



H.F. 3673 (Murphy, M., by req.) **S.F. 3266** (Prettner Solon)

H.F. 3927 (Thissen) **S.F. 3599** (Betzold)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): Duluth Teachers Retirement Fund Association (DTRFA)
Relevant Provisions of Law: Minnesota Statutes, Chapter 354A
General Nature of Proposal: Rule of 90 benefit tier extension to post-1989 hires
Date of Summary: March 26, 2008

Specific Proposed Changes

- a. Resets "normal retirement age" at age 65 rather than Social Security full benefit age for post-1989 hires.
- b. Increases member and employer contribution rates by an amount to be specified.
- c. Includes post-1989 hires in "Rule of 90" normal retirement age.

Policy Issues Raised by the Proposed Legislation

- 1. Consistency of a benefit increase with Commission Pension Policy Principles.
- 2. Lack of conformity with 1989 benefit increase agreement.
- 3. Actuarial condition of DTRFA and actuarial cost of benefit increase.
- 4. Affordability of contribution increases.
- 5. Intra-fund equity.
- 6. Comparability with other teacher plans.
- 7. Appropriateness of encouraging early retirements in light of current labor force trends and needs.
- 8. Collateral impacts from encouraging early retirement.

Potential Amendments

No Commission staff-suggested amendments.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director *JAM*

RE: H.F. 3673 (Murphy, M., by request); S.F. 3266 (Prettner Solon): DTRFA; Rule of 90 Benefit Tier Extension to Post-1989 Hires

H.F. 3927 (Thissen); S.F. 3599 (Betzold): DTRFA; Rule of 90 Benefit Tier Extension to Post-1989 Hires

DATE: March 25, 2008

Summary of H.F. 3673 (Murphy, M., by request); S.F. 3266 (Prettner Solon)

H.F. 3673 (Murphy, M., by request); S.F. 3266 (Prettner Solon) amends various portions of Minnesota Statutes, Chapter 354A, the statutory chapter governing the first class city teacher retirement fund associations, to make the following changes with respect to the New Law Coordinated Program of the Duluth Teachers Retirement Fund Association (DTRFA).

1. Age 65 Normal Retirement Age. The DTRFA-New Law Coordinated Program normal retirement age, currently set at age 65 for pre-July 1, 1989 hires and currently set at the Social Security full benefit age, not to exceed age 66, for post-June 30, 1989 hires, is set at age 65 for all members irrespective of date of hire (Section 1);
2. Increased Member and Employer Contribution Rates. The current DTRFA member and employer contribution rates are all increased by a yet-to-be-specified amount, effective July 1, 2009 (Sections 2 and 3); and
3. DTRFA "Rule of 90" Expansion. The current DTRFA-New Law Coordinated Program "Rule of 90" early normal retirement age provision is extended beyond pre-July 1, 1989 hires to include all DTRFA-New Law members, along with the age 62 with 30 years of service early normal retirement age provision and subsidized early retirement reduction rate in the "Rule of 90" tier benefit calculator (Section 4).

Summary of H.F. 3927 (Thissen); S.F. 3599 (Betzold)

H.F. 3927 (Thissen); S.F. 3599 (Betzold) is the identical proposed legislation to H.F. 3673 (Murphy, M., by request); S.F. 3266 (Prettner Solon).

Background Information

Background information that may be of assistance is attached. Information on the current "Rule of 90" and related provisions is contained in **Attachment A**. Information on the 1989 pension legislation, when aspects of the "Rule of 90" benefit package were merged with aspects of the alternative "level benefit" package for the statewide general employee and the first class city teacher retirement fund associations, is contained in **Attachment B**.

Analysis and Discussion

H.F. 3673 (Murphy, M., by request); S.F. 3266 (Prettner Solon) and H.F. 3927 (Thissen); S.F. 3599 (Betzold) raise several pension and related policy issues, as follows:

1. Consistency With Policy Principles. The policy issue is the extent to which the proposed legislation is consistent with the Pension Policy Principles of the Legislative Commission on Pensions and Retirement. The Principles indicate that:
 - the purpose of Minnesota public pension plans, in addition to public employee recruitment and retention assistance, is to assist in the systematic outtransitioning of public employees at the normally expected conclusion of their working careers (II.A.1.);
 - the normal retirement age be set in a reasonable relationship to the employability limits of the average public employee (II.B.4.); and
 - early retirement incentives should be appropriately targeted and should not be subsidized by the public pension plan (II.B.5.).

