TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director

RE: S.F. 543 (Larson); H.F. 914 (Beard): TRA; Pre-1969 Teachers Provided with Partial Improved Money Purchase Program Savings Clause Benefit Adjustment; and

S.F. 838 (Gaither); H.F. xxx: TRA; Pre-1969 Teachers Provided with Partial Improved Money Purchase Program Savings Clause Benefit Adjustment

DATE: April 18, 2005

Summary of S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx

S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx provide a benefit adjustment of 45 percent of the difference, if positive, between an Improved Money Purchase (IMP) Program savings clause benefit on the date of initial benefit receipt and a single life annuity formula annuity amount (an annuity computed using the high-five average salary, service credit, and the applicable accrual rate or rates) on that same date for certain active and retired members of the Teachers Retirement Association (TRA). The eligible members are retired and active TRA members who were TRA members during the 1968-1969 school year and were not covered by the TRA Improved Money Purchase (IMP) Program savings clause, or who terminated TRA coverage before the 1968-1969 school year and later returned as active TRA members and were eligible to elect various forms of defined contribution and defined benefit TRA coverage available under Minnesota Statutes 1971, Section 354.55.

Comparable to Legislation Heard in 2004, But Broader Scope

S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx are very similar to legislation heard last year by the Commission and revised at the Commission meeting to incorporate the amendments which the proponents deemed desirable at that meeting. This included an amendment to base the increase on 45 percent of the difference between the formula annuity and the IMP benefit amount, rather than a 25 percent ad hoc adjustment and a technical amendment to clarify that the benefit changes are permanent and to be built into the base annuity used to compute any further post-retirement increases over time. The one substantive difference is that the current bills have a larger eligibility group. One of the eligibility requirements in last year's bill was that the teacher must have retired after January 15, 1998. The current bills, S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, do not include this restriction.

Background on the Improved Money Purchase Program Savings Clause and Other Election Options

Some TRA members who taught in 1969 are covered by a savings clause which gives them access to a defined contribution annuity (referred to as an Improved Money Purchase (IMP) annuity), if that annuity provides a higher benefit than a TRA defined benefit annuity (which is referred to in TRA statutes as a formula annuity). It was long presumed that the formula annuity would always provide the higher annuity and that the savings clause had no real value, but due to extraordinarily high returns in the 1990s which boosted the value of IMP benefits, many individuals covered by the savings clause have received an unexpected windfall at retirement, with benefits in excess of that provided by the formula plan.

S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx are an effort to boost the benefits of TRA members who taught in 1969 or in the early 1970s and who do not have access to the savings clause. They do not have access to the savings clause because decades ago they actively elected coverage other than the IMP. The current bills would provide a benefit of 45 percent of the difference, if positive, between an IMP annuity and the formula annuity.

To better understand the bill, it is useful to review of the benefit options available in TRA law in the late 1960s and early 1970s. To better understand those options, it is useful to start with a few comments on the money purchase annuities offered by TRA and its predecessor prior to the 1970s.

1. Nature of Early TRA, MSRS, and PERA Plans. The Teachers Insurance and Retirement Fund (TIRF), the predecessor to the Teachers Retirement Association (TRA), was created in 1915. TRA was established in 1935 to replace the bankrupt TIRF. The pension plans provided by the TIRF and the early TRA plan were quasi defined contribution plans, and were referred to as "money purchase plans." In a pure defined contribution plan, the value of the benefit is determined by the accumulated

contributions and the investment income earned on those contributions, and there can be no unfunded liability. TRA's money purchase plans were primarily defined contributions plans, but unfunded actuarial accrued liability was created in TRA due to provisions of law which added to the value of the money purchase annuity, including various disability and other supplemental benefits, and due to assuming liabilities from the old TIRF plan.

In contrast, the other two statewide pension plans, the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) and the Public Employees Retirement Association (PERA-General), were defined benefit plans from their inceptions, in 1929 and 1931 respectively. Defined benefit plans provide a benefit based on a formula with each year of service producing an increment of the total benefit, typically based on a percentage of covered salary.

