Report To The 1998 Legislature

On The

Appropriate Retirement Coverage For

Legislators And For Constitutional Officers

Legislative Commission on
Pensions and Retirement
January 30, 1998

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State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

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Dear Members of the Minnesota Legislature:

As provided for in Laws 1997, Chapter 233, Article 2, Section 16, the Legislative Commission on Pensions and Retirement has studied the issue of the appropriate retirement coverage for legislators and for constitutional officers awaiting full implementation in July, 1998, of the 1997 coverage changes.

The Commission considered the issue during six meetings over the course of the 1997-1998 Interim and the early portion of the 1998 Session. The Commission decided to retain the 1997 changes in the retirement coverage for legislators and constitutional officers with one modification, as provided for in draft proposed legislation LCPR98-85.

The Commission requests consideration by the Legislature during the 1998 Session of this report and the accompanying draft proposed legislation.

Sincerely,

Steven Morse
Senator, District 32
Chair, Legislative Commission on Pensions and Retirement

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I. **Introduction**

Laws 1997, Chapter 233, Article 2, Section 16, requires that the Legislative Commission on Pensions and Retirement study during the course of the 1997-1998 Interim, the issue of the appropriate retirement coverage for members of the Legislature and for constitutional officers following significant changes in that coverage enacted in the same law.

The Commission is charged with studying three items relating to the retirement coverage provided to legislators and to elective state officers, which are:

1. Sharing the Funding Burden. The appropriate member contribution rates to the Legislators Retirement Plan and to the Elective State Officers Retirement Plan and the adequacy of those rates in funding the normal cost and administrative expenses of the two plans in comparison to other public pension plans.

2. Social Security Coverage and Pension Coverage Adaptations To Social Security Coverage. The appropriateness of extending Social Security coverage to legislators and to constitutional officers and the necessary adaptations in order to supplement social Security coverage in either the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified).

3. Elective Coverage Change For Existing Participants. The appropriateness of permitting current members of the Legislature and current constitutional officers to elect MSRS-Unclassified Program coverage for prospective service and the impact of that election on the service credit accrued under the current pension plans.

In completing its study, the Commission is obligated to follow several principles, which are:

a. Comparability of Pension Coverage For Legislative Employees and Agency Heads. Legislator and constitutional officer pension coverage should match or parallel the pension coverage provided to legislative employees and agency heads to the extent practicable.

b. Reflection of Part-time Legislative Service and Unique Constitutional Officer Service. Legislator and constitutional officer pension coverage should appropriately reflect the part-time nature of legislative service for many legislators and the unique character of constitutional officer service.

c. Commission Pension Policy Conformity. Legislator and constitutional officer pension coverage should conform with the applicable provisions of the principles of pension policy adopted by the Commission.

The Commission is to complete its study in time for the 1998 legislative session. The study is to include any applicable proposed legislation, which may amend or repeal the 1997 legislators and elective state officer pension coverage changes among other legislative options.

II. Background Information on the Legislators Retirement Plan and the Elective State Officers Retirement Plan

A. Background Information On The Legislators Retirement Plan

The Legislators Retirement Plan, governed by Minnesota Statutes, Chapter 3A, was enacted in 1965. It is the successor to the Public Employees Retirement Association as the retirement coverage for members of the Legislature. Prior to 1965, there was no separate Legislator's Plan. Legislators were covered under the Public Employees Retirement Association (PERA-General Plan). At that time, PERA-General was a basic plan and no contributions were made into the federal Social Security program for the covered service. PERA-General used a career average salary and had back-loaded accrual rates, heavily favoring long time employees. A member received one percent of career average salary for each of the first ten years of service, two percent of career average salary for each of the next ten years, 2.5 percent for each year between twenty and thirty years of service, and three percent for each year over thirty years of service.

In 1965, the Legislature created a separate Legislative Plan, but current members and new members with prior PERA-General coverage had an option to retain PERA-General coverage. The motivation for establishing a separate Legislator's Plan probably came from a growing recognition that the back-loaded PERA-General Plan was not well suited to provide legislative retirement coverage, since the typical legislator would not be providing many decades of service. Prior to 1977, the Legislator's Plan provided a retirement benefit of 40 percent of the average monthly salary received during the final term of office for the first eight years of service, and an additional 2.5 percent per year for each year beyond eight. For those who left service and were too young to draw a benefit, the annuity augmented at five percent per year. The surviving spouse was entitled to a benefit equal to half the legislator's benefit, and a benefit was also provided to surviving children. The plan members participated in the Minnesota Adjustable Fixed Benefit Fund, a forerunner of the current Minnesota Post Retirement Investment Fund.

Beginning with the 1979 session, the maximum benefit accrual rate for any new legislative service was set at 2.5 percent. This lower accrual rate was adopted in recognition of the changing nature of legislative work. Until the early 1970's, legislative salaries were minimal. In order to provide any meaningful retirement benefit, a high benefit accrual rate was used. As legislative salaries increased in recognition that legislative work was becoming more like a full-time occupation, the Legislature recognized that it needed to revise the benefit accrual rates downward. The legislative salary for pension purposes was redefined to exclude an additional compensation for leadership positions. A twenty year cap on creditable service was also imposed. The Legislator's Plan was revised in 1978 and 1979 to use the high-five average salary rather than the average salary in the final term in office and the normal retirement age was increased from age 60 to age 62, with age 60 becoming the earliest age for retirement with a reduced annuity. Vesting for a retirement annuity was reduced from eight years to six years. In 1989, the definition of salary was changed to include regular and special session per diem payments, the deferred annuity augmentation rates were revised to three percent per year up to the year in which the ex-legislator becomes age 55, and five percent per year thereafter, the reduction factors for early retirement were revised to require a more substantial penalty, and the 20 year cap on service credit was removed. Members who were no longer accruing service credit because their service exceeded 20 years were authorized to again begin accruing service credit. The 1989 removal of the Legislative Plan service credit cap was made retroactive in 1992. Long-term legislators, including those in deferred status, with uncredited service prior to June 2, 1989, were authorized to purchase service credit for the uncredited period and the affected legislators were required to contribute nine percent of salary received during the uncredited period plus six percent interest from the midpoint of the period of uncredited service to the date of payment. Payment had to be received prior to retirement or by January 1, 1994, whichever was earlier.

In 1997, the annual benefit accrual rates for the Legislators Retirement Plan were increased from 5.00 percent (pre-1997 service) or 2.5 percent (post-1978 service) to that annual individual benefit accrual rate that has the same actuarial value as the one percent annual post retirement adjustment benefit reduction imposed by the same legislation. For new legislators first serving in office after July 1, 1997, retirement coverage will be by the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), a defined contribution pension plan. An individual Social Security coverage election referendum will be held and an opportunity to elect MSRS Unclassified coverage by pre-July 1, 1997 legislators will be made available on or shortly after July 1, 1998, unless modified by 1998 legislation arising out of this mandated study by the Commission of appropriate legislative retirement coverage.

B. Background Information On The Elective State Officers Retirement Plan

The Elective State Officers Retirement Plan, governed by Minnesota Statutes, Chapter 352C, was enacted in 1967. The Elective State Officers Retirement Plan is the successor, in part, to the Attorney General Retirement Plan, established in 1953, and to the State Auditor Retirement Plan, established in 1955. The Attorney General Retirement Plan (Laws 1953, Chapter 455, Section 1) was a defined benefit plan, providing an age and service retirement annuity of one-half of the 1949-1950 salary for the office at the normal retirement age of 70 and with more than 25 years of total elective state officer service, including as a member of the legislature, and with at least 15 continuous years of service as the attorney general. In the history of the State, only J. A. A. Burnquist, who left the office of the Attorney General on January 2, 1955, ever met the vesting requirements of the Attorney General Retirement Plan. The State Auditor Retirement Plan (Laws 1955, Chapter 648, Section 1) was also a defined benefit plan, providing an age and service retirement annuity of the 1955 salary for the office at the normal retirement age of 65 and with at least 25 years of total elective state office and election for seven consecutive terms as State Auditor. In the history of the State, only Stafford King, who left the office of the State Auditor on March 6, 1969, could have met the vesting requirements of the State Auditor Retirement Plan.

In 1967, the Legislature created a retirement plan for the various elective state officers, including the elected members of the public service commission. The plan largely duplicated the Legislator's Retirement Plan and undoubtedly was motivated by the establishment of that plan. The Elective State Officers Retirement Plan, originally named the Constitutional Officers Retirement Plan, contained a policy and intent provision, which noted that service as a constitutional officer is a unique contribution to the State and is dissimilar to any other public employment and further indicated that constitutional officer service equal to or longer than the vesting period of the plan, disrupts any opportunity for a constitutional officer to follow a more usual vocational pursuit and gain the accompanying retirement benefits. The 1967 Elective State Officers Retirement Plan was a defined benefit plan, with a ten year vesting period and an age 65 normal retirement age for an age and service retirement annuity of one half of salary after ten years of service, plus one percent for each year of subsequent service, to a maximum of 75 percent of covered salary. The plan included an automatic post retirement surviving widow's benefit, but not a generalized surviving spouse benefit. Upon the death of a retired or vested deferred elected state officer, the surviving widow received 50 percent of the primary annuity as a benefit. The benefit terminated upon remarriage. No benefit was payable to any dependent children. The retirement or surviving widow benefit received from the Elected State Officers Retirement Plan was to be reduced by any annuity received from another Minnesota public plan. Benefits from the Elected State Officers Retirement Plan were exempt from state taxes. No optional annuities were provided by the Elective State Officers Retirement Plan. If a vested elected constitutional officer dies in office or prior to age 65, the surviving widow was entitled to 50 percent of the benefit the elected state official would have been entitled to at age 65, using the years of service actually served by the individual.

In 1969, vesting for the age and service retirement annuity was reduced to eight years, the benefit formula was changed by basing the annuity on average salary since January 1, 1965, rather than upon final salary, the individual would receive 40 percent of this average salary for the first eight years, and an additional two percent per year for each additional year, and for elected state officers who also had legislative service, service in both plans could be used for vesting and benefit computation purposes. In 1971, post retirement survivor benefits were extended to dependent children similar to that for the Legislator's Plan, with the eldest dependent child to receive 25 percent of the primary annuity amount, and each additional child to receive 12.5 percent, up to a family maximum of 100 percent when the surviving spouse benefit is included.

In 1978, the two part retirement annuity benefit accrual rate was eliminated and replaced by a flat 2.5 percent accrual rate for all years of constitutional officer service, computed on the five highest successive years average salary, and the normal retirement age was reduced from age 65 to age 62, with a reduced retirement annuity permitted at age 60. In 1978, deferred annuities augmentation also was added to the plan, the vesting for preretirement survivor benefits was made immediate, and the required reduction of Elective State Officers Retirement Plan benefits by any other Minnesota public pension plan benefits was eliminated. In 1983, the exemption of Elective State Officers Retirement Plan benefits from State taxation was eliminated. In 1986, the surviving widow benefits were converted to surviving spouse benefits. In 1990, the practice of discontinuing surviving spouse benefits upon remarriage was eliminated and the interest rate on member contribution refunds was increased to six percent. In 1992, the interest rate charged on a repayment of previously taken member contribution refunds was increased to 8.5 percent. In 1996, a designated beneficiary death refund was authorized for Elective State Officers Retirement Plan participants who die without a surviving spouse or surviving child.

In 1997, the annual benefit accrual rate was increased from 2.5 percent to that annual individually calculated benefit accrual rate that has the same actuarial value as the one percent annual post retirement adjustment benefit reduction imposed by Laws 1997, Chapter 233, Article 1, Section 5. For new constitutional officers first serving in office after July 1, 1997, retirement coverage will be by the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), a defined contribution pension plan. An individual Social Security coverage election referendum will be held and an opportunity to elect MSRS Unclassified coverage by pre-July 1, 1997 constitutional officers will be made available on or shortly after July 1, 1998, unless modified by 1998 legislation arising out of this mandated study by the Commission of appropriate retirement coverage for state constitutional officers.

III. 1997 Changes In Legislators and Constitutional Officers Retirement Coverage

A. 1997 Changes In The Legislators Retirement Plan

Retirement coverage for Legislators and Elected State Officers was substantially revised during the 1997 Session. All newly elected legislators will become members of the MSRS Unclassified Plan, an existing defined contribution plan, and will have Social Security coverage. Legislators currently holding office may remain in the current Legislators Plan, as revised below, which is a basic member defined benefit plan, or elect prospective Social Security and MSRS Unclassified Plan coverage.

The following revisions to the existing Legislators Retirement Plan were intended to provide annuities of equivalent lifetime value to those offered under the plan prior to the 1997 revisions, in recognition of the change in the post-retirement interest rate assumption which will lower the rate of post-retirement increases over the annuitant's lifetime.

1. Computation of actuarial equivalent annuities for existing Legislators. The retirement benefits computed under the existing Legislators Retirement Plan, for existing members of the Legislature who terminate service after June 30, 1997, will be increased on an actuarial equivalent basis to retain equivalent value, reflecting the change in the post-retirement interest assumption from five percent to six percent. (Laws 1997, Chapter 233, Article 1, Section 3.)

2. Recomputation of deferred annuities. Retirement and survivor benefits relating to former legislators who terminated service before July 1, 1997, which are not first payable until after June 30, 1997, must be increased on an actuarial equivalent basis to reflect the change in the post retirement interest assumption from five percent to six percent. (Laws 1997, Chapter 233, Article 1, Section 4.)

3. Deferred annuity actuarial reserve revisions. The required reserves for deferred annuities will be computed with a six percent interest assumption rather than five percent. (Laws 1997, Chapter 233, Article 1, Section 4.)

4. Recomputation of existing annuities. Retirement and survivor benefits for existing annuitants are permanently increased effective July 1, 1997 to make the benefit actuarially equivalent to the benefit currently received, given the change in the post-retirement interest assumption from five percent to six percent. (Laws 1997, Chapter 233, Article 1, Section 72.)

5. Reduction in inflation match guarantee. The requirement to provide minimum post-retirement adjustments that match annual inflation up to 3.5 percent is reduced to a match up to 2.5 percent. (Laws 1997, Chapter 233, Article 1, Section 5.)

The following provisions create Social Security and MSRS Unclassified Plan coverage for newly elected legislators and constitutional officers (those first elected after June 30, 1997) and allow existing legislators and constitutional officers to elect that prospective coverage.

6. Application of existing plan law. The existing Legislators Plan, governed by Chapter 3A as amended, and the existing Elected State Officers Plan, governed by Chapter 353C as amended, provides ongoing coverage to members first elected before July 1, 1997, providing the member

does not elect MSRS Unclassified Plan prospective coverage. (Laws 1997 Chapter 233, Article 2, Sections 1 and 2.)

7. Coverage for newly elected legislators and constitutional officers, and existing members electing revised coverage. The MSRS Unclassified Plan will provide coverage for all legislators and constitutional officers newly elected after June 30, 1997, and those existing legislators and constitutional officers who choose prospective MSRS Unclassified Plan coverage. (Laws 1997, Chapter 233, Article 2, Section 3.)

8. Technical corrections, coverage-upon-employment-change and investment option provisions. Cross references are revised in an MSRS Unclassified Plan change of coverage provision to reflect revisions in other sections, and references to "employee" in the investment option provision are revised to "person." (Laws 1997, Chapter 233, Article 2, Sections 4 and 5.)

9. Definition of legislative salary for purposes of Unclassified Plan. For legislator contribution rate purposes under the Unclassified Plan, the same definition of salary is used as that applying to salary under the current Legislators Plan (salary includes regular and special session per diem, but not any additional compensation due to leadership positions, living expense payments, or special session living expense payments). (Laws 1997, Chapter 233, Article 2, Section 6.)

The following provisions apply to the Social Security coverage referendum for existing legislators and constitutional officers. By electing the Social Security coverage, the member will also receive prospective MSRS Unclassified Plan coverage.

10. Social Security referendum. The Governor will designate an agency or individual to supervise a Social Security referendum to be held after July 1, 1998 for legislators and constitutional officers. These individuals must be provided with notice of the referendum including a statement of Social Security Act rights and an explanation of the implications of electing Social Security coverage. (Laws 1997, Chapter 233, Article 2, Sections 7, 8 and 9.)

11. Elections under the referendum. Members of the existing Legislators Plan or the existing Elected State Officers Plan as of July 1, 1998 are eligible to participate in the referendum. The member may retain coverage under the current plan, as amended, or may elect prospective Social Security and MSRS Unclassified Plan coverage. If this prospective coverage by the MSRS Unclassified Plan is elected, the individual is entitled to an augmented, deferred retirement annuity from the prior plan. Refunds are not permitted until termination of service. (Laws 1997, Chapter 233, Article 2, Section 15.)

12. Division of Legislators Plan and Elected State Officers Plan. Consistent with requirements of the Social Security Act, the Legislators Plan must be divided into two parts; similarly with the Elected State Officers Plan. The first division of the plan will include all future legislators (elected state officers), and those current legislators (elected state officers) electing Social Security coverage under the referendum. These groups will be covered under the MSRS Unclassified Plan. The second division will provide pension coverage for the existing legislators (existing elected state officers) who do not desire the Social Security coverage, under the current Legislators Plan as revised, or Elected State Officers Plan as revised, as applicable. (Laws 1997 Chapter 233, Article 2, Sections 10 and 11.)

13. Certification by Governor, agreements with federal agency. If the referendum has been properly conducted, the Governor will so certify, and will enter into necessary agreements with federal agencies on behalf of the legislators and elected state officers. (Laws 1997, Chapter 233, Article 2, Sections 12 and 13.)

14. Responsibility for Social Security contributions. On behalf of legislators and elected state officers with Social Security coverage, the House, Senate, or relevant constitutional office must make applicable Social Security employer contribution payments, and Social Security employee contributions must be deducted from pay. (Laws 1997, Chapter 233, Article 2, Sections 14 and 15.)

The following is a mandated study.

15. Legislators and Elected State Officer pension coverage, mandated study. The LCPR must study the question of appropriate pension coverage for legislators and elected state officers. The study must consider member contribution rates and their relation to plan normal cost and expenses; the appropriateness of including new or current legislators and elected state officers in Social Security along with the current plan or new defined contribution plan; and the appropriateness of permitting Social Security elections and the impact on prior service coverage. The study must reflect the following principles: the pension plan coverage should match or parallel the coverage provided to legislative employees and agency heads; the coverage should be appropriate given the part-time nature of legislative service and the unique character of elected public service; and the coverage should be consistent with LCPR pension policy principles. The study, to be reported to the 1998 Legislature, should include applicable proposed legislation including possible repeal of coverage as reflected in 1997 legislation. (Laws 1997, Chapter 233, Article 2, Section 16.)

The following item is from an appropriations bill.

16. Legislative Plan appropriation. $2,093,000 in fiscal 1998 and $2,197,000 in fiscal 1999 are appropriated to cover the existing plan's cost for expected transfers to the Minnesota Post Retirement Investment Fund of actuarial reserves at the time of retirement, and to pay refunds, death benefits, and other miscellaneous benefits. (Laws 1997, Chapter 202, Article 1, Section 31.)

B. 1997 Changes In The Elected State Officers Retirement Plan

Retirement coverage for Legislators and Elected State Officers was substantially revised during the 1997 session. All newly elected legislators and elected state officers will become members of the MSRS Unclassified Plan, an existing defined contribution plan, and will have Social Security coverage. Elected State Officers currently holding office may remain in the current Elected State Officers Plan, as revised below, which is a basic member defined benefit plan, or elect prospective Social Security and MSRS Unclassified Plan coverage.

1. Computation of actuarial equivalent annuities for existing Constitutional Officers. The retirement benefits computed under the existing Elected State Officers Plan, for existing constitutional officers who terminate service after June 30, 1997, will be increased on an actuarial equivalent

basis to retain equivalent value, reflecting the change in the post-retirement interest assumption from five percent to six percent. (Laws 1997, Chapter 233, Article 1, Section 35.)

2. Recomputation of deferred annuities. Retirement and survivor benefits relating to former constitutional officers who terminated service before July 1, 1997, which are not first payable until after June 30, 1997, must be increased on an actuarial equivalent basis to reflect the change in the post retirement interest assumption from five percent to six percent. (Laws 1997, Chapter 233, Article 1, Section 36.)

3. Recomputation of existing annuities. Retirement and survivor benefits for existing annuitants are permanently increased effective July 1, 1997 to make the benefit actuarially equivalent to the benefit currently received, given the change in the post-retirement interest assumption from five percent to six percent. (Laws 1997, Chapter 233, Article 1, Section 72.)

4. Reduction in inflation match guarantee. The requirement to provide minimum post-retirement adjustments that match annual inflation up to 3.5 percent is reduced to a match up to 2.5 percent. (Laws 1997, Chapter 233, Article 1, Section 5.)

The following provisions establish the new coverage for newly elected legislators and constitutional officers (those first elected after June 30, 1997) and allow existing legislators and constitutional officers to elect prospective Social Security and MSRS Unclassified Plan coverage.

5. Application of existing plan law. The existing Legislators Plan, governed by Chapter 3A as amended, and the existing Elected State Officers Plan, governed by Chapter 353C as amended, provides continued coverage to members first elected before July 1, 1997, providing the member does not elect MSRS Unclassified Plan prospective coverage. (Laws 1997 Chapter 233, Article 2, Sections 1 and 2.)

6. Coverage for newly elected legislators and constitutional officers, and existing members electing revised coverage. The MSRS Unclassified Plan will provide coverage for all legislators and constitutional officers newly elected after June 30, 1997, and those existing legislators and constitutional officers who choose prospective MSRS Unclassified Plan coverage. (Laws 1997, Chapter 233, Article 2, Section 3.)

7. Technical corrections, coverage-upon-employment-change and investment option provisions. Cross references are revised in an MSRS Unclassified Plan change of coverage provision to reflect revisions in other sections, and references to "employee" in the investment option provision are revised to "person." (Laws 1997, Chapter 233, Article 2, Sections 4 and 5.)

The following provisions apply to the Social Security coverage referendum for existing legislators and constitutional officers. By electing the Social Security coverage the member also receives prospective MSRS Unclassified coverage.

8. Social Security referendum. The Governor will designate an agency or individual to supervise a Social Security referendum to be held after July 1, 1998 for legislators and constitutional officers. These individuals must be provided with notice of the referendum including a statement of Social

Security Act rights and an explanation of the implications of electing Social Security coverage. (Laws 1997, Chapter 233, Article 2, Sections 7, 8 and 9.)

9. Elections under the referendum. Members of the Legislature and Elected State Officers as of July 1, 1998 are eligible to participate in the referendum. The member may retain coverage under the current plan, as amended, or may elect prospective Social Security and MSRS Unclassified Plan coverage. If this prospective coverage by the MSRS Unclassified Plan is elected, the individual is entitled to an augmented, deferred retirement annuity from the prior plan. Refunds are not permitted until termination of service. (Laws 1997, Chapter 233, Article 2, Section 15.)

10. Division of Legislators Plan and Elected State Officers Plan. Consistent with requirements of the Social Security Act, the Legislators Plan must be divided into two parts; similarly with the Elected State Officers Plan. The first division of the plan will include all future legislators (elected state officers), and those current legislators (elected state officers) electing Social Security coverage under the referendum. These groups will be covered under the MSRS Unclassified Plan. The second division will provide pension coverage for the existing legislators (existing elected state officers) who do not desire the Social Security coverage, under the current Legislators Plan as revised, or Elected State Officers Plan as revised, as applicable. (Laws 1997 Chapter 233, Article 2, Sections 10 and 11.)

11. Certification by Governor, agreements with federal agency. If the referendum has been properly conducted, the Governor will so certify, and will enter into agreements with federal agencies on behalf of the legislators and elected state officers. (Laws 1997, Chapter 233, Article 2, Sections 12 and 13.)

12. Responsibility for Social Security contributions. On behalf of legislators and elected state officers with Social Security coverage, the House, Senate, or relevant constitutional office must make applicable Social Security employer contribution payments, and Social Security employee contributions must be deducted from pay. (Laws 1997, Chapter 233, Article 2, Sections 14 and 15.)

The following is from an appropriations bill to cover the existing Elected State Officer Plan expected benefit payments.

13. Appropriation, Elected State Officers Plan. \$173,000 and \$182,000 are appropriated to cover the pay-as-you-go benefit payments of this plan: the retirement benefits, survivor benefits, and miscellaneous refunds. (Laws 1997, Chapter 202, Article 1, Section 31.)

IV. Sharing The Burden For Funding The Legislators Retirement Plan And The Elective State Officers Retirement Plan

A. Adequacy of Member Contribution Rate

As Laws 1997, Chapter 233, Article 2, Section 16, required the Commission to study the burden of sharing the burden of funding of the Legislators Retirement Plan and the Elective State Officers Retirement Plan between the plan member and the employer, on a concurrent basis or otherwise. The issues are whether or not the current member contribution rates to the Legislators Retirement Plan and to the Elective State Officers Retirement Plan are appropriate and whether or not those member contribution rates are adequate in funding the normal cost and the administrative expenses of each plan in comparison to other plans.

The Principles of Pension Policy of the Legislative Commission on Pensions and Retirement, Principle D.3.a. and b., requires that retirement benefits should be financed on a shared basis between the employee and employer. For general public employees, the employee and employer should each cover half the normal cost plus expenses. The sharing of amortization cost by general employees is left unspecified, with the statement that "both the employee and the employer may be required to share some financial responsibility for funding the amortization requirement of the defined benefit pension plan." For police and paid fire employees in general in statewide plans, the employee should pay forty percent of the total actuarial costs of the defined benefit plan and the employer should pay 60 percent.

