Legislative Commission on Pensions and Retirement

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TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Susan Lenczewski, Executive Director
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DATE: June 11, 2018

SUBJECT: Summary of SF 2620 (Rosen/O'Driscoll), as enacted

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Introduction

SF 2620 (Rosen/O'Driscoll), the First Unofficial Engrossment, is the 2018 omnibus pension and retirement bill as passed by the House and Senate and signed by the Governor as Laws 2018, Chapter 211. It is the culmination of a process that dates back to 2015 when necessary changes to actuarial assumptions, such as for mortality and investment rate of return, were expected to worsen the contribution deficiencies and underfunded status reported by the state's public pension plans.

Most of the provisions in the bill were previously approved by the Senate and the House of Representatives when they appeared in either the 2016 omnibus bill or the 2017 omnibus bill. Bills introduced this session and approved by the Legislative Commission on Pensions and Retirement have been incorporated into the omnibus bill. These 2018 bills are summarized in section 12, "New Provisions," at the end of this memo.

2016 Veto. The 2016 omnibus bill was vetoed by the Governor because it contained "only one piece of the overall sustainability plans, placing sole responsibility for reducing plan liabilities on current retirees." The Governor further explained, "Legislation in the 2017 Session, which will be necessary to address the current pension plan funding projections, must contain a shared participation and be funded in order to gain my signature."

2017 Veto. The 2017 omnibus bill contained benefit reductions shared among active, deferred and retired members, increases to contributions by employers and, to a lesser extent, employees, as well as appropriations and direct state aid. It was introduced in the House, however, as part of a larger bill that included "preemption" provisions. In vetoing this bill, the Governor stated that he could not accept the labor standards that would preempt local governments' ability to set wage and benefit levels higher than state law, even though "the changes to public employee retirement plans…would improve the economic security of tens of thousands of Minnesotans, including hardworking state employees and retirees."

Summary

The 2018 bill amends existing statutes or adds new statutes to the chapters governing the state's pension and retirement plans. Highlights are the following:

- Benefit reforms, including the end of augmentation, elimination of subsidies in the calculation of early retirement benefits, postponement of the start of post-retirement adjustments (i.e., "COLAs") until normal retirement age, and the reduction in the rate of interest paid on refunds;
- Reduction in the COLA increases applied to retiree benefits;
- Changes to the actuarial assumptions, including the assumption for investment rate of return;
- Increases to employer and employee contributions;
- New direct state aid payments;
- Amendments to provisions governing volunteer firefighter relief associations;
- Session laws for the benefit of small groups and individuals; and
- Amendments to claims procedures, federal law conformity provisions, and other administrative and technical provisions.

Appropriations. State funding is provided in Article 8, in the form of direct state aid, Article 20, which amends the "pension adjustment revenue" statute that provides K-12 education funding for teacher pensions, and Article 21, which appropriates funding to reimburse employers for the employer contribution increases imposed in Article 7.

Anticipated Outcomes. If the 2018 omnibus bill is enacted, public pension plans will see substantial improvement in their funded status, as both dollars into the plans are being increased and dollars out of the plans are being decreased. Funded status is expected to improve even after taking into account the adverse impact of reducing the actuarial assumption for investment rate of return. Depending on the actual investment return each year, the plans are expected to be between 85-95% funded by the end of the amortization period, in 30 years.

1. Benefit Reforms

During the 2017 legislative session, the Commission considered a variety of reforms that would ensure the sustainability of the pension plans. A goal was to leave intact core benefits, while reducing benefit liabilities. The benefit reforms adopted by the Commission during the 2017 legislative session, which are included in the 2018 bill, are the following:

- *Augmentation is eliminated.* "Augmentation" is a cost of living adjustment made each year to the pension benefit earned by a member who is no longer in public service. In other words, it is an automatic annual increase in the pension benefit accrued by former employees.
- *Early retirement subsidies removed.* Early retirement benefits are calculated by adding in augmentation (at 2.5% or 3%, depending on hire date) that an early retiree would have otherwise received had the retiree waited until normal retirement age to begin receiving a pension. The bill eliminates this subsidy over a five-year period, for the Minnesota State Retirement System (MSRS) General Plan, the Public Employees Retirement Association (PERA) General Plan, the Teachers Retirement Association (TRA), and the St. Paul Teachers Retirement Fund Association (St. Paul Teachers).
- *Rate of interest on refunds reduced.* After leaving public employment, a member may take a refund of employee contributions, while forfeiting the right to a pension at retirement age. Interest is paid on the refund for the years that the contributions were in the plan. The bill reduces the rate of interest on refunds of employee contributions to former employees from 4% to 3%.

