



# Defined Benefit Plan

## Elements and Terminology

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# Plan Type Differences

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- **Defined benefit retirement plan**

- A defined benefit retirement plan is a plan that provides a retirement annuity that is fixed or predetermined in amount or as to its calculation through a formula, leaving the required funding for that benefit as a variable.

- **Defined contribution retirement plan**

- A defined contribution retirement plan is a plan that uses a predetermined or fixed amount of pension plan support or contribution, leaving the eventual benefit amount payable as a variable based on the accumulation of contributions and any investment income on those contributions in an individual account.

Principle II.C.1. General Preference for Defined Benefit Plans Over Defined Contribution Plans

- a. Defined benefit plans, where they currently exist, should remain as the primary retirement coverage for Minnesota public employees.
- b. Defined contribution plans are particularly appropriate where interstate portability or private sector-public sector portability is a primary consideration of the public employee group, where the public employee group lacks civil service or analogous employment protections, or where the defined contribution plan is a supplemental pension plan.

# Minnesota Public Pension Plans

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- **Minnesota defined benefit plans**
  - **Statewide plans**
    - General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General)
    - Correctional State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Correctional)
    - State Patrol Retirement Plan
    - Judges Retirement Plan
    - Legislators Retirement Plan
    - Elected State Officers Retirement Plan
    - Military Affairs Personnel Retirement Plan
    - Department of Transportation Pilots Retirement Plan
    - State Fire Marshal Division Arson Investigators Retirement Plan
    - General Employee Retirement Plan of the Public Employees Retirement Association (PERA General)
    - Public Employees Police and Fire Retirement Plan (PERA-P&F)
    - Local Government Correctional Service Retirement Plan (PERA-Correctional)
    - Teachers Retirement Association (TRA)
    - University of Minnesota Faculty Supplemental Retirement Plan
    - Voluntary Statewide Lump-Sum Volunteer Firefighter Retirement Plan (PERA-SVF)
  - **Local Plans**
    - Duluth Teachers Retirement Fund Association (DTRFA)
    - MERF Division of the Public Employees Retirement Association (PERA-MERF)
    - St. Paul Teachers Retirement Fund Association (SPTRFA)
    - Various volunteer firefighter relief associations

# Minnesota Public Pension Plans

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- **Minnesota defined contribution plans**
  - **Statewide plans**
    - MSRS Unclassified State Employees Retirement Program (MSRS-Unclassified)
    - Higher Education Individual Retirement Account Plan (MnSCU-IRAP)
    - Higher Education Supplemental Retirement Plan (MnSCU-Supplemental)
    - PERA Defined Contribution Retirement Plan
    - Ambulance Service Personnel Longevity Plan
    - University of Minnesota Faculty Retirement Plan
  - **Local Plans**
    - Hennepin County Supplemental Retirement Plan
    - Various volunteer firefighter relief associations
    - Various Housing and Redevelopment Authority (HRA) retirement plans

# Retirement Program Type Differences

- **Social Security alternative or Social Security supplement**
  - General employee plan Basic Programs
    - A Basic Program, in Minnesota pension parlance, is a public employee retirement plan that exists instead of the federal Old Age, Survivors and Disability Insurance (Social Security) program. In Minnesota, basic plans include those plans where Social Security coverage was added after the plans creation and applies to public employees (i.e., general employees and correctional employees) who did not elect Social Security coverage in that referendum.
  - General employee plan and correctional plan Coordinated Programs
    - A Coordinated program, in Minnesota pension parlance, is a public employee retirement plan that exists to supplement the federal Social Security program and applies to general employees and correctional employees who either elected Social Security coverage in a referendum held for that purpose or were hired subsequent to the referendum.
- Public safety employee plans
  - In Minnesota, basic plans also include those plans where Social Security coverage is prohibited by federal law for some employees (i.e., police and firefighters).

## Principle II.C.2. Social Security Coverage

Except for public employees who are police officers or firefighters, coverage by the federal Old Age, Survivors, Disability and Health Insurance (Social Security) Program should be part of the retirement coverage for Minnesota public employees.