The early MSRS and PERA defined benefit plans were quite modest by current standards. For covered salary, the early MSRS and PERA programs used a flat dollar amount retirement benefit, then (1957-1973) used a career average salary rather than the high-five average salary. When career average salary is used to compute a benefit for a long-service individual, that salary base is more typical of the salary received by the individual in mid-career, 15 years or more prior to retirement. When the high-five average salary is used, which was first adopted in 1973, the benefit is based on the salary received by the individual a few years prior to retirement.

2. <u>TRA Plan Changes, 1969: New and Revised Programs</u>. TRA's money purchase plan had been revised several times prior to 1969, but by 1969 there was growing concern that the plan continued to provide inadequate benefits. In response to complaints from the teacher unions and others about the inadequacy of TRA retirement benefits, the 1969 Legislature created alternative benefit programs in TRA and the various member groups were allowed to elect one of the programs or a combination of programs. These elections were to occur no later than June 30, 1972. These alternative benefit programs were as follows:

    a. <u>The Improved Money Purchase (IMP) Program Savings Clause</u>. The IMP replaced the prior money purchase program. For Coordinated members, the money purchase plan in prior law was revised by requiring, for purposes of computing the annuity, a doubling of value of employee contributions plus investment earnings credited prior to July 1, 1957. For both Basic and Coordinated members, the monthly payments payable under the annuity were to be computed assuming that annuity assets, prior to payout, earned a 3.5 percent return, rather than a three percent return. That interest rate assumption change allowed higher monthly benefits for any given level of reserves.

    b. <u>Career Average Salary Formula Program</u>. A Career Average Salary Formula Program was established in TRA to parallel the MSRS-General and PERA defined benefit plans. The salary used in the computation was the career average salary rather than the high-five as currently used for Minnesota pension plans. The accrual rates, the percent of the career average salary received per year of service, varied depending upon whether the individual was a Basic or Coordinated member. They also varied depending upon whether this was the only retirement option chosen by the teacher, or whether the teacher chose this option in combination with another of TRA's new plans. The accrual rates also strongly favored long service, with a very low rate for each of the first ten years of service, increasing with each decade of service, reaching their highest level only after the teacher had provided 40 or more years of service.

    c. <u>Variable Annuity Program</u>. The Variable Annuity Program is another defined contribution program. However, while the rate of return credited to the money purchase program presumably was the rate of return earned on TRA assets (a portfolio composed of a combination of cash, bond, and stock investments under State Board of Investment (SBI) management), any assets in Variable Annuity Program Accounts were to be invested solely in stock investments.

3. <u>Plan Elections by 1968-1969 TRA Members</u>. TRA members (both Basic and Coordinated) who rendered service during the 1968-1969 school year and any member who had at least 20 years of service credit as of July 1, 1969, were allowed to elect coverage by one of the above programs or a combination of these programs as specified below. The IMP was the default option. Teachers were instructed to complete the election form only if they wished to have coverage other than the IMP. The options were as follows:

    a. <u>Improved Money Purchase Program</u>. Teachers in this group would be covered by this option unless they elected other options as specified below.

    b. <u>Career Average Salary Formula Program</u>.

c. Variable Annuity Program. This option was open to Coordinated members only.

d. Combined Improved Money Purchase Program and Variable Annuity Program. Under this option, the employee contributions and corresponding employer contributions would be divided between these two defined contribution programs. Four-sevenths of the contributions were placed in the Improved Money Purchase Program, and the remaining contributions were directed to the Variable Annuity Program.

e. Combination Career Average Salary Formula Program and Variable Annuity Program. This option combined a defined contribution program and a defined benefit program, with four-sevenths of the contributions going to the formula program and the remainder to the Variable Annuity Program.