All changes are effective prospectively, which means that the benefit accrued to the effective date of the change is not reduced, or the change becomes effective for retirements after the effective date or as phased in over a period of years.

2. COLA Changes

The bill reduces or temporarily suspends the COLA increases automatically applied to retiree pension benefits and, for two pension plans administered by PERA, changes the method for determining the amount of COLA increases to tie them to COLA increases on federal Social Security pensions.

The COLA-related changes in the bill are the following:

- *COLA percentage reduced.* The percentage of automatic increase is modified for these plans:
  - MSRS General Plan: from the current 2% to 1% for five years, then 1.5% thereafter
  - MSRS Correctional Plan: from the current 2% to 1.5%
  - TRA: from the current 2% to 1% for five years, then the rate will increase by .1% each year until it reaches 1.5%, and remain at 1.5% thereafter
  - St. Paul Teachers: No COLA increase for 2 years, then 1% thereafter
- *COLA tied to SSA COLAs.* For the PERA General and Correctional Plans, the COLA will be tied to the COLA as announced each year by the federal Social Security Administration.
  - PERA General Plan: The increase as of a January 1 will be 50% of the increase announced by the SSA, but no less than 1% and no greater than 1.5%.
  - PERA Correctional Plan: The increase as of a January 1 will be equal to the increase announced by the SSA, but no less than 1% and no greater than 2.5%. When the Plan's funded ratio is less than 85% for two years or less than 80% for one year, the 2.5% maximum is reduced to 1.5% and remains at 1.5% thereafter.
- *First COLA postponed until NRA.* For members who retire before normal retirement age (at an early retirement age), the member's pension benefit will not be increased by a COLA until the member reaches normal retirement age. This change is to take effect for retirements that occur after January 1, 2024, and affects MSRS General, PERA General, TRA, and St. Paul Teachers.

3. Actuarial Assumption Changes

The bill updates assumptions for investment rate of return and re-sets the amortization period for all plans to a new 30-year period, extending the period until 2048. The bill removes the assumptions for payroll growth and salary increases and adds a reference to an appendix to the Standards for Actuarial Work, published by the Commission, where these assumptions will be reported and updated.

Reduction of investment ROR to 7.5%. The bill reduces the assumption for investment rate of return that is required to be used in the actuarial valuation for each plan to 7.5%. Currently, the statute requires that the actuarial valuations be prepared assuming that the return on plan investments is 8% per year for all the plans except TRA, and 8.5% for TRA. The Governor's Blue Ribbon Panel on Pension Reform, which issued its report just before the 2017 session, recommended reducing the rate to 7.5%. The outside actuaries for the pension plans have stated that the current rates are "outside the reasonable range" and also recommend that the rate be reduced.

4. Contribution Increases

Employers and employees are required to contribute a specified percentage of pay to the pension plan in which they participate. The bill imposes contribution increases for all the pension plans except the PERA General Plan and the PERA Correctional Plan.

MSRS	**General Plan Contribution Increases**						**Unclassified Plan**	
	Employee			**Employer**			**Employer**	
	FY19	**FY20**	**TOTAL**	**FY19**	**FY20**	**TOTAL**	**FY20**	**TOTAL**
% Increase	0.25%	0.25%	**0.5%**	0.375%	0.375%	**0.75%**	0.25%	**0.25%**
% of Pay	5.75%	6%		5.875%	6.25%		6.25%	

MSRS Correctional Plan Contribution Increases								
	Employee			**Employer**				
	FY19	**FY20**	**TOTAL**	**FY19**	**FY20**	**FY21**	**FY22**	**TOTAL**
% Increase:								
Regular Contrib.	0.5%	**-**	**0.5%**	1.55%	**-**	**-**	**-**	**1.55%**
Supplemental Contrib.	NA	NA		-	1.45%	1.5%	1.5%	**4.45%***
% of Pay	9.6%	9.6%		14.4%	15.85%	17.35%	18.85%	

** The 4.45% annual supplemental contribution remains in effect until the plan is 100% funded.*

MSRS State Patrol Plan Contribution Increases								
	Employee			**Employer**				
	FY19	**FY20**	**TOTAL**	**FY19**	**FY20**	**FY21**	**FY22**	**TOTAL**
% Increase:								
Regular Contrib.	0.5%	0.5%	**1%**	0.75%	0.75%	**-**	**-**	**1.5%**
Supplemental Contrib.	NA	NA		1.75%	1.25%	2%	2%	**7%***
% of Pay	14.9%	15.4%	**15.4%**	24.1%	26.1%	28.1%	30.1%	