# Employee Type

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- **Public safety employee/uniformed employee plan type**
  - Public safety employee retirement plans are retirement plans which cover police officers and firefighters or retirement plans which cover correctional employees. Police and firefighter retirement plans do not supplement Social Security coverage (i.e., are Basic programs) and provide a more substantial level of benefits while correctional employee retirement plans supplement Social Security coverage (i.e., are Coordinated programs) and provide a Social Security supplement that is greater than that provided to most general employee retirement plans, but is less than that provided to police and firefighter retirement plans.
- **General employee/non-uniformed employee plan type**
  - General employee retirement plans are those plans that cover employees other than police officers, firefighters, or correctional officers.

# Defined Benefit Plan Elements

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- Membership
- Mandatory/Voluntary participation
- Allowable service credit
- Vesting requirement(s)
- Covered salary
- Final average salary
- Benefit accrual/formula percentage rate(s)
- Normal retirement age(s)
- Early retirement age(s)
- Single life retirement annuity calculation
- Retirement annuity forms
- Supplemental retirement plan coverage
- Deferred retirement annuity and augmentation
- Reemployed annuitant earnings limitations
- Disability casualty benefit coverage
- Survivor casualty benefit coverage
- Portability provisions
- Post-retirement adjustment mechanisms
- Refund of accumulated member contributions
- Repayment of refunds

# Defined Benefit Plan Elements

- **Membership**

- The membership of a public employee retirement plan is comprised of the individuals who participate in the plan either as active members or as retirees and other retirement benefit recipients. In Minnesota, most, but not all, public sector employees are covered by a public employee retirement plan. Minnesota public employee retirement plans all have statutory specifications as to which public employees are eligible for membership.

Principle II.C.16. Duplicate Public Pension Coverage for the Same Employment  
Unless supplemental pension plan coverage is involved, public employees should not have coverage by more than one Minnesota public pension plan for the same period of service with the same public employer.

- **Mandatory / voluntary participation**

- Public pension plan participation can either be required of all public employees (i.e., mandatory) or be available if the public employee elects to participate (voluntary).

Principle II.B.2. Mandatory Public Pension Plan Membership  
To the extent possible, membership in a public pension plan should be mandatory for the personnel employed on a recurring or regular basis.



# Defined Benefit Plan Elements

- **Allowable service credit**
  - Concurrent with employment
    - The recorded length of qualifying employment and plan membership used in calculating a defined benefit plan retirement annuity where a service related formula is used.
  - Prior service credit purchases
    - The authorization of the acquisition of a recorded length of time equivalent to qualifying employment and plan membership for use in the calculation of a defined benefit retirement plan where a service related formula is used.

## Principle II.C.10. Purchases of Prior Service Credit

Purchases of public pension plan credit for periods of prior service should be permitted only if it is determined by the Commission:

- that the period to be purchased is public employment or relates substantially to the public employee's career,
- that the purchase payment amount from the member or from a combination of the member and the current or former employer must equal the actuarial liability to be incurred by the pension plan for the benefit associated with the purchase, appropriately calculated, without the provision of a subsidy from the pension plan unless an error or an omission by the pension plan was responsible for the loss of service credit,
- that the purchase payment amount must include a minimum payment by the member of the equivalent member contributions, plus compound interest from the purchase period to the date of payment unless the employer committed a particularly egregious error,
- that the purchase payment is the responsibility of the member, with the current or former employer authorized to pay some or all of the portion of the payment amount in excess of the minimum member payment amount, unless the employer has some culpability in the circumstances giving rise to the purchase and then a mandatory employer contribution may be imposed, and
- that the purchase must not violate notions of equity.

# Defined Benefit Plan Elements

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- **Vesting requirements**
  - The length of allowable service credit required for a retirement plan member to receive a non-forfeitable entitlement to an eventual retirement annuity or benefit.
    - **Cliff vesting:** A vesting requirement that conveys 100% retirement annuity or benefit entitlement upon attaining that allowable service credit amount.
    - **Graduated vesting:** A vesting requirement that conveys an increasing percentage of retirement annuity or benefit entitlement with each credited allowable service period rendered.