The following compares the member contribution with either the retirement plan normal cost and expenses or the full retirement plan actuarial requirement (normal cost, expenses, and amortization) for the various general employee retirement plans and the various public safety employee retirement plans as of July 1, 1997, as indicated in the respective actuarial valuation:

General Employee Pension Plans, July 1, 1997 Actuarial Valuation Data\[1]

Plan	Member Contribution\[2]	Normal Cost and Expenses	Amortization	Full Actuarial Requirement	Member Contrib. as % of Normal Cost and Expenses	Member Contribution as % of Full Actuarial Requirement
Legislators	9.00%	19.34%	32.44%	51.78%	46.54%	17.38%
Constitutional Officers	9.00	14.71	42.44	57.15	61.18	15.79
Judges	6.29	16.38	11.22	27.60	38.40	22.79
MSRS-General	4.0	7.61	.00	7.61	52.56	52.56
PERA	4.55	7.29	2.51	9.8	62.41	46.43
TRA	5.0	9.85	.00	9.85	50.76	50.76
DTRFA	5.50	9.18	3.69	12.87	59.91	42.74
StPTRFA	6.3	10.39	8.06	18.45	60.64	34.15
MTRFA	6.54	11.76	16.47	28.23	55.61	23.17

Public Safety Employee Pension Plans, July 1, 1997 Actuarial Valuation Data

Plan	Member Contribution	Normal Cost and Expenses	Amortization	Full Actuarial Requirement	Member Contrib. as % of Normal Cost and Expenses	Member Contribution as % of Full Actuarial Requirement
PERA-P&F	7.60%	21.78%	(6.57%)	15.21%	34.89%	49.97%
State Patrol	8.40	22.06	(6.39)	15.67	38.08	53.61
MSRS-Correctional	5.50	14.52	(2.03)	12.49	37.88	44.04

\1 The first four columns of numbers are percentages of covered payroll figures. The fifth and sixth columns of numbers are percentages of the total.

\2 For plans containing basic and coordinated members, the rates are blended, weighted by salary.

B. Employer Funding of the Legislators Retirement Plan and the Elective State Officers Retirement Plan

1. Background on the Financial Support Provided to the Legislators Retirement Plan and to the Elective State Officers Retirement Plan

The Legislators Retirement Plan, created in 1965, and the Elective State Officers Retirement Plan, created in 1967, lack dedicated retirement funds and are financed in a manner different from that applicable to any other Minnesota public pension plan.

The Legislators Retirement Plan is funded on a terminal funding basis. The Legislators Retirement Plan participates in the Minnesota Post Retirement Investment Fund (MPRIF). Since the plan has no dedicated retirement fund other than its portion of the total MPRIF assets (approximately two-tenths of one percent of the total assets of the MPRIF), when a former legislator retires, the full actuarial value of the former legislator's retirement annuity must be transferred to the MPRIF from the State General Fund. During the course of a legislator's active service, the nine percent member contribution deductions are deposited back into the State General Fund. Survivor benefits from the Legislators Retirement Plan are payable on a current disbursements or "pay-as-you-go" basis from the State General Fund. The State General Fund terminal funding requirements are estimated annually by the Minnesota State Retirement System (MSRS) and are certified to the Department of Finance for inclusion in the biennial State Departments appropriation legislation, although, according to MSRS, the Department of Finance actually treats the MPRIF transfers for the Legislators Retirement Plan as an open and standing appropriation.

The Elective State Officers Retirement Plan is funded wholly on a current disbursements or "pay-as-you-go" basis. The Elective State Officers Retirement Plan does not participate in the MPRIF and has no dedicated retirement fund whatsoever. The financial requirements to pay retirement benefits to former Elective State Officers Retirement Plan members (former constitutional officers and former elected members of the Public Utility Commission) and to their survivors are paid directly from the State General Fund. During the active service of Elective State Officers Retirement Plan members, the nine percent member contribution deductions are deposited back into the State General Fund. The "pay-as-you-go" requirements are estimated annually by MSRS and also are certified to the Department of Finance for inclusion in the biennial State Departments appropriation legislation, although, according to MSRS, the Department of Finance actually treats the funding requirements as an open and standing appropriation.

2. Final July 1, 1997, Actuarial Condition of the Legislators Retirement Plan and the Elective State Officers Retirement Plan

The following sets forth the results of the most recent (July 1, 1997) actuarial valuation reports for the Legislators Retirement Plan and the Elective State Officers Retirement Plan prepared by the consulting actuarial firm retained by the Legislative Commission on Pensions and Retirement, Milliman & Robertson, Inc.:

	Legislators\1	Elective State Officers\2	Combined
Membership			
Active Members	201	6	207
Service Retirees	181	5	186
Disabilitants	0	0	0
Survivors	66	6	72
Deferred Retirees	128	4	132
Nonvested Former Members	10	0	10
Total Membership	586	15	601
Funded Status			
Actuarial Accr. Liab.	$60,055,000	$3,214,000	$63,269,000
Current Assets	21,208,000	0	21,208,000
Unfunded Act. Accr. Liab.	$38,847,000	$3,214,000	$42,061,000
Funding Ratio	35.31%	0.00%	33.52%
Financing Requirements			
Covered Payroll	$7,626,000	$483,000	$8,109,000
Annuities Payable	$2,639,000	$160,000	$2,799,000

	Legislators %	Legislators $	Elective State Officers %	Elective State Officers $	Combined %	Combined $
Normal Cost	18.93%	$1,443,000	13.67%	$66,000	18.61%	$1,509,000
Admin. Expenses	0.41	31,000	1.04	5,000	0.44	36,000
Amortization	32.44	2,473,000	42.44	205,000	33.03	2,678,000
Financial Requirements	51.78%	$3,947,000	57.15%	$276,000	52.08%	$4,223,000
Member Contributions	9.00%	$686,000	9.00%	$43,000	9.00%	$729,000
Employer Contributions	0.00	0\1	0.00	0\2	0.00	0
Direct State Funding	0.00	0	0.00	0	0.00	0
Other Gov't Contrib.	0.00	0	0.00	0	0.00	0
Admin. Assessment	0.00	0	0.00	0	0.00	0
Total Support	9.00%	$686,000	9.00%	$43,000	9.00%	$729,000
Financial Requirements	51.78%	$3,947,000	57.15%	$276,000	52.08%	$4,223,000
Total Support	9.00	686,000	9.00	43,000	9.00	729,000
Deficiency (Surplus)	42.78%	$3,261,000	48.15%	$233,000	43.08%	$3,494,000

\1 Plan is funded on a terminal basis.
\2 Plan is funded on a current disbursements or "pay-as-you-go" basis.

3. Budgetary Consequences of Planned Changes in the Coverage Group of the Legislators Retirement Plan and the Elective State Officers Retirement Plan.

By virtue of recent deaths, resignations, and announced intentions of incumbents, there will be changes in the Legislature and in the various constitutional offices that will change the coverage of the Legislators Retirement Plan and of the Elective State Officers Retirement Plan and the covered payrolls of these two plans. Based on newspaper accounts and official announcements, slight changes in the Legislators Retirement Plan and four changes in the Elective State Officers Retirement Plan coverage groups are anticipated at a minimum, with the subsequent office holder expected to be covered by the Unclassified State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Unclassified).

The covered payroll impact of these membership changes, which will change the actuarial funding requirements as a percentage of payroll in the future, are as follows:

Legislators Retirement Plan

Current (7/1/1997; 1998 Fiscal Year) Covered Payroll	$7,626,000
Reduction of Coverage Group By Eight Members 1998 Fiscal Year Covered Payroll Associated	$ 304,000
Resulting Covered Payroll	$7,322,000
Adjusted Fiscal Year 1998 Covered Payroll	$7,322,000
Fiscal Year 1999 Expected Additional Per Diem ($3,190 x 193 members)	+ 616,000
	$7,938,000
Salary Increase Actuarial Assumption (5%)	x 1.05
Fiscal Year 1999 Anticipated Covered Payroll	$8,335,000

Elective State Officers Retirement Plan

Current (7/1/1997; 1998 Fiscal Year) Covered Payroll		$ 483,000
Reduction of Coverage Group		
By Five Officers (including Governor)	$415,000	
By Four Officers (excluding Governor)		$300,000
Resulting Covered Payroll	$ 68,000	$183,000
Adjusted Fiscal Year 1998 Covered Payroll	$ 68,000	$183,000
Salary Increase Actuarial Assumption (5%)	x 1.05	x 1.05
Fiscal Year 1999 Anticipated Covered Payroll	$ 71,000	$192,000

4. Commission Policy on the Full Actuarial Funding of Public Pension Plans

During the 1995-1996 Interim, the Commission revisited and revised its Principles of Pension Policy, including its policy on the actuarial funding of pension benefits and liabilities. The Commission has developed these policy principles over four decades, following the creation of the Commission to address the potential financial default facing the Public Employees Retirement Association (PERA) in 1955.

The Commission's policy on pension funding is as follows:

D. Pension Plan Funding

1. Equal Pension Financing Burden For Generations of Taxpayers
   There should be utilized a financing method that will distribute total pension costs fairly among the current and future generations of taxpayers and that will discourage unreasonable benefit demands.

2. Actuarial Funding of Pension Benefits
   a. Retirement benefits in Minnesota defined benefit plans should be funded on an actuarial basis.

   b. Currently earned pension plan service credit, as measured by the actuarially determined entry age normal cost of the defined benefit pension plan, should be funded on a current basis.

   c. The administrative expenses of the defined benefit pension plan should be funded on a current basis.

   d. Existing unfunded actuarial accrued liabilities of the defined benefit pension plan should be amortized over a reasonable period of time, and that amortization period should be related to the average working career of the membership of the pension plan, but not to exceed forty years.

3. Allocation of Funding Burden Between Members and Employers
   a. Retirement benefits should be financed on a shared basis between the public employee and the public employer.

   b. For general public employees, the employee and employer should make matching contributions to meet the normal cost and the administrative expenses of the defined benefit pension plan and both the employee and the employer may be required to share some financial responsibility for funding the amortization requirement of the defined benefit pension plan.

   c. For protective and public safety employees covered by a statewide public pension plan, the employee should pay forty percent of the total actuarial costs of the defined benefit pension plan and the employer should pay sixty percent of the total actuarial costs of the defined benefit pension plan.

   d. For protective and public safety employees covered by a local relief association, employee and employer contributions should be considered in light of the special circumstances and history unique to that association. Employees should pay an appropriate portion of the normal cost and administrative expenses of the relief association.

4. Funding of Postretirement Adjustments
   a. Ad hoc postretirement adjustments should be funded separately from the regular defined benefit public pension plan financing and should not be added to the unfunded actuarial accrued liability of the defined benefit public pension plan.

   b. Automatic postretirement adjustment mechanisms should be funded on an actuarial basis as part of the actuarial requirements and contribution structure of the defined benefit public pension plan.

5. Appropriate Basis For Actuarial Assumption Changes
   a. Actuarial assumption changes should only be based on the results of the gain and loss analyses in the regular actuarial valuation reports and the results of a periodic experience study.

   b. Actuarial assumption changes should stand on their own merit, and should not be changed solely to improve benefits or to lower contribution rates.

6. Appropriate Basis For Modifying Contribution Rates
   Member and employer contribution rates should only be modified based on the trend in total support rate deficiency or sufficiency revealed in the regular actuarial valuation reports.

5. The Policy Basis For the Goal of Full Actuarial Funding of Public Pension Plans

For defined benefit retirement plans, the actual cost of the plan can only be accurately assessed at the end of the plan, when all benefit recipients have died or lost benefit eligibility and all administrative expenses have been paid. Because it is implausible to fund a defined benefit retirement plan on the basis of the actual ultimate cost, it is necessary to arrange a system of funding the pension plan during the lifetime of the pension plan. That overriding impracticability of funding a defined benefit retirement plan on a basis other than on some ongoing basis requires the development of some funding system.

Once the necessity of a pension funding system is recognized, the question becomes the most appropriate way to develop that system. In Minnesota, over the course of developments since 1955 and the creation of the Legislative Commission on Pensions and Retirement, public pension plans largely have been placed on a full actuarial funding mechanism. The exceptions are those retirement plans where the total statutory support rates are less than the calculated full actuarial funding requirements at this time, principally the Legislators Retirement Plan, and the Elected State Officers Retirement Plan. For the plans other than the Legislators Retirement Plan and the Elected State Officers Retirement Plan, the departure from full actuarial funding represents either a reluctance or an inability to appropriately reset member and employer contribution rates. With the Legislators Retirement Plan and the Elected State Officers Retirement Plan, the plans have never been placed on a full actuarial funding basis. The Elected State Officers Retirement Plan is the last current disbursements or "pay-as-you-go retirement plan" in Minnesota. The Legislators Retirement Plan is funded in a manner that is more actuarially based than the Elected State Officers Retirement Plan. This is the terminal funding method, where the full required reserves are funded upon retirement.

The actuarial funding of public pension plans is primarily a budgeting tool, in which a calculated estimate of the applicable portion of the ultimate cost of a public pension program is allocated over time, membership, and covered payroll. An actuarial funding method for a public pension plan offers the following public policy advantages:

1. Appropriate Reflection of Pensions in the Cost of Government. Allocating the applicable portion of pension cost over time, membership, and covered payroll will provide a more accurate indication of the pension component of the annual cost of government.

2. Increased Benefit Security For Plan Members. Amassing assets in a dedicated fund associated with a pension plan will provide pension plan active and retired members with a greater sense of security about the ability of the pension plan to ultimately pay promised pension benefits.

3. Governmental Budgetary Continuity and Predictability. Allocating pension costs over time, membership and covered payroll through an actuarial funding method rather than funding pensions on a less systematic or non-actuarial basis will produce a relatively consistent recognition of pension costs over time, allowing for greater predictability of future contribution requirements when preparing governmental budgets.

4. <u>Potential Pension Contributions Will Be Displaced By Investment Income</u>. Amassing public pension assets in a systematic manner will allow for the investment of those assets and the production of investment income from those assets will reduce the need for greater future annual pension contributions.

5. <u>Reliable Indication of the Value of Pensions in Total Compensation</u>. Funding public pensions in a systematic actuarial manner, especially using an actuarial method that generates distinct normal cost and amortization funding requirements, will provide a useful indication of the actual value of pension coverage in attempting to gauge total public employee compensation levels.

6. <u>Appropriate Basis For Setting Member Contributions</u>. Systematic actuarial pension funding methods, especially those that generate a distinct normal cost requirement, provide a basis for policy makers to determine the appropriate portion of the ongoing public pension plan cost that should be paid by member contributions.

7. <u>Means For Assessing the Full Impact of Benefit Plan Modifications</u>. If public pensions are funded in a systematic actuarial manner, it will be easier to assess the true financial impact of contemplated benefit increases or other plan modifications before they are enacted.

The actuarial funding of public pension plans means, first, undertaking the necessary actuarial calculations to reliably assess the current funded status and the ongoing funding requirements of a public pension plan, and second, the establishment of the contribution levels necessary to match those funding requirements. In Minnesota, since the 1960's, regular periodic actuarial valuations of most statewide and local public pension plans have been required by statute (Minnesota Statutes, Sections 356.20 and 356.215). Actuarial valuations in Minnesota are prepared using the entry age normal cost actuarial method, which allocates the actuarial present value of anticipated future benefits over a member's working lifetime from the actual entry age to the anticipated retirement age as a level percentage of covered payroll as the normal cost, determines the past normal costs as the plan accrued liability from which the value of plan assets can be subtracted in order to determine the plan's unfunded accrued liability, and calculates the contribution required to amortize that unfunded accrued liability. The Legislators Retirement Plan and the Elected State Officers Retirement Plan were not subject to regular actuarial valuations, under Minnesota Statutes, Sections 356.20 and 356.215, until 1984.

6. <u>Budgetary Impact and Cost Effectiveness of Establishing Concurrent Plan Funding For the Legislators Retirement Plan and the Elective State Officers Retirement Plan</u>

If the establishment of a retirement fund for the two plans and the shift from terminal funding or pay-as-you-go funding to concurrent funding for the two plans is appropriate on a policy basis, questions remain whether or not the fund creation and employer contribution shift has an adverse budgetary impact and whether or not the changes are cost effective over the near-term and over the long-term.

A budget is a systematic future plan for meeting periodic expenses from periodic revenue, especially when the realization of revenue differs significantly in timing from the occurrence of expenditures. Actuarial methods, actuarial valuations, and actuarial funding are the introduction of budgetary methods into pension plans, where there is a substantial time differential between the events that give rise to a pension benefit (years of service credit) and the payment of the pension benefit (monthly annuity over a retired lifetime). Concurrent actuarial funding tends to produce consistent annual costs when compared to less systematic actuarial methods (such as the terminal funding method used for the Legislators Retirement Plan) or to non-actuarial methods (such as the current disbursements or "pay-as-you-go" method used for the Elective State Officers Retirement Plan). The following compares the full actuarial funding requirements with the current law funding requirements for the two plans since 1985:

	Legislators Retirement Plan		**Elective State Officers Retire. Plan**	
	Terminal Funding (MPRIF Transfers)	**Non-member Contribution Portion of Actuarial Requirements**	**Pay-as-you-go Financing**	**Non-member Contribution Portion of Actuarial Requirements**
Fiscal Year 1985	$551,000	$943,000	$102,000	$104,000
Fiscal Year 1986	973,000	1,112,000	99,000	103,000
Fiscal Year 1987	1,213,000	1,103,000	97,000	108,000
Fiscal Year 1988	383,000	1,215,000	98,000	118,000
Fiscal Year 1989	275,000	1,377,000	105,000	100,000
Fiscal Year 1990	189,000	1,519,000	110,000	111,000
Fiscal Year 1991	1,710,000	1,230,000	119,000	106,000
Fiscal Year 1992	719,000	1,451,000	117,000	122,000
Fiscal Year 1993	2,149,000	1,525,000	143,000	136,000
Fiscal Year 1994	1,618,000	2,032,000	164,000	152,000
Fiscal Year 1995	2,938,000	2,340,000	165,000	156,000
Fiscal Year 1996	1,789,000	2,596,000	159,000	185,000
Fiscal Year 1997	3,127,000	3,348,000	165,000	233,000
Fiscal Year 1998	793,000*	N/A	N/A	N/A
Fiscal Year 1999	1,110,000*	N/A	N/A	N/A

* Projected
N/A means figure is not available

Sources: Actuarial Valuations; MSRS Comprehensive Annual Financial Report, Statement of Revenues, Expenses and Change in Reserves, New Annuity Transfers Item; MSRS Information

It is clear that the full actuarial funding requirement for the Legislators Retirement Plan produces a more consistent funding obligation then the current terminal funding method. The full actuarial funding requirement generally will not be affected by the future retirements of current active legislators or by the future retirement of the large number of deferred retirees currently amassed (127 in 1996, up from 100 in 1992), unlike the terminal funding method, and will also produce a fully funded retirement fund (no unfunded actuarial accrued liability) over the next 23 years, unlike the terminal funding method. The full actuarial funding requirement for the Elective State Officers Retirement Plan closely tracks the current "pay-as-you-go" funding requirement, but this is more a function of coincidence rather than design. The "pay-as-you-go" funding requirement will be greatly affected by expected future retirements, while the full actuarial funding requirement will not be. One-third of the active membership of the Elective State Officers Retirement Plan is over age 60 and has over 15 years of service credit, 83 percent of the active membership is over age 50, and there are almost as many deferred retirees (4) as there are retired members (5). The full actuarial funding requirement will produce a fully funded retirement fund over the next 23 years, with the opposite result produced by the "pay-as-you-go" funding requirement.

There will be a potential impact on the State's General Fund of creating a dedicated retirement fund for the Legislators Retirement Plan and the Elective State Officers Retirement Plan, depending on the manner in which the retirement fund is created and the concurrent employer contribution rate is set. Currently, the Legislators Retirement Plan does not have any dedicated assets beyond the plan's participation in the Minnesota Post Retirement Investment Fund, although the plan does have a likely priority claim under law against the State's General Fund for accumulated member contributions of current and former legislators plus interest. The Elective State Officers Retirement Plan has no assets other than a claim for the accumulated member contributions and interest against the State's General Fund. If both the Legislators Retirement Plan and the Elective State Officers Retirement Plan will be participating in the Minnesota Post Retirement Investment Fund (the Elective State Officers Retirement Plan currently does not participate in the Minnesota Post Retirement Investment Fund), a substantial transfer to the Minnesota Post Retirement Investment Fund would be needed initially after the creation of the fund to cover the current Elective State Officers Retirement Plan retirees and sufficient assets would be needed to cover MPRIF transfers for new Legislators Retirement Plan or Elective State Officers Retirement Plan retirees in the initial years. The current accumulated member contributions and interest for both plans, if shifted to the fund for the two plans, would require a State General Fund appropriation and would provide some margin for future MPRIF reserve transfers until the fund is more fully funded. However, the differential between the member contribution rate and the calculated employer concurrent contributions may cause perceptual difficulties for the general public. The MPRIF transfer issue could be avoided by creating separate funds for each plan and not including the Elective State Officers Retirement Plan in direct participation in the Minnesota Post Retirement Investment Fund. The MPRIF transfer issue could also be avoided by adding the Legislators Retirement Plan and the Elective State Officers Retirement Plan to an existing retirement fund, such as the Judges Retirement Fund or to the State Employees Retirement Fund, both of which would have sufficient assets to cover the time differentials between anticipated MPRIF transfers and future contributions.

7. Cost Effectiveness of Shifting to Concurrent Actuarial Funding

A chief reason for implementing full actuarial funding with concurrent employer contributions is to reduce the ultimate future employer contributions by the investment income earned on the accumulated assets of the retirement fund. Currently, the Legislators Retirement Plan and the Elective State Officers Retirement Plan have no assets on which the plans earn direct investment income. Investment income on the Post Fund participation of the Legislators Retirement Plan is dedicated to future benefit increases while the claim of the two plans for accumulated member contributions and interest in effect earns a six percent investment return, but is payable in full to the terminating member upon an application for a refund and only upon termination of employment. If the plans were funded on a full actuarial funding basis, both plans would have sizable assets on which direct investment income would be earned. The full actuarial funding of the two plans would reduce the assets in the State's General Fund on which the State would earn undedicated investment income in the Treasurer's Cash Pool. Pension fund assets are typically invested with a long time horizon, while the Treasurer's Cash Pool is invested with a very short comparative time horizon because of liquidity needs. To get a sense of the value of the additional potential investment performance that could accrue from systematic pension funding and its expanded investment horizon, the following sets forth the net investment performance that would have been obtainable in both plans if they were funded as well as the average statewide or major local Minnesota public pension plan funded on an actuarial basis (66.84 percent funded in 1985, increasing to 88.8 percent funded in Fiscal Year 1996), based on the actual investment performance of the State Board of Investment for the period:

				Legislators Retirement Plan				Elective State Officers Retirement Plan				
Fiscal Year	Average Funding Ratio\1 Perform.	Basic Retire. Funds Total Rate of Return\2	Treasurer's Cash Pool Total Rate of Return\3	Non-MPRIF Assets\4	Retire. Fund Invest. Perform.	General Fund Invest. Perform.	Net Invest. Perform.	Non-MPRIF Assets\5	Retire. Fund Invest. Perform.	General Fund Invest. Perform.	Net Invest. Perform.	Total Net Invest.
1985	66.84%	26.8%	9.31%	$6,151	$1,648	$573	$1,075	$1,166	$312	$109	$203	$1,278
1986	68.61	26.2	7.27	7,864	2,060	572	1,488	1,170	307	85	222	1,710
1987	70.87	14.5	5.68	8,041	1,166	457	709	1,276	185	72	113	822
1988	72.14	(0.3)	8.00	9,454	(28)	756	(784)	1,392	(4)	111	(115)	(899)
1989	73.90	15.5	8.80	12,532	1,942	1,103	839	1,553	241	137	104	943
1990	75.67	10.8	8.80	14,892	1,608	1,310	298	1,718	186	151	35	1,345
1991	77.44	6.7	8.60	13,675	916	1,176	(260)	1,742	117	150	(33)	(293)
1992	79.21	14.5	6.70	16,012	2,322	1,073	1,249	1,885	273	126	147	1,396
1993	80.97	14.4	4.80	17,344	2,498	833	1,665	2,177	313	104	209	1,042
1994	81.15	2.1	3.0	26,185	550	786	(236)	2,311	49	69	(20)	(256)
1995	82.48	15.8	5.8	29,192	4,612	1,693	2,919	2,431	384	141	243	3,162
1996	88.80	18.8	5.7	33,517	6,301	1,910	4,391	2,649	498	151	347	4,738
1997		21.8	5.3									
Total							$13,353				$1,455	$14,808

Note: Dollar figures are expressed in thousands.

\1 The average funding ratio represents the average of the funding ratios of ten plans valued by the Commission actuary (excluding the Legislators Retirement Plan and the Elective State Officers Retirement Plan) in 1985 and of the funding ratios of eleven plans valued by the Commission actuary (also excluding the Legislators Retirement Plan and the Elective State Officers Retirement Plan) in 1993 (1992 if 1993 valuation is not yet available), assuming a steady progression between the two averages over the period.

\2 The total rate of return is for the active member portion of the retirement fund assets invested by the State Board of Investment, excluding the Minnesota Post Retirement Investment Fund, as reported by the State Board of Investment for the total Basic Retirement Funds portfolio in the regular reporting of the State Board of Investment.

\3 The total rate of return is the average for 91 day Treasury bills for the period 1985-1987 and the investment performance of the Treasurer's Cash Pool for the period 1988-1993, as reported by the State Board of Investment.

\4 The Non-Minnesota Post Retirement Investment Fund assets represents the amount calculated by multiplying the plan's total actuarial accrued liability by the average funding ratio and subtracting the plans Minnesota Post Retirement Investment Fund participation amount.

\5 The Non-Minnesota Post Retirement Investment Fund assets represent the amount calculated by multiplying the plan's total actuarial accrued liability by the average funding ratio, since the plan does not currently participate in the Minnesota Post Retirement Investment Fund.

If the plans were funded on a full actuarial funding basis over the past decade and achieved the average funded status of other statewide and major Minnesota public pension plans, the required non-member or employer contribution of each plan would be substantially smaller than it is currently because the unfunded actuarial accrued liability would be smaller and the amortization requirement consequently would be smaller.

8. Potential Options For Implementing Greater Actuarial Funding of the Legislators Retirement Plan and the Elective State Officers Retirement Plan

The Commission reviewed several options for implementing greater actuarial funding of the Legislators Retirement Plan and of the Elective State Officers Retirement Plan.