The "Rule of 90," when initially enacted for the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) in 1982 and when extended to the existing (pre-July 1, 1989) memberships of the statewide general employee and first class city teacher retirement plans in 1989, was not accompanied by any studies, research, or other relevant documentation of a decline in the expected limits of Minnesota public employee working careers and clearly promoted early retirement with a subsidy. To be consistent with the Commission Principles, an extension now, to post-July 1, 1980 public sector hires, should be accompanied by some documentary showing of its consistency with general public employee work career limits if it is to conform with the Commission's Pension Policy Principles. If the argument for the extension is not based on public employee employability limits, but is based on presumed salary savings from early retirement, making it an early retirement incentive program, the funding should be provided wholly or primarily from the public employers who would obtain the salary savings to conform with the Commission Policy Principles against public pension plan subsidies of early retirement incentives.

2. Conformity With 1989 Benefit Increase Agreement. The policy issue is the extent to which the extension of the 1989 "Rule of 90" benefit package beyond pre-July 1, 1989 hires violates the legislative understanding under which the 1989 benefit increases were enacted. As **Attachment B** sets forth, the 1989 benefit increase package was a merging of two different approaches to providing a retirement benefit increase and contained certain constraints on the "Rule of 90" in an attempt to gain sufficient support in both the House and the Senate to be enacted. Those constraints were a limit of the "Rule of 90" benefit package to existing public employees in 1989, thereby phasing out the benefit tier over time (Laws 1989, Chapter 319, Article 13, Sections 9, 10, 33, 34, 58, 59, 75, 77, 78, and 94), an increase in the normal retirement age to match the Social Security full benefit age as it increases under the 1986 Social Security Amendments (Laws 1989, Chapter 319, Article 13, Sections 2, 29, 53, 71, and 95), and an automatic elimination of the "Rule of 90" benefit tier for all applicable retirement plans when a period review and report on "Rule of 90" utilization indicates utilization of the benefit tier in excess of 45 percent of those eligible for the tier (Laws 1989, Chapter 319, Article 13, Section 96). The agreed-upon constraints have been relaxed over time, with the affected retirement plans successfully seeking the repeal of the "Rule of 90" quadrennial utilization review and automatic tier repeal upon over-utilization provision, in 1993 (Laws 1993, Chapter 280), when utilization approached the repeal trigger percentage, and with the affected retirement plans successfully seeking a maximum of age 66 on the indexation of the normal retirement age to the federal Social Security full benefit age in 1997 (Laws 1997, Chapter 233, Article 1, Sections 16, 37, and 47, and Article 3, Section 1). The proposed expansion would eliminate the last constraint fashioned in 1989 as part of the 1989 benefit increase legislative deliberations.

3. Actuarial Condition of DTRFA and Actuarial Cost of the Benefit Increase. The policy issue is the current actuarial condition of the Duluth Teachers Retirement Fund Association (DTRFA), the likely actuarial cost of the proposed "Rule of 90" benefit package, and the affect that the benefit improvement will have on the retirement plan. The following summarizes the actuarial condition of DTRFA in 2006 and 2007:

Duluth Teachers Retirement Fund Association (DTRFA)