4. TRA Plan Changes, 1969: Plan Elections by New Hirees. The legislative changes in 1969 created somewhat different options for the post-1969 hirees than for existing employees. The IMP was closed to post-1969 hirees. The default option for the post-1969 hirees was the Career Average Salary Formula Program. These hirees were asked to complete an election form only if they wished to have some other available option. The available options for this group were as follows:

   a. Career Average Salary Formula Program. This defined benefit plan was the default option.

   b. Variable Annuity Program.

   c. Combination Career Average Salary Formula Program and Variable Annuity Program. This option combined a defined contribution program invested entirely in stock with a defined benefit program, with four-sevenths of the contributions going to the formula program and the remainder to the Variable Annuity Program.

5. TRA Plan Changes, 1973 and Later: Move to High-Five Average Salary Defined Benefit Plan, Consequences. The 1973 Legislature replaced the TRA Career Average Salary Formula Program with the High-Five Average Salary Program. The legislation also made similar revisions in MSRS, PERA, and other major plans, and provided ad hoc benefit improvements to those already retired in an effort to raise the monthly benefit paid to retirees.

The shift from career average salary to the high-five average salary for computing benefits under Minnesota's larger public defined benefit plans dramatically improved the benefit levels provided by those plans. TRA members who a few years earlier had chosen the pure IMP or Variable Annuity options became dissatisfied because their decision to elect those programs was based on comparisons to the less generous Career Average Salary Formula Program. To address the concerns of these TRA members, laws were enacted which moved all TRA members into the High-Five Average Salary Program or a combination of the High-Five Average Salary Program and the Variable Annuity Program. Specifically:

a. TRA members previously covered under the IMP Program and who performed teaching service after June 30, 1972, were transferred to the High-Five Formula Program as of July 1, 1973. These transferred members retained rights under a savings clause to an IMP Program benefit calculation if that produced a larger benefit. This IMP Program savings clause applies only to TRA members who taught during the 1968-1969 school year or who were on an approved leave of absence. That savings clause, which remains in current statute as Section 354.55, Subdivision 17, reads:

> Teachers who retire after June 30, 1973 and who failed to make an election pursuant to Minnesota Statutes 1971, Section 354.145, subdivision 1, clause (1) and subdivision 2, clause (1) shall have their annuity at retirement computed under section 354.44, Subdivision 2 or 6 [the IMP or formula annuity, respectively], whichever is larger.

b. TRA members who were previously covered under either the Combined IMP and Variable Annuity Program or the Total Variable Annuity Program and who performed teaching service after June 30, 1972 were transferred to the Combined High-Five Average Salary Formula Program and Variable Annuity Program. The Commission staff is not aware of any savings clause relating to this provision.

The Combined High-Five Average Salary Formula Program/Variable Annuity Program continued in existence until 1989, when all Variable Annuity Program assets were transferred to the High-Five Average Salary Formula Program. The 1989 Omnibus Pension Bill (Laws 1989, Chapter 319, Article 9, Sections 1 to 4) transferred all Variable Annuity Program accounts to the High-Five Average Salary Formula Program and specified that the annuities of these members would be computed solely under the defined benefit plan provisions. The Commission staff is not aware of any savings clause in law that would provide members, who had accounts that transferred in 1989, with a full or partial benefit from the Variable Annuity Plan or Improved Money Purchase Plan if that prior plan happened to provide a benefit greater than that payable to the member from the full defined benefit program.

For those individuals who retired in 1989 or earlier, all retiree assets relating to Variable Annuity Program annuities also transferred in 1989. From that date forward, post-retirement adjustments on the benefit computed under the Variable Annuity Program annuities are generated by SBI Post Retirement Fund.