The three alternative Legislators Retirement Plan and Elective State Officers Retirement Plan funding options identified by the Commission for further legislative consideration are as follows:

Option I. The option would be the creation of a joint retirement fund for the Legislators Retirement Plan and the Elective State Officers Retirement Plan, funded by the future member contributions of active legislators and active constitutional officers covered by the respective retirement plans (nine percent of covered salary) and by concurrent future equivalent employer contributions (nine percent of covered salary). An initial transfer of assets from the State General Fund to the joint retirement fund would be made upon the creation of the fund of an amount equal to the prior (pre-July 1, 1998) member contributions to the credit of the two retirement plans in the State General Fund, plus compound interest at a six percent rate, and of an identical amount representing the matching employer contributions equal to the accumulated member contributions plus interest. For the future, the House of Representatives, the Senate, and the constitutional offices would make a concurrent employer contribution equal to the balance of the full actuarial funding requirements of the applicable pension plan beyond the nine percent member contribution rate.

Option II. The option would also be the creation of a joint retirement fund for the Legislators Retirement Plan and the Elective State Officers Retirement Plan, with a dedication of future member contributions of active legislators and active constitutional officers covered by the respective retirement plans and by concurrent future equivalent employer contributions. Additionally, there would be an initial transfer of assets from the State General Fund to the joint retirement fund in the amount required to bring the joint retirement fund to the funding ratio of the least well-funded statewide general employee retirement plan, the Public Employees Retirement Association (82.72 percent). For the future, an annual employer contribution equal to the dollar amount of the balance of the full actuarial funding requirements of the two plans in total beyond the 18.00 percent member and concurrent employer contribution rates.

Option III. The option is a continuation of Option I. In addition to dedicating the future Legislators Retirement Plan and Elective State Officers Retirement Plan member contributions to a joint retirement fund, there would be a single lump sum transfer from the State General Fund to the joint retirement fund of an amount equal to the current unfunded actuarial accrued liability of the Legislators Retirement Plan and equal to the current unfunded actuarial accrued liability of the Elective State Officers Retirement Plan. In the future, an annual employer contribution equal to the dollar amount of the balance of the full actuarial funding requirements of the two plans in total beyond the 18.00 percent member and concurrent employer contribution rates.

The three options would have the following financial or budgetary impact adjusted for the anticipated reductions in covered payroll relating to the two retirement plans arising from recent or anticipated legislative and constitutional office membership changes:

Option I. (Dedicated member and concurrent employer contributions; transfer from State General Fund of past member contributions and equivalent past employer contributions; future full actuarial funding.)

	Legislators Retirement Plan			Elective State Officers Retirement Plan	
One-Time Funding	House	Senate	Total Legislature	State Auditor	Auditor & Governor
i) Accumulated member contributions and interest (General Fund one time appropriation)	$4,624,000	$2,312,000	$ 6,936,000	$ 645,000	$ 645,000
ii) Equivalent past employer contributions and interest (General Fund one time appropriation)	$4,624,000	$2,312,000	$ 6,936,000	$ 645,000	$ 645,000
iii) Total one-time funding	$9,248,000	$4,624,000	$13,872,000	$1,290,000	$1,290,000

Resulting Related Actuarial Condition of Plans

	Legislators Retirement Plan		Elective State Officers Retirement Plan		Combined Plans	
Funded Status						
Actuarial Accrued Liability		$60,055,000		$3,214,000		$63,269,000
Assets		35,080,000		1,290,000		36,370,000
Unfunded Actuarial Accrued Liab.		$24,975,000		$1,924,000		$26,899,000
Funding Ratio		58.41%		40.14%		57.48%
Financing Requirements						
Covered Payroll		$7,322,000		$183,000		$7,505,000
Annuities Payable		$2,639,000		$160,000		$2,799,000
Funded Status	18.93%	$1,386,000	13.67%	$25,000	18.80%	$1,411,000
Normal Cost						
Administrative Expenses	0.42	31,000	2.73	5,000	0.48	36,000
Amortization	21.72	1,590,000	66.67	122,000	22.81	1,712,000
Financial Requirements	41.07%	$3,007,000	83.07%	$152,000	42.09%	$3,159,000

	Legislators Retirement Plan			Elective State Officers Retirement Plan	
	House	Senate	Total Legislature	State Auditor	Auditor & Governor
Annual Funding					
iv) 9.00 Percent Member Contribution (dedication reduces General Fund revenue)	$494,000	$256,000	$750,000	$6,000	$17,000
v) 33.09 Percent* concurrent employer contribution (reduces General Fund balance; requires additional appropriation)	$1,645,000	$855,000	$2,500,000	$21,000	$58,000
vi) Total Ongoing Funding	$2,139,000	$1,111,000	$3,250,000	$27,000	$75,000

*Stated contribution rate is calculated based on the expected unfunded actuarial accrued liability for the combined retirement plans after deducting the one-time funding from the State General Fund. The rate is 10.28 percent (9.00 percent matching plus 1.28 percent) remaining balance of normal cost and administrative contribution plus 22.81 percent amortization contribution. If the employer contribution was set separately for the two plans, rather than blended, the employer contribution rate would be 32.07 percent of the Legislators Retirement Plan and 74.07 percent for the Elective State Officers Retirement Plan.

Option II. (Dedicated member and concurrent employer contributions; transfer from State General Fund of additional assets sufficient to fund post retirement fund to 82.72 percent; future full actuarial funding.)

	Legislators Retirement Plan			Elective State Officers Retirement Plan	
	House	Senate	Total Legislature	State Auditor	Auditor & Governor
One-Time Funding					
i) State General Fund Appropriation	$18,981,000	$9,489,000	$28,470,000	$2,659,000	$2,659,000

Resulting Actuarial Condition of Plans

	Legislators Retirement Plan	Elective State Officers Retirement Plan	Combined Plans
Funded Status			
Actuarial Accrued Liability	$60,055,000	$3,214,000	$63,269,000
Assets	49,678,000	2,659,000	52,337,000
Unfunded Actuarial Accrued Liab.	$10,377,000	$555,000	$10,932,000
Funding Ratio	82.72%	82.72%	82.72%
Financial Requirements			
Covered Payroll	$7,322,000	$183,000	$7,505,000
Annuities Payable	$2,639,000	$160,000	$2,799,000

	Legislators Retirement Plan		Elective State Officers Retirement Plan		Combined Plans	
Normal Cost	18.93%	$1,386,000	13.67%	$25,000	18.80%	$1,411,000
Administrative Expenses	0.42	31,000	2.73	5,000	0.48	36,000
Amortization	9.03	661,000	19.13	35,000	9.27	696,000
Financial Requirements	28.38%	$2,078,000	35.53%	$65,000	28.55%	$2,143,000

	Legislators Retirement Plan			Elective State Officers Retirement Plan	
	House	Senate	Total Legislature	State Auditor	Auditor & Governor
Annual Funding					
ii) 9.00 Percent Member Contribution (dedication reduces General Fund revenue)	$494,000	$256,000	$750,000	$6,000	$17,000
iii) 9.00 Percent concurrent Employer Contribution (reduces General Fund balance; requires additional appropriation)	$494,000	$256,000	$750,000	$6,000	$17,000
iv) Additional General Fund Annual Funding (reduces General Fund balance; requires additional appropriation)	$515,000	$258,000	$773,000	$59,000	$37,000
v) Total Ongoing Funding	$1,503,000	$770,000	$2,273,000	$71,000	$71,000

Option III. (Dedicated member contribution; transfer from State General Fund of lump sum amount equal to unfunded actuarial accrued liability; future full actuarial funding.)

	Legislators Retirement Plan	Elective State Officers Retirement Plan
One Time Funding		
i) Amount equal to current unfunded actuarial accrued liability	$38,847,000	$3,214,000

Resulting Related Actuarial Condition of Plans

	Legislators Retirement Plan		Elective State Officers Retirement Plan		Combined Plans	
Funded Status						
Actuarial Accrued Liability		$60,055,000		$3,214,000		$63,269,000
Assets		60,055,000		3,214,000		63,269,000
Unfunded Actuarial Accrued Liab.		$0		$0		$0
Funding Ratio		100.00%		100.00%		100.00%
Financing Requirements						
Covered Payroll		$7,322,000		$183,000		$7,505,000
Annuities Payable		$2,639,000		$160,000		$2,799,000
Normal Cost	18.93%	$1,386,000	13.67%	$25,000	18.80%	$1,411,000
Administrative Expenses	0.42	31,000	2.73	5,000	0.48	36,000
Amortization	0.00	0	0.00	0	0.00	0
Financial Requirements	19.35%	$1,417,000	16.40%	$30,000	19.28%	$1,447,000

	Legislators Retirement Plan			Elective State Officers Retirement Plan	
	House	Senate	Total Legislature	State Auditor	Auditor & Governor
Annual Funding					
iv) 9.00 Percent Member Contribution (dedication reduces General Fund revenue)	$494,000	$256,000	$750,000	$6,000	$17,000
v) 9.00 Percent concurrent employer contribution (reduces General Fund revenue; requires additional appropriation)	$494,000	$256,000	$750,000	$6,000	$17,000
vi) Additional General Fund Annual Funding (reduces General Fund balance; requires additional appropriation)	$49,000	$25,000	$74,000	$ 00	$ 00
vii) Total Ongoing Funding	$1,037,000	$537,000	$1,574,000	$12,000	$34,000

V. **Social Security Coverage and Pension Coverage Adaptations To Social Security Coverage**

A. Background Information on Social Security Coverage

1. In General

Social Security, the Old Age, Survivors, Disability and Health Insurance Program (OASDHI), provides retirement benefits to older covered employees, to disabled employees, to certain dependents of living benefit recipients, and to certain dependent survivors of deceased covered employees. It also provides hospitalization insurance and medical insurance to eligible Social Security recipients and dependents under the Medicare Program.

2. Old Age, Survivors and Disability (OASDI) Insurance Program

a. Social Security Old Age Benefit

A fully insured covered worker at the Social Security normal retirement age will be entitled to a Social Security old age benefit equal to 100 percent of the primary insurance amount. A reduced benefit is available as early as age 62 and an increased benefit is payable if benefit receipt is postponed beyond age 65.

A covered worker typically must have 40 calendar year quarters of Social Security coverage to be considered to be fully insured (if born before January 2, 1929, adjusted downward on a sliding scale to 28 quarters for a 1917 year of birth). Social Security coverage is a function of employment covered by Social Security and the magnitude of employment earnings. Private sector employees have been covered by the Social Security program since the 1930's. Public sector employees are covered if the employing unit is covered by an agreement with the federal government (Department of Health and Human Services) extending the program to new employees on a mandatory basis and to existing employees on an individually elective basis through a Social Security referendum. A covered worker receives a quarter of coverage if the worker had at least $640 (1996 figure; which is indexed) in covered employment earnings, up to four quarters per calendar year. Self-employed individuals also are covered by Social Security for self-employed income, which does not generally include real estate rental income, stock dividends, bond interest, net capital gains, limited partner income from a partnership, and incidental, casual work, or de minimis self-employment wages or income.

The compensation covered by the Social Security Old Age benefit is limited ($62,700 in 1996 and $65,400 in 1997, indexed annually).

The Social Security normal retirement age varies, depending on the year of birth of the covered worker, as follows:

Year of Birth	Normal Retirement Age	
1937 and before	65 years	
1938	65 years	2 months
1939	65 years	4 months
1940	65 years	6 months
1941	65 years	8 months
1942	65 years	10 months
1943-54	66 years	
1955	66 years	2 months
1956	66 years	4 months
1957	66 years	6 months
1958	66 years	8 months
1959	66 years	10 months
1960 and later	67 years	

The Social Security primary insurance amount is the basic Social Security benefit calculation. While the Social Security old age benefit is a defined benefit plan benefit, the computation of the benefit amount is more complicated than a typical public sector defined benefit plan benefit. Social Security uses a modified career average salary base, known as the average indexed monthly earnings amount, and replaces a preset amount of the base without reference to the length of employment. Short employment will be reflected in a reduced career average salary amount, with the inclusion of several low earnings or no earnings years. The average indexed monthly earnings amount is the covered wages of a covered worker in covered employment since 1950 or after age 21, if later, through age 62, after dropping out the lowest five years from the averaging period, and indexed based on the national average wage through the year in which the worker reached age 60. The primary insurance amount is determined by multiplying the three component parts of the average indexed monthly earnings by the applicable replacement percentage. For 1996, the three component parts were average indexed monthly earnings up to $437, average indexed monthly earnings over $437 and under $2,636, and average indexed monthly earnings over $2,635 up to the maximum covered average indexed monthly earnings amount. The average indexed monthly earnings component part dollar amounts are referred to as the bend points and the bend points are adjusted annually on January 1 based on the comparison between the national average wage for the second preceding year with the comparable figure for the year 1977, with the ratio applied to the 1979 bend points. The replacement ratio formula is as follows:

average indexed monthly earnings $0 - $437	90 percent
average indexed monthly earnings $438 - $2,635	32 percent
average indexed monthly earnings $2,636 and over	15 percent

The calculated Social Security old age benefit is payable at the normal retirement age. Social Security old age benefits are payable early at age 62, with a reduction of five-ninths of one percent per month under the normal retirement age. Social Security old age benefits paid after the Social

Security normal retirement age are increased based on an age-related schedule from one-twelfth of one percent (for years of birth before 1917) to thirteen - twenty fourths of one percent (for 1937).

Social Security old age benefits are subject to an annual earnings test and limits. A covered worker begins receipt of a Social Security old age benefit based on attaining a requisite age, rather than terminating employment with a particular employer or all employers. If an old age benefit recipient is employed after commencing receipt, the Social Security old age benefit is reduced by one dollar for each three dollars of earnings above a designated limit until the recipient reaches age 70. The 1996 limits were $8,280 for the period age 62 - age 64 and $12,500 for the period age 65 - age 69.

If a covered worker has pension coverage from noncovered employment at the time of benefit calculation, such as a pre-1998 legislator, there is a potential "windfall offset" reduction in the primary insurance amount replacement percentage for the initial component portion of the average indexed monthly earnings, which is normally 90 percent and could be reduced to 40 percent. No reduction in the replacement rate applies to persons who were age 62 before 1986, or who had at least 30 years of covered employment with substantial earnings (at least one-quarter of the prior (old law) maximum taxable earnings base, or $1,200 in 1960, $1,950 in 1970, $5,100 in 1980, $9,525 in 1990, and $11,625 in 1996, for example). If the years of substantial covered employment earnings are less than 30 years, the reduction will vary (from 90 to 85 percent with 29 years of substantial earnings ranging down on a sliding scale to 40 percent with less than 21 years of substantial earnings). The maximum windfall offset is one-half of the pension attributable to post-1956 employment earnings not covered by Social Security. For covered workers who turn age 62 in 1996 and have less than 20 years of substantial earnings in Social Security covered employment, the maximum reduction would be one-half (90 percent reduced to 40 percent) of the amount under the first bend point ($437), or $218.50 per month.

Based on the primary insurance amount computation worksheet from a Hay/Huggins Company publication, <u>1996 Social Security Summary</u>, the following sets forth the calculation of the Social Security old age benefit for a person covered by Social Security 1951-1996, retiring in 1996 at age 65, earning the annual salary (excluding per diem) of a Minnesota legislator:

(a)	year of eligibility (age 62)	1993
(b)	number of years 1951-1993	42
(c)	number of years included in calculation (42-5)	37
(d)	months in averaging period (37x12)	444
(e)	year (a) - 2	1991
(f)	national average wage for 1991	$21,811.60
(g)	indexed earnings table:	

(1) Calendar Year	(2) Enter Covered Earnings for Year	(3) Maximum Taxable Earnings Base	(4) Enter the Smaller of Column (2) or Column (3)	(5) National Average Wage*	(6) Indexed Earnings [(f)x(4)/(5)] (to nearest cent)**
1951	$1,000	$3,600	$1,000	$2,799.16	$7792.19
1952	1,000	3,600	1,000	2,973.32	7,335.77
1953	1,500	3,600	1,500	3,139.44	10,421.41
1954	1,500	3,600	1,500	3,155.64	10,367.91
1955	1,500	4,200	1,500	3,301.44	9,910.04
1956	1,500	4,200	1,500	3,532.36	9,262.19
1957	2,400	4,200	2,400	3,641.72	14,374.48
1958	2,400	4,200	2,400	3,673.80	14,248.96
1959	2,400	4,800	2,400	3,855.80	13,576.39
1960	2,400	4,800	2,400	4,007.12	13,063.71
1961	2,400	4,800	2,400	4,086.76	12,809.13
1962	2,400	4,800	2,400	4,291.40	12,198.31
1963	2,400	4,800	2,400	4,396.64	11,906.33
1964	2,400	4,800	2,400	4,576.32	11,438.85
1965	2,400	4,800	2,400	4,658.72	11,236.53
1966	2,400	6,600	2,400	4,938.36	10,600.24
1967	4,800	6,600	4,800	5,213.44	20,081.88
1968	4,800	7,800	4,800	5,571.76	18,790.41
1969	4,800	7,800	4,800	5,893.76	17,763.82
1970	4,800	7.800	4,800	6,186.24	16,923.96
1971	4,800	7,800	4,800	6,497.08	16,114.27
1972	4,800	9,000	4,800	7,133.80	14,676.00
1973	8,400	10,800	8,400	7,580.16	24,170.66
1974	8,400	13,200	8,400	8,030.76	22,814.46
1975	8,400	14,100	8,400	8,630.92	21,228.03
1976	8,400	15,300	8,400	9,226.48	19,857.78
1977	8,400	16,500	8,400	9,779.44	18,734.96
1978	8,400	17,700	8.400	10,556.03	17,356.66
1979	16,500	22,900	16,500	11,479.46	31,350.90
1980	18,500	25,900	18,500	12,513.46	32,246.45
1981	18,500	29,700	18,500	13,773.10	29,297.30
1982	18,500	32,400	18,500	14,531.34	27,768.57
1983	18,500	35,700	18,500	15,239.24	26,478.66
1984	18,500	37,800	18,500	16,135.07	25,008.54
1985	21,140	39,600	21,140	16,822.51	27,409.54
1986	22,350	42,000	22,350	17,321.82	28,143.07
1987	23,244	43,800	23,244	18,426.51	27,514.10
1988	23,941	45,000	23,941	19,334.04	27,008.92

(1) Calendar Year	(2) Enter Covered Earnings for Year	(3) Maximum Taxable Earnings Base	(4) Enter the Smaller of Column (2) or Column (3)	(5) National Average Wage*	(6) Indexed Earnings [(f)x(4)/(5)] (to nearest cent)**
1989	25,138	48,000	25,138	20,099.55	27,279.22
1990	26,395	51,300	26,395	21,027.98	27,378.63
1991	27,979	53,400	27,979	21,811.60	27,979.00
1992	27,979	55,500	27,979	22,935.42	27,979.00
1993	27,979	57,600	27,979	23,132.67	27,979.00
1994	27,979	60,600	27,979	23,753.53	27,979.00
1995	29,657	61,200	29,657	23,753.53	29,657.00
1996	29,657	62,700	29,657	23,753.53	29,657.00

* This column applies only through 1991, the year of eligibility (age 62) less two years. Thereafter, use same figure as shown for 1991.

** This computation applies through 1991. Thereafter, use the figure from Column (4).

(h)	total of highest entries for 37 years, excluding 1996	$810,585.95
(i)	average indexed monthly earnings ((h)/444)	1,825
(j)	lower bend point for 1993	$401
(k)	upper bend point for 1993	$2,420
(l)	amount by which (k) exceeds (j)	$2,019
(m)	primary insurance amount	
	(1) 90% of lesser of (j) or (i)	$401x.90 = $360.90
	(2) 32% of lesser of (l) or (i) minus (j)	$1,424x.32 = $455.68
	(3) 15% of (i) minus (k), not less than zero	$0
	(4) (m)(1) + (m)(2) + (m)(3), rounded down to $0.10	$816.50
(n)	post age 62 general benefit increases	
	1993	$816.50 x 1.026 = $837.70
	1994	$837.70 x 1.028 = $861.10
	1995	$861.10 x 1.026 = $883.40

b. Social Security Disability Benefit

A fully insured covered worker who becomes disabled will be entitled to a Social Security disability benefit equal to 100 percent of the primary insurance amount without reduction for payment earlier than the Social Security normal retirement age.

A covered worker who is older than age 30 and becomes disabled after 1990 must have 40 calendar year quarters of Social Security coverage and must have 20 calendar year quarters of Social Security coverage in the 40 quarter period ending with the quarter in which the disability began, which must not include any quarter used for a prior disability benefit. A covered worker who is older than age 23 and younger than age 31 and becomes disabled for a reason other than blindness must have 20 calendar year quarters of Social Security coverage after the quarter in which the covered worker attains age 21 and ending with the quarter in which the disability begins. A covered worker who is under age 24 and becomes disabled for a reason other than blindness must have six calendar year quarters of Social Security coverage in the 12 calendar year quarters ending with the quarter in which the disability begins. A covered worker who becomes disabled by blindness must have 40 calendar year quarters of Social Security coverage.

A covered worker is disabled if the person is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that is expected to result in death or either has continued or is expected to continue without interruption for a period of at least 12 months unless alcoholism or drug addition is a contributing material factor. For blindness that occurs after age 54, the inability must be to engage in the person's usual occupation.

The Social Security primary insurance amount calculation for the Social Security old age benefit also applies to the Social Security disability benefit coverage.

Social Security disability benefits are not subject to the earnings test and limits applicable to Social Security old age benefits, but workers compensation benefits may be offset if the benefit combined with workers compensation and certain governmental disability programs exceed 80 percent of average current earnings, which is typically the average monthly earnings for the highest year in the six years of covered employment ending with the year in which the disability occurred. Social Security disability benefits are also subject to the windfall offset reduction that is applicable to Social Security old age benefits.

c. <u>Social Security Benefit For Dependent of Living Recipient</u>

The spouse, the divorced spouse, the child, or the grandchild of a Social Security old age benefit recipient or a Social Security disability benefit recipient will be entitled to a Social Security dependent benefit. The dependent benefit is 50 percent of the primary insurance amount subject to early receipt reductions after age 61 and before age 65 for dependent spouses and former spouses and subject to a family maximum benefit.

The dependent spouse benefit automatically applies to the spouse of an old age benefit recipient or a disability benefit recipient who is at least age 62. The dependent spouse benefit applies to the former spouse of an old age benefit recipient or a disability benefit recipient if the person is unmarried or is remarried after age 60 (age 50 if disabled), was married for at least ten years before the divorce and the divorce occurred after the benefit recipient began receipt or occurred two years before benefit receipt. The dependent spouse benefit also applies to the spouse who cares for a child under age 16 or is disabled, is unmarried, and is under age 22. The dependent child benefit applies to an unmarried child of a recipient who is either under age 18, is under 19 if a full-time elementary or secondary school student, or becomes disabled before age 22, when eligibility is continuing. The dependent grandchild benefit is identical in its requirements to the dependent child benefit, but additionally requires that the grandchild's parents must be deceased or must be disabled.

The family maximum benefit limits the total amount of benefits payable with respect to the record of each covered worker or benefit recipient. For covered workers turning age 62 in 1996, the family maximum benefit formula for old age benefits and dependent benefits is as follows:

150 percent of the first $559 of the primary insurance amount, plus

272 percent of the primary insurance amount between $559 and $806, plus

134 percent of the primary insurance amount between $806 and $1,052, plus

175 percent of the primary insurance amount in excess of $1,052.

The disability benefit family maximum benefit is the smaller of the following:

the larger of 85 percent of the average indexed monthly earnings or 100 percent of the primary insurance amount; or

150 percent of the primary insurance amount.

A government pension offset also applies to dependent spouse benefits. The Social Security dependent spouse benefit will be reduced by 66.67 percent of the amount of any public pension benefit payable to the spouse based on the spouse's own work in employment not covered by Social Security. Thus, a retiring State patrol trooper who is the dependent spouse of a Social Security old age benefit recipient will have an amount equal to 85 percent of the State Patrol Retirement Plan single life age and service retirement annuity offset against the 50 percent of the primary insurance amount dependent spouse benefit otherwise payable on account of the spouse of the trooper retiring with a Social Security old age benefit.

d. Social Security Survivor Benefits

The surviving spouse, the surviving former spouse, the surviving child, the surviving grandchild, or the surviving parent of a deceased covered worker or benefit recipient will be entitled to a Social Security survivor benefit. The surviving spouse or surviving former spouse benefit is either 100 percent or 75 percent of the covered worker's primary insurance amount, the surviving child or grandchild benefit is 75 percent of the covered worker's primary insurance amount, and the surviving parent benefit is 82.5 percent of the covered worker's primary insurance amount.

A surviving spouse or surviving former spouse of a covered worker or benefit recipient with at least 40 calendar quarters of coverage, if the spouse is either at least age 60 or is disabled and is at least age 50, is eligible for the 100 percent of the primary insurance amount. A surviving spouse or surviving former spouse of a covered worker or benefit recipient with at least six calendar quarters during the 13 quarter period ending with death, disablement, or the termination of active service, if the spouse is caring for a child who is under age 16 or who became disabled before reaching age 22 and is unmarried, is eligible for 75 percent of the primary insurance amount. A surviving child of a covered worker with at least six calendar quarters during the 13 quarter period ending with death, disablement, or the termination of active service, if the child ;is unmarried and is under age 18, under age 19 and is a full time elementary or secondary school student, or is disabled before age 22 is eligible for 75 percent of the primary insurance amount. The same benefit applies to a surviving grandchild who meets the same requirements as a surviving child and whose parents are either dead or disabled. A surviving parent of a covered worker or benefit recipient with at least 40 calendar quarters of coverage, if the parent is dependent on the worker or recipient and the parent is at least age 62, is eligible for 82.5 percent of the primary insurance amount.

The family maximum benefit limits also apply to these survivor benefits as they do to dependent benefits. The government pension offset also applies to these survivor benefits.

B. Likely Social Security Referendum Election Procedures

1. The Social Security Coordination Process

When the Old Age, Survivors and Disability Insurance program (Social Security) was initially enacted in 1935, it did not authorize public employees to be covered for their public sector employment. In 1950, with the enactment of 42 United States Code Section 418, coverage by Social Security was extended to public sector employees if the applicable state entered into an agreement with the applicable federal agency (first, the Department of Health, Education and Welfare; currently, the Department of Health and Human Services) providing for that extension and a majority of affected public employees elected Social Security coverage on a referendum held on that issue. Initially, Social Security coverage was extended to public employees on a "total group" basis following a successful referendum and the General State Employees Retirement Plan (MSRS-General) and the Duluth Teachers Retirement Fund Association (DTRFA) coordinated on this "total group" basis, while "total group" basis coordination referendums for the General Public Employees Retirement Plan (PERA-General) and the Teachers Retirement Association (TRA) failed in 1956.

