HF 3808 (Nadeau); SF 4348 (Pratt): Teachers Retirement Association; Providing for an unreduced retirement annuity upon reaching age 62 with 30 years of service; increasing the employee contribution rate

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Date: March 21, 2024

Introduction

Affected Plan: Teachers Retirement Association (TRA)

Laws Amended: Minnesota Statutes, sections 354.42 and 354.44

Brief Description: The bill provides an unreduced early retirement annuity to TRA members upon retirement at age 62 with 30 years of service, which is funded by an increase in employee contributions based on years of service.

Attachment: Cost estimate from Cavanaugh Macdonald Consulting dated January 12, 2024.

Background

Minnesota's public pension plans are designed to pay a full, undiscounted annuity to eligible employees upon reaching "normal retirement age." This means that if the employee waits to retire until reaching an age set in statute, the benefit the employee receives is the amount calculated using the plan's benefit formula. Due to legislation passed during the 2023 legislative session, the normal retirement age for the Teachers Retirement Association (TRA) is reduced from age 66 to 65 for Tier II members (hired after June 30, 1989), starting on July 1, 2025. If a teacher covered by TRA chooses to retire before reaching normal retirement age, the teacher's monthly benefit is reduced as provided in statute, because the teacher is receiving the annuity for a longer period of time.

Certain early retirement benefits allow eligible employees to receive a full, unreduced annuity before reaching normal retirement age. The first generally applicable early retirement benefits in Minnesota were established in 1973, which allowed employees covered by the Minnesota State Retirement System General State Employees Retirement Plan (MSRS General), the Public Employees Retirement Association General Employees Retirement Plan (PERA General), or TRA to retire at age 62 with 30 years of allowable service. This benefit, often referred to as "62 and 30," is no longer available for employees covered by MSRS, PERA, or TRA. However, the 2023 Omnibus Pension Budget Bill added a "62 and 30" benefit for members of the St. Paul Teachers Retirement Fund Association, which was funded by an increase in employee contributions and state aid.

Another example of an early retirement benefit is the "Rule of 90," which was first enacted for PERA General in 1982 and was extended to MSRS General and TRA in 1989. Under Rule of 90, if a member's age plus years of allowable service is equal to or exceeds 90, the member is eligible to retire with an unreduced annuity. This benefit is available only to Tier I members (hired prior to July 1, 1989) of PERA General, MSRS General, and TRA.

The bill provides a "62 and 30" early retirement benefit to TRA members, which is funded by an increase in employee contributions based on years of service. Under the bill, a teacher's contribution rate gradually increases over the teacher's career.

Section- by- Section Summary

Section 1 amends section 354.42, subdivision 2, by increasing the employee contribution rate for members of TRA based on years of service. Under current law, the employee contribution rates are 7.75 percent of pay for coordinated members (members who will receive a Social Security pension based on teaching service) and 11.25 percent of pay for basic members (members who will not receive a Social Security pension based on teaching service). These employee contribution rates are scheduled to increase by 0.25 percent of pay on July 1, 2025, which is intended to pay for the reduction in the normal retirement age for Tier II members from age 66 to 65.

Under the bill, a teacher's employee contribution rate is dependent on years of service and will increase throughout a teacher's career. The increase applies to both Tier I and Tier II members. The bill creates four different contribution levels or service tiers. When a teacher reaches a new service tier based on years of service, the teacher's contribution rate will increase. The service tiers are:

- fewer than 10 years of service (48.71 percent of active members);
- 10 or more and fewer than 20 years of service (26.86 percent of active members);
- 20 or more and fewer than 30 years of service (19.65 percent of active members); and
- 30 or more years of service (4.78 percent of active members).[1]

For example, under the bill, the employee contribution rate for a teacher with fewer than 10 years of service is eight percent of pay after June 30, 2024. When the teacher reaches 10 years of service, the teacher's employee contribution rate will increase. When the teacher reaches 20 years of service, the teacher's employee contribution rate will increase again, and so forth.

The increased employee contribution rates in the bill were drafted to provide an example of how the service tiers could work but are not actuarially determined rates. The bill was drafted before VIA Actuarial Solutions conducted an actuarial analysis to determine if the contribution rate increases in the bill will cover the cost of the benefit improvement. As a result, the Commission may want to consider amending the contribution rates.

Section 1 may also need to be clarified to ensure a teacher's employee contribution rate increases upon reaching a new service tier, as intended.

[1] TRA membership distribution data based on years of service is according to the TRA Annual Comprehensive Financial Report, as of June 30, 2023 (page 110).

