SF 1386 (McEwen): Restoring augmentation of deferred annuities for members who left public employment before 2019

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Date: April 25, 2024

Introduction

Affected Plans:

Minnesota State Retirement System (MSRS):
- General Employees Retirement Plan
- State Patrol Retirement Plan
- Correctional State Employees Retirement Plan

Public Employees Retirement Association (PERA):
- General Employees Retirement Plan
- Police and Fire Retirement Plan
- Local Government Correctional Employees Retirement Plan

Teachers Retirement Association (TRA)

St. Paul Teachers Retirement Fund Association (St. Paul Teachers)

Laws Amended: Minnesota Statutes, sections 352.22, subdivision 3a; 352B.08, subdivision 2b; 353.34, subdivision 3; 354.55, subdivision 11; and 354A.37, subdivision 2

Laws Added: Uncoded session law

Brief Description: Augmentation is an automatic increase of the retirement annuity accrued by a member who left public employment but has not yet begun to take their pension benefit. The bill restores augmentation for members who left public employment before January 1, 2019 (for members of MSRS and PERA), or July 1, 2019 (for members of TRA and St. Paul Teachers). Augmentation was ended for all members of the plans above by the 2018 Omnibus Pension Bill prospectively after December 31, 2018, (for members of MSRS and PERA) or June 30, 2019, (for members of TRA and St. Paul Teachers). The bill also includes a retroactive implementation of the annual increase for the benefit of deferred members who started to receive a retirement annuity after the 2018 legislation took effect.

Attachment: VIA Actuarial Solutions Cost Estimate dated January 24, 2024

Background

Augmentation is an automatic annual percentage increase of the pension benefit accrued by a member who is no longer working in public employment but has not yet begun to take their pension benefit. These members are sometimes referred to as deferred members because, while they have a vested pension benefit, they have to "defer" starting their pension benefit until they reach the earliest retirement age.

Under augmentation, a deferred member's pension benefit increases each year by a fixed percentage until the member reaches at least the earliest retirement age and elects to begin receiving their pension. For example, before augmentation was eliminated (see next paragraph), if a member of MSRS or TRA left public employment after having accrued a pension benefit of $1,000 per month, the member's benefit increases each year by 2%. One year after leaving employment, the monthly benefit increases to $1,020; two years, $1,040; three years, $1,061; four years, $1,082; five years, $1,104; six years, $1,126; and so on, until the member reaches retirement age and elects to receive a monthly pension benefit.

The 2018 Omnibus Pension Bill (Laws 2018, Chapter 211) made various pension reforms aimed at ensuring the sustainability of public pension plans. The goal of that legislation was to leave intact core pension benefits, while reducing particular benefit liabilities. As part of that legislation, augmentation of deferred annuities was eliminated prospectively after December 31, 2018, for members of MSRS and PERA and June 30, 2019, for members of TRA and St. Paul Teachers. Once the legislation took effect, a deferred member's pension benefit no longer increased by a fixed percentage every year.

Section- by- Section Summary

Section 1 amends section 352.22, subdivision 3a, which governs augmentation for the MSRS General Employees Retirement Plan (MSRS General Plan) and the MSRS Correctional State Employees Retirement Plan (MSRS Correctional Plan), by restoring the augmentation of deferred annuities at the rate of 2% for members who left public employment before January 1, 2019.

Section 2 amends section 352B.08, subdivision 2b, which governs augmentation for the MSRS State Patrol Retirement Plan, by restoring the augmentation of deferred annuities at the rate of 2% for members who left public employment before January 1, 2019.

Section 3 amends section 353.34, subdivision 3, which governs augmentation for PERA plans, by restoring the augmentation of deferred annuities at the rate of 1% for members who left public employment before January 1, 2019. Not all members of PERA were receiving augmentation in 2018. A deferred member's pension benefit was augmented only if the member terminated service before January 1, 2012.

Section 4 amends section 354.55, subdivision 11, which governs augmentation for TRA, by restoring the augmentation of deferred annuities at the rate of 2% for members who left public employment before July 1, 2019.