In 1956 and 1957, "split basis" coordinations in Minnesota and several other states were authorized. In a "split basis" coordination, those in the potential coverage group who select Social Security coverage in the referendum and all new (post-coordination) employees will be covered by Social Security and those who voted against Social Security coverage in the referendum or who did not participate (i.e. were not eligible to participate) in the referendum are excluded from Social Security coverage. The Teachers Retirement Association coordinated with Social Security in 1959 on a split basis and all subsequent coordinations of Minnesota public employees with Social Security have been split basis coordinations.

The Social Security Act generally excludes police officers and firefighters from inclusion in the agreements extending social security coverage to public employees. Title 42 United States Code Section 418(d)(5)(A) provides that nothing in the subchapter is to authorize the extension of social security coverage to service in "any policeman's or fireman's position". Title 42 United States Code Section 418(d)(8)(D) provides that the agreements between the various states and the Secretary of the Department of Health and Human Services are not to apply to service in any "policeman's" or "fireman's" position, with some exceptions. In the past, specific states were permitted to extend Social Security coverage to police officers or firefighters by obtaining specific Congressional exceptions. That practice has been replaced with a general authorization to include police officers and firefighters in Social Security coverage with a referendum.

2. Coordination of Minnesota Public Employees Retirement Plans With Social Security

Since 1955 (Laws 1955, Chapter 665), the State of Minnesota has been engaged in the process of coordinating Minnesota public pension plan coverage with Social Security coverage. The following sets forth the history of coordinating Minnesota public employee pension coverage with Social Security:

Year	**Public Employee Group or Pension Plan**
1955 (Chapter 684)	Municipal Housing and Redevelopment Authorities
1955	University of Minnesota faculty
1957 (Chapter 650)	Duluth Teachers Retirement Fund Association
1957 (Chapter 919)	State or local employees not covered by the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), or Teachers Retirement Association (TRA)
1957 (Extra Session Chapter 18)	University of Minnesota clerical and administrative employees
1957 (Extra Session Chapter 18)	
1959 (Chapter 513)	State historical society employees, state horticultural society employees, crop improvement association employees, Minnesota Disabled American veterans employees, and Minnesota Veterans of Foreign Wars employees
1959 (Chapter 558; Extra Session Chapter 50)	TRA
1959 (Chapter 633)	Soil and water conservation district employees, port authority employees, and hospital district employees
1963 (Chapter 793)	Public hospital employees
1967 (Chapter 687)	PERA-General
1973 (Chapter 744)	Uniform Judges Retirement Plan
1976 (Chapter 238)	Minneapolis Teachers Retirement Fund Association (MTRFA)
1977 (Chapter 399)	Minneapolis Employees Retirement Fund (MERF)*
1977 (Chapter 429)	St. Paul Teachers Retirement Fund Association (StPTRFA)
1986 (Chapter 399)	Economic Development Authorities
1997 (Chapter 233)	Legislators Retirement Plan
1997 (Chapter 233)	Elective State Officers Retirement Plan

* The MERF Coordinated Program was consolidated into the PERA Coordinated Program in 1979 (Chapter 303, Article 6).

Most Minnesota public employees are currently (as of June 30, 1996) covered by Social Security, as follows:

Minnesota Public Pension Plan	Coordinated Members	Basic Members
MSRS-General Retirement Plan	49,914	0
MSRS-Correctional Retirement Plan	2,264	0
State Patrol Retirement Plan	0	777
Legislators Retirement Plan	0	201
Elective State Officers Retirement Plan	0	6
Judges Retirement Plan	275	4
PERA-General Retirement Plan	128,087	1,344
PERA-P&F	0	7,680
PERA Police and Fire Consolidation Accounts	0	1,003
Teachers Retirement Association	68,408	82
Minneapolis Employees Retirement Fund	0	1,782
Duluth Teachers Retirement Fund Association	1,415	0
Minneapolis Teachers Retirement Fund Association	3,406	1,235
St. Paul Teachers Retirement Fund Association	2,835	970
Sub-Total	256,604	15,084
Percentage	94.45%	5.55%

3. Social Security Referendum Procedures

Laws 1997, Chapter 233, Article 2, Section 8, provides that the Governor designate a state agency or an individual to supervise a Social Security referendum for legislators and for constitutional officers. The Social Security referendum is scheduled to occur after July 1, 1998, on a date designated by the Governor or by the supervising agency or individual. Under Title 42 United States Code Section 418(d)(3), the referendum must be conducted by secret written ballot, must be on the question of whether service in the positions covered by the applicable retirement plan are to be excluded from or included in the Social Security coverage agreement, must include and be limited to eligible employees, and must occur after at least 90 days notice of the referendum. Laws 1997, Chapter 233, Article 2, Section 9, requires that legislators and constitutional officers be given a statement of the rights accruing to employees covered by Social Security and of the impact of electing Social Security coverage on future public pension coverage with the contents of the statement specified by the supervising agency or individual as deemed necessary and sufficient.

If the referendum is approved by majority vote, under Laws 1997, Chapter 233, Article 2, Sections 10, 11, 12, and 13, the Governor certifies the referendum results to the federal Department of Health and Human Services, the applicable pension plan will be divided into two parts (one for eligible employees desiring Social Security coverage and the other for those who do not), legislators and constitutional officers will be transferred to the applicable pension plan part or division, and the supervising state agency (likely the Department of Employee Relations) will modify the State's agreement with the federal Department of

Health and Human Services to include legislators and constitutional officers, with the approval of the Governor.

In past Social Security referendums, the Department of Employee Relations (previously the Department of Personnel) has been the supervising state agency and has prepared extensive written materials about Social Security benefits. The retirement plans involved in past Social Security referenda also have participated in the process by providing benefit plan and accrued retirement benefit information. The Social Security system also can be expected to be of assistance in providing information to current legislators and current constitutional officers on accrued Social Security coverage quarters, which will be of assistance in determining potential vesting for Social Security benefits and the impact of public pension benefit offsets from future Social Security benefits.

C. Available Options For Redesigning the Legislators Retirement Plan or the Elective State Officers Retirement Plan

When the Conference Committee on S.F. 637 considered what became Laws 1997, Chapter 233, Article 2, the committee discussed briefly, and in concept only, the idea of fashioning a modified version of the existing defined benefit plans, the Legislators Retirement Plan and the Elective State Officers Retirement Plan, to accompany the coordination of the two plans with Social Security. The typical pattern of coordinating Minnesota public pension plans with Social Security has been to downsize the existing defined benefit plan benefits. There are options that are available for redesigning the Legislators Retirement Plan and the Elective State Officers Retirement Plan, as follows:

Option 1: Reset Existing Benefit Accrual Rate By The Historic Reduction Factor.

Minnesota has reset Basic program (no Social Security) benefit accrual rates upon coordination with Social Security during three different decades (1959 with the coordination of the State Employees Retirement Association, the predecessor to the current General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General); 1967 with the coordination of the Public Employees Retirement Association (PERA-General); and 1976-1979 with the coordinations of the Minneapolis Teachers Retirement Fund Association (MTRFA), the St. Paul Teachers Retirement Fund Association (StPTRFA), and the Minneapolis Municipal Retirement Fund, the predecessor to the current Minneapolis Employees Retirement Fund (MERF)). The relationship between the Coordinated program benefit accrual rates and the Basic program benefit accrual rates varied in coordination over time, as follows:

Years of Service	MSRS-General 1959 Coord. Rate	Basic Rate	% C/B	PERA-General 1967 Coord. Rate	Basic Rate	% C/B	MTRFA, StPTRFA, & MERF 1976-1979 Coord. Rate	Basic Rate	% C/B	Average Coord. Rate	Basic Rate	% C/B
10 Years	6.25%	10.00%	62.5%	6.25%	10.00%	62.5%	10.00%	20.00%	50.00%	7.50%	13.33%	56.26%
20 Years	15.00	30.00	50.0	18.75	30.00	62.50	25.00	45.00	55.50	19.58	35.00	55.94
30 Years	31.60	55.00	57.45	35.75	55.00	65.00	40.00	70.00	57.14	35.78	60.00	59.63
40 Years	49.10	85.00	57.76	59.75	85.00	70.29	55.00	95.00	57.89	54.62	88.33	61.84

If the Legislators Retirement Plan and the Elective State Officers Retirement Plan benefit accrual rates increased by an average of 15 percent by virtue of Laws 1997, Chapter 233, Article 1, Sections 3 and 35, from 2.5 percent to 2.875 percent per year of service the Legislators Retirement Plan and Elective State Officers Retirement Plan Coordinated Program benefit accrual rate, under the average historical shift for a 30 year employee, would be 1.7 percent per year of service.

<u>Option 2: Reset Existing Benefit Accrual Rate Based On the Current Relationship of Coordinated and Basic Benefit Accrual Rates For Other Plans</u>.

Several Minnesota public pension plans have both Basic and Coordinated benefit programs, with differing benefit accrual rate percentages. The pension plans involved are the Public Employees Retirement Association (PERA), the Teachers Retirement Association (TRA), the Minneapolis Teachers Retirement Fund Association (MTRFA), and the St. Paul Teachers Retirement Fund Association (StPTRFA). For the level benefit tier (non-Rule of 90 tier) of each pension plan, after the passage of Laws 1997, Chapter 233, the Coordinated Program annual benefit accrual rate is 1.7 percent and the Basic Program annual benefit accrual rate is 2.7 percent, meaning that the Coordinated Program benefit accrual rate is 62.96 percent of the Basic Program benefit accrual rate. Assuming that the Legislators Retirement Plan and Elective State Officers Retirement Plan Coordinated Programs benefit accrual rates would be 1.81 percent per year of service.

<u>Option 3: Reset Existing Benefit Accrual Rate To Equal Current Coordinated Program Benefit Accrual Rate For Other Plans</u>.

For the Minneapolis Teachers Retirement Fund Association (MTRFA), the Public Employees Retirement Association (PERA), the St. Paul Teachers Retirement Fund Association (StPTRFA), and the Teachers Retirement Association (TRA) Coordinated Programs, after the passage of Laws 1997, Chapter 233, the annual benefit accrual rate for the level benefit tier (non-Rule of 90 tier) is 1.7 percent. If the potential Legislators Retirement Plan and Elective State Officers Retirement Plan Coordinated Program benefit accrual rate were set identical to that benefit accrual rate, the rate would be 1.7 percent per year of service.

<u>Option 4: Reset Existing Benefit Accrual Rate Based on Target Pre-retirement Salary Replacement Ratio In Combination With Social Security</u>.

Since pension plans exist to provide an adequate amount of income to a person after retirement based on the person's income during the immediate or near-term pre-retirement period, the Legislators Retirement Plan and Elective State Officers Retirement Plan Coordinated Program benefit accrual rates could be reset so that the total benefit, including Social Security, would generally match the replacement ratio of the Legislators Retirement Plan and Elective State Officers Retirement Plan Basic Programs. Assuming that the Legislators Retirement Plan and Elective State Officers Retirement Plan benefit accrual rates average 2.875 under laws 1997, Chapter 233, Article 1, Section 3 and 35, the Legislators Retirement Plan and the Elective State Officers Retirement Plan replace the following portion of pre-retirement earnings:

(1) **Service Period**	(2) **Replacement of Highest Five Successive Years Average Salary**	(3) **Replacement of Final Year's Salary**
6	17.25%	15.68%
10	28.75	26.14
15	43.125	39.21
20	57.50	52.28
25	71.875	65.35
30	86.25	78.42
35	100.625	91.49
40	115.00	104.56

* Figure assumes 5.00 percent annual increases during the highest five years average salary period and relates the benefit amount in column (2) to a projected final year salary assuming that constant increase factor (90.92%).

For a worker earning $30,000 in 1996, retiring in 1997, Social Security can be expected to replace 42 percent of the final year's salary (declining to 39 percent in the year 2000, 38 percent in the year 2005, 36 percent in the year 2010, and 35 percent in the year 2015). Because Social Security is constructed assuming a 40+ year pre-retirement working lifetime, it would be appropriate to utilize a 40 year Legislators Retirement Plan or Elective State Officers Retirement Plan retirement annuity benefit accrual total, leaving 62.56 percent of final salary (68.82 percent of highest five years average salary) to be provided by the Legislators Retirement Plan Coordinated Program. Reduced to an annual rate, this would produce a 1.7205 percent annual benefit accrual rate. If the effect of legislative per diems are taken into account, by assuming a $35,000 1996 salary, the replacement rate drops from 42 percent to 40 percent, leaving 64.56 percent of final salary (71.02 percent of highest five years average salary) to be provided by the Legislators Retirement Plan, or a 1.7755 percent annual benefit accrual rate. For constitutional officers, with salaries essentially at or in excess of the Social Security maximum taxable earnings base, the replacement rate is 25 percent, leaving 79.56 percent of final salary (87.52 percent of highest five years average salary) to be provided by the Elective State Officers Retirement Plan, or a 2.1879 percent annual benefit accrual rate.

Option 5: Reset Existing Benefit Accrual Rate To An arbitrarily Established Replacement Coordinated Benefit Accrual Rate.

Historically, the Elective State Officers Retirement Plan explicitly (see Minnesota Statutes, Section 352C.01) and the Legislators Retirement Plan implicitly have attempted to provide advantageous pension benefit coverage to elected officials who have suffered monetary disadvantages from that service compared to the opportunities that otherwise would have been available to them from other occupational or business endeavors. While some of the actual attributes of that advantageous pension benefit coverage have been moderated in the last two decades, that perceived need may still be a widespread belief among legislators and constitutional officers. If advantageous benefit coverage compared to other public pension plan coverage is sought by policy makers in designing a coordinated program for the Legislators Retirement Plan and the Elective State Officers Retirement Plan, an arbitrary benefit accrual rate in excess of 1.7 percent per year of service credit would need to be designated.

Option 6: Integrate Potential Coordinated Legislators Retirement Plan and Elective State Officers Retirement Plan.

While rarely used in Minnesota, a new potential coordinated program for the Legislators Retirement Plan or the Elective State Officers Retirement Plan could be explicitly integrated with Social Security. Under an integrated benefit plan, a total benefit of a certain magnitude is provided, with the supplementary pension plan providing the balance in excess of the Social Security benefit derived from employment with that employer. The potential integrated Legislators Retirement Plan or Elective State Officers Retirement Plan could continue the average current benefit accrual rate for the Legislators Retirement Plan or the Elective State Officers Retirement Plan, assumed to be 2.875 percent per year of covered service, but would be reduced by any Social Security earned from legislative service or constitutional officer service.

D. Policy Considerations In Reviewing Options For Potential Legislators Retirement Plan and Elective State Officers Retirement Plan Coordinated Programs.

In considering the six available options for designing a potential new coordinated program for the Legislators Retirement Plan and the Elective State Officers Retirement Plan identified by the Commission staff and any other potential options identified by other sources, there are several policy considerations that appropriately would be factored into the discussion. These policy considerations, in no particular order, are as follows:

a. "Election-Against-The-Fund" Potential. Whenever pension plan members are provided with an alternative benefit provision or alternative benefit coverage, there is a substantial risk of an adverse selection or "election against the fund." Laws 1997, Chapter 233, Article 2, already creates this adverse selection risk by allowing existing legislators and constitutional officers a choice between the current Legislators Retirement Plan or Elective State Officers Retirement Plan, defined benefit plans, and the combination of Social Security and the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), a defined contribution plan. Legislators Retirement Plan and Elective State Officers Retirement Plan members who are most likely to be advantaged by the current benefit plan coverage can be expected to retain that current plan coverage, while plan members who are not likely to be similarly advantaged by the current benefit plan coverage can be expected to elect the combination of Social Security and MSRS-Unclassified Program. Adding the choice of Coordinated Programs of the Legislators Retirement Plan and the Elective State Officers Retirement Plan or substituting that choice for the MSRS-Unclassified Program will enhance or continue that adverse selection risk. With adverse selection, the cost of any defined benefit plan involved can be expected to increase and the cost of the total benefit coverage will be greater.

b. Uncertain Future Actuarial Costs and Unclear Adequacy of Future Member Contribution Rates. The actuarial cost of public pension plan coverage, and the actual cost also, is a function of the benefits provided by the defined benefit pension plan and the demographics of the population covered by the pension plan. With the scheduled election of benefit coverage by existing legislators and constitutional officers and with the potential addition of the option of a coordinated program to the choice or with the potential substitution of the option of a coordinated program for the MSRS-Unclassified Program as a choice, the membership remaining in the current Legislators Retirement Plan or the current Elective State Officers Retirement Plan will likely be higher due to adverse selection by current plan members and the current member contribution rate may significantly depart from the Commission's policy of an equal split of the normal cost and expenses of the pension plan, expressed as a percentage of covered payroll. The actuarial cost of a potential Legislators Retirement Plan Coordinated Program or of a potential Elective State Officers Retirement Plan Coordinated Program and the adequacy of any member contribution to those programs is wholly unknowable at this time.

c. Departure From Sound Actuarial Funding Practices In the Existing Legislators Retirement Plan and Elective State Officers Retirement Plan. The Legislators Retirement Plan is funded on a terminal funding basis and the Elective State Officers Retirement Plan is funded on a current disbursements or "pay-as-you-go" basis. Both funding procedures are departures from the Commission's policy principles calling for the concurrent funding of a public pension plan on a full actuarial basis. The current law, Laws 1997, Chapter 233, Article 2, will resolve this funding departure by phasing-out the coverage groups involved, resolving the problem in a decade or two for the Legislators Retirement Plan and resolving the problem in several decades for the Elective State Officers Retirement Plan. The creation of coordinated programs for the Legislators Retirement Plan and the Elective State Officers Retirement Plan as alternatives or substitutes to Laws 1997, Chapter 233, Article 2, will undue this phase-out and will not eventually resolve the existing funding problems of the two plans without additional legislative changes.

d. Question of Defined Benefit Plan or Defined Contribution Plan Coverage As Optimal Fit For Legislators or Constitutional Officers. Laws 1997, Chapter 233, Article 2, creates defined contribution plan coverage for legislators or constitutional officers for the first time, while the potential coordinated programs for the Legislators Retirement Plan and the Elective State Officers Retirement Plan would retain defined benefit plan coverage for legislators or constitutional officers. The Commission has not specifically addressed the question of whether defined contribution plan coverage or defined benefit plan coverage is the optimal retirement coverage for the average legislator or the average constitutional officer. If the potential coordinated programs were alternatives to MSRS-Unclassified Program coverage, leaving current legislators and constitutional officers with a choice between one of two defined benefit pension plans or a single defined contribution pension plan and new legislators and constitutional officers with a choice between a defined benefit pension plan or a defined contribution pension plan, the issue of the optimal fit would be resolved by individual legislators. If the potential coordinated programs in the Legislators Retirement Plan and the Elective State Officers Retirement Plan were substitutes to MSRS-Unclassified Program coverage, leaving only defined benefit plan coverage as the choice, the issue of the optimal fit of defined benefit plan coverage for legislators and constitutional officers becomes substantial.

e. Creation of Confusion Through An Increase In Options. Options in retirement coverage for plan participants are difficult because of the inherent complexity of the subject matter. The increase in options potentially occurring through a creation in coordinated programs for the Legislators Retirement Plan and the Elective State Officers Retirement Plan runs the risk of creating additional confusion for plan members because of the greater complexity resulting.

f. Continued Targeting of Legislator's Retirement Coverage By Other Public Employees. Historically, when the benefit practices of the retirement coverage provided to legislators have differed significantly from the retirement coverage provided to other public employees, the Legislators Retirement Plan has been the target of criticism from various public employee groups and the source of benefit increase demands. If potential coordinated programs are created for the Legislators Retirement Plan and for the Elective State Officers Retirement Plan and those programs significantly replicate current benefit practice differences or create new benefit practice differences, rather than utilizing the more broadly applicable MSRS-Unclassified Program, this practice of targeting the Legislators Retirement Plan or Elective State Officers Retirement Plan for public employee criticism or using the Legislators Retirement Plan and the Elective State Officers Retirement Plan as a precedent for public employee groups arguing for various benefit increases.

g. Adverse Public Perception About Legislator and Constitutional Officer Compensation Practices. From press accounts, it would appear that the public has an adverse perception about the appropriateness of the compensation practices of legislators and constitutional officers. When the benefits for legislators and constitutional officers differ from those generally available to private sector employees and to public employees broadly, as do the current Legislators Retirement Plan and the current Elective State Officers Retirement Plan, that adverse public perception is aggravated. The potential coordinated programs for the Legislators Retirement Plan and the Elective State Officers Retirement Plan, as defined benefit plan coverage compared to the defined contribution plan coverage that more typically represents the situation of private sector employees, likely does not improve the adverse public perception.

VI. **Elective Coverage Change For Existing Legislators Retirement Plan and Elective State Officers Retirement Plan Participants**

A. Nature of Legislative Service 1965-1995 And The Appropriateness Of The Two Major Types Of Pension Benefit Coverage

1. In General

The 1997 Legislature, in Laws 1997, Chapter 233, Article 2, began the shift in retirement coverage for legislators and constitutional officers from defined benefit plan coverage to primarily defined contribution plan coverage by mandating Unclassified State Employees Retirement Program (MSRS-Unclassified) for legislators and constitutional officers newly elected after July 1, 1997, and by authorizing a Social Security referendum and a retirement coverage election for existing legislators and constitutional officers after July 1, 1998, on a date to be specified by the Governor.

The Commission, in its principles of pension policy, has expressed a general preference for defined benefit pension plans over defined contribution pension plans. The Commission also has specified that defined contribution pension plans are appropriate if certain circumstances prevail, such as interstate portability desires, public sector-private sector portability desires, the existence of public employee groups with inadequate civil service or without other analogous employment protections, or a desire to have supplemental pension coverage.

2. Comparison of Legislators 1965, 1975, 1985, and 1995

From the applicable Legislative Manual and other relevant sources, the Commission staff has assembled a comparison of members of the 1965 Legislature, when the Legislators Retirement Plan was established, the 1975 Legislature, the 1985 Legislature, and the 1995 Legislature. That comparison is as follows:

a. Gender

	1965	**1975**	**1985**	**1995**
Male	98.51%	96.02%	86.07%	75.12%
Female	1.49%	3.98%	13.93%	24.88%

b. Attained Age

i. Mean, Median and Range of Ages

	1965	**1975**	**1985**	**1995**
Mean	49.35 years	43.15 years	45.59 years	49.04 years
Median	49 years	41 years	43 years	47 years
Youngest	27 years	24 years	25 years	29 years
Oldest	75 years	69 years	74 years	84 years

ii <u>Distribution of Attained Ages</u>

Attained Age	1965	1975	1985	1995
24	0.00%	1.00%	0.00%	0.00%
25	0.00	1.00	0.50	0.00
26	0.00	2.49	0.50	0.00
27	0.50	1.00	0.50	0.00
28	0.00	0.50	0.00	0.00
29	0.00	2.49	0.50	0.50
30	0.00	3.48	1.00	1.49
31	0.50	2.99	1.99	1.00
32	0.99	2.99	1.99	0.00
33	0.99	3.48	1.00	1.49
34	1.98	1.49	4.98	1.00
35	1.98	3.98	1.00	2.49
36	0.99	2.49	3.48	1.49
37	2.97	2.49	2.49	0.50
38	2.48	3.98	2.99	3.48
39	1.98	2.49	1.99	2.49
40	4.46	3.48	5.97	1.49
41	2.48	3.98	5.47	1.49
42	3.47	1.00	2.49	2.99
43	2.48	1.99	3.98	3.98
44	2.48	3.98	2.99	3.98
45	1.98	2.49	1.49	4.98
46	1.98	2.49	2.49	5.47
47	0.99	4.48	4.98	3.48
48	2.48	2.49	3.48	3.98
49	1.98	1.49	2.99	1.49
50	2.97	2.99	1.49	4.98
51	1.98	2.49	2.99	3.48
52	1.98	2.49	1.49	1.99
53	1.98	1.00	3.98	3.48
54	1.98	2.49	3.48	2.99
55	1.98	1.99	1.97	1.99
56	3.96	1.00	2.49	1.49
57	0.99	1.99	3.48	2.99
58	2.97	2.49	2.49	2.99
59	1.98	1.99	1.99	1.49
60	2.97	1.00	1.49	1.99
61	2.48	0.50	0.00	0.50
62	1.48	0.50	0.50	1.00
63	0.99	0.00	0.50	1.49
64	0.99	1.49	0.50	2.99

Attained Age	1965	1975	1985	1995
65	0.50	1.00	0.50	1.49
66	1.48	1.00	0.50	0.50
67	0.50	0.00	0.00	1.00
68	0.99	0.00	0.50	1.49
69	0.99	1.00	0.50	0.00
70	0.50	0.00	0.00	0.50
71	0.00	0.00	0.00	0.00
72	0.00	0.00	0.00	0.50
73	0.99	0.00	0.00	0.00
74	0.00	0.00	0.50	0.00
75	0.50	0.00	0.00	0.00
76	0.00	0.00	0.00	0.00
77	0.00	0.00	0.00	0.00
78	0.00	0.00	0.00	0.00
79	0.00	0.00	0.00	0.00
80	0.00	0.00	0.00	0.00
81	0.00	0.00	0.00	0.00
82	0.00	0.00	0.00	0.00
83	0.00	0.00	0.00	0.00
84	0.00	0.00	0.00	0.50
Undisclosed	21.78	6.47	7.46	8.96

c. Entry Age*

i. Mean, Median and Range of Entry Ages*

	1965	1975	1985	1995
Mean	42.7 years	38.8 years	39.3 years	41.3 years
Median	42 years	38 years	39 years	41 years
Youngest	23 years	22 years	22 years	25 years
Oldest	68 years	63 years	67 years	63 years

ii. Distribution of Entry Ages*

Entry Age	1965	1975	1985	1995
22	0.00%	1.49%	0.50%	0.00%
23	0.50	0.50	0.50	0.00
24	0.00	0.50	1.00	0.00
25	0.50	1.49	1.49	0.50
26	1.00	1.99	0.50	0.50
27	1.00	3.48	4.48	6.47
28	1.00	1.99	1.49	1.00
29	2.48	3.98	1.99	1.99
30	1.49	4.48	5.47	3.48