** The 7% annual supplemental contribution remains in effect until the plan is 100% funded.*

PERA Police & Fire Plan Contribution Increases						
	Employee			**Employer**		
	2019	**2020**	**TOTAL**	**2019**	**2020**	**TOTAL**
% Increase	0.5%	0.5%	**1%**	0.75%	0.75%	**1.5%**
% of Pay	11.3%	11.8%		16.95%	17.7%	

TRA Contribution Increases									
	Employee		**Employer**						
	FY24	**TOTAL**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**TOTAL**
% Increase	0.25%	**0.25%**	0.21%	0.21%	0.21%	0.21%	0.21%	0.2%	**1.25%**
% of Pay	7.75%		7.71%	7.92%	8.13%	8.34%	8.55%	8.75%	

St. Paul Teachers Contribution Increases									
	Employee		**Employer**						
	FY23	**TOTAL**	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**TOTAL**
% Increase	0.25%	**0.25%**	0.835%	0.835%	0.21%	0.21%	0.21%	0.2%	**2.5%**
% of Pay	7.75%		7.335%	8.17%	8.38%	8.59%	8.8%	9%	

5. Direct State Aid

The bill requires the state to make annual payments each October 1 directly to the PERA Police and Fire Plan and to the St. Paul Teachers Retirement Fund Association starting in Fiscal Year 2019.

Direct State Aid $ Millions (ONGOING)						
	FY19	**FY18-19**	**FY20**	**FY21**	**FY20-21**	**FY 22**
PERA P&F Plan	$4.5	**$4.5**	$4.5	$9	**$13.5**	$9
St. Paul Teachers	$5	**$5**	$5	$5	**$10**	$5

The bill also amends all the statutes that provide for direct state aid payments to the pension plans to add an expiration date that is, generally, the earlier of attainment of a funded ratio of 100% or 2048.

6. Additional E-12 Education Funding

The bill amends the statute providing for pension adjustment revenue to add funding intended to reimburse school districts for the employer contribution increases to TRA and St. Paul Teachers. Pension adjustment revenue is based on salaries paid to teachers.

7. Appropriations

As in the 2017 bill, the 2018 bill includes appropriations to state agencies and subdivisions intended to offset in part the employer contribution increases to the MSRS plans and TRA.

8. Volunteer Firefighter Relief Associations/PERA Statewide Voluntary Firefighter Plan

The changes recommended by the Volunteer Firefighter Working Group, chaired by the State Auditor, from 2016 and 2017, are included in the 2018 bill. Generally, these changes bring the statutes into conformity with actual or desired operation of the VFRAs throughout the state.

In addition to the changes sought by the Volunteer Firefighter Working Group, the bill makes the following changes to statutes for the benefit of these cities or firefighter groups:

City of Austin. Permits the City of Austin to allocate a portion of fire state aid to pay employer contributions on behalf of firefighters covered by the PERA P&F Plan and relieves the City from having to repay the debt owed to the relief association under current law.

Fire Departments of Cities of Cromwell and Wright. Permits the transfer of pension benefits of a group of firefighters under the PERA Voluntary Statewide Firefighter Plan to a volunteer firefighter relief association, to accommodate the merger of the Cromwell and Wright fire departments.

City of Eden Prairie and its Volunteer Firefighter Relief Association. Increases the maximum lump sum benefit amount available to the Eden Prairie relief association from $10,000 to $15,000 and reduces the vesting requirements for firefighters upon return to active service.

City of Brook Park. Allows the lump sum defined benefit amount to be reduced for the City's volunteer firefighters under the PERA Voluntary Statewide Firefighter Plan.

9. Individuals and Small Groups

The bill includes provisions that assist individuals who were excluded from a state pension plan due to plan or employer error. The individuals have been waiting to transfer from a defined contribution plan to coverage under a public pension plan, which cannot occur until legislation is enacted. These individuals include two St. Cloud State University employees, a Winona State University employee, two Mesabi Range Community and Technical College employees, and a Duluth Township employee. The bill permits a group of Department of Transportation employees to purchase service credit and thereby become eligible for Rule of 90 retirement.

10. Fairview

The bill reduces the enhanced rate of augmentation for former employees of the University of Minnesota Hospital and Clinics under the MSRS General Plan who were transferred to private sector employment with Fairview Hospital and Healthcare Services in 1996. The current rates of augmentation, 5.5% (until age 55) and 7.5% (from age 55 to the date pension payments begin) are reduced by .75% each year, until augmentation ceases, after December 31, 2024. The bill modifies the impact of an exception from enhanced augmentation upon return to public service.