## Principle II.C.12. Vesting Requirement Waivers

Waivers of vesting requirements should be permitted only if, on a case-by-case basis, it is determined that there is a strong equitable argument to grant the waiver for the requesting public employees.

# Defined Benefit Plan Elements

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- **Covered salary**
  - The amount of compensation paid to a pension plan participant by that plan member's employer on which retirement plan contributions are made and which is used in the calculation of a retirement annuity or benefit.
- **Final average salary**
  - The average of covered salary credited to a retiring retirement plan member at or before retirement over a designated period, most generally in Minnesota public retirement plans the five successive years of salary that produces the highest average, to which the benefit accrual percentage multiplied by the years of allowable service credit is applied to determine the retirement annuity or benefit..

# Defined Benefit Plan Elements

- **Benefit accrual/formula percentage rate(s) or amount(s)**
  - The percentage of salary rate or the benefit amount specified for each year of allowable service credit used to determine the retirement annuity.

## Principle II.C.7. Adequacy of Benefits at Retirement

- a. Benefit adequacy requires that retirement benefits respond to changes in the economy.
- b. The retirement benefit should be adequate at the time of retirement.
- c. Except for local police or firefighter relief associations, the retirement benefit should be related to an individual's final average salary, determined on the basis of the highest five successive years' average salary unless a different averaging period is designated by the Legislature.
- d. Except for local police or firefighter relief associations, the measure of retirement benefit adequacy should be at a minimum of thirty years service, which would be a reasonable public employment career, and at the generally applicable normal retirement age.
- e. Retirement benefit adequacy must be a function of the Minnesota public pension plan benefit and any Social Security benefit payable on account of Minnesota public employment.

## Principle II.C.3. Equal Treatment Within Pension Plans

There should be equal pension treatment of public employees in terms of the relationship between benefits and contributions.

## Principle II.C.6. Uniformity and Equal Benefit Treatment Among Plans

There should be equal pension treatment in terms of the relationship between benefits and contributions among the various plans and, as nearly as practicable, within the confines of plan demographics, retirement benefits and member contributions should be uniform.

# Defined Benefit Plan Elements

- **Normal retirement age(s)**

- **“Rule of 90” benefit tier**

The benefit tier applicable to general employee retirement plan members who became Minnesota public employee retirement plan members before July 1, 1989, where, if it is greater than the level benefit tier annuity amount, the retiree is entitled to a split rate benefit (i.e., smaller benefit accrual rate for each of the first ten years and a larger benefit accrual rate for each successive years) at that age when the sum of age and years of allowable service credit totals at least 90.

- **“Level Benefit” benefit tier**

The benefit tier applicable to general employee retirement plan members who became Minnesota public employee retirement plan members after June 30, 1989, or, for a retirement plan member who became such before July 1, 1989, where it is greater than the “Rule of 90” benefit tier annuity amount, the retiree is entitled to an identical accrual rate per year benefit (i.e., equal to the benefit accrual rate under the “Rule of 90” utilized for each year of service in excess of ten years of service) at the full Social Security benefit amount age for that person, but not older than age 66.

- **Age 62 with 30 years of service**

- A minimum age and service requirement for the payment of an unreduced retirement annuity also applicable to general employee retirement plan members who became Minnesota public employee retirement plan members before July 1, 1989.

- **Public safety and correctional plan normal retirement ages – Age 55**

Principle II.C.4. Appropriate Normal Retirement Ages

The normal retirement age should be set in a reasonable relationship to the employability limits of the average public employee and should differentiate between regular public employees and protective and public safety employees.

# Defined Benefit Plan Elements

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- **Early retirement age(s)**

The earliest age at which a retirement plan member is entitled to receive a retirement annuity, generally reduced for that early age of annuity commencement.

- **Early retirement reduction factors**

The amount of the reduction imposed when a retirement plan participant commences receipt of the retirement annuity at an age earlier than the normal retirement age or ages.