Section 2 amends section 354.44, subdivision 6, which governs retirement benefits under TRA, by providing an unreduced annuity benefit for members that are at least age 62 and have at least 30 years of service. As previously mentioned, this benefit is referred to as "62 and 30."

Section 2 also removes a provision related to early retirement reduction factors for members that are eligible for "62 and 30." Under current law, if a member has reached age 62 with 30 years of service, the teacher's retirement benefit is reduced by six percent for each year that the teacher's early retirement age proceeds normal retirement age. Since members eligible for "62 and 30" can retire with an unreduced annuity benefit, the early retirement reduction factors for "62 and 30" are unnecessary.

Effective Dates. Sections 1 and 2 are effective July 1, 2024.

Public Policy Considerations

Cost

TRA's retained actuary, Cavanaugh MacDonald Consulting, calculated the cost of several benefit improvements, including "62 and 30," and sent the results to TRA in a letter dated January 12, 2024. For each benefit improvement, Cavanaugh MacDonald calculated three different estimates based on different assumptions. According to Cavanaugh MacDonald:

- assumption 1 is Cavanaugh MacDonald's best estimate of what the benefit improvement will cost;
- assumption 2 assumes a higher utilization of the benefit, resulting in a higher estimate than assumption 1; and
- assumption 3 assumes all members eligible for the benefit will retire with an unreduced annuity once eligible.

The cost of providing a "62 and 30" benefit to TRA members is estimated to range from approximately $617.4 million (assumption 1) to $1 billion (assumption 3). If paid on an annual basis, the cost is estimated to range from approximately $24 million to $38.43 million per year.

Employee Contribution Service Tiers

VIA Actuarial Solutions, the Commission's retained actuary, conducted an analysis to determine the necessary employee contribution rates for the different service tiers, in order to pay for the "62 and 30" benefit. The analysis relies on the cost estimates calculated by Cavanaugh MacDonald.

Utilizing employee contribution service tiers based on years of service is a new approach for pension plans in Minnesota. While no plan in Minnesota currently structures contributions in this way, a similar approach is utilized in other states. For instance, the employee contribution rate for teachers covered by the New York State Teachers' Retirement System hired on or after April 1, 2012, changes throughout a teacher's career based on salary.

The purpose of gradually increasing a teacher's contribution rate is for the teacher to contribute a smaller percentage of pay earlier in the teacher's career. As a result, the teacher will be able to take home more pay while the teacher is lower on the school district's pay scale. As the teacher attains more years of service and makes a higher salary, the teacher will gradually pay a higher contribution rate to TRA. Also, a teacher will gradually pay a higher contribution rate as it becomes more likely that the teacher will become eligible for the early retirement benefit.

While the employee contribution rate for early career teachers does not increase until reaching 10 years of service, early career teachers may pay more for the benefit improvement in the long run than other groups of teachers. VIA Actuarial Solutions informed LCPR staff that because the bill increases employee contribution rates over an employee's career, the cost of the benefit improvement shifts from longer-service employees who are near retirement to those who are early in their careers.

Fairness concerns

VIA Actuarial Solutions estimates that approximately 345 active members will become immediately eligible for an unreduced retirement annuity on the effective date of the bill, which is July 1, 2024. Since the benefit is paid for by an increase in employee contributions, this group of members can retire with the "62 and 30" benefit without helping to pay for the increase in liability to TRA. The Commission may want to consider a delayed effective date, which would require this group of members to help pay for the enhanced benefit.

Due to current law governing benefits for Tier I members, some Tier I members would be eligible for the "62 and 30" benefit. Under current law, when a Tier I member retires and the member's annuity amount is higher when calculated under the provisions used to calculate a retirement annuity for Tier II members, the Tier I member receives the higher annuity benefit. The Commission may want to consider revising section 354.44 if this outcome is not desired. If the bill is amended to provide a "62 and 30" benefit only to Tier II members, the Commission may want to evaluate whether Tier I members should be required to pay a higher contribution rate.

Administrative burden

Under current law, there is one contribution rate paid by teachers covered by TRA (7.75 percent, scheduled to increase to eight percent on July 1, 2025), with the notable exception of one basic member who is currently working and paying a higher contribution rate. As a result, it is relatively easy for school districts to withhold the correct contribution amount from a member's paycheck. However, it may be more difficult for school districts to administer employee contribution rates based on years of service.

To withhold the proper amount of pay for each teacher, school districts may need to adopt additional administrative processes to keep track of how many years of allowable service credit each teacher has and when each teacher's contribution rate is scheduled to increase. School districts do not currently need to track years of service for pension contribution purposes.

In addition, TRA may need to put additional administrative processes in place to validate that the correct employee contribution is being withheld from each teacher's paycheck.