Entry Age	1965	1975	1985	1995
31	1.98	5.47	1.49	1.49
32	1.98	2.99	3.98	2.99
33	2.48	1.49	1.99	3.48
34	3.47	1.99	5.47	4.98
35	1.49	3.98	3.48	0.50
36	2.48	2.49	4.98	3.48
37	3.47	5.47	3.48	2.49
38	4.46	5.47	2.99	4.48
39	2.97	5.47	5.97	4.98
40	2.97	4.98	3.48	3.98
41	1.49	0.50	2.49	3.98
42	4.46	3.98	3.48	4.98
43	2.48	1.00	3.48	4.98
44	1.98	1.99	2.49	4.98
45	0.50	2.99	2.49	2.49
46	2.97	3.98	3.48	4.98
47	2.48	2.49	3.48	2.49
48	4.95	3.48	1.99	2.49
49	3.47	0.00	1.99	1.00
50	2.48	1.49	2.49	1.99
51	0.50	2.49	1.99	1.99
52	1.49	1.00	0.50	1.00
53	2.48	1.49	1.49	1.49
54	1.00	1.00	1.49	1.00
55	0.50	0.00	1.00	1.00
56	1.98	0.50	0.50	1.49
57	1.49	0.50	0.00	1.49
58	1.98	1.00	0.50	1.49
59	0.50	1.00	0.50	0.00
60	0.50	0.50	0.50	1.00
61	0.50	0.50	0.00	0.00
62	0.50	0.00	0.00	0.50
63	0.50	1.00	0.50	1.00
64	0.00	0.00	0.50	0.00
65	0.50	0.00	0.00	0.00
66	0.00	0.00	0.00	0.00
67	0.00	0.00	0.50	0.00
68	0.50	0.00	0.00	0.00
Unknown Age	21.78	6.47	7.46	8.96

* Entry age is determined by subtracting accrued service credit from attained age, which may mischaracterize the entry age for legislators with one or more breaks-in-legislative-service.

d. Accrued Service

i. Mean, Median and Range

	1965	1975	1985	1995
Mean	7.59 years	4.43 years	5.97 years	7.43 years
Median	6 years	2 years	4 years	4 years
Low	0 years	0 years	0 years	0 years
High	46 years	22 years	28 years	38 years

ii. Distribution of Accrued Service

Accrued Service	1965	1975	1985	1995
0	12.87%	28.36%	13.43%	15.92%
1	0.00	0.00	0.00	1.49
2	27.72	24.38	22.39	19.90
3	0.00	0.00	0.00	0.50
4	8.42	17.91	16.92	12.44
6	13.37	5.47	10.95	6.47
8	3.47	7.96	9.95	12.94
10	10.89	1.49	5.97	4.98
12	3.96	6.97	13.43	3.48
14	4.95	1.00	2.99	4.98
16	1.49	2.99	1.00	1.99
18	2.97	2.49	1.49	4.48
20	0.99	0.50	1.00	3.48
22	0.99	0.50	0.00	4.48
24	2.48	0.00	0.00	1.99
26	1.49	0.00	0.00	0.00
28	0.50	0.00	0.50	0.00
30	1.49	0.00	0.00	0.00
32	0.50	0.00	0.00	0.00
34	0.00	0.00	0.00	0.00
36	0.00	0.00	0.00	0.00
38	0.50	0.00	0.00	0.50
40	0.00	0.00	0.00	0.00
42	0.00	0.00	0.00	0.00
44	0.00	0.00	0.00	0.00
46	0.50	0.00	0.00	0.00
Not Reported	0.50	0.00	0.00	0.00

e. Marital Status and Dependents

	1965	1975	1985	1995
Married, With Children	78.71%	77.61%	77.11%	76.12%
Married, Without Children	3.96	7.46	5.97	7.46
No Marital Status Disclosed, With Children	0.99	1.49	1.49	4.98
Single, With Children	0.00	0.00	0.50	0.50
Single, Without Children	0.99	3.98	3.48	6.47
No Marital Status Disclosed, Without Children	15.35	9.45	11.44	4.48

f. Occupation

	1965	1975	1985	1995
Legislator	0.00%	2.49%	1.99%	13.43%
Lawyer	26.24	14.43	10.95	13.93
Farmer	23.76	16.92	18.91	11.94
Business	7.43	2.49	10.45	10.95
Consultant	0.00	0.50	1.49	1.99
Insurance	5.94	2.49	1.00	1.99
Teacher	2.97	9.45	11.44	10.45
Retiree	1.49	0.00	0.50	1.49
Banker	0.99	1.99	0.50	1.49
Real Estate	1.98	1.49	1.99	1.49
Other Employment	25.25	45.27	32.84	26.87
No Occupation Disclosed	3.96	2.49	7.96	3.98

3. Nature of 1965 Legislative Service: Appropriateness of Current Defined Benefit Coverage

In 1965, the Legislature began coordinating the Public Employees Retirement Association (PERA) with Social Security and established the Legislators Retirement Plan as a free-standing basic public employee pension plan rather than including legislators on a voluntary basis in PERA. Both PERA and the Legislators Retirement Plan are defined benefit pension plans. A question arises about whether or not a defined benefit plan in the nature of the 1965 Legislators Retirement Plan as a basic program was well suited for the population of members of the 1965 Legislature.

The 1965 Legislature was substantially male (98.51 percent), had generally reached mid-middle age (mean age of 49.35 years), had generally entered legislative service in early middle age (mean entry age of 42.7 years), had accrued a moderate length of legislative service (mean accrued service of 7.59 years; median service of six years), predominantly was married with children (78.71 percent married with children), and predominantly were employed outside of the Legislature as lawyers, farmers, business persons, or other outside employment (82.68 percent in those four categories).

The Legislative Commission on Pensions and Retirement determined, as part of its 1996-1997 mandated interim report Relative Advantages and Disadvantages of Defined Contribution Pension Plans and Defined Benefit Pension Plans, Including Federal Taxation Considerations, that defined benefit pension plans most advantage individuals who enter public service in middle age, who have long service, who are highly compensated, who have a pattern of late career rapidly increasing compensation, who have a moderate or high preretirement casualty risk, who have an early expected actual normal retirement age, who plan to retire at an early age, who have substantial late-career promotional or advancement opportunities, who have low political sensitivity or low employment volatility, who have spouses without significant pension coverage on their own, who have full portability for any prior defined benefit pension plan accrued service credit, and who do not have other contemporaneous employment and pension coverage.

The characteristics of the members of the 1965 Legislature met several, but not all, of the factors which make defined benefit pension plan coverage advantageous for a coverage group, chiefly entry age, length of service, and early retirement age. In some significant aspects, the Legislators Retirement Plan would appear to be a poor choice for defined benefit plan retirement coverage, such as the relatively static pattern of legislative salary, the relative lack of promotional opportunities, the high political sensitivity of legislative service, and the existence of outside contemporaneous employment.

4. Nature of Post-1965 Legislative Service: Appropriateness of the Shift To a Defined Contribution Plan and Social Security Coverage

In 1997, the Legislature began the process of converting from defined benefit plan coverage to defined contribution plan coverage for members of the Legislature and of adding Social Security coverage. A question arises about whether or not a defined contribution pension plan in the nature of the 1997 Unclassified Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Unclassified) and Social Security is becoming better suited for the Legislature given the changes in the membership characteristics that have occurred since 1965.

The post 1965 Legislature has become less substantially male (from 98.51 percent to 75.12 percent), but remains mid-middle aged (mean attained age from 49.35 years to 49.04 years), continues to experience the entrance into legislative service in early middle age (mean entry age from 42.7 years to 41.3 years), continues to experience the accrual of a modest length of legislative service (mean accrued service from 7.59 years to 7.43 years, although median accrued service has declined from 6 years to 4 years), and remain predominantly married with children (married and children from 78.71 percent to 76.12 percent). The most significant change between the 1965 Legislature and the post-1965 legislative experience has been in the occupations of legislators, with a growth in the number of legislators listing legislator (from 0.00 percent to 13.43 percent), consultant (from 0.00 percent to 1.99 percent), business person (from 7.43 percent to 10.95 percent) and a decline in the number of lawyers (from 26.24 percent to 13.93 percent), farmers (from 23.76 percent to 11.94 percent), and insurance personnel (from 5.94 percent to 1.99 percent).

As the Legislative Commission on Pensions and Retirement noted in the mandated interim report Relative Advantages and Disadvantages of Defined Contribution Pension Plans and Defined Benefit Pension Plans, Including Federal Taxation Considerations, defined contribution pension plans most advantage individuals who enter public service either at a young age or at or after the normal retirement age, who have short service, who are low or moderately compensated public employees, who have a pattern of relatively static compensation, who have a low or nominal pre-retirement casualty risk, who have a later expected actual normal retirement age, who do not plan to retire at an early age, who have limited opportunities for a late career promotion or advancement, who have high political sensitivity or high volatility, who have spouses with significant spousal pension coverage, who have prior defined contribution plan coverage, and who have other contemporaneous employment and pension coverage.

The characteristics of the members of the 1975, 1985, and 1995 Legislature are more consistent with the factors that make defined contribution pension plan coverage advantageous for a coverage group, especially the volatility of service and the extent of outside employment. However, the membership of the 1995 legislature reflects a trendline with respect to attained age, entry age, and accrued service that is returning the characteristics of the 1965 Legislature, when the Legislature first determined that defined benefit plan coverage was appropriate for legislators.

B. Factors Likely To Influence Social Security Referendum Vote

As provided in Laws 1997, Chapter 233, Article 2, Section 8, unless modified by the 1998 Legislature, sometime after July 1, 1998, a referendum will be held for current members of the Legislature and for current constitutional officers on the question of future retirement coverage. During the Social Security referendum, current legislators and current constitutional officers will either elect to retain as their sole future pension coverage their current defined benefit basic program retirement coverage, the Legislators Retirement Plan under Minnesota Statutes, Chapter 3A, or the Elected Stated Officers Retirement Plan under Minnesota Statutes, Chapter 352C, or elect to change their future pension coverage to a combination of Social Security (the federal Old Age, Survivors, Disability and Health Insurance Program) and the Unclassified State Employee Retirement Program (MSRS-Unclassified), primarily a defined contribution plan.

To assist current legislators and current constitutional officers, a Social Security referendum notice and statement will be provided to each legislator and constitutional officer summarizing the rights accruing under the federal Social Security Act (Title 28 United States Code Sections 401 et seq.) and providing information on the effect of the addition of Social Security coverage will have on the future legislative and constitutional officer pension coverage. In addition to the Social Security referendum notice and statement, current legislators and current constitutional officers would be well advised to request the following additional information:

1. Social Security System Statement of Earnings and Benefit Estimate. A record of each individual's potential Social Security benefits is available from the Social Security System and will clarify the individual's remaining needs to qualify for a Social Security benefit, the amount of the potential Social Security benefit, and the amount of any potential benefit offsets. The earnings statement and benefit estimate can be obtained free of charge by completing Form SSA-7004-SM (Request For Earnings And Benefit Estimate Statement), which can be obtained from either of the following sources:

Social Security Administration
6401 Security Boulevard
Baltimore, Maryland 21235

1-800-772-1213

Social Security Administration
316 North Robert Street
St. Paul, Minnesota 55101

1-800-772-1213

2. Retirement Plan Benefit Estimate. An estimate of each individual's accrued benefit from the Legislators Retirement Plan, the Elective State Officers Retirement Plan and any other Minnesota public pension plan is available from the retirement plan administration. The benefit estimate for the Legislators Retirement Plan or the Elective State Officers Retirement Plan can be obtained from the following source:

David Bergstrom
Executive Director
Minnesota State Retirement System
175 West Lafayette Road - Third Floor
St. Paul, MN 55107-1425

(612) 296-2761

While each legislator and each constitutional officer will need to assess their individual resources and their individual plans for retirement, there are a broad set of indicators that would generally favor retention of the current sole defined benefit retirement plan coverage by legislators and constitutional officers or that would generally favor the selection of a combination of Social Security coverage and defined contribution plan Unclassified Employees Retirement Program (MSRS-Unclassified) coverage by legislators and constitutional officers. These indicators, as identified by the Commission staff, are as follows:

Indicators Favoring Retention of Legislators or Elective State Officers Retirement Plan Coverage

1. Long Current Service Credit
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has extended service (over 15 or 20 years) either will not be able to gain enough Social Security coverage to vest or will not be able to gain enough Social Security coverage to provide a substantial Social Security benefit.

Indicators Favoring Selection of Social Security and MSRS-Unclassified Program Coverage

1. Short Current Service Credit
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has short service will be able to both vest for a Social Security benefit and will be able to maximize both a Social Security benefit and an MSRS-Unclassified benefit.

Indicators Favoring Retention of Legislators or Elective State Officers Retirement Plan Coverage

2. Older Attained Age
A member of the Legislators Retirement Plan or of the Elected State Officers Retirement Plan who is at, near, or over the normal retirement age for the plan will not likely be able to vest for a Social Security benefit or to provide a significant Social Security benefit unless there was prior Social Security coverage.

3. Significant Accrued Social Security Coverage From Prior or Contemporaneous Employment
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has significant accrued Social Security coverage from prior or contemporaneous employment outside of legislative or constitutional officer service will not gain any or much additional Social Security benefits from shifting coverage at this time.

4. Very Young Age With Prospect For Modest Future Service Or With Prospect For Higher Office
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who is relatively young and either has little prospect for total accrued service credit in these plans beyond the vesting requirement (six years of the Legislators Retirement Plan and eight years for the Elective State Officers Retirement Plan) or has good prospects for higher office (elective or appointive) will have a significant period of post-Legislators Retirement Plan or post-Elective State Officers Retirement Plan employment to gain a significant Social Security benefit while gaining the additional Legislators Retirement Plan or Elective State Officers Retirement Plan benefit.

Indicators Favoring Selection of Social Security and MSRS-Unclassified Program Coverage

2. Younger Attained Age
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who is early in the person's working career will vest for a Social Security benefit and will have sufficient years remaining in order to maximize Social Security benefits and MSRS-Unclassified benefits.

3. Limited or No Accrued Social Security Coverage From Prior or Contemporaneous Employment
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has little or no significant accrued Social Security coverage from prior or contemporaneous employment outside of legislative or constitutional officer service can gain significant additional Social Security benefits from a coverage shift at this time.

4. High Turnover Prospect
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who is not yet vested and has a high probability of terminating legislative or constitutional officer service before becoming vested without a high probability of future Minnesota public sector employment is unlikely to gain anything beyond rights to a refund of member contributions from the Legislators Retirement Plan or the Elective State Officers Retirement Plan and would benefit from the additional Social Security coverage, which is the likely pension coverage for post-legislative or post constitutional officer service.

Indicators Favoring Retention of Legislators or Elective State Officers <u>Retirement Plan Coverage</u>

5. <u>Likely Future Minnesota Public Sector Employment</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has a strong probability of future employment in the Minnesota public sector, where defined benefit pension plan coverage predominates and where intersystem portability exists, will have the greatest continuity of benefit coverage in continuing that defined benefit plan pension coverage.

6. <u>Significant Concern About Future Social Security Financial Solvency</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has a significant concern about the fiscal solvency of the Social Security System, where increased contributions, reduced future benefits, privatization, or even eventual bankruptcy are potential developments, would avoid the potential problem by retaining coverage. Current projections indicate a potential default in the old age and survivors insurance trust fund in 2029, a potential default in the disability insurance trust fund in 2015, a potential default in the hospitalization insurance trust fund in 2001.

7. <u>High Potential For Death While In Active Service</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has a high potential for death while in active service will have the greatest likely survivor benefit coverage by electing to retain the current benefit plan coverage.

Indicators Favoring Selection of Social Security and MSRS- <u>Unclassified Program Coverage</u>

5. <u>Likely Future Private Sector Employment</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has a strong probability of future employment in the private sector, where Social Security provides the greatest portability of benefit coverage, will likely optimize the benefit coverage by the addition of Social Security coverage.

6. <u>Significant Desire To Personally Invest Retirement Assets</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has a strong desire to personally invest retirement-oriented assets and receive the direct benefit (or loss) resulting from those personal decisions rather than obtaining retirement benefits related to other factors would gain that ability, for at least a portion of their future retirement benefits by electing the combined Social Security-MSRS Unclassified Retirement Program option.

7. <u>High Potential For Disability During Employment</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who has a high potential for becoming disabled during active employment currently have no disability benefit coverage by virtue of public employment and will gain that coverage by electing a combination of Social Security and the MSRS-Unclassified Retirement Program.

Indicators Favoring Retention of Legislators or Elective State Officers <u>Retirement Plan Coverage</u>

8. <u>Desire to Retire Early (Before Age 65-Age 67)</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who desires to retire at an early age (before age 65 or age 67, the normal retirement ages applicable for most Social Security benefit recipients) will maximize access to early retirement (age 62 normal retirement age; age 60 early (reduced benefit) retirement age) by retaining the existing coverage.

9. <u>Poor Long Term Investment Horizon</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who expects poor investment returns (i.e. returns equal to or below inflation) on retirement assets over the long term will be insulated from that potentiality by retaining the current coverage.

10. <u>Single or Married With Employed Spouse and Few or No Children</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who is single or who is married with a spouse employed outside of the home will not be as benefited by Social Security as other members and likely will be advantaged by retaining the current coverage. At an average salary level, a single male will receive Social Security benefits with a value of 72 percent of the contributions paid into the system, while a single female will receive benefits equal to 84 percent of contributions. For maximum salary level single males, benefits equal 48 percent of contributions, and for maximum salary level single females, benefits equal 56 percent of contributions.

Indicators Favoring Selection of Social Security and MSRS- <u>Unclassified Program Coverage</u>

8. <u>Desire to Have Flexible Retirement Coverage To Accommodate Late Age Retirement</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who plans to delay retirement until a later age (older than age 62 or age 65) and wants retirement coverage that is flexible enough to provide all or most of the value of the benefit coverage will maximize that flexibility by electing the combination of Social Security and the MSRS-Unclassified Retirement Program.

9. <u>Good Long Term Investment Horizon</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who expects good investment returns (i.e. returns substantially greater than inflation) on retirement assets over the long term will best be able to gain personal advantage of those gains by electing the combination of Social Security and the MSRS-Unclassified Retirement Program.

10. <u>Married With At-Home Spouse and Numerous Children</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who is married with a spouse who is not employed outside of the household and has a large family matches the family composition targeted by Social Security in its initial design and likely will be advantaged by selecting the combination of Social Security and MSRS-Unclassified Retirement Program.

Indicators Favoring Retention of Legislators or Elective State Officers <u>Retirement Plan Coverage</u>

11. <u>Desire To Match the Benefit Practices Applicable To Most Public Employees</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who seeks to have pension coverage that generally matches that of Minnesota public employees, defined benefit plan coverage, will elect to retain the current pension plan coverage.

12. <u>Desire To Maximize Take-Home Pay Over Retirement Contributions</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who seeks to maximize take-home pay over contributions to retirement coverage will elect to retain the current pension coverage, with a 9.00 percent member contribution plus a 1.45 percent member contribution to the Medicare portion of Social Security (total of 10.45 percent) as compared to a 7.65 percent member contribution to Social Security and a 4.00 percent member contribution to the MSRS-Unclassified Retirement Program (total of 11.65 percent).

Indicators Favoring Selection of Social Security and MSRS-<u>Unclassified Program Coverage</u>

11. <u>Desire To Replicate the Pension Coverage of Average Private Sector Constituent</u>
A member of the Legislators Retirement Plan or of the Elective State Officers Retirement Plan who seeks to have pension coverage that essentially replicates the pension coverage available to most constituents employed in the private sector (Social Security only or supplemented by a defined contribution plan) will elect the combination of Social Security and MSRS-Unclassified Retirement Program.

C. <u>Potential For Retroactive Social Security Coverage</u>

Under the Social Security law, upon authorization of a Social Security referendum, the effective date of Social Security coverage can be made retroactive for up to five years before the year in which the State Social Security agreement was modified to include the new coverage group. The employee and employer Social Security contributions that would have been paid during the period of retroactive Social Security coverage are payable in a lump sum upon the grant of retroactive Social Security coverage. The retroactive Social Security coverage provides the pension plan participant with a more complete Social Security coverage history, which will provide earlier vesting for Social Security benefits, greater calculated Social Security benefits, and smaller potential reductions under the Social Security windfall offset.

In many prior consolidations of a Minnesota public pension plan with Social Security, the legislature has authorized the making of retroactive employee and employer Social Security contributions for current pension plan members who elect future Social Security coverage and have their prior pension coverage shifted from the basic program to the coordinated program. These retroactive employee and employer Social Security contributions have been payable from the retirement fund from the accumulated member and employer contributions credited to or on behalf of that plan member. If the retroactive Social Security employee and employer contributions exceed those accumulated contribution amounts, the member or the employing unit or both are liable to pay the difference to the applicable pension plan.

Laws 1997, Chapter 233, Article 2, did not permit the payment of retroactive Social Security employee and employer contributions for legislators or constitutional officers who elect Social Security coverage and future Unclassified Employees Retirement Program (MSRS-Unclassified). Future proposed legislation could authorize the payment of these retroactive Social Security employee and employer contributions, on a voluntary basis, although there are several policy questions about the potential change, as follows:

1. Lack of Retirement Fund Source of Retroactive Payment. The issue is the lack of a separate dedicated retirement fund associated with either the Legislators Retirement Plan or the Elective State Officers Retirement Plan and the consequent lack of a ready source for making the retroactive Social Security employee and employer contributions. For administrative ease and procedural simplicity, all past instances of the authorization of retroactive Social Security contributions have utilized a disbursement of the retroactive payment from the applicable retirement fund. However, since the Legislators Retirement Plan and the Elective State Officers Retirement Plan lack separate dedicated retirement funds, the source of the retroactive payments would need to be the State General Fund and would require a state appropriation. Because the State, as employer, does not make concurrent employer contributions to either plan, if there are several current legislators who elect the retroactive Social Security contributions, the potential appropriation from the State General Fund could be very large. At an average legislative salary and session per diem payments of $36,930, the retroactive Social Security employee or employer contribution per year would be $2,825, or $14,125 for a full five year retroactive coverage period.

2. Adjustment In Prior Basic Program Accrued Benefits. The issue is the need to adjust the accrued Legislators Retirement Plan or Elective State Officers Retirement Plan Basic Program benefits for legislators or constitutional officers who elect to make the retroactive Social Security contributions. In past retroactive Social Security contribution authorizations, the retroactive Social Security contributions and Social Security coverage were balanced against the conversion of past Basic Program accrued benefits to Coordinated Program accrued benefits. That conversion was not required by laws 1997, Chapter 233, Article 2, since legislators and constitutional officers who elect Social Security coverage would affect only future benefit program coverage and would leave any accrued Basic Program benefits unaffected. If the balance was not required, affected legislators and constitutional officers would receive undue benefit generosity, the liability of the affected retirement plans and the State would be unduly increased, and the employer obligation of the State would similarly be unduly increased.

3. <u>Additional Complexity In The Upcoming Benefit Coverage Election</u>. The issue is the potential additional complexity that the authorization of retroactive Social Security employee and employer contributions will produce for current legislators and current constitutional officers. Shortly after July 1, 1998, current legislators and constitutional officers will be faced with significant retirement benefit coverage decisions. For some legislators and constitutional officers contemplating a change to Social Security coverage, the change to obtain up to five years of retroactive Social Security coverage may be a clear advantage, but the addition of one more retirement option may overload the selection process.

D. <u>Continued Authority For Legislators and Constitutional Officers To Use The MSRS-Unclassified Program Provision Allowing MSRS-General Plan Coverage</u>

Laws 1997, Chapter 233, Article 2, creates a combination of Social Security coverage and Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) coverage for new (post July 1, 1997) legislators and constitutional officers instead of Legislators Retirement Plan or Elective State Officers Retirement Plan coverage and allows existing legislators and constitutional officers to elect that combination coverage after July 1, 1998.

Although MSRS-Unclassified is a defined contribution pension plan, the governing law, Minnesota Statutes, Chapter 352D, includes authority for an MSRS-Unclassified participant to elect defined benefit pension plan coverage, the MSRS General State Employees Retirement Plan (MSRS-General), instead of the MSRS-Unclassified benefit if the participant has acquired ten years or more of "state service." "State service" is service that would qualify as allowable service for either MSRS-General or MSRS-Unclassified. The authorization is coded as Minnesota Statutes, Section 352D.02, Subdivision 3, which provides that

> [a]n election to not participate is irrevocable during any period of covered employment. An employee credited with employee shares in the unclassified program, after acquiring credit for ten years of allowable service but prior to termination of covered employment, may, notwithstanding other provisions of this subdivision, elect to terminate participation in the unclassified plan and be covered by the regular plan by filing such election with the executive director. The executive director shall thereupon redeem the employee's total shares and shall credit to the employee's account in the regular plan the amount of contributions that would have been so credited had the employee been covered by the regular plan during the employee's entire covered employment. The balance of money so redeemed and not credited to the employee's account shall be transferred to the state contribution reserve of the state employees retirement fund, except that (1) the employee contribution paid to the unclassified plan must be compared to (2) the employee contributions that would have been paid to the general plan for the comparable period, if the individual had been covered by that plan. If clause (1) is greater than clause (2), the difference must be refunded to the employee as provided in section 352.22. If clause (2) is greater than clause (1), the difference must be paid by the employee within six months of electing general plan coverage or before the effective date of the annuity, whichever is sooner.

The defined benefit plan coverage election authorization in the MSRS-Unclassified Program allows various MSRS-Unclassified Program participants to adversely select or elect against the pension plan, with a significant potential benefit gain for the participant and a significant potential risk of the creation of an unfunded actuarial accrued liability in the MSRS-General Plan.