11. Miscellaneous and Technical Changes

The bill also includes many less substantive changes, including adding positions at the Department of Corrections and Department of Human Services eligible for coverage under the MSRS Correctional Plan, expansion of the definition of “line of duty death” under the PERA Police and Fire Plan, and an increase in the maximum employer contribution to the laborers national industrial pension plan.

12. New Provisions

The omnibus pension bill incorporates bills introduced and amendments offered during the 2018 session and approved by the Commission. These bills and amendments are the following:

Clearbrook Fire Department Relief Association. The bill extends the reporting deadline for the Clearbrook relief association to give the relief association more time to submit required reports to the State Auditor and, thereby, not forfeit entitlement to its fire state aid for 2017.

TRA Coverage Election. The bill permits an individual who is currently employed at Minnesota State system to elect TRA coverage if the individual submits a timely election and pays the employee contributions he would have paid during the missed period of TRA coverage. The individual had not been provided with the statutorily required right to elect TRA coverage and transfer from the Minnesota State Individual Retirement Account Plan.

Distributions from the PERA Defined Contribution Plan. The bill amends the statutes governing the PERA Defined Contribution Plan to permit distributions to participants while still employed, if the participant is at least age 65, and makes other changes to bring the statutes into conformity with plan operation and federal law.

Investment of Accounts in the Hennepin County Supplemental Retirement Plan. The bill expands the investment options available to members of the now-closed Hennepin County Supplemental Retirement

Plan to permit investment in the same types of investments available to the participants in the State's other defined contribution plans for public employees.

PERA Police and Fire Coverage of Part-Time Paramedics and EMTs at Hennepin Healthcare System. The bill extends coverage under the PERA Police and Fire Plan to part-time paramedics and emergency medical technicians employed at Hennepin County Medical Center.

Excluding Union Laborers from PERA General. The bill adds an exemption from coverage under PERA General for laborers who are temporarily employed by St. Paul or the St. Paul School District and are also covered by the Minnesota Laborers Pension Fund.

Swift County-Benson Hospital. The bill deletes a requirement in a 1992 session law that a successor employer of the employees of the hospital be provided a pension program and benefits comparable to those provided by the PERA General Plan.

Disposition of Surplus Assets upon Dissolutions of Relief Associations. This amendment, which appears as Article 14, Section 25, of the bill, affects any volunteer firefighters relief association that provides a lump sum pension benefit equal to at least $9,500 per year of service as of the day following enactment of the section. If the relief association dissolves and has assets in excess of benefit liabilities, the excess is to be paid to the municipality if the municipality made a required contribution to the relief association during the preceding ten years. If not, then the excess is to be paid to the state.

Increase in the Lump Sum Amount for Certain Overfunded Relief Associations. This amendment, which appears as Article 14, Section 29, of the bill, affects any volunteer firefighters relief association that has a funding ratio that is greater than 100% and provides a lump sum pension benefit equal to at least $9,500 per year of service as of the day following enactment of the section. These relief associations are entitled to amend their bylaws to increase their lump sum pension amount per year of service to as much as $12,500, if they would otherwise satisfy the requirements for such an increase.

Maplewood Firefighters Relief Association. This amendment, which appears as Article 14, Section 30, of the bill, dissolves the Maplewood Firefighters Relief Association and terminates its pension plan. In connection with the dissolution and plan termination, the following are to occur:

- Each firefighter still employed on February 27, 2018, will become fully vested and will receive a retirement benefit equal to $11,000 multiplied by the firefighter's years of service and, if the firefighter is at least age 50, the firefighter will receive a supplemental lump sum benefit;
- The relief association's bylaws are to be amended to incorporate the changes required by the bill;
- The affairs and any other obligations of the relief association are to be wound down; and
- Remaining assets after satisfaction of all liabilities and fire state aid for 2017 are to be paid to the City of Maplewood.

This section will take effect if approved within 45 days of enactment by the board of trustees of the relief association, a majority of the members of the relief association in attendance at a meeting to consider these changes, and the Maplewood city council.

Relief Association Work Group. This amendment, which appears as Article 14, Section 32, of the bill, establishes a work group to consider possible changes to existing law on (i) conversions of defined benefit relief associations to defined contribution relief associations, and (ii) dissolution of relief associations and disposition of surplus assets (assets in excess of amounts needed to pay all benefits). The work group is to meet during the legislative interim and produce a report by December 31, 2018. The work group is to consist of at least the following: two municipal officials, a representative of the League of Minnesota Cities, two fire chiefs, two active volunteer firefighters, a fire chief or firefighter from an independent nonprofit firefighting corporation, and a representative of the State Auditor's Office.