The 1989 termination of the remaining Variable Annuity Plan accounts was desired by TRA administrators, presumably with the support of the various teacher unions and other interest groups covered by the pension plans, because these groups concluded that the 100 percent defined benefit plan approach would provide a superior benefit. The House floor amendment that constituted the 1989 Omnibus Pension Bill was assembled by TRA, PERA, and MSRS administrators and administrators from other Minnesota larger public plans. The Commission was provided with a general overview of the broad changes sought by TRA, PERA, MSRS, and other pension systems, but the Commission never reviewed language and took no formal position on the proposal. The 1989 Omnibus Pension Bill originated as a major delete-everything amendment added by the House near the end of the session to a minor Duluth Teacher Retirement Fund Association (DTRFA) bill. The Senate passed the Omnibus Pension Bill on the last day of the Session.

<u>Groups of TRA Members Actually or Potentially Included in the Pre-1969 Teacher Benefit Plan Coverage Issue</u>

TRA members who would be covered by S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, or who could demand a similar special benefit increase if these bills were to pass, include the following:

1. <u>Active Members Who Elected the Career Average Formula Program 1969-1972</u>. The group includes TRA members who were teaching in the late 1960s and early 1970s and who elected the formula program before the 1973 benefit increase (shift from career average salary formula to highest five successive years' average salary formula). This group, which is covered by S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, contends that they are similar to the IMP savings clause group and are equally deserving, justifying an IMP-like benefit or comparable equitable treatment. They are comparable to the IMP group by providing service during the same period, by providing comparable length of service, and by making comparable member contributions.

2. <u>Active Members Who Elected Variable Annuity Program in Whole or in Combination with Other Programs</u>. This group, which also appears to be covered by S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, includes TRA members who were comparable to the first group noted above, but who elected variable annuity coverage in whole or part. This group can make arguments comparable to the above, and in addition might contend that the legislative phase-out of the Variable Annuity Program (1974-1978) and the legislative elimination of the Variable Annuity Program (1989) constituted a legislative take-away of benefits that now can only be rectified by giving them the IMP savings clause extension or comparable equitable treatment.

3. <u>Current TRA Active Members Who Missed the 1969 Election Because They Were Not Active or Were on Leave in 1969</u>. The group includes teachers who had a break in service over the 1969-1970 school year and consequently were automatically placed in the TRA formula program by operation of law rather than individual election. The group argues that their similarity to the group covered by the TRA IMP savings clause should allow their inclusion in the savings clause or in comparable equitable treatment.

4. <u>Current TRA Active Members Who Purchased Prior Service Covering the 1969-1970 School Year</u>. The group, which is not covered under S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, includes current active members who recently purchased prior service credit that included the 1969-1970 school year, when the IMP savings clause originated. The group argues that the factors that prevented them from providing teaching service during or before the 1969-1970 school year (such as a break in service due to maternity, or a leave, or providing military service during that period) should not prevent them from having the advantages of the IMP savings clause or comparable treatment.

<u>Impact of 1973 TRA Improved Money Purchase Program Savings Clause</u>

The savings clause enacted in 1973 (Minnesota Statutes, Section 354.55, Subdivision 17, which appears on page 3) is applicable to TRA members who taught or were on an approved leave during the 1968-1969 school year. The savings clause extends a right to receive an IMP benefit to individuals who were transferred from IMP coverage to the full formula annuity, if the value of that option is greater than the formula annuity.

The value of an IMP benefit is determined by investment market returns. Because of the substantial investment returns during the 1990s compared to moderate wage inflation (the economic factor that drives the formula annuity benefit), the IMP benefit provides a larger retirement annuity for some TRA members covered by the IMP savings clause. Thus, the savings clause that was put in place in the early 1970s, but not used for over 20 years, is now being utilized.