A specific question arises whether or not this defined benefit plan election option should be applicable to legislators and constitutional officers covered by the MSRS-Unclassified Program and a general question arises whether or not the option should be indefinitely retained for all other MSRS-Unclassified Program participants.

While, from a participant benefit standpoint, the defined benefit plan election option of the MSRS-Unclassified Program is a very valuable attribute, the authority carries with it numerous opportunities for the creation of unfunded actuarial accrued liabilities within the MSRS-General Plan. These actuarial loss potentials include:

1. Investment Loss. Participants in the MSRS-Unclassified Program select their own broad investment strategy by designating the proportion of contributions to be invested in one or more accounts in the State Board of Investment's Supplemental Investment Fund. If that member-directed investment strategy, which can be modified regularly, produces actual investment losses, and the participant gains at least ten years of state service, those losses can be avoided by the selection of the MSRS-General Plan defined benefit plan retirement annuity in lieu of the MSRS-Unclassified Program defined contribution retirement annuity.

2. Investment Underperformance Compared To Final Years' Salary Increases. Similar to investment losses, if an MSRS-Unclassified Program participant's final five years average salary increases much more significantly than the performance of the participant's accumulated contributions in the Supplemental Investment Fund, the participant can take retirement benefit advantage of that late-career salary growth by electing a larger retirement annuity under the MSRS-General Plan rather than a smaller retirement annuity under the MSRS-Unclassified Program.

3. Early Retirement. If an MSRS-Unclassified Program participant changes end-of-career plans and decides to retire at an early age rather than a later age and the participant has at least ten years of state service, the participant can elect to take a greater MSRS-General Plan retirement annuity rather than a lesser MSRS-Unclassified Program retirement annuity.

4. Late Career Benefit Increase. If a benefit increase is granted to the MSRS-General Plan late in the career of an MSRS-Unclassified Program participant, the participant can elect to take the increased MSRS-General Plan retirement annuity rather than the more static MSRS-Unclassified Program retirement annuity.

5. Mid-Career or Late Career Mobility With Subsequent Portable Defined Benefit Plan Coverage. A participant in the MSRS-Unclassified Program with at least ten years of state service who makes a career change to public employment with defined benefit plan coverage that is portable with MSRS-General Plan pension coverage will likely elect to

shift from MSRS-Unclassified Program coverage to MSRS-General Plan coverage, in order to take advantage of the Combined Service Annuity portability mechanism.

In order to avoid these potential losses, the option to shift from defined contribution plan coverage under the MSRS-Unclassified Program to the defined benefit plan coverage under the MSRS-General Plan could be eliminated specifically for legislators and constitutional officers and generally for other MSRS-Unclassified Program participants (new only or new and existing). Any elimination of the option for eligible general employees, however, will put pressure on the process of pre-employment or early employment counseling. Currently, under Minnesota Statutes, Section 352D.02, Subdivision 1, Paragraph (a), a person eligible for MSRS-Unclassified Program coverage will be covered by the MSRS-Unclassified Program unless the person files a notice of election of MSRS-General Plan coverage within one year of the start of eligible employment.

E. Authority To Transfer Past Contributions By Legislators and Constitutional Officers Electing Future MSRS-Unclassified Coverage

1. In General

Recently, the administrator of the Legislators Retirement Plan and the Elective State Officers Retirement Plan, Minnesota State Retirement System Executive Director David Bergstrom, has raised an implementation question associated with the election of future pension plan coverage by existing legislators and existing constitutional officers after July 1, 1998. The questions are whether or not legislators and constitutional officers who elect future coverage by the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) should be allowed to transfer past contributions made during legislative or constitutional officer service to the MSRS-Unclassified program, with a forfeiture of any associated accrued Legislators Retirement Plan or Elective State Officers Retirement Plan retirement benefit, whether any authorized past contribution transfer amount would include some level of equivalent employer contributions and would include some interest, and what would be the source of any or all of these transfer amounts.

2. Precedent

Minnesota Statutes, Section 352D.12, provides that any participant in the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) who has prior service credit in the MSRS General State Employees Retirement Plan (MSRS-General), the MSRS Correctional Employees Retirement Plan (MSRS-Correctional), the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), the Public Employees Police and Fire Plan (PERA-P&F), the Teachers Retirement Association (TRA), the Duluth Teachers Retirement Fund Association (DTRFA), the Minneapolis Teachers Retirement Fund Association (MTRFA), the St. Paul Teachers Retirement Fund Association (StPTRFA), or the Minneapolis Employees Retirement Fund (MERF), may elect to transfer past member contributions and an equal amount of employer contributions, plus annual compound interest at the rate of 8.5 percent. The MSRS-Unclassified participant has one year from the start of MSRS-Unclassified coverage to make the transfer. If the participant has taken a prior refund from an applicable retirement plan, the participant can repay that refund and then make the transfer of assets to the MSRS-Unclassified Plan.

The provision was enacted during the First 1985 Special Session (First Special Session Laws 1985, Chapter 7, Section 9), as part of a package of a number of administrative provisions. The Commission files on the legislation are sparse and offer no insight on the intent of the Commission regarding the provision or on the motivation of the sponsors of the provision.

3. Potential Authority To Transfer Past Legislator and Constitutional Officer Contributions

Because Minnesota Statutes 352D.12, does not reference Minnesota Statutes, Chapter 3A, the Legislators Retirement Plan, or Minnesota Statutes, Chapter 352C, the Elective State Officers Retirement Plan, legislators and constitutional officers who will elect retirement coverage by the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) after July 1, 1998, will not be able to transfer any of their contributions previously made to either retirement plan.

Assuming that legislators and constitutional officers who are under age 40 and who have less than 10 years of service are the most likely to transfer to the MSRS-Unclassified Program, 28 legislators and one constitutional officer would be potentially interested in transferring past pension contributions to MSRS-Unclassified. The breakdown of this group, and the average salary amount, is as follows:

	Legislators	Constitutional Officers
Under Age 25/Under One Year Service	2 ($34,458)	
Age 25-29/Under One Year Service	2 ($34,458)	
Age 30-34/Under One Year Service	1 ($34,458)	
Age 30-34/One to Four Years Service	8 ($43,090)	
Age 35-39/Under One Year Service	4 ($34,458)	1 ($68,453)
Age 35-39/One to Four Years Service	7 ($42,818)	
Age 35-39/Five to Nine Years Service	4 ($43,854)	

If legislators and constitutional officers who are likely to select future coverage by the MSRS-Unclassified Program are authorized to transfer their prior Legislators Retirement Plan or Elective State Officers Retirement Plan member contributions, the phase-out of the two plans enacted in 1997 will thus be accelerated.

Because so little legislative history exists about the intent of Minnesota Statutes, Section 352D.12, it is difficult to reconstruct the policy considerations that favored its enactment in 1985. However, the provision does allow public employees with nominal or minimal prior service in other Minnesota public employee pension plans who are not covered by the MSRS-Unclassified Program to consolidate all of their prior public pension plan coverage in that defined contribution plan for simplicity sake. Presumably, with ten years of State service or more, under Minnesota Statutes, Section 352D.02, Subdivision 3, a participant can elect to convert the person's defined contribution plan coverage into MSRS-General Plan defined benefit plan service credit, including the service credit associated with any contributions transferred from another defined benefit plan to the MSRS-Unclassified Program.

The primary policy consideration adverse to allowing current legislators and constitutional officers to transfer prior Legislators Retirement Plan or Elective State Officers Retirement Plan contributions to the MSRS-Unclassified Program is budgetary, since neither plan has a pool of available assets from which the contribution transfer could be made. If the transfer were to be authorized, a State General Fund appropriation would most likely be required, irrespective of the amount of the transfer that was authorized.

4. Amount of Any Past Legislator and Constitutional Officer Contribution Transfer

If it is determined by the Commission to be appropriate to allow for the transfer of past Legislators Retirement Plan or Elective State Officers Retirement Plan contributions to the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) by legislators and constitutional officers electing that defined contribution retirement plan coverage, the question arises as to the amount of the past contribution transfer to authorize. Minnesota Statutes, Sections 352D.12, allows various other MSRS-Unclassified Program participants to transfer their prior member contributions, an equal amount of employer contributions, and interest on both amounts at an annual compound interest rate of 8.5 percent. In the Legislators Retirement Plan and the Elective State Officers Retirement Plan, the member contribution is not deposited into a dedicated retirement fund, but simply becomes an asset of the State General Fund. Also, the Legislators Retirement Plan and the Elective State Officers Retirement Plan are not funded on a concurrent employer contribution actuarial basis and there is no dedicated investment earnings attributable to active members.

Assuming that current legislators and current constitutional officers with less than ten years of credited service who are under age 40 elect MSRS-Unclassified Program coverage after July 1, 1998 (28 legislators and one constitutional officer), the likely budgetary impact of any authorized transfer of prior Legislators Retirement Plan or Elective State Officers Retirement Plan would be as follows:

	Legislators Retirement Plan	**Elected State Officers Retirement Plan**
Total Accumulated Member Contributions	$300,000	$6,200
Interest at 8.5 percent annual rate	40,000	750
Equal amount of employer contributions	300,000	6,200
Interest at 8.5 percent annual rate	40,000	750
Total past contributions and interest amount	$680,000	$13,900

If only the accumulated member contributions, without interest, were authorized for transfer, the budgetary impact of the change would be reduced, but the likelihood that all but the youngest and shortest service legislators (total of nine) would be reduced or eliminated. As the size of the potential transfer increases, the budgetary impact will increase and the likelihood of utilization will also increase.

5. Recommendation For Authorization of Transfer of Past Legislators Retirement Plan or Elective State Officers Retirement Plan Contributions

After considering the issues, the Commission recommends that legislators and constitutional officers who elect retirement coverage by the Unclassified State Employees Retirement Program of the Minnesota

State Retirement System (MSRS-Unclassified) after July 1, 1998, and who serve in the Legislature or a constitutional office after January 5, 1999, be permitted to transfer their past member contributions plus 6.5 percent compound annual interest and an identical amount representing what would have been employer contributions if concurrent contributions had been previously required. The transfer could be elected between January 5, 1999, and May 1, 1999. An amount equal to $70,000 should be appropriated to a special reserve account to fund those transfers. This recommendation is included as draft proposed legislation LCPR98-25.

VII. Attachments

The Commission considered five additional items as part of its deliberations on the topic. Those additional items, which are contained as attachments, were as follows:

1. Draft Proposed Legislation LCPR98-25

2. Comparison of Legislators Retirement Plan, Elective State Officers Retirement Plan, MSRS-Unclassified Program and MSRS-General Benefit Plan Provisions (Attachment A)

3. Richard S. Foster, "Ask An Actuary-Part I: The Value of Social Security Benefits," Oasis, Social Security System, Washington D.C., 1994 (Attachment B)

4. Orlo R. Nichols, "Ask An Actuary-Part II: Do People Get Their Money's Worth From Social Security," Oasis, Social Security System, Washington D.C., 1994 (Attachment C)

5. William Ritchie, "Ask An Actuary-Part IV: Social Security's Long Range Financial Outlook," Oasis, Social Security System, Washington D.C., 1995 (Attachment D)

6. Robert E. Ruben, et al, A Summary of the 1997 Annual Reports, Social Security System, Washington D.C., 1997 (Attachment E)

State Retirement System (MSRS-Unclassified) after July 1, 1998, and who serve in the Legislature or a constitutional office after January 5, 1999, be permitted to transfer their past member contributions plus 6.5 percent compound annual interest and an identical amount representing what would have been employer contributions if concurrent contributions had been previously required. The transfer could be elected between January 5, 1999, and May 1, 1999. An amount equal to $70,000 should be appropriated to a special reserve account to fund those transfers. This recommendation is included as draft proposed legislation LCPR98-85.

VII. Attachments

The Commission considered five additional items as part of its deliberations on the topic. Those additional items, which are contained as attachments, were as follows:

1. Draft Proposed Legislation LCPR98-85

2. Comparison of Legislators Retirement Plan, Elective State Officers Retirement Plan, MSRS-Unclassified Program and MSRS-General Benefit Plan Provisions (Attachment A)

3. Richard S. Foster, "Ask An Actuary-Part I: The Value of Social Security Benefits," Oasis, Social Security System, Washington D.C., 1994 (Attachment B)

4. Orlo R. Nichols, "Ask An Actuary-Part II: Do People Get Their Money's Worth From Social Security," Oasis, Social Security System, Washington D.C., 1994 (Attachment C)

5. William Ritchie, "Ask An Actuary-Part IV: Social Security's Long Range Financial Outlook," Oasis, Social Security System, Washington D.C., 1995 (Attachment D)

6. Robert E. Ruben, et al, A Summary of the 1997 Annual Reports, Social Security System, Washington D.C., 1997 (Attachment E)

A bill for an act

relating to retirement; unclassified state employees retirement program; authorizing the transfer of certain prior retirement contributions to the legislators retirement plan or the elective state officers retirement plan; creating a contribution transfer account; appropriating money; amending Minnesota Statutes 1996, section 352D.12.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. Minnesota Statutes 1996, section 352D.12, is amended to read:

352D.12 [TRANSFER OF PRIOR SERVICE CONTRIBUTIONS.]

(a) An employee who is a participant in the unclassified program and who has prior service credit in a covered plan under chapters 3A, 352, 352C, 353, 354, 354A, and 422A may, within the time limits specified in this section, elect to transfer to the unclassified program prior service contributions to one or more of those plans. Participants with six or more years of prior service credit in a plan governed by chapter 3A or 352C on July 1, 1998, may not transfer prior service contributions. Participants with less than six years of prior service credit in a plan governed by chapter 3A or 352C on July 1, 1998, must be contributing to the unclassified plan on or after January 5, 1999, in order to transfer prior contributions.

(b) For participants with prior service credit in a plan governed by chapter 352, 353, 354, 354A, or 422A, "prior service contributions" means the accumulated employee and equal employer contributions with interest at an annual rate of 8.5 percent compounded annually, based on fiscal year balances. For participants with less than six years of service credit as of July 1, 1998, and with prior service credit in a plan governed by chapter 3A or 352C, "prior service contributions" means, to the extent of the balance in the reserve account established under section 2, an amount equal to twice the amount of the accumulated member contributions plus annual compound interest at the rate of 8.5 percent, computed on fiscal year balances.

(c) If a participant has taken a refund from a ~~fund~~ retirement plan listed in this section, the participant may repay the refund to that ~~fund~~ plan, notwithstanding any restrictions on repayment to that ~~fund~~ plan, plus 8.5 percent interest compounded annually and have the accumulated employee and equal employer contributions transferred to the unclassified program with interest at an annual rate of 8.5 percent compounded annually based on fiscal year balances. If a person repays a refund and subsequently elects to have the money transferred to the unclassified program, the repayment amount, including interest, is added to the fiscal year balance in the year which the repayment was made.

(d) A participant electing to transfer prior service contributions credited to a retirement plan governed by chapter 352, 353, 354, 354A, or 422A as provided under this section must complete the application for the transfer and repay any refund within one year of ~~July 1, 1985, or~~ the commencement of the employee's participation in the unclassified program~~, whichever is later~~. A participant electing to transfer prior service contributions credited to a retirement plan governed by chapter 3A or 352C as provided under this section must complete the application for the transfer and repay any refund between January 5, 1999, and June 1, 1999, if the employee commenced participation in the unclassified program before January 5, 1999, or within one year of the commencement of the employee's participation in the unclassified program if the employee commenced participation in the unclassified program after

January 4, 1999.

Sec. 2. [RESERVE ACCOUNT FOR CERTAIN RETIREMENT CONTRIBUTION TRANSFERS; APPROPRIATION.]

Subdivision 1. [RESERVE ACCOUNT.] There is established in the general fund a retirement contribution transfer reserve account. The transfer reserve account may be expended solely to make the transfer of member contributions previously made to the general fund under Minnesota Statutes, section 3A.03, subdivision 1, or 352C.09, subdivision 1, as permitted under Minnesota Statutes, section 352D.12.

Subd. 2. [FY 1999 APPROPRIATION.] $700,000 is appropriated to the retirement contribution transfer reserve account. Any amount remaining in the reserve account on June 15, 1999, cancels.

Subd. 3. [SUBSEQUENT APPROPRIATIONS.] Unless the applicable state department's appropriation legislation provides a different amount, $100,000 each biennium is appropriated to the retirement contribution transfer account for the fiscal year 2000-fiscal year 2001 biennium, for the fiscal year 2002-fiscal year 2003 biennium, and for the fiscal year 2004-fiscal year 2005 biennium.

Sec. 3. [EFFECTIVE DATE.]

Sections 1 and 2 are effective July 1, 1998.

Attachment A

Comparison of Legislators Retirement Plan, Elective State Officers Retirement Plan, MSRS-Unclassified Program, and MSRS-General Benefit Plan Provision

	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
General				
Eligibility:	Members of the State Legislature. A member of PERA who is elected to the Legislature may elect to remain a member of PERA and receive credit under PERA for service as a legislator.	Constitutional Officers.	Legislative employees, employees of Constitutional Officers, department or agency heads and deputies, State Board of Investment employees, various Metropolitan Council and Education Services Office employees.	State employees, non-academic staff of the University of Minnesota and employees of certain metro level governmental units, unless excluded by law.
Contributions:				
Member:	9% of salary.	9% of salary.	4.00% of salary.	4.00% of salary.
Employer:	No specified statutory contribution rate. State must contribute and amount equal to the full annuity value at benefit commencement less accumulated member contributions.	No specified statutory contribution rate. State must meet current disbursements or "pay-as-you-go" obligation monthly.	6.00% of salary.	4.00% of salary.
Service:	Credit for the full term unless termination occurs before the end of the term. Service during all or part of four regular legislative sessions is deemed to be eight years of service.	Service while in an eligible position.	Service while in an eligible position.	Service during which member contributions were made. May also include certain leaves of absence, military service and periods while temporary Worker's Compensation is paid. Excludes lump sum vacation pay at termination.
Salary:	Compensation received for service as a member of the legislature. Salary includes the monthly compensation paid to a legislator and the per diem payments paid during a regular or special session. Salary does not include additional compensation attributable to a leadership position.	Salary upon which Elective State officers Retirement Plan contributions have been made.	Salary upon which contributions have been made.	Includes wages, allowances, and fees. Excludes lump-sum payments at separation, employer contributions to deferred compensation and tax-sheltered annuity plans and benevolent vacation and sick leave donation programs.
Average Salary:	Average of the five highest successive years of salary.	Average of the five highest successive years of salary.	Defined contribution plan.	Average of the five highest successive years (60 successive months) of salary. Average salary is based on all allowable service if less than five years.

	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
Retirement				
Normal Retirement Benefit				
Eligibility:	Age 62 and either six full years of service or service during all or part of four regular legislative sessions. For eligibility purposes, service does not include credit for time not served when a member does not serve a full term of office.	Age 62 and eight years of allowable service.	Age 55 with any length of service.	**First hired before July 1, 1989**: Age 65 and three years of allowable service. Proportionate retirement annuity is available at age 65 and one year of allowable service. **First hired after June 30, 1989**: The lesser of age 66 or the age eligible for full Social Security retirement benefits and three years of allowable service. Proportionate retirement annuity is available at normal retirement age and one year of allowable service.
Amount:	A percentage of average salary for each year of service as follows: Prior to 1/1/79 - 5% for the first eight years - 2.5% for subsequent years After 12/31/78 - 2.5%, increased on an individual actuarial equivalent basis to reflect the value of a one percent reduction in future post retirement adjustments.	2.5% of average salary for each year of allowable service, increased on an individual actuarial equivalent basis to reflect the value of a one percent reduction in future post retirement adjustments.	Annuity based on the value of the retiree's shares in the Minnesota Supplemental Investment Fund.	1.7% of average salary for each year of allowable service.
Early Retirement Benefit				
Eligibility:	Age 60 and either six full years of service or service during all or part of four regular legislative sessions.	Age 60 and eight years of allowable service.	Not applicable.	First hired before July 1, 1989: Age 55 and three years of allowable service. Any age with 30 years of allowable service. Rule of 90: Age plus allowable service totals 90. First hired after June 30, 1989: Age 55 and three years of allowable service.

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	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
Amount:	Normal retirement benefit based on service and average salary at retirement date assuming augmentation to age 62 at 3% per year and actuarial reduction for each month the member is under age 62.	Normal retirement benefit based on allowable service and average salary at retirement date with reduction of 0.5% for each month the member is under age 62 at time of retirement.	Not applicable.	First hired before July 1, 1989: 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 or age 62 if 30 years of allowable service. No reduction if age plus years of allowable service totals 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. First hired after June 30, 1989: 1.7% of average salary for each year of allowable service assuming augmentation to the age eligible for full Social Security retirement benefit at 3% per year and actuarial reduction for each month the member is under the Social Security retirement age.
Form of Payment:	Paid as a joint and survivor annuity to member, spouse and dependent children. Combined service annuitants with less than six years of Legislator service may elect 100% joint and survivor bounceback annuity or a term certain and life annuity on an actuarially equivalent basis.	Life annuity.	Same as MSRS-General except death refund of entire remaining value of individual account.	Life annuity with return on death of any balance of contributions over aggregate monthly payments. Actuarially equivalent options are: 50% or 100% joint and survivor with bounceback feature without additional reduction. 15 year certain and life thereafter.

	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
Benefit Increases:	Benefits may be increased each January 1 depending on increases in the Consumer Price Index, not to exceed 2.5 percent, and on the investment performance of the Minnesota Post Retirement Investment Fund (MPRIF).	Adjusted by MSRS to provide same increase as MPRIF.	Same as MSRS-General MPRIF increase.	Benefits may be increased each January 1 depending on the investment performance of the Minnesota Post Retirement Investment Fund (MPRIF). A benefit recipient who has been receiving a benefit for at least 12 full months as of June 30 will receive a full increase. Benefit recipients receiving benefits for at least one full month but less than 12 full months will receive a partial increase.
Disability				
Disability Benefit				
Eligibility:	None.	None.	Total and permanent disability.	Total and permanent disability before normal retirement age with three years of allowable service.
Amount:			Same as retirement annuity.	Normal retirement benefit based on allowable service and average salary at disability without reduction for commencement before normal retirement age. Payments stop if disability ceases or death occurs. Payments revert to a retirement annuity at normal retirement age. Benefits may be reduced on resumption of partial employment.
Form of Payment:			Same as for retirement.	Same as for retirement.
Benefit Increases:			Same as for retirement.	Same as for retirement.
Retirement After Disability				
Eligibility:			Disability benefit continues for life.	Normal retirement age with continued disability.
Amount:			Not applicable.	Any optional annuity continues. Otherwise, a normal retirement benefit equal to the disability benefit paid before normal retirement age, or an actuarially equivalent optional annuity.
Benefit Increases:			Same as for retirement.	Same as for retirement.

	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
Death Benefits				
Surviving Spouse Benefit				
Eligibility:	Death while active, or after termination if service requirements for a normal retirement benefit are met but payments have not begun.	Death while active or after retirement or with at least eight years of allowable service.	Death without named beneficiary.	Member or former member who dies before retirement or disability benefits commence with three years of allowable service. If a former member dies before age 55 and has less than 30 years of allowable service, benefits commence when the former member would have been age 55. If an active member dies, benefits may commence immediately regardless of age.
Amount:	Survivor's payments of 50% of the retirement benefit of the member assuming the member had attained normal retirement age and had a minimum of eight years of service. Benefit is paid for life. A former member's benefit is augmented as a deferred annuity to date of death before determining the portion payable to the spouse. If the legislator was at least age 60 at death, the surviving spouse may elect an optional joint and survivor annuity.	Survivor's payment of 50% of the retirement benefit of the member assuming the member had attained age 62 and had a minimum of eight years of allowable service. Benefit is paid for life. A former member's benefit is augmented the same as a deferred annuity to date of death before determining the portion payable to the spouse.	Lump sum payment of the value of the individual account, or annuity based on one-half of the value of the individual account and lump sum payment of the other half, or annuity based on the value of the individual account.	Surviving spouse receives the 100% joint and survivor benefit the member could have elected if terminated. If commencement is prior to age 55, the appropriate early retirement formula described above applies except that one-half the monthly reduction factor is used from age 55 to the commencement age and the Rule of 90 does not apply. In lieu of this benefit, the surviving spouse may elect a refund of contributions with interest or an actuarially equivalent term certain annuity.
Benefit Increases:	Same as retirement annuity.	Same as retirement annuity.	If annuity taken, same as retirement annuity.	Same as for retirement.
Surviving Dependent Children's Benefit				
Eligibility:	Same as spouse's benefit.	Same as spouse's benefit.	Death without named beneficiary and without surviving spouse.	If no surviving spouse all dependent children (biological or adopted) below age 20 who are dependent for more than half of their support on deceased member.

	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
Amount:	Benefit for first child is 25% of the retirement benefit (computed as for surviving spouse) with 12.5% for each additional child. Maximum payable (including spouse) is 100% of the retirement benefit. Benefits cease when a child marries or attains age 18 (22 if a full-time student).	Benefit for first child is 25% of the retirement benefit (computed as for surviving spouse) with 12.5% for each additional child. Maximum payable (including spouse) is 100% of the retirement benefit. Benefits cease when a child marries or attains age 18 (22 if a full-time student).	Same as surviving spouse benefit amount.	Actuarially equivalent to surviving spouse 100% joint and survivor annuity payable to the later of age 20 or five years. The amount is to be proportionally divided among surviving children.
Benefit Increases:	Adjusted by MSRS to provide same increase as MPRIF.	Adjusted by MSRS to provide same increase as MPRIF.	If annuity taken, same as retirement benefit.	Same as for retirement.
Refund of Contributions				
Eligibility:	Member dies before receiving any retirement benefits and survivor benefits are not payable.		Death of member.	a. Active employee dies and survivor benefits are not payable, or a former employee dies before annuity begins, or a former employee who is not entitled to an annuity dies. b. Retired or disabled annuitant who did not select an optional annuity dies, or the remaining recipient of an option dies.
Amount:	Member's contributions without interest.		Cash value of individual account, payable in a lump sum.	a. The member's contributions with 5% interest if death occurred before May 16, 1989, and 6% interest if death occurred on or after May 16, 1989. b. The excess of the member's contributions over all benefits paid.
Termination				
Refund of Contributions				
Eligibility:	Termination of service.	Termination of service.	Termination of state service.	Termination of state service.
Amount:	Member's contributions with 5% interest compounded annually if termination occurred before May 16, 1989 and 6% interest if termination occurred on or after May 16, 1989. A deferred annuity may be elected in lieu of a refund.	Member's contributions with 5% interest compounded annually if termination occurred before May 16, 1989 and 6% interest if termination occurred on or after May 16, 1989. A deferred annuity may be elected in lieu of a refund.	Cash value of individual account, payable in lump sum.	Member's contributions with 5% interest compounded annually if termination occurred before May 16, 1989 and 6% interest compounded annually if termination occurred on or after May 16, 1989. A deferred annuity may be elected in lieu of a refund.