	2006		2007		Change 2006-2007	
<u>Membership</u>						
Active Members		1,174		1,150		(24)
Service Retirees		1,076		1,119		43
Disabilitants		17		15		(2)
Survivors		97		93		(4)
Deferred Retirees		312		321		9
Nonvested Former Members		<u>570</u>		<u>682</u>		<u>112</u>
Total Membership		3,246		3,380		134
<u>Funded Status</u>						
Accrued Liability		\$322,229,167		\$332,216,981		\$9,987,814
Current Assets		<u>\$270,925,689</u>		<u>\$288,264,749</u>		<u>\$17,339,060</u>
Unfunded Accrued Liability		\$51,303,478		\$43,952,232		(\$7,351,246)
Funding Ratio	84.08%		86.77%		2.69%	
<u>Financing Requirements</u>						
Covered Payroll		\$57,482,791		\$58,666,809		\$1,184,018
Benefits Payable		\$19,229,911		\$20,065,048		\$835,137
Normal Cost	9.19%	\$5,281,712	9.23%	\$5,416,358	0.04%	\$134,646
Administrative Expenses	<u>0.76%</u>	<u>\$436,869</u>	<u>0.79%</u>	<u>\$463,468</u>	<u>0.03%</u>	<u>\$26,599</u>
Normal Cost & Expense	9.95%	\$5,718,581	10.02%	\$5,879,826	0.07%	\$161,245

Duluth Teachers Retirement Fund Association (DTRFA)

	2006		2007		Change 2006-2007	
Normal Cost & Expense	9.95%	\$5,718,581	10.02%	\$5,879,826	0.07%	\$161,245
Amortization	<u>5.24%</u>	<u>\$3,012,098</u>	<u>4.51%</u>	<u>\$2,645,873</u>	<u>(0.73%)</u>	<u>(\$366,225)</u>
Total Requirements	15.19%	\$8,730,679	14.53%	\$8,525,699	(0.66%)	(\$204,980)
Employee Contributions	5.50%	\$3,161,554	5.50%	\$3,226,675	(0.00%)	\$65,121
Employer Contributions	5.79%	\$3,328,254	5.79%	\$3,396,808	(0.00%)	\$68,554
Employer Add'l Cont.	0.00%	\$0	0.00%	\$0	0.00%	\$0
Direct State Funding	0.00%	\$0	0.00%	\$0	0.00%	\$0
Other Govt. Funding	0.00%	\$0	0.00%	\$0	0.00%	\$0
Administrative Assessment	<u>0.00%</u>	<u>\$0</u>	<u>0.00%</u>	<u>\$0</u>	<u>0.00%</u>	<u>\$0</u>
Total Contributions	11.29%	\$6,489,808	11.29%	\$6,623,483	(0.00%)	\$133,675
Total Requirements	15.19%	\$8,730,679	14.53%	\$8,525,699	(0.66%)	(\$204,980)
Total Contributions	<u>11.29%</u>	<u>\$6,489,808</u>	<u>11.29%</u>	<u>\$6,623,483</u>	<u>(0.00%)</u>	<u>\$133,675</u>
Deficiency (Surplus)	3.90%	\$2,240,871	3.24%	\$1,902,216	(0.66%)	(\$338,655)
Amortization Target Date	2032		2032		2032	
Actuary	Segal		Segal		Segal	

When DTRFA went from being fully funded to having an unfunded actuarial accrued liability in 2004, The Segal Company appears to have misread Minnesota Statutes, Section 356.215, Subdivision 11, Paragraph (b), and continued to use the same amortization date (2032) as was applicable when the plan initially had a funding surplus and an amortization credit. If the 2020 amortization target date that is required for DTRFA by Minnesota Statutes, Section 356.215, Subdivision 11, Paragraph (b), was used, the 2007 amortization requirement would increase from 4.51 percent of covered pay to 8.13 percent of covered pay, the total actuarial requirements of the plan would increase from 14.53 percent of covered pay to 18.15 percent of covered pay, and the plan's contribution deficiency would increase from 3.24 percent of covered pay to 6.86 percent of covered pay.

No actuarial estimate of the impact of the proposed legislation has been provided to the Commission staff by DTRFA.

