement Program. The issue is that Section 1 basically permits in-service distributions to any TRA teacher who is at least age 62. Given this section, it is unclear why the so-called phased retirement program in Section 3 is included in the bill. If any teacher age 62 or older can commence receipt of an annuity while, in effect, continuing in the same employment, there is reason to consider the “phase retirement program” under Section 3.
7. Cost Implications. The issue is the cost implications of the changes proposed by this bill. The Commission may wish to have some testimony on this, and may choose to consider that any claimed cost, or any claim of no cost, is based on assumptions about the willingness of retirees to provide service, and how those who are currently active will respond to changed incentives. Assumptions may not prove to be reliable over time.
8. Issue of Whether Defined Benefit Pension Plans Should Continue to be Offered. The issue is whether defined benefit pension plans for teachers should continue, if programs such as that being proposed become TRA law. The justification for defined benefit programs was that the pension program was a tool of the employer. The defined benefit pension plan served to attract and retain capable employees, and to outtransition those employees at the end of their productive working careers. The level of benefits provided was intended to allow long-service retirees with sufficient retirement income, when coupled with personal savings and Social Security benefits, to maintain the individual in retirement without a noticeable decline in the standard of living. The Commission may wish to consider that the design of these plans has drifted over time, with the plan being less a personnel tool of the employer and more an unrestricted asset of the employee, to be used at the discretion of the employee, either during true retirement or before. For many individuals, early termination is encouraged by providing subsidized early retirement benefits. More recently, after being subsidized to retire, these individuals are then offered programs to get them back to work by removing restrictions against reemployed retirees. The current proposal goes further by allowing the individual to commence receiving retirement benefits, including subsidized early retirement benefits, without any termination of service, or any change in the nature of the employment. At some point the Commission may need to consider whether sufficient justification remains for the employer to continue bearing the risk and liabilities of these pension programs, by guaranteeing a specified benefit for the individual based on length of service, salary, and age.
9. Need for New Phased Retirement Program. The issue is whether there is sufficient justification for this claimed phased retirement program given that TRA already has a program that can be used to transition into retirement. The Qualified Part-Time Teacher Program, Minnesota Statutes, Section