	Legislators Retirement Plan	Elective State Officers Retirement Plan	MSRS-Unclassified	MSRS-General
Deferred Benefit				
Eligibility:	Same service requirement as for normal retirement.	Eight years of allowable service.	Any length of service.	Three years of allowable service.
Amount:	Benefit computed under law in effect at termination and increased by the following annual percentage: 0% before 7/1/73; 5% from 7/1/73 to 1/1/81; and 5% thereafter until the annuity begins. Amount is payable as a normal or early retirement.	Benefit computed under law in effect at termination and increased by the following annual percentage: 0% before 7/1/79; 5% from 7/1/79 to 1/1/81; and 3% until age 55; and 5% thereafter until the annuity begins. Amount is payable as a normal or early retirement.	Same as retirement annuity.	Benefit computed under law in effect at termination and increased by the following annual percentage: 0% before 7/1/71; 5% from 7/1/71 to 1/1/81; and 3% thereafter until January 1 of the year following attainment of age 55 and 5% thereafter until the annuity begins. Amount is payable as a normal or early retirement.

Ask an Actuary

Part I: The Value of Social Security Benefits

by Richard S. Foster
[*Editor's note: At the time this article was originally published, Mr. Foster was the Deputy Chief Actuary for Short-Range OASDI Estimates. In January 1995, Mr. Foster became the Chief Actuary of the Health Care Financing Administration.*]

(Originally published in OASIS Magazine, Fall 1994 issue)

Oasis FALL 1994

My wife and I had just moved into a new house. While I was mowing the lawn, my next-door neighbor wandered over to introduce himself. We talked about the usual, introductory sorts of things, including the fact that I worked at the Social Security Administration. He candidly told me that while he thought Social Security was a necessary program and he didn't mind paying the taxes, he did not expect to ever receive any benefits.

Later, I considered my neighbor's situation. He appeared to be in his early thirties and to have fairly substantial earnings. Both of his children were under 6 years of age and his wife worked at home, raising them.

The next time we met, I asked my neighbor how familiar he was with Social Security survivor and disability benefits. He admitted knowing very little. I explained that if he died, his wife and children would be eligible to receive roughly $2,400 per month for many years, with annual increases for the cost of living. And, after age 60, his wife would again be eligible for benefits--this time for the rest of her life. The total value of these benefits, I told him, was equivalent to a life insurance policy with a face value of about $500,000. We then went through a similar example of the benefits that would be payable if he became disabled.

My neighbor was pleased--as well as surprised--to learn that he was covered by such valuable protection against the possible loss of earnings. He had viewed Social Security as just a distant promise of retirement benefits.

After a quick calculation, he determined that the monthly survivor benefits would be about 50 percent of his gross earnings (and a significantly higher proportion of his net take-home pay). In comparing these values to his private life insurance policies (a total of about $250,000 in face value) and his company's group long-term disability coverage (40 percent of average "high-five" earnings), he found that his insurance arrangements--private plus governmental--were more adequate than he had realized.

Of course, my neighbor's situation does not represent an accurate example for all Social Security participants. Benefit levels vary depending on the worker's earnings level and family status. For example, if my neighbor had relatively low earnings, say about $11,000 per year, rather than earnings close to the Social Security maximum ($60,600 this year), then the family's survivor benefit would have been about $780 per month, equivalent to about $175,000 in life insurance.

Table 1 summarizes a few examples of survivors benefits for various earnings levels and types of families.

Table 1--Survivor benefit examples

Illustration	Initial monthly benefit			Total value of all future benefits			Initial benefit as a percentage of prior earnings		
	Low	Average	Maximum	Low	Average	Maximum	Low	Average	Maximum
Worker age 25:									
One child (age 0)..................	$392	$647	$1,041	$69,000	$115,000	$185,000	45%	33%	22%
Two children (ages 0 and 2)......	$784	$1,294	$2,082	$133,000	$219,000	$352,000	89%	66%	43%
Spouse and two children..........	$784	$1,574	$2,430	$174,000	$333,000	$519,000	89%	81%	51%
Worker age 45:									
One child (age 14).................	$390	$642	$984	$18,000	$29,000	$45,000	44%	33%	21%
Two children (ages 14 and 16).....	$780	$1,284	$1,968	$27,000	$45,000	$68,000	89%	66%	41%
Spouse and two children...........	$780	$1,565	$2,296	$82,000	$141,000	$214,000	89%	80%	48%

Most of us tend to downplay the possibility of dying before reaching retirement age. We're uncomfortable with such thoughts. Actuaries are in the sometimes thankless position of calculating such probabilities and reminding us that we do, indeed, need to worry about the financial implications. For the record: today's 20-year-old faces roughly a 2-in-10 possibility of dying before reaching retirement age.

Even less recognized is the possibility of becoming severely disabled and being unable to work. Our 20-year-old friend would not be comforted to learn of the nearly 3-in-10 chance of becoming disabled before reaching retirement.

Thus, the value of Social Security disability benefits is also very important, as shown in table 2.

Table 2--Disability benefit examples

Illustration	Initial monthly benefit			Total value of all future benefits			Initial benefit as a percentage of prio earnings		
	Low	Average	Maximum	Low	Average	Maximum	Low	Average	Maxi
Worker age 25:									
Worker only..........................	$521	$861	$1,382	$69,000	$113,000	$182,000	59%	44%	2
Worker and one child (age 0).........	$736	$1,291	$2,073	$89,000	$154,000	$247,000	84%	66%	4
Worker age 45:									
Worker only..........................	$520	$856	$1,303	$54,000	$88,000	$135,000	59%	44%	2
Worker and one child (age 14).........	$731	$1,285	$1,954	$61,000	$104,000	$158,000	83%	66%	4
Note: *Benefits for larger families are same as shown for worker and one child.*									

People are used to thinking of Social Security as a retirement program. Retirement benefits also vary by the worker's earnings level, age at retirement and whether there are qualifying auxiliary beneficiaries. Table 3 represents benefit examples for workers retiring in 1994.

Table 3--Retirement benefit examples

Illustration	Initial monthly benefit			Total value of all future benefits			Initial benefit as a percentage of prior earnings		
	Low	Average	Maximum	Low	Average	Maximum	Low	Average	Maximu
Worker age 62:									
Worker only.....................	$418	$690	$954	$68,000	$112,000	$155,000	48%	35%	20
Worker and spouse................	$614	$1,014	$1,402	$120,000	$197,000	$273,000	70%	52%	29
Worker age 65:									
Worker only.....................	$505	$829	$1,147	$74,000	$121,000	$168,000	57%	42%	24
Worker and spouse................	$757	$1,243	$1,720	$134,000	$219,000	$304,000	86%	64%	36
Worker age 70:									
Worker only.....................	$579	$967	$1,358	$70,000	$117,000	$164,000	66%	50%	28
Worker and spouse................	$831	$1,387	$1,948	$126,000	$210,000	$295,000	95%	71%	41

People often ask whether it's fair for Social Security to pay very valuable benefits in some cases and little or nothing in others, especially since workers all pay the same tax rate. The answer depends on your perspective. Many participants mistakenly believe that Social Security operates like a bank account--that their taxes are accumulated with interest and returned to them in installments when they retire. By this standard of *individual equity*, they would consider it unfair when no benefits are payable in the case of a deceased worker without qualifying survivors.

Social Security is not a bank account, however. From the very beginning, the program was designed with an emphasis also on the principle of *social adequacy*--that is, the need to provide at least a minimum "floor of protection" for all workers. A worker with a family is presumed to have greater need for earnings replacement in case of retirement, death, or disability than is a worker without a family.

Similarly, workers with relatively high earnings are presumed to be in a better position to help provide for their own financial risks than are workers with low earnings who can just scrape by. Thus, as a percentage of a worker's earnings, Social Security provides relatively higher benefits to those with low earnings and to workers with families.

The program incorporates an element of individual equity, since a worker's benefit amount is based on his or her earnings. Other things being equal, workers with higher earnings will qualify for higher benefit amounts. The benefit formula is *weighted*, however, so that additional earnings result in progressively less in additional benefits.

Social Security's blending of individual equity and social adequacy principles is not easy for the public to understand or appreciate. Many experts, however, believe that the program's design represents an effective compromise in meeting diverse goals for public income security.

The examples above show how Social Security benefits can be very valuable throughout life. For lower-income workers with families, benefits can represent a substantial portion of their prior earnings, particularly if reductions in federal and state income taxes, Social Security taxes, and work expenses are considered. And while benefits for higher-income workers are a lower proportion of earnings, their potential value can still be measured in the hundreds of thousands of dollars--a considerable amount by anyone's standards.

Next month we'll compare the value of Social Security benefits with the value of Social Security *taxes*--the famous "money's worth" issue.

Return to the list of articles.

Comments on any of the published articles or suggestions for additional articles in this series may be e-mailed to: Eli.N.Donkar@ssa.gov

Office of the Chief Actuary
Social Security Administration
March 10, 1997

Ask an Actuary

Part II: Do People Get Their Money's Worth From Social Security?

by Orlo R. Nichols
Actuary

(Originally published in OASIS Magazine, December 1994 issue)

While listening to a discussion of Social Security on talk radio, my neighbor heard the guest say that today's young workers will not get back in benefits what they will pay in taxes. "Is that true?" he asked me.

This incident typifies the public's reaction to the "money's worth" question, which invariably focuses on whether *individual* workers contributing to Social Security get their "money's worth." But is this the best way to evaluate a social insurance program? In fact, it is not.

As noted in last month's "Ask An Actuary" article, Social Security has always been designed to meet broad social goals, including the need to provide a basic "floor of protection" for all workers. Therefore, people who expect Social Security to provide benefits equal to the value of each individual's taxes will no doubt be disappointed. Some participants will always get much more than their money's worth and some will get less.

A better idea is to consider the money's worth question for the nation as a whole. Overall, the nation clearly receives its money's worth from Social Security because the program is administered very efficiently.

In 1993, less than 1 percent of OASDI tax income was spent on administrative expenses--a low figure by almost any standard. From 1937 through 1993, the OASDI trust funds received $4,256 billion in taxes and other income and spent $3,878 billion, only $49 billion of which was for administrative costs. The difference of $378 billion was safely invested in Treasury bonds at the end of 1993.

Another way to view the money's worth question is to consider the relationship of one generation to another under Social Security. People who retired in the past have received much more in benefits than they paid in taxes. In the early years of the program, employees (and their employers) paid taxes on earnings for only a few years of employment but received full-rate benefits. As more years of earnings were covered, the ratio of benefits to taxes decreased. This ratio remains relatively large even for workers retiring in 1994, however, because tax rates in the early years of the program were much lower than they are now.

What about future retirees? Much attention is focused on the current generation of new workers and whether or not they will receive benefits equal in value to their taxes. In particular, young workers are aware of the projected bankruptcy of the system in the next century. Are they destined not to get their money's worth because of future tax increases and/or benefit reductions?

The answer may come as a surprise. Our current estimates show that, even after adjustment to eliminate future deficits, workers entering the labor force now will be close to breaking even as a group. That is, under reasonable actuarial assumptions, the value of future benefits to this group is approximately equal to the value of their combined employee and employer taxes.

"This discussion is all very interesting," one may say, "but what I really want to know is whether or not *I* will get *my* money's worth from Social Security."

The money's worth question from an individual's viewpoint is much more difficult to examine than for

The money's worth question from an individual's viewpoint is much more difficult to examine than for groups. In the first place, the program has been designed specifically to give a better deal to lower-paid workers and to workers with families. As noted, it is not the intention of the program that all workers receive the same return on their contributions.

Whether specific individuals get their money's worth also depends on a variety of other factors, including age at entry into the labor force, sex, periods of unemployment and family composition. Furthermore, the relationship between benefits and taxes also depends on the life experience of the individual.

An employee who remains single and works for 40 years and then dies before retirement pays a great deal in taxes but receives no benefits. On the other hand, a person who has several dependents and dies or becomes disabled after a short career receives much more in benefits in comparison with taxes paid.

Thus, to analyze money's worth for individual workers we need to use "average-case" examples, that is, cases representing groups of similar individuals. To do this, we need to use probabilities of death or disability, the value of retirement, survivors and disability benefits, assumed interest and inflation rates, tax rates adequate to cover future benefits, and a number of other factors. Many outside of SSA who have done money's worth estimates have overlooked one or more of these variables. One of the more common omissions, for example, is the availability of survivors and disability benefits.

Comparison of Value of Social Security Taxes and Benefits for Workers Entering Covered Employment in 1994

	Single male			Single female			Married male with fa		
	Low	Average	Maximum	Low	Average	Maximum	Low	Average	Maxi
Value of OASDI taxes:									
Employee only............	$19,512	$43,360	$104,062	$20,389	$45,310	$108,715	$19,512	$43,360	$104,
Employee and employer......	$39,024	$86,720	$208,124	$40,778	$90,620	$217,430	$39,024	$86,720	$208,
Value of OASDI benefits:									
Retirement.......	$29,744	$49,274	$78,016	$39,053	$64,696	$102,433	$40,274	$66,718	$105,
Disability......	$8,260	$13,614	$21,773	$6,971	$11,489	$18,368	$8,843	$14,786	$23,
Survivors........	---	---	---	---	---	---	$28,846	$48,359	$76,
Total..........	$38,004	$62,889	$99,789	$46,025	$76,185	$120,801	$77,963	$129,863	$205,

Note: *Amounts shown are "actuarial present values." These figures represent the lump-sum equivalent value today of a future stream of payments, taking into account inflation, interest, probabilities of death disability, etc. Workers' earnings are assumed to increase annually by 5 percent and are accumulated w interest at 6 percent per year. Automatic benefit increases are assumed to be 4 percent annually. The married worker and spouse are assumed to have two children.*

The table above presents results based on the factors mentioned above for single male workers, single female workers, and married male workers with spouses who do not work outside of the home. (Results for female workers with male homemakers are similar.)

In all cases the individuals are assumed to begin covered employment in 1994 at one of three earnings levels which we call "low" ($11,000 per year in 1994), "average" ($24,000), and "maximum" ($60,600). We separate single workers by sex because women generally live longer than men. Results are shown relative to both employee taxes and combined employee-employer taxes. Finally, the tax rates used in the calculations would be adequate to finance the system for the next 75 years. The present OASDI tax rate of 6.2 percent (for employees and employers, each) is assumed to remain in effect until 2020 at which time it is increased as necessary to match program costs. Failure to make this adjustment would present a misleadingly favorable comparison of taxes and benefits.

In conclusion, the money's worth question does not have a simple answer, because it depends on one's point of view, generation, individual circumstances, and assumptions about the future. These results suggest that the relationship between Social Security taxes and benefits--whether it is for the nation overall, particular generations of workers, or individuals--may be more favorable than it is frequently portrayed. The fact remains, however, that the program should be evaluated more broadly, with consideration of all of its goals and purposes.

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Comments on any of the published articles or suggestions for additional articles in this series may be e-mailed to: Eli.N.Donkar@ssa.gov

Office of the Chief Actuary
Social Security Administration
March 10, 1997

Attachment: D

Ask an Actuary

Part IV: Social Security's long-range financial outlook

by William Ritchie
Actuary

(Originally published in OASIS Magazine, February 1995 issue)

"I won't reach retirement age until the year 2030--but the newspaper says Social Security will be broke by then!" The prospect of long-term financial difficulties for Social Security has contributed to much concern and lack of confidence on the part of young people. Is this concern warranted? This article addresses this question by describing the financial outlook over the long-range (75-year) period.

Because estimates for years that far into the future are inherently uncertain, we generally base them on a range of assumptions about future economic trends and demographic composition. The resulting range and trends of income, costs, and assets can reveal likely problems well in advance. It is essential that policy-makers receive the best available information about potential long-term problems as early as possible so that they can develop timely solutions, thereby ensuring that long-term commitments will be met.

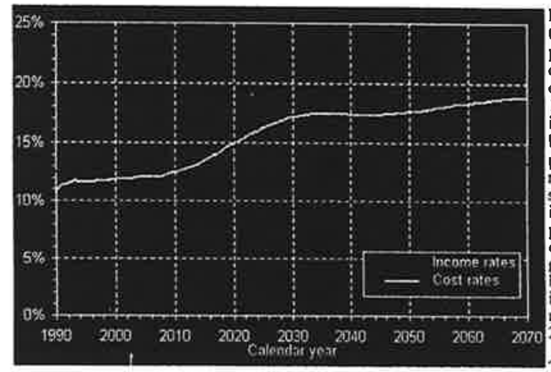
For brevity, estimates discussed in this article are based on only one set of assumptions, the "intermediate" set adopted by the Board of Trustees. Actual future events may be significantly more favorable or less favorable than the estimates shown here.

The long-range outlook can be summarized as follows. Tax income exceeds program costs through 2012; the opposite is true thereafter. This pattern largely results from having a "baby-boom" generation followed by a "baby-bust" generation. Resulting trust fund assets increase steadily to relatively high levels and then, without corrective legislation, decrease rapidly to depletion in 2029. Over the long-range period, the OASDI program has an "actuarial deficit" of 2.13 percent of "taxable payroll." Because of the magnitude of this deficit, the long-range financial status of the program is not satisfactory.

To understand this outlook more fully, it is useful to see how income, costs, and assets are typically expressed and compared over long time-periods. Income and costs are generally expressed in relation to the total amount of earnings subject to taxation under the OASDI program (called "taxable payroll"). Total tax income (from payroll taxes and income taxes on OASDI benefits), expressed as a percentage of taxable payroll, is called the "income rate," and total OASDI cost (of benefits and administration), expressed similarly, is the "cost rate." The long-range pattern of both rates is shown in chart 1.

Chart 1--OASDI Income Rates and Cost Rates

(expressed as a percentage of taxable payroll)



For 1994, the income rate for the OASDI program is 12.63 percent. This consists of the combined employer-employee tax rate, 12.40 percent, plus the income taxes on OASDI benefits, equivalent to 0.23 percent. OASDI payroll tax rates under present law are scheduled to remain constant in the future at 12.40 percent, while income taxes on benefits will increase gradually. Thus, over the long-range period, the income rate increases slowly, reaching 13.34 percent in 2070.

The cost rate follows a much different pattern. It rises slowly for 10-15 years, rises rapidly for the following 20-25 years, and then generally trends slowly upward thereafter. More specifically, from its current level of 11.64 percent, the cost rate rises slowly to 12.27 percent in 2010, rapidly to 17.22 percent in 2030, and then slowly again, to 19.00 percent in 2070.

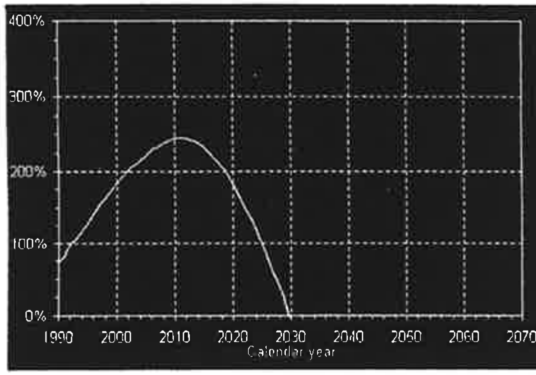
The primary reason for the rapid increases from about 2010 to 2030 is that the beneficiaries increase in number more rapidly than the covered workers. Because of this, the cost rate--that is, cost (primarily payments to *beneficiaries*) as a percentage of taxable payroll (the taxable earnings of *covered workers*)--rises.

During these years, the people born from the end of World War II through the mid-1960s (the "baby-boom" generation) retire. At the same time, the people born during the subsequent period of much lower birth rates (the "baby-bust" generation) comprise the covered workers. Consequently, the number of beneficiaries per 100 covered workers increases from 31 to about 50; or, as more often viewed, the number of workers per beneficiary decreases from 3.2 to 2.0.

The patterns of income and cost rates, taken together, result in about 2 decades of positive net income followed by generally increasing annual deficits thereafter. The resulting effect is that trust fund assets increase steadily to relatively high levels and then, without corrective legislation, decrease rapidly to depletion.

Chart 2--OASDI Trust Fund Assets

(expressed as a percentage of annual program cost)



Because of inflation, interpreting trust fund sufficiency is facilitated by comparing assets to annual cost, as shown in Chart 2. At the beginning of 1994, the combined assets of the OASI and DI Trust Funds represented 116 percent of total OASDI cost for the year. This percentage increases steadily to a peak in 2012 of 241 percent (almost 2 1/2 times the annual cost) and then declines rapidly, reaching zero during 2029. Thus, without corrective legislation, the combined trust funds are depleted within 35 years, which is less than half of the period over which the program should be properly financed.

To assess the overall financial status for the long range, it is often useful to have one summary measure for the full 75-year period. The selected measure is the difference between overall long-term income and cost, both expressed as a percentage of taxable payroll. It is called the "actuarial balance."

The actuarial balance represents a measure of the program's long-range financial adequacy. If it is positive, the program is adequately financed overall. If it is negative, however, policy-makers need to consider the size of the "actuarial deficit" and determine whether tax or benefit adjustments are required to restore financial adequacy.

Currently, the actuarial balance is -2.13 percent of taxable payroll--that is, the program has an actuarial deficit of 2.13 percent. The magnitude of the actuarial deficit can be interpreted as the amount of change that, if made to the scheduled payroll tax rates each year, would be exactly sufficient to pay the total long-range cost and leave a trust fund at the end of the 75th year equal to 100 percent of the next year's cost. The program would then be in exact actuarial balance. For example, if the actuarial deficit of 2.13 percent had been addressed by raising tax rates scheduled for the long-range period by 1.065 percentage points for employers and employees, each, and by 2.13 percentage points for the self-employed, then the OASDI program would be in exact actuarial balance. There are, of course, numerous combinations of changes to tax and benefit provisions that can achieve the same result.

The actuarial deficit represents about 14 percent of the overall long-term cost. Because this exceeds 5 percent, the program does not meet the requirements of the Trustees' test for long-range "close actuarial balance". Failure to pass this test highlights the need for corrective legislation.

What then does this outlook mean for today's concerned young workers? While the current long-range deficit is significant, in the past larger deficits have been encountered and eliminated through corrective legislation (namely, the 1977 and 1983 Amendments). Already the Board of Trustees has advocated addressing the long-range deficit and, accordingly, recommended "that the Advisory Council on Social Security conduct an extensive review of Social Security issues and develop recommendations for restoring the long-range actuarial balance of the OASDI program." In addition, several legislative bills were introduced already in 1994. The next article in this series will describe some of the proposals being considered.

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Comments on any of the published articles or suggestions for additional articles in this series may be e-mailed to: Eli.N.Donkar@ssa.gov

Office of the Chief Actuary
Social Security Administration
March 10, 1997

A Summary of the 1997 Annual Reports

A MESSAGE TO THE PUBLIC:

Social Security and Medicare are among our most important public programs. As a current or future beneficiary, you should know that Social Security and Medicare have always paid full benefits on time.

Each year we, the Trustees of the Social Security and Medicare trust funds, report in detail on their financial condition. The reports describe their current and projected financial condition, within the next ten years (the "short term") and over the next 75 years (the "long term"). This document is a summary of the 1997 reports.

As we have reported for the last several years, one of the Medicare trust funds, the Hospital Insurance ("HI") fund, would be exhausted in four years without legislation that addresses its financial imbalance. Any trust fund exhaustion can and should be avoided, as it has been in the past. We note that both the Administration and the Congress have made proposals to address the short-term imbalance in the Hospital Insurance Trust Fund. However, no agreement has yet been reached. Further delay in implementing changes makes the problem harder to solve. We urge the earliest possible enactment of legislation to extend the life of the HI Trust Fund for the near term and thereby provide sufficient time to develop measures to solve the large financing problem facing HI over the long term.

Costs of the Medicare Supplementary Medical Insurance ("SMI") program are also rising rapidly and need to be addressed in the near term. To facilitate long-term reform of Medicare, we recommend the establishment of a national advisory group to examine the Medicare program. The advisory group would develop recommendations for effective solutions to the long-term Medicare financing problem.

The Social Security trust funds, though solvent for the next ten years and many years thereafter, are not solvent over the long term. The Old-Age and Survivors Insurance ("OASI") Trust Fund, which pays retirement and survivors benefits, is projected to be able to pay full benefits on time for about 34 years. The Disability Insurance ("DI") Trust Fund, which pays disability benefits, is projected to pay full benefits until 2015. It is important to address both the OASI and DI problems soon to allow time for phasing in any necessary changes and for workers to adjust their retirement plans to take account of those changes. We recommend that the proposals in the recent Advisory Council Report and others being advanced by public officials and private organizations should be carefully evaluated by the government and the public. However, we continue to believe that there is time to discuss and evaluate alternative solutions with deliberation and care.

The timing and magnitude of the financing problems among the four trust funds are distinctly different. We are urging the earliest possible enactment of legislation to further control HI program costs because of the nearness of the HI Trust Fund exhaustion date. Prompt action in the short term will provide sufficient time to assess the changes in our nation's health care system and design solutions to the more serious long-term Medicare financing shortfall. And, while we believe there is time to discuss and examine alternative long-term solutions for OASDI, we also recognize that the impact of any required changes will be less disruptive the sooner they are enacted.

With proper public discussion and timely legislative action, Social Security and Medicare will continue to play their critical role in the lives of virtually all Americans.

By the Trustees:

Attachment: E

Robert E. Rubin,
Secretary of the Treasury,
and Managing Trustee

Cynthia A. Metzler,
Acting Secretary
of Labor, and Trustee

Donna E. Shalala,
Secretary of Health
and Human Services,
and Trustee

John J. Callahan,
Acting Commissioner
of Social Security,
and Trustee

Stephen G. Kellison,
Trustee

Marilyn Moon,
Trustee

A SUMMARY OF THE 1997 ANNUAL SOCIAL SECURITY AND MEDICARE TRUST FUND REPORTS

Who Are the Trustees?