4. Affordability of Increased Contributions. The policy issue is the affordability of the contribution increases that would be required to maintain sound actuarial funding after an extension of the "Rule of 90" package to post-June 30, 1989 hires covered by the Duluth Teachers Retirement Fund Association (DTRFA). If the DTRFA addresses the current contribution deficiency (either 3.24 percent of covered salary as incorrectly calculated by The Segal Company or 6.86 percent of covered salary as recalculated by the Commission staff to reflect a 2020 amortization date), as required by Commission Pension Policy Principle III.A.1. and allocates the burden equally between members and employers (largely Independent School District No. 709), that would increase the member contribution for the average DTRFA member by either \$851.95 or \$1,749.81 and would increase the school district's required contribution by either \$951,108 or \$2,012,272. For each one percent of covered pay actuarial cost increase resulting from the proposed benefit increase, if allocated equally, the average DTRFA member would be obligated for an additional \$255 member contribution and Independent School District No. 709 would be obligated for an additional \$293,334. As drafted, any DTRFA employer contribution rate increase would not be accompanied by an increase in the general state education aid funding provided to the school district, so the employer contribution increase would be borne entirely from existing school district revenue sources.

5. Equity Within DTRFA. The policy issue is the impact of the proposed benefit increase on equity concerns within the Duluth Teachers Retirement Fund Association (DTRFA). The equity concerns relate to the actual or the perceived lack of equal or comparable treatment between DTRFA members. Because the funding of the DTRFA benefit plan occurs on a group basis, all members pay a larger member contribution than they would pay if DTRFA did not have the "Rule of 90" benefit package proposed to be extended to post-June 30, 1989 hires by this legislation. For the 71 percent of the DTRFA membership, based on DTRFA cumulative active service credit earned through June 30, 2007, who were likely hired after June 30, 1989, they complain about bearing the additional funding obligation for a benefit applicable to a minority of plan members and feel that they have been inequitably treated. If the "Rule of 90" benefit package was extended to the entire DTRFA membership, more plan members would be covered by that part of the overall DTRFA benefit plan, but because of individual differences in entry age and teaching career duration, not all DTRFA members can qualify for the "Rule of 90," the primary component of the "Rule of 90" benefit package, and, because of a variety of individual considerations, only a portion of the DTRFA members eligible for the "Rule of 90" will actually retire under the "Rule of 90." Thus, for some portion of the DTRFA membership, the extension of the "Rule of 90" benefit package to post-June 30,

1989 hires will address some equitable concerns, but will still leave many DTRFA members to continue to bear a higher member contribution by virtue of the "Rule of 90" benefit package but will never be eligible to use the "Rule of 90" or will be unable to use the "Rule of 90" when eligible. The truth about pension plans, as specialized insurance pools with liability and cost averaging, is that there are endless cross-subsidies where every member or virtually every member could contend that they are treated inequitably.

6. Comparability Between DTRFA and Other Teacher Retirement Plans. The policy issue is the current lack of comparability between the Duluth Teachers Retirement Fund Association (DTRFA) and the other first class city teacher retirement fund association, the St. Paul Teachers Retirement Fund Association (SPTRFA). The SPTRFA, with a funding ratio of 73.0 percent and a contribution deficiency of 8.03 percent of covered pay (total actuarial requirement of 24.10 percent of covered pay compared to total support of 16.07 percent of covered pay), is not well positioned actuarially or financially to undertake the benefit increase without even more significant member and employer contribution rate increases than DTRFA.
7. Appropriateness of Encouraging "Rule of 90" Early Retirement Given Current Labor Force Trends and Needs. The policy issue is the appropriateness of an extension of the "Rule of 90" benefit package as proposed in light of current and likely future labor force trends and needs. Pension coverage, under the Commission's Pension Policy Principles, is intended to augment the public sector personnel and compensation systems. If the pension benefit plan encourages early retirement at a time when the working lives of employees are lengthening, the benefit plan will do a disservice to the employment system by robbing it of valuable workers and to the workers by prematurely inducing them to reduce their productive years. Specifically, in public education, where shortages are forecasted for some subject areas, such as mathematics, science, and special education, and replacement teachers are difficult to recruit, especially in rural schools, the pension system by encouraging early retirement may require the personnel system to counter that early retirement encouragement by increased compensation or other inducements in order to retain teachers in specific areas.
8. Collateral Impacts of Encouraging Early Retirement. The policy issue is the appropriateness of encouraging early retirement by extending the "Rule of 90" benefit package in light of the collateral impact that early retirement produces. At a minimum, these collateral impacts are increased pressure on public employers to provide retiree health insurance coverage, increased pressure on the pension benefit program to provide greater and more regular post-retirement adjustments, and increased pressure on the pension system to permit receipt of retirement benefits without terminating employment first or to relax or eliminate reemployed annuitant earnings limitations for retirees returning to employment on a part-time or full-time basis. Recent accounting changes have increased the visibility of post-retirement benefit programs and have increased the pressure on employers to fund them on a systematic basis. Post-retirement health coverage benefits are expensive, especially for retirees who begin drawing benefits well in advance of the earliest age for receipt of Medicare benefits at age 62 as can occur under the "Rule of 90." Pressure on the reemployed annuitant earnings limitations has already prompted the Legislature to eliminate the benefit forfeiture aspect of the prior limits, but that 1989 change has not stemmed continuing pressure to increase the earnings limitation amount significantly. More retirees appear to be arranging a post-retirement employment return with their employers, causing contentious disagreements with retirement plans over the employment termination requirement of current retirement benefit plans. Early retirement provisions that favor or require long service credit periods, such as the "Rule of 90," also have resulted in recent increased requests for prior service credit purchase authorizations.