Principle II.C.5. Appropriate Early Retirement Reductions

Public employee pension plans should not subsidize early retirement benefits and, except for appropriately designed early retirement incentive programs, retirement benefits should be actuarially reduced for retirement before any applicable normal retirement age.

# Defined Benefit Plan Elements

- **Single life retirement annuity calculation**

- In Minnesota public retirement plans that do not provide an automatic survivor benefit for the surviving spouse of the retirement annuitant, the calculation of the retirement annuity amount that is payable to the retirement plan participant after retirement at the normal retirement age for the remaining lifetime of the retiree. The single life annuity amount and its present value is the base for optional annuity form calculations.

## Principle II.C.7. Adequacy of Benefits at Retirement

- a. Benefit adequacy requires that retirement benefits respond to changes in the economy.
- b. The retirement benefit should be adequate at the time of retirement.
- c. Except for local police or firefighter relief associations, the retirement benefit should be related to an individual's final average salary, determined on the basis of the highest five successive years' average salary unless a different averaging period is designated by the Legislature.
- d. Except for local police or firefighter relief associations, the measure of retirement benefit adequacy should be at a minimum of thirty years service, which would be a reasonable public employment career, and at the generally applicable normal retirement age.
- e. Retirement benefit adequacy must be a function of the Minnesota public pension plan benefit and any Social Security benefit payable on account of Minnesota public employment.

## Principle II.C.22. No Intended Ultimate Benefit Diminutions

- a. In recommending benefit plan modifications, the imposition of reductions in overall benefit coverage for existing pension plan members should not be recommended.
- b. The imposition of a reduction in overall benefit coverage may be imposed for new pension plan members in order to achieve sound pension policy goals.
- c. A reduction in some aspect or aspects of benefit coverage may be recommended in combination with a proposed benefit increase or benefit increases in implementing sound pension policy goals.

# Defined Benefit Plan Elements

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- **Retirement annuity forms**

- Married retiree waive-able mandatory joint and survivor annuity

If a retiring member of a Minnesota public pension plan that does not provide automatic survivor benefits is married at the time of retirement, a reduced optional annuity is payable to the retiree and, if the retiree predeceases the person's spouse at the time of retirement, to the surviving spouse or former spouse. The presumptive optional annuity form may be waived by the retiree's spouse at retirement, whereupon the retiree is entitled to a single life annuity for life unless the retiree elects some other optional annuity form.



# Defined Benefit Plan Elements

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- **Optional annuity forms**

- **Joint and survivor optional annuity forms**

An optional annuity form that pays a reduced benefit to the retiring member and a designated percentage of that annuity amount to the designated optional annuitant if the retiree predeceases the designated survivor. The typical forms include a 25% joint and survivor optional annuity form, a 50% joint and survivor optional annuity form, a 75% joint and survivor optional annuity form, or a 100% joint and survivor optional annuity form. The reduction is required by law to be that amount that makes the benefits projected to be paid to both recipients using the mortality table of the retirement plan and its interest rate actuarial assumption have the same actuarial present value as the retiree's single life annuity amount.

- **Bounce-back feature:** A feature of some joint and survivor optional annuity forms whereby the annuity is restored to the single life annuity amount if the intended survivor under the optional annuity form dies before the retiree. In Minnesota public retirement plans, the bounce-back feature is part of all joint and survivor optional annuity forms without any additional actuarial reduction for the addition of the feature.

# Defined Benefit Plan Elements

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- **Optional annuity forms, continued**

- **Accelerated optional annuity form**

An optional annuity form that pays a greater annuity amount before beginning Social Security or attaining age 65 and then a smaller amount after that date, with the total benefit outlay reduced to be the actuarial equivalent of the single life annuity form.

- **Term-certain optional annuity form**

An optional annuity form that pays the annuity for a minimum period of years, even if the retiree dies before that date, or for the life of the retiree if a longer period, reduced to be the actuarial equivalent of the single life annuity form.