Section 5 amends section 354A.37, subdivision 2, which governs augmentation for St. Paul Teachers, by restoring the augmentation of deferred annuities at the rate of 2% for members who left public employment before July 1, 2019.

Section 6 has four subdivisions, one for each retirement system (MSRS, PERA, TRA, and St. Paul Teachers). Section 6 requires that the executive directors of each retirement system recalculate the annuity of any retired member who started to receive a pension on or after January 1, 2019 (for the MSRS and PERA plans), or July 1, 2019 (for TRA and St. Paul Teachers), and whose monthly pension benefit would have been larger had this bill been in effect on January 1, 2019, or July 1, 2019, as applicable.

The executive director must adjust the member's annuity amount to reflect the member's increased benefit for future payments. The adjusted annuity must take into account postretirement increases and any optional annuity forms of payment if elected by the member.

The executive director must also offer a lump sum distribution to the member, which must reflect applicable postretirement increases and optional annuity forms of payment if elected by the member. The lump sum distribution is calculated as follows:

*Lump sum distribution = (Increased monthly benefit level – current monthly benefit level) * the number of monthly payments made to the former employee prior to the effective date*

Effective Date. Sections 1 to 6 are effective the day following final enactment.

Public Policy Considerations

Cost

Restoring augmentation under the bill is estimated to cost the MSRS General Plan roughly 0.31% of pay and increase the plan's actuarial accrued liability by roughly $210 million. On an annual basis, restoring augmentation under the bill is estimated to cost the MSRS General Plan roughly $11.83 million during fiscal year 2024. In addition, the estimated lump sum value of retroactive augmentation payments (see section 6) is roughly $4.6 million.

Staff, at the direction of the Chair, asked the Commission's actuary, VIA Actuarial Solutions, to determine the cost of the bill to just one plan. To estimate the cost of the bill to all affected pension plans, the Commission would incur additional fees for actuarial services.

Rationale for the Elimination of Augmentation

The elimination of augmentation, as part of the 2018 Omnibus Pension Bill, was intended to ensure the sustainability of Minnesota's public pension plans. In 2018, legislators decided to focus on retaining core pension benefits for employees who work in public service until retirement, at the expense of benefits for individuals who leave public service mid-career.

Active members who remain in public service may reasonably be concerned about the fairness of providing augmentation because it is a benefit for members who have left public service, and those members can no longer contribute to the funding of their pension benefits. In addition, augmentation benefits all former public employees, including individuals who were terminated for poor performance or inappropriate behavior or left public service for more lucrative positions in the private sector.

Augmentation was a benefit provided only by public pension plans in Minnesota and in South Dakota, where it was included in a new tier of benefits offered to recently hired employees in exchange for a less generous pension formula.

Rationale for the Restoration of Augmentation

Supporters of augmentation claim that it is unfair for a member's benefit to remain stagnant at the same level, sometimes for decades, while the employee contributions paid by the member into the pension fund continue to grow due to investment earnings. The member's contributions and the employer contributions made on the member's behalf are invested along with all other plan assets. Supporters of augmentation may argue that a 2% annual increase (or 1% for PERA members) is reasonable, given that the plans currently assume a 7% rate of return.

Defined benefit plans are not typically portable, which means members of defined benefit plans are not able to take their retirement benefit with them upon leaving a job and invest it in another retirement account. Augmentation may be viewed as compensation to the deferred member for the lack of portability. A deferred member can't, for instance, transfer the value of their benefit amount to a defined contribution plan, such as a 401(k) plan, affiliated with their new employer. A deferred member may take a refund of their employee contribution amount (plus interest) and transfer the refund to another retirement account. However, that member will forfeit the value of all employer contributions made on the member's behalf and will lose the right to receive a pension benefit at retirement age.

SF 1386 does not propose a full restoration of augmentation. Instead, the bill restores the augmentation of deferred annuities for members who left public employment before augmentation was eliminated by the 2018 Omnibus Pension Bill. These members may have believed that their benefit would continue to increase each year until retirement. They enjoyed the annual increase in their benefit for a period of time, but the increase stopped once augmentation ended.