There are six Trustees: the Secretary of the Treasury, the Secretary of Labor, the Secretary of Health and Human Services, the Commissioner of Social Security and two members appointed by the President and confirmed by the Senate to represent the public. Currently, the Public Trustees are Marilyn Moon, an economist who has written extensively on Medicare, and Stephen G. Kellison, an actuary who has taught and consulted widely on social insurance. All trustees serve on the Boards of all of the trust funds described below.

What Are the Trust Funds?

The trust funds are accounts in the U.S. Treasury. Social Security and Medicare taxes, premiums and other income are deposited in these accounts, and Social Security and Medicare benefits are paid from them. The only purposes for which these trust funds can be used are to pay benefits and program administrative costs.

The trust funds hold money not needed to pay benefits and administrative costs and, by law, invest it in special Treasury bonds that are guaranteed by the U. S. Government. A market rate of interest is paid to the trust funds on the bonds they hold, and when those bonds reach maturity or are needed to pay benefits, the Treasury redeems them.

There are four separate trust funds. For Social Security, the Old-Age and Survivors Insurance (OASI) Trust Fund pays retirement and survivors benefits, and the Disability Insurance (DI) Trust Fund pays disability benefits. (The two trust funds are described together as OASDI.)

For Medicare, the Hospital Insurance (HI) Trust Fund pays for inpatient hospital and related care, and the Supplementary Medical Insurance (SMI) Trust Fund pays for physician and outpatient services. Medicare benefits are provided to most people age 65 and over and to workers who are receiving Social Security disability benefits.

What Were the Trust Fund Results in 1996?

In December 1996, almost 38 million people were receiving OASI benefits, just over 6 million were receiving DI benefits, and about 38 million people were covered under Medicare. Trust fund operations, in billions of dollars, are shown below (totals may not add due to rounding).

	OASI	DI	HI	SMI
Assets (end of 1995)	$458.5	$37.6	$130.3	$13.1
Income during 1996	363.7	60.7	124.6	85.6
Outgo during 1996	308.2	45.4	129.9	70.4
Net increase in assets	55.5	15.4	-5.3	15.2
Assets (end of 1996)	514.0	52.9	124.9	28.3

How Are Social Security and Medicare Paid for?

For Social Security and the Hospital Insurance part of Medicare, the major source of financing is payroll taxes on earnings that are paid by employees and their employers, and by the self-employed. People who are self-employed are charged the equivalent of the combined employer and employee tax rates. In 1996, $489 billion (89 percent) of total OASI, DI and HI income came from payroll taxes. The remainder was provided primarily by interest earnings ($49 billion or 9 percent) and revenue from taxation of OASDI benefits ($11 billion or 2 percent).

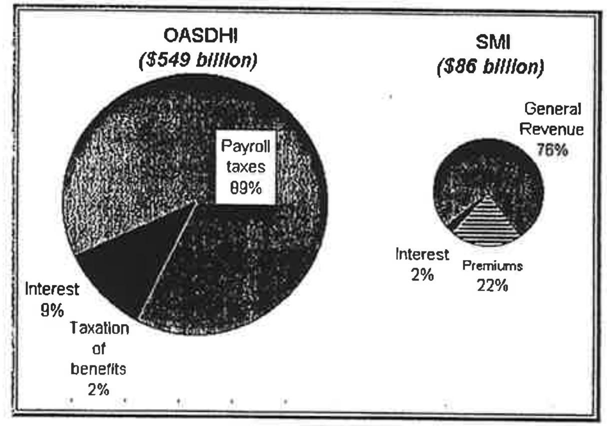
The payroll tax rates are set by law and for OASI and DI apply to earnings up to a certain annual amount. This amount, called the earnings base, rises as average wages increase. In 1997, the earnings base for OASDI is $65,400. HI taxes are paid on total earnings. The tax rates for employees and employers each under current law are:

Year	OASI	DI	OASDI	HI	Total
1997-99	5.35	0.85	6.20	1.45	7.65
2000 and later	5.30	0.90	6.20	1.45	7.65

The Supplementary Medical Insurance part of Medicare is financed by monthly premiums charged beneficiaries ($43.80 in 1997) and by payments from Federal general revenues. In 1996, premiums accounted for almost $19 billion (22 percent) of SMI income and interest income was about $1.8 billion (2 percent). The remainder, $65 billion (76 percent), consisted of general revenue payments. Chart A shows sources of income in 1996 for OASDI and HI combined and for SMI.

Chart A - Sources of Income to Trust Funds in 1996

Chart A - Sources of Income to Trust Funds in 1996



What Were the Administrative Expenses in 1996?

Administrative expenses, as a percentage of benefit payments, were:

	OASI	DI	HI	SMI
Administrative Expenses 1996	0.6	2.6	1.0	2.6

How Are Estimates of the Trust Funds' Future Status Made?

Short-range (10-year) and long-range (75-year) estimates are reported for all funds. These estimates are based on assumptions about all of the factors that affect the income and outgo of each trust fund. They include economic growth, wage growth, inflation, unemployment, fertility, immigration, and mortality, as well as specific factors relating to disability incidence and the cost of hospital and medical services.

Because the future cannot be predicted with certainty, three alternative sets of economic and demographic assumptions are used to show a range of possibilities. The intermediate assumptions (alternative II) reflect the Trustees' best estimate of future experience. The low-cost alternative I is more optimistic for trust fund financing, and the high-cost alternative III is more pessimistic; they show trust fund projections if economic and demographic conditions are more or less favorable than the best estimate.

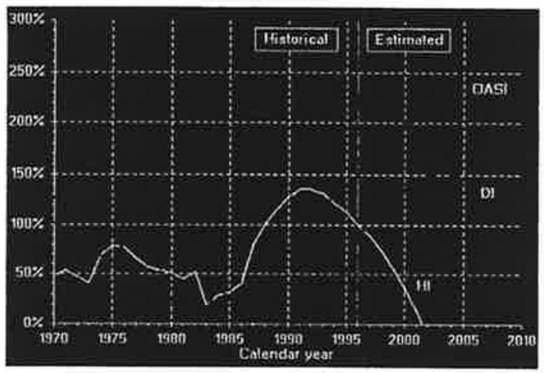
The assumptions are reexamined each year in light of recent experience and new information about future trends, and are revised if warranted. In general, greater confidence can be placed in the assumptions and estimates for earlier projection years than for later years. While estimates of income and expenditures usually have been close to actual experience, any estimates for as long as 75 years into the future are inherently uncertain. Nonetheless, careful review and updating on an annual basis provides an indication of the range of future possibilities.

What is the Short-Range Outlook (1997-2006) for the Trust Funds?

For the short range, we measure the adequacy of the trust funds by comparing their assets at the beginning of a year to projected benefit payments for that year (the "trust fund ratio"). A trust fund ratio of 100 percent - that is, assets at the beginning of a year at least equal to projected benefit payments for that year-is considered a good test of a trust fund's short-term adequacy. This level of assets means that even if no income were received for a year, the trust fund could pay full benefits, thereby allowing time for legislative action to restore financial adequacy.

By this measure, the OASI and DI funds are considered financially adequate throughout the next decade. The OASI and DI trust fund assets are over the 100 percent level through the year 2006. However, the trust fund ratio for HI is below 100 percent at the beginning of the 10-year period and declines rapidly. Under the intermediate assumptions, the HI Trust Fund is exhausted in 2001. Chart B shows the OASI, DI and HI "trust fund ratios" under the intermediate assumptions.

Chart B - OASI, DI, and HI Trust Fund Ratios
[Assets as a percentage of annual expenditures]



A less stringent asset test applies to SMI, but only because its financing - beneficiary premiums and Federal general revenue payments - is automatically adjusted each year to meet expected costs.

The table below shows, in dollars, the projected income and outgo, and the change in the balance of each trust fund over the next 10 years.

ESTIMATED OPERATIONS OF TRUST FUNDS
(in billions of dollars - totals may not add due to rounding)

	Income				Expenditures				Change in fund			
Year	OASI	DI	HI	SMI	OASI	DI	HI	SMI	OASI	DI	HI	SMI
1997	392	60	127	81	322	49	140	77	70	11	-13	4
1998	409	62	131	85	337	52	152	85	72	10	-20	0
1999	430	65	135	94	353	56	164	93	77	9	-29	1
2000	450	72	140	103	370	60	178	102	80	12	-38	1
2001	476	77	144	113	389	65	193	112	87	12	-49	1
2002	503	81	148	124	409	70	209	124	93	10	-61	1
2003	531	85	152	137	430	76	226	136	101	9	-74	1
2004	562	90	155	151	453	83	244	150	109	7	-89	1
2005	595	95	159	168	476	90	263	166	119	5	-104	3
2006	629	99	162	188	501	97	283	184	128	2	-121	4

What is the Long-Range (1997-2071) Outlook for the Trust Funds?

Over the long term neither the OASI, the DI nor the HI Trust Fund is projected to be in balance. Chart C compares, under the intermediate assumptions, the trends over the next 75 years in income and costs of these funds.

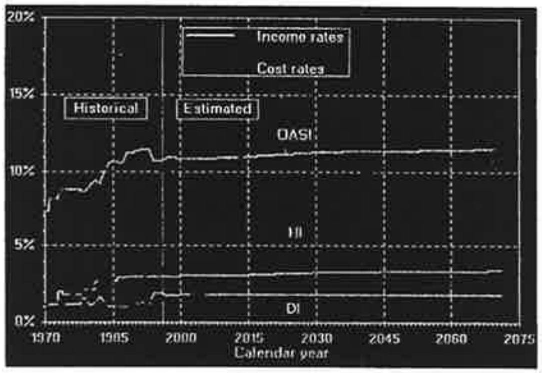
In Chart C the long-range income and cost of OASI, DI and HI are measured in percentage of taxable payroll rather than in dollars because the value of a dollar changes over time. (Taxable payroll is the portion of total wages and self-employment earnings that is taxed under the OASDI and HI programs.) Over the 75-year period, the income rates for OASI, DI and HI remain relatively constant, while the cost rates rise substantially.

For OASI, the income rate is projected to remain above the cost rate for 17 years. Starting in about 2010, however, the OASI cost rate will begin increasing rapidly as the leading edge of the baby boom generation reaches retirement age. In 2014 and later, the cost rate for OASI will exceed the income rate by generally growing amounts-by the end of the 75-year projection period the cost rate for OASI will be almost 1 1/2 times as large as the income rate.

The income rate for DI is higher than the cost rate only through 2003, after which the annual shortfall of tax income is projected to increase slowly over the 75-year period.

Chart C - Income and Cost Rates

Chart C - Income and Cost Rates
[percentage of taxable payroll]



The cost rate for HI is higher than the income rate by rapidly growing amounts throughout the projection period-by 2071, the HI cost rate is projected to be almost 3 1/2 times as large as the HI income rate.

The income rates for OASI, DI and HI remain relatively constant in Chart C because the payroll tax rates for the programs are not scheduled to change (except for a small shift from OASI to DI in 2000). Income from taxation of benefits will rise gradually, primarily because a greater proportion of beneficiaries will become subject to taxation in future years, and this accounts for the slight upward trend in the income lines.

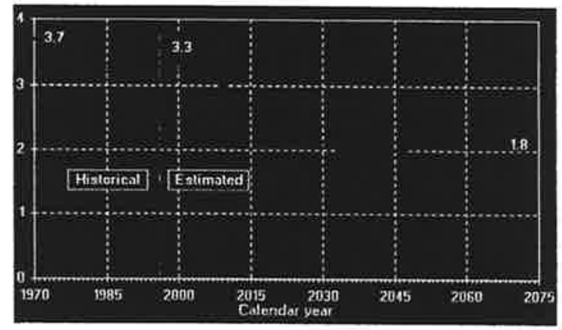
The cost rates increase much more rapidly, especially for OASI and HI. The cost rate for OASI rises slowly for about 15 years, increases rapidly for about the next 20 years, and then grows more moderately. The cost rate for HI increases throughout the 75-year period.

Why Do Costs Rise Faster Than Income?

The primary reason that the OASI cost rate increases more steeply after 2010 is that the number of people receiving benefits will increase rapidly as the baby boom generation retires, while the number of workers paying payroll taxes grows more slowly. The HI cost rate increases not only because of growth in the number of beneficiaries per worker, but also because of increases in both the use and cost of health care per person. Chart D shows the number of workers per OASDI beneficiary over the 75-year period. (The ratio of workers to HI beneficiaries is similar.)

Chart D - Number of Workers per OASDI Beneficiary

Chart D - Number of Workers per OASDI Beneficiary



In addition to demographic changes, the other major factor in the long-range financing of OASDI and HI is the rate of increase in the wages on which workers pay Social Security and Medicare taxes. The rate of increase in workers' wages in turn depends on how workers are able to combine their skills and work tools to increase the amount they can produce. Thus, increases in workers' productivity can help offset some of the decline in the number of workers per beneficiary.

What is the Long-Range Actuarial Balance of Each Trust Fund?

Another useful way to view the outlook of the trust funds is in terms of their long-range actuarial balances over the whole 75-year valuation period. The actuarial balance of a fund is the difference between annual income and costs, expressed as a percentage of taxable payroll, summarized over the 75-year projection period. The OASI, DI and HI Trust Funds each have an actuarial deficit under the intermediate assumptions, as shown below. These actuarial deficit amounts can be interpreted as the percentage that would have to be added to the current law income rate in each of the next 75 years, or subtracted from the cost rate in each year, to bring the funds into actuarial balance.

ACTUARIAL DEFICIT OF THE OASI, DI AND HI TRUST FUNDS
(Deficit as a percent of taxable payroll)

	OASI	DI	OASDI	HI
Actuarial Deficit	1.84	0.39	2.23	4.32

What Are Key Dates in Long-Range OASI and DI Financing?

For the next 15 years annual income to the OASI and DI Trust Funds is projected, under the intermediate assumptions, to exceed outgo. As the baby boom generation reaches retirement age over the period from 2010 to 2030, several important points will occur, as shown below.

- 2012- First year OASDI outgo exceeds tax income
- 2015- Year DI trust fund assets are exhausted

- 2019- First year OASDI outgo exceeds tax plus interest income
- 2029- Year combined OASDI trust funds' assets are exhausted
- 2031- Year OASI trust fund assets are exhausted

These key dates are the same as those shown in the 1996 report.

Exhaustion of a trust fund means that its accumulated assets are depleted. Payroll tax and other income will continue to flow into the fund, however. For example, in 2031, tax income to the OASI fund is estimated to be sufficient to pay about 3/4 of program costs; that ratio is projected to decline to about 2/3 by the end of the projection period.

Before a trust fund is exhausted, the cash flow of the fund changes in stages. When combined OASDI expenditures exceed current tax income beginning in 2012, OASDI current tax income plus a portion of annual interest income will be needed to meet expenditures in 2012 through 2018. Beginning in 2019 and continuing through exhaustion of the combined OASDI Trust Funds in 2029, current tax income, annual interest income, plus a portion of the principal balance in the trust funds will be needed to pay benefits.

As noted earlier, the future cannot be predicted with certainty, and three sets of assumptions are used to project the range of possibilities. The year in which the trust funds are projected to be exhausted varies significantly under the three sets of assumptions. The table below shows this range.

YEAR OF TRUST FUND EXHAUSTION

Set of Assumptions	OASI	DI	OASDI	HI
Alternative I (Low Cost)	Never	Never	Never	2002
Alternative II (Best Estimate)	2031	2015	2029	2001
Alternative III (High Cost)	2022	2007	2018	2000

How Large Are Social Security and Medicare Compared to the Whole Economy?

An additional way to view the outlook for the trust funds is in relation to the economy as a whole. The table below shows the estimated outgo from each trust fund as a percentage of estimated gross domestic product (GDP) from 1997 to 2071.

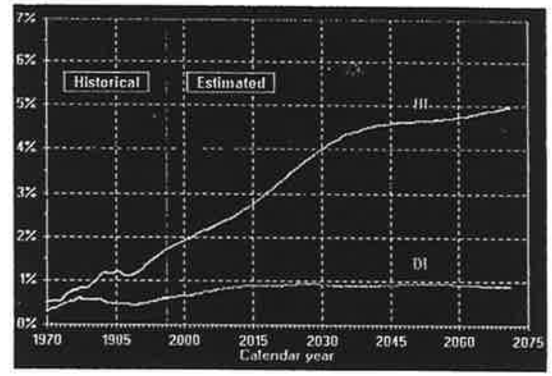
OASI, DI, HI AND SMI OUTGO AS A PERCENT OF GROSS DOMESTIC PRODUCT

Trust Fund	1997	2020	2045	2071	% Increase
OASI	4.04	4.92	5.60	5.80	44
DI	0.61	0.88	0.90	0.88	44
HI	1.76	3.18	4.59	4.98	183
SMI	0.97	2.54	3.20	3.42	253

Chart E shows in graphic form the growth in the outgo as a percentage of GDP. OASI and DI outgo

increase by the same percentage over the full long-range period, while the increases in HI and SMI outgo are much larger. Shortly after 2020, Medicare spending for health care is projected to exceed Social Security spending for retirement, survivors and disability benefits.

Chart E - OASI, DI, HI, and SMI Cost as a Percentage of GDP



Conclusions

Based on the Trustees best estimates (alternative II):

The Hospital Insurance (HI) Trust Fund, which pays inpatient hospital expenses, will be able to pay benefits for only about 4 years and is severely out of financial balance in the long range. The Trustees urge enactment of legislation this year to further control HI program costs and thereby extend the life of the HI Trust Fund. Such legislation, however, would represent only a modest first step toward achieving long-range balance between HI costs and funding. To facilitate long-term reform, we recommend the establishment of a national advisory group to examine the Medicare program. The advisory group would develop recommendations for effective solutions to the long-term financing problem. The Trustees believe that solutions can and must be found to restore and maintain the financial integrity of the HI program in both the short term and the long term.

The Supplementary Medical Insurance (SMI) Trust Fund, which pays doctor bills and other outpatient expenses, is financed on a year-by-year basis and trust fund income is projected to equal expenditures for all future years, but only because beneficiary premiums and Government general revenue contributions are automatically set to meet expected costs each year. The Trustees urge the Congress to take additional actions designed to control SMI costs in the near term. For the longer term, legislative proposals to address the large increases in SMI costs associated with the baby boom's retirement should be developed through the same process used to address HI cost increases caused by the aging of the baby boom. The Trustees believe that prompt, effective, and decisive action is necessary.

The OASI Trust Fund is expected to be able to pay benefits for about the next 34 years. At that time annual tax income is projected to cover the cost of only about 3/4 of benefits payable. The Board believes that the long-range deficit of the OASI Trust Fund should be addressed in a timely way. We recommend that the proposals in the recent Advisory Council Report and others being advanced by public officials and private organizations should be carefully evaluated by the government and the public. While we continue to believe that there is time to discuss and evaluate alternative solutions with deliberation and care, we also recognize that the impact of any required changes will be less disruptive the sooner they are enacted.

The Disability Insurance (DI) Trust Fund, which pays disability benefits, is projected to be exhausted in 2015. The Board believes that the experience of the DI fund should be closely monitored and the long-range deficit of the DI Trust Fund addressed.

A MESSAGE FROM THE PUBLIC TRUSTEES:

This is the second set of Trustees Reports in which we have participated since we began four-year terms as Public Trustees on July 20, 1995. Our goal as Public Trustees is to ensure the integrity of the process by which these Reports are prepared and the credibility of the information they contain. We are honored that the President and the Senate have entrusted us with this responsibility. Further, although we are of different political parties, we approach our work as Public Trustees on a bipartisan basis because we strongly believe that this is the only way through which financial problems facing Medicare and Social Security can be solved. It is in this vein that we offer the following observations regarding the 1997 Annual Reports.

Informed Debate Is Needed

This year may finally mark the beginning of serious consideration of the future of Medicare and Social Security. The publication of the Social Security Advisory Council's report offering three very different approaches to the long-run financing problem facing Social Security has brought increased attention to that program, although it also illustrates that we have a long way to go before reaching consensus on a solution. The debate thus far on Medicare's future has focused on the need to achieve short-run savings to extend the life of the HI Trust Fund beyond 2001. But even this discussion has directed some attention to the longer run problems facing Medicare after 2010 as a result of the aging of the baby boom generation.

We welcome these discussions and hope that the trust fund reports and this Summary contribute to the factual basis necessary for an informed debate. The numbers contained in these reports are sobering, but their magnitude should not cause us to choose inaction as the appropriate response. Indeed, Americans need to become actively engaged in the debate about changes in these programs because the choices we make (or fail to make) in the next few years will carry important consequences for all of us. The aging of the baby boom generation will place heavy demands on both Social Security and Medicare, requiring substantial changes and sacrifices by some or all Americans.

A key point to remember as the debates go forward is that while Social Security and Medicare are large and complicated programs which are usually considered separately, they are clearly interrelated. Together, these programs form the foundation that Americans depend upon in retirement, both are vying for the same limited resources, and in the long run the shape of both programs will be driven by the same demographic forces that are leading us to an aging society.

Medicare

A major focus of issues facing Medicare is the imminent exhaustion of the HI Trust Fund. Under the intermediate (best estimate) assumptions in the 1997 Annual Reports, the fund will be depleted in early 2001-only 4 years from now. Legislative changes should be made this year since most proposals for slowing the growth in spending have their greatest impact only after several years. Even so, changes enacted this year to slow Medicare's growth would achieve most of their savings in the year 2000 and beyond, dangerously close to when the HI Trust Fund will be exhausted. Further, starting in 1995, income to the HI Trust Fund has been less than expenditures, and the HI fund has been drawing on its assets to meet the shortfall. In every year that passes without change, we will have to consume more and more of the trust fund's assets to meet current needs.

But focusing so heavily on HI's immediate problem diverts our attention from SMI, which has grown more rapidly than HI over Medicare's history. These two parts of Medicare are financed very differently and as a consequence, they have separate trust funds. But in practice, HI and SMI are just two parts of one program, and over time there has been shifting of benefits between them. Also, the factors that are driving up the costs of each part of Medicare are the same-better but more expensive medical technology, more medical care per person, and an aging population. Continued SMI growth at current rates will ultimately lead to costs which exceed the capacity of the funding sources-Federal general revenues and beneficiary premiums-to provide benefits.

Thus, the need to act quickly on the financial problems facing HI should not lead us to ignore SMI. Like HI, SMI's growth is unsustainable over time. Therefore, Medicare legislation this year should include changes in SMI as well as in HI.

Another fact which should be recognized in the debate about changes in Medicare is that, as history shows, the program must adjust every few years to changes in healthcare technology, methods of delivery and utilization. If we can say one thing that we think would be helpful in the public debate on Medicare financing, it is that there are no magic bullets for solving the problem of high rates of healthcare spending. Therefore, even major legislation this year cannot fully resolve the issues of healthcare cost growth. We should expect that further legislative action will be needed even before tackling the increase in Medicare costs that will occur when the baby boon generation begins to retire.

Addressing the long-run issues will be difficult and challenging under any circumstance. However, finding longer term solutions will be facilitated if we can improve the current Medicare program, find legitimate short-run savings, and improve the balance between the traditional program and private plan offerings under Medicare. These short-run challenges will likely demand continuing vigilance and legislation over the next decade.

Do the challenges facing Medicare mean that it cannot be continued? No! But Medicare cannot stay exactly as it is and it is misleading to think that any part of the program-beneficiary premiums, provider payments, controls on utilization, covered services or revenues-can be exempt from change.

Social Security

The cash benefits programs (OASI and DI) face longer term challenges. The aging of the baby boom generation will also increase OASI expenditures, but OASI annual income, including interest, will exceed outgo for almost 25 years. Thus, the financing deficits facing OASI are smaller and further into the future than those facing either HI or SMI. Immediate changes in OASI are not necessary and the magnitude of the program changes that will eventually be needed will be less than those required for HI and SMI.

Action should be taken soon, however, for several reasons. First, the earlier that changes are implemented the more incremental they can be. Second, implementing changes soon would permit time for phasing them in and for workers to adjust their retirement plans. Third, there has been an alarming erosion of public confidence in the Social Security system over the past few years, particularly among younger generations. Early attention to Social Security's longer range financing problems is vital in restoring public confidence in the program.

The Advisory Council on Social Security has put forth three different approaches to deal with the long-run financing problem in OASI. Those and other plans deserve serious discussion now so that reform legislation can be developed in the next few years which can gain the support of the American public. Some of these proposals would introduce fundamentally new concepts into the system, such as investment of the trust fund in common stock or the creation of individual accounts. Such proposals represent a profound shift in philosophy and would have significant ramifications. These ramifications deserve careful examination and consideration by policymakers and the American public before any changes are made.

Even in OASI, however, it should be possible to begin making adjustments to pave the way for longer *run solutions. For example, improvements in the CPI to provide a more accurate measure of the cost of living should be actively sought and adopted for calculating Social Security annual cost-of-living adjustments. The future of the program requires not only that we make changes as soon as possible but also that we demonstrate to younger Americans a commitment to a viable retirement system that they can be assured will serve them in the future.*

The DI Trust Fund faces other challenges. After significant increases in DI costs in the early 1990's, experience from 1994 through 1996 shows that applications for DI leveled off during this period. However, the DI program has, throughout its history, experienced periods of growth and decline for which causes cannot be established with any precision. Consequently, the DI fund should be carefully monitored and its experience assessed in developing legislation to close the deficit projected in the DI fund in the decades ahead.

Conclusion

We are privileged to take part in the thorough and careful process by which the Annual Reports are prepared to provide this vital public accounting. We strongly believe that these Reports serve as an early warning of the need for changes to ensure continuation of these programs and not as evidence of their failure to protect future generations. Working cooperatively, with informed public debate, we believe solutions can be found to the financing problems facing America as our population ages, and it is in this spirit that we will pursue further efforts at public education on Social Security and Medicare issues during our terms as Public Trustees.

Stephen G. Kellison,
Trustee

Marilyn Moon,
Trustee

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