- **Guaranteed refund optional annuity form**

For retirement plans that do not automatically pay a refund of the balance of any member contributions with interest if the retiree dies leaving a balance, an optional annuity form by the that includes that member account balance death payment.

Principle II.C.13. Reopening Optional Annuity Elections  
Reopenings of optional annuity elections should not be permitted.

# Sample Defined Benefit Computation

## TRA Coordinated Program – hypothetical teacher

2012 Age: 43.5 years<sup>1</sup>    2012 Service: 12.0 years<sup>1</sup>    2012 Salary: \$53,507<sup>1</sup>

Normal Retirement			Early Retirement		
Normal Retirement Age (NRA) <sup>2</sup>	66 yrs		Early Retirement Age (ERA) <sup>6</sup>	55 yrs	
NRA Service Credit	34.5 yrs		ERA Service Credit	23.5 yrs	
NRA Final Salary <sup>3</sup>	\$148,572		ERA Final Salary <sup>3</sup>	\$91,550	
NRA High-5 Average <sup>4</sup>	\$136,590	\$136,590	ERA High-5 Average <sup>4</sup>	\$80,389	\$80,389
NRA Benefit Accrual <sup>5</sup>			ERA Benefit Accrual <sup>8</sup>		
6 years @ 1.7	10.2		6 years @ 1.7	10.2	
28.5 years @ 1.9	<u>54.15</u>		17.5 years @ 1.9	<u>33.25</u>	
	64.25	<u>x .6425</u>		43.45	<u>x 0.4345</u>
NRA Single Life Annuity		<b>\$87,896</b>	ERA Unreduced Annuity Amount	\$34,929	\$34,929
			Reduction to age 55 (21%) <sup>7</sup>		<u>x 0.79</u>
			ERA Single Life Annuity		<b>\$27,594</b>
NRA Joint & Survivor Opt. Annuity			ERA Joint & Survivor Opt. Annuity		
50% J&S Annuity Reduction <sup>8</sup>		<u>x 0.93</u>	50% J&S Annuity Reduction <sup>8</sup>		<u>x 0.92</u>
50% J&S Optional Annuity		<b>\$81,743</b>	50% J&S Optional Annuity		<b>\$25,386</b>

<sup>1</sup> Number represents the TRA average member as of June 30, 2012

<sup>2</sup> See Minn. Stat. §354.05, Subd. 38

<sup>3</sup> Assumes increases equal to TRA salary scale assumption (see Minn. Stat. §356.215, Subd. 8, Para. (b), Cl. (3), Assumption C)

<sup>4</sup> See Minn. Stat. §354.05, Subd. 13a

<sup>5</sup> See Minn. Stat. §354.44, Subd. 6, Para. (d)-(e); §356.315, Subd. 2, 2b

<sup>6</sup> See Minn. Stat. §354.44, Subd. 1

<sup>7</sup> Reduction required under Minn. Stat. § 354.44, Subd. 6, Para. (e), using the reduction amount for Age 55 reported by L.F. Hacking to TRA Board on September 11, 2012

<sup>8</sup> The reduction uses the approximations set forth on the TRA website ([www.minnesotatra.org/IMAGES/PDF/MemberHandbook09-12.pdf](http://www.minnesotatra.org/IMAGES/PDF/MemberHandbook09-12.pdf)) on Feb. 6, 2013, at 7% at age 66 and 8% at age 55.

# Defined Benefit Plan Elements

- **Supplemental retirement plan coverage**

The provision of an optional or mandatory retirement benefit arrangement in addition to the primary retirement plan membership and coverage.

Principle II.C.21. Supplemental Pension Plans

- a. Public employees should be encouraged to engage in personal savings for their retirement.
- b. The state should assist this process by making personal retirement savings opportunities available to public employees.
- c. Public employers should have an opportunity to elect to provide financial support to established supplemental pension arrangements for their employees.

# Defined Benefit Plan Elements

- **Deferred retirement annuity and augmentation**

The entitlement to an eventual retirement annuity that a public retirement plan member terminates active public employment after obtaining sufficient allowable service credit to vest for a benefit, but not having attained the early retirement age receipt age or postponing an annuity receipt, which annuity amount increases over the deferral period to retain some or all of the purchasing power of the annuity over time.

