HF 3972 (Wolgamott); SF 4196 (Gustafson): Teachers Retirement Association (TRA); Modifying the reduction for early retirement; increasing employer contributions and funding for school districts

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Introduction

Affected Plan: Teachers Retirement Association (TRA)

Laws Amended: Minnesota Statutes, sections 126C.10, subdivision 37; 354.42, subdivision 3; 354.44, subdivision 6

Brief Description: The bill changes the percentages by which a normal retirement benefit is reduced when a member elects an early retirement benefit and pays for the benefit improvement with a state-funded employer contribution increase.

Background

The normal retirement age for Tier I members of TRA is 65. The normal retirement age for Tier II members of TRA is 66, until July 1, 2025, when it becomes 65. Tier I are teachers who became a member of TRA or another public pension plan before July 1, 1989; Tier II are teachers who became a member on or after that date.

The retirement benefit of a TRA member is calculated by applying a percentage, such as 1.9%, to the product of the member's number of years of service multiplied by the member's average high five salary.

When a member retires before normal retirement age, the member's normal retirement benefit is reduced by a specified percentage for each year that the member's early retirement age precedes normal retirement age. Under current law, the reduction percentage for Tier II members is 7% for each year that the age of retirement precedes 66, until age 58, when the percentage changes to 4% for each year until age 55, the earliest age a member can begin to receive a retirement benefit. (This applies to Tier I members too if this results in a bigger benefit than the benefit they would get under the Tier I formula and early retirement reductions.)

Not all plans use fixed percentages to reduce the normal retirement benefit for early commencement. For example, in the case of the PERA General Plan, the early retirement benefit is *"…the actuarial equivalent of the annuity that would be payable to the employee if the employee deferred receipt of the annuity until normal retirement age…."* (Minnesota Statutes, section 353.30, subdivision 5.) The actuary

provides PERA with factors that allow PERA to calculate early retirement benefits that are cost neutral to the plan.

When an early retirement benefit is determined using factors provided by the plan's actuary to result in a benefit that is actuarially equivalent to the normal retirement benefit, the reduction is not a "penalty." It's math and fairness—if a retiree will receive three years' worth of additional monthly payments because the member retired at age 63, the member has received more payments than a member will receive if the member begins monthly payments at age 66. The monthly amount to the member receiving more payments will need to be less than the monthly amount to the member who receives fewer payments to make them actuarially equal.

If fixed factors result in a greater reduction than would be the case using actuarial equivalence, the fixed factors could be called a penalty. When fixed factors result in less of a reduction than would be the case using actuarial equivalence, the fixed factors might be called a subsidy. We understand that when TRA replaced actuarial equivalence with fixed factors in 2015, the fixed factors resulted in a subsidized early retirement benefit; in other words, the early retirement benefit is a bigger benefit than would have resulted using actuarial equivalence factors.

According to the LCPR staff memo, dated March 4, 2013, on the bill that replaced the actuarially equivalent reduction factors with fixed factors, the purpose of the change was to provide more favorable factors for TRA members and thereby provide them with a larger early retirement benefit than they would have received using actuarial equivalence. The memo states:

> *The policy issue is whether or not it is appropriate for the TRA Board to recommend a set of specific rate early retirement reduction factors that depart from the required actuarial equivalent early retirement reduction factors. Apparently the decision by the TRA Board to create a set of early retirement reduction factors is prompted by the discomfort with the magnitude of reductions required by the implementation of the actuarial equivalence reduction factors and a desire to implement reduction factors that are more favorable to future early retirees… Now, the TRA Board wants to depart from that arrangement [actuarially equivalent reduction factors] because it wants to provide a greater subsidy to early retirees than what would occur with actuarial equivalent factors.*

General Summary

The chart on the next page shows the percent reduction at each early retirement age under current law and under the bill. The far right two columns is an example that shows how much the monthly annuity will be at each early retirement age for a benefit that is $3,000 at normal retirement age, under current law and under the bill.

Age of Early Retirement	**Current law**: Percent by which the normal retirement benefit is reduced		**HF 3972 / SF 4196**: Percent by which the normal retirement benefit is reduced		**Example**: Normal retirement benefit of $3,000 per month	
	Per year reduction	Total amount of reduction	Per year reduction	Total amount of reduction	Current law	HF3972/ SF4196
65	-7%	-7%	-7%	-7%	$2,790	$2,790
64	-7%	-14%	-7%	-14%	$2,580	$2,580
63	-7%	-21%	-7%	-21%	$2,370	$2,370
62	-7%	-28%	-3%	-24%	$2,160	$2,280
61	-7%	-35%	-3%	-27%	$1,950	$2,190
60	-7%	-42%	-3%	-30%	$1,740	$2,100
59	-7%	-49%	-3%	-33%	$1,530	$2,010
58	-4%	-53%	-3%	-36%	$1,410	$1,920
57	-4%	-57%	-7%	-43%	$1,290	$1,710
56	-4%	-61%	-7%	-50%	$1,170	$1,500
55	-4%	-65%	-7%	-57%	$1,050	$1,290

Cost

TRA's retained actuary, Cavanaugh MacDonald Consulting, estimated the cost of the bill. Cavanaugh estimates that the change in the early retirement reduction will increase the plan's liability by approximately $606.47 million. On an annual basis, the bill is estimated to cost 1.06% of pay, or approximately $66.7 million in the first year, according to TRA. (Cavanaugh's report shows an annual cost of $64.75 million, and Commission staff cannot reconcile this difference.)

To defray the cost, the bill increases employer contributions by an undefined amount and funds the school districts and other participating employers through an increase in the pension adjustment revenue and appropriations.

Section- by- Section Summary

Section 1 amends section 126C.10, subdivision 37, to increase the pension adjustment revenue annually paid to each school district. The amount of the increase is left blank in the bill, but we understand that the authors' intent is to have the increase match the employer contribution increase. The increase would take effect in fiscal year 2026 (beginning July 1, 2025).

Section 2 amends section 354.42, subdivision 3, to increase the employer contribution rate beginning July 1, 2025. The amount of the increase is left blank in the bill, but we understand that the authors' intent is to have the increase fully fund the cost of the more generous early retirement reductions.

Section 3 amends section 354.42, subdivision 3, to replace the reduction percentages in current law for early commencement of the retirement benefit with percentages that will result in a larger benefit for members that retire at age 62 or younger.

The changes are as follows, effective July 1, 2025, for each year that the member's age of retirement precedes normal retirement age:

Current law:

- For each year prior to age 66, through age 59: 7% per year
- For each year prior to age 59, through age 55: 4% per year

Under the bill:

- For each year prior to age 66, through age 63: 7%
- For each year prior to age 63, through age 58: 3%
- For each year prior to age 58, through age 55: 7%

Section 4 contains appropriations for the participating employers that are not school districts. By paragraph in this section:

(a) Department of Education
(b) Minnesota State Academies
(c) Perpich Center for the Arts
(d) Minnesota State Colleges and Universities

The amounts are left blank, but we understand that the authors' intent is to have the increase match the employer contribution increase. The increase would take effect in fiscal year 2026 (beginning July 1, 2025).