Attachment A

Background Information on the "Rule of 90"

The "Rule of 90" benefit tier is an early normal retirement age provision that was initially enacted for the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) in 1982 and that was extended in 1989 to all other general employee (non public safety employee) Minnesota public pension plans, for pre-July 1, 1989, hires only.

The historic reason for creating and maintaining pension plans, in the private sector or the public sector, is to augment an employer's personnel and compensation system by assisting in the recruitment of new qualified employees, the retention of existing qualified employees, and the systematic out-transitioning of existing employees at the conclusion of their normally expected working careers. The pension system does this by providing retirement annuities (and frequently other casualty or ancillary benefit coverage) that are deemed adequate in view of both the employer and the employees and that are deemed affordable by the employer. This traditional pension plan purpose apparently underlies the development of public pension plans in Minnesota, although it never has clearly been articulated in law.

The systematic out-transitioning of existing employees at the conclusion of their normally expected working careers is the basis for setting normal retirement ages. The Commission's Principles of Pension Policy indicate that the normal retirement age of Minnesota public pension plans should be set in accord with the employability limits of the average public employee, and indicate that the normal retirement age generally should differentiate between general public employees and set at an earlier age for protective and public safety employees.

Age 65 has come to be the traditional age at which many employees are expected to retire. It is, however, unclear why this age has become the regularly expected retirement age for many public retirement plans. Age 65 does not appear to represent an empirically determined conclusion about when most employees retire from the experience of employees before the creation of Social Security and the significant expansion of employment-based pension coverage in the 1930s. Before the 1930s, retirement for most people appears to have been a function of a physical inability to continue in employment, at whatever age that occurred. Until recent decades, the most impoverished sector of the American population was older people. Since the 1960s, in both larger corporate pension plans and public employee pension plans, the trend has been to institute normal retirement ages earlier than age 65. In the counter direction, based on considerations of lengthening expected lifespan and of the related cost of providing benefits for ever-lengthening retirement periods, Social Security has instituted a later full benefit retirement age, as follows:

Social Security			
Year of Birth	Normal Retirement Age	Year of Birth	Normal Retirement Age
Before 1938	Age 65	1955	Age 66, 2 months
1938	Age 65, 2 months	1956	Age 66, 4 months
1939	Age 65, 4 months	1957	Age 66, 6 months
1940	Age 65, 6 months	1958	Age 66, 8 months
1941	Age 65, 8 months	1959	Age 66, 10 months
1942	Age 65, 10 months	1960 and later	Age 67
1943-1954	Age 66		

The following compares the normal retirement ages applicable to the various general employee Minnesota public pension plans:

Retirement Plan	Normal Retirement Age Provisions
1. General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General)	If hired before July 1, 1989: Age 65; Age 62 with 30 years of service; or "Rule of 90" If hired after June 30, 1989; Social Security full benefit age, with a maximum age of age 66
2. General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General)	If hired before July 1, 1989: Age 65; Age 62 with 30 years of service; or "Rule of 90" If hired after June 30, 1989; Social Security full benefit age, with a maximum age of age 66
3. Teachers Retirement Association (TRA)	If hired before July 1, 1989: Age 65; Age 62 with 30 years of service; or "Rule of 90" If hired after June 30, 1989; Social Security full benefit age, with a maximum age of age 66

- | | |
|---|---|
| 4. Duluth Teachers Retirement Fund Association (DTRFA) | If hired before July 1, 1989: Age 62 with 30 years of service; or "Rule of 90"
If hired after June 30, 1989; Social Security full benefit age, with a maximum age of age 66 |
| 5. St. Paul Teachers Retirement Fund Association (SPTRFA) | a. Basic Program:
Age 65; Age 60 with 25 years of service; or "Rule of 90"
b. Coordinated Program:
If hired before July 1, 1989: Age 65; Age 62 with 30 years of service; a "Rule of 90"
If hired after June 30, 1989: Social Security full benefit age, with a maximum age of age 66 |
| 6. Minneapolis Employees Retirement Fund (MERF) | Age 65; Age 60 with 10 years of service; or any age with 30 years of service |
| 7. Legislators Retirement Plan | Age 62 |
| 8. Elective State Officers Retirement Plan | Age 62 |
| 9. MSRS Military Affairs Department Retirement Plan | Mandatory federal military retirement age or age 65 |
| 10. Transportation Department Pilots Retirement Plan | Age 62 |
| 11. Judges Retirement Plan | Age 65 |

The age 62 with 30 years of service and the "Rule of 90" provisions are early normal retirement age provisions, where a benefit unreduced for early retirement is provided at an age before the generally applicable normal retirement age. The age 62 with 30 years of service early normal retirement age provision was added to the statewide general employee retirement plans in 1973 as the first generally applicable early normal retirement age provision. The "Rule of 90" early normal retirement age provision was enacted for the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) in 1982 (Laws 1982, Chapter 519, Section 2). In 1989 (Laws 1989, Chapter 319, Article 13), the "Rule of 90" provision was extended to the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the Teachers Retirement Association (TRA), and the coordinated programs of the first class city teachers retirement fund associations, applicable only to pre-July 1, 1989, hires. That restriction was also made applicable to PERA-General in 1989.

The "Rule of 90" tier and the "Level Benefit" tier compare as follows:

	Rule of 90	Level Benefit
<u>Normal Retirement</u>		
Eligibility:	Age 65 and three years of allowable service. Age 62 and 30 years of allowable service. "Rule of 90," where the sum of age and allowable service equals or exceeds 90. Proportionate requirement annuity is available at age 65 and one year of allowable service.	The greater of age 65 or the age eligible for full Social Security retirement benefits (but not to exceed age 66) and three years of allowable service. Proportionate retirement annuity is available at normal retirement age and one year of allowable service.
Retirement Amount:	1.2% of average salary for each of the first 10 years of allowable service and 1.7% of average salary for each subsequent year.	1.7% of average salary for each year of allowable service.
<u>Early Reduced Retirement</u>		
Eligibility:	Age 55 and three years of allowable service. Any age with 30 years of allowable service.	Age 55 with three years of allowable service.

Retirement Amount: The greater of 1.2% of average salary for each of the first 10 years of allowable service and 1.7% of average salary for each subsequent year with reduction of 0.25% for each month the member is under age 65 at time of retirement (age 62 if 30 years of allowable service). No reduction if age plus years of allowable service totals 90; 1.7% of average salary for each year of allowable service assuming augmentation to age eligible for full Social Security retirement benefits at 3% per year and actuarial reduction for each month the member is under the full Social Security benefit retirement age but not to exceed age 66.

OR

1.7% of average salary for each year of allowable service assuming augmentation to age 65 at 3% per year and actuarial reduction for each month the member is under age 65.

Plan members hired before July 1, 1989, have the option to receive the greater of their "Rule of 90" tier benefit or the "Level Benefit" tier benefit. Plan members hired after June 30, 1989, only have the "Level Benefit" tier benefit.