- **Reemployed annuitant earnings limitations**

The practice of reducing or withholding all or a portion of a retirement annuity when the retiree resumes active employment after beginning retirement annuity receipt and earns a specified amount of compensation for that reemployment.

Principle II.C.17. Reemployed Annuitant Earnings Limitations

- a. Limitations on the earnings by reemployed annuitants should apply only to the re-employment of an annuitant by an employing unit that is a participating employer in the same public pension plan from which the annuitant is receiving a pension benefit.
- b. Reemployed annuitant earnings limitations should be standardized to the extent possible among the various Minnesota public pension plans.

# Defined Benefit Plan Elements

- **Disability casualty benefit coverage**

- **Occupational-based disability vs. total and permanent disability definitions**

A disability is a mental or physical impairment that prevents future employment and brings entitlement for a disability retirement benefit. An occupational-based disability is a disability that prevents further employment in the type of employment that the plan participant was engaged in immediately before the disability occurred and typically is utilized by public safety or correctional retirement plans. A total and permanent disability is a disability that prevents any further substantial gainful employment of any sort and typically is utilized by general employee retirement plans.

- **Disability benefit calculation**

Disability benefits are typically calculated as the same amount as an unreduced normal retirement annuity based on the amount of allowable service credit earned through the date of disability for general employee retirement plans and are typically calculated as the amount of an unreduced normal retirement annuity based on the amount of allowable service credit earned to the date of disablement or a specified minimum number of years of service credit for public safety employee retirement plans.

- **Survivor Casualty Benefit Coverage**

The benefits provided by a public retirement plan for the survivors of a deceased active member.

Principle II.C.18. Disability Definitions

The definitions of what constitutes a disability giving rise to a disability benefit should be standardized to the extent possible, recognizing the differences in the hazards inherent in various types of employment.

# Defined Benefit Plan Elements

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- **Portability Provisions**

- **Service-in-more-than-one plan provisions**

For a public retirement plan participant with allowable service credit in more than one retirement plan, an elective option to add the periods of allowable service credit together to meet the vesting requirement of each retirement plan, with the retirement annuity for each plan calculated separately based on the allowable service credit in that plan.

- **Combined service annuity provision**

For a public retirement plan participant with allowable service credit in more than one retirement plan, an elective option to add the periods of allowable service credit together to meet the vesting requirement of each retirement plan and to have the retirement annuity from each plan calculated separately based on the allowable service credit in that plan, but using a common final average salary figure.

- **Combined service disability benefit provision**

Same as the Combined Service Annuity, but applicable to disability benefits, with an adaptation in the event that different disability definitions apply.

- **Combined service survivor benefit provision**

Same as the Combined Service Annuity, but applicable to survivor benefits.

# Defined Benefit Plan Elements

- **Post-retirement adjustment mechanism**

A change, generally an increase, in a retirement annuity or benefit occurring after retirement.

- Ad hoc post-retirement adjustments are one time modifications, generally granted to correct for some benefit level inadequacy.
- Automatic post-retirement adjustments are periodic modifications in annuity or benefit amounts payable when there is a triggering event, such as inflation or active plan participant wage increases, or by virtue of the passage of a period of time.

Principle II.C.8. Postretirement Benefit Increases

- a. Retirement benefits should be increased during the period of retirement to offset the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement.
- b. The system of periodic post retirement increases should be funded on an actuarial basis.



# Defined Benefit Plan Elements

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- **Refund of accumulated member contributions**

The payment, upon the termination of active public employment and plan participation, of a former member's accumulated member contributions and any credited interest.

- **Repayment of refunds**

The entitlement of a former retirement plan member, upon re-employment in public employment and the resumption of pension plan participation and typically upon the acquisition of a minimum period of allowable service credit, to repay the amount of any previously received accumulated member contributions and interest, with interest for the period from which the refund was taken until the date on which the refund is repaid.