In 1999, TRA requested that Buck Consultants, the actuarial firm retained by TRA, provide an estimate of the cost of the savings clause, given only the active and deferred members eligible for that coverage under current law. The cost of the higher annuities paid to the existing retirees was not included. The report indicated that 3,811 current active TRA members and 1,057 deferred members were potentially eligible. Because the estimates require a comparison of the value provided by these two alternative benefits at the assumed future retirement date, the actuary made assumptions about future investment rates of return up to the assumed retirement date, because those assumed rates of return will impact the value of the IMP benefit. The actuary concluded that the savings clause in current law may add an additional $237 million in liability if TRA assets earn 8.5 percent per year. If the average rate of return during the five years prior to 1999 was earned, which was 14.80 percent annually, $514 million in liability would be added. Extending the savings clause to other groups, or providing an ad hoc benefit increase for the non-savings clause group, as S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx would do, will further add to these liabilities.

Recent Proposals/Actions Attempting to Boost Benefits of Non-IMP TRA Members

The current bills are the most recent effort to address the claimed grievance of 1960-1970s TRA members who were not covered by the IMP savings clause. This general issue has been before the Legislature for several years. The first instance discussed here occurred in 1999.

1. 1999 Legislative Session H.F. 2285 (Kalis); S.F. 2239 (Larson) would have allowed current teachers who became TRA members on or before January 1, 1969, and who elected coverage other than the IMP, to have access to an Improved Money Purchase (IMP) Program savings clause benefit if that provides a higher benefit than the defined benefit plan. The Commission reviewed the situation created by the IMP savings, and reviewed H.F. 2285 (Kalis); S.F. 2239 (Larson), requesting comparable treatment for those not covered by the IMP savings clause, at the Commission’s July 1999 interim meeting.

   TRA’s retained actuary, Buck Consultants, was asked to estimate the cost of H.F. 2285 (Kalis); S.F. 2239 (Larson). Their report, which concluded that about 4,000 teachers would be eligible under the 1999 bill, predicted a cost ranging from $417 million in additional liability assuming 8.5 percent investment returns, to $759 million assuming a continuation of 14.80 percent investment returns. These liabilities would be in addition to those imposed by the savings clause in current law, as indicated previously, for the group currently eligible.

2. 2000 Legislative Session Review of H.F. 2285 (Kalis); S.F. 2239 (Larson). On February 28, 2000, the Commission again reviewed H.F. 2285 (Kalis); S.F. 2239 (Larson), but in the form of a delete-everything amendment that would have capped TRA’s cost at $350 million. Gary Austin, Executive Director of the Teachers Retirement Fund Association (TRA), testified that the TRA Board was not in favor of expanding eligibility for an IMP-like benefit unless the total cost of those additional benefits was financed by an outside source. Hank Stankiewicz and Greg Burns, representing Education Minnesota, stated that their membership voted overwhelmingly not to support the type of change provided by H.F. 2285 (Kalis); S.F. 2239 (Larson). The Minnesota Department of Finance also opposed the legislation. The Commission voted and recommended that the bill should not pass.

3. 2002 Legislative Session S.F. 3456 (Larson); H.F. 3713 (Molnau) was similar to the proposed 2000 legislation discussed above, but TRA’s maximum liability would have been capped at $300 million rather than $350 million. S.F. 3456 (Larson); H.F. 3713 (Molnau) was not heard.

4. Court Action during the 2002-2003 Biennium. The claim of the pre-1969 teachers who are not covered by TRA’s Improved Money Purchase Program savings clause has been litigated in *Jacobson v. TRA*, CX-00-2097. The Ramsey County District Court concluded that the plaintiffs were time barred from pursuing the potential cause of action. The Minnesota Court of Appeals affirmed that decision, with cert denied by the Minnesota Supreme Court. While the case was decided on procedural issues rather than directly on its substantive merits, TRA had substantive defenses to raise in the event that the case was fully litigated and there is no reason necessarily to assume that the plaintiffs could have prevailed if they had brought their suit in a timely manner.

5. 2003 Session H.F. 282 (Beard); S.F. 213 (Larson). On April 8, 2003, the Commission heard H.F. 282 (Beard); S.F. 213 (Larson) which, as drafted, would provide a 25 percent increase in the annuity of teachers who taught during the 1968-69 school year but elected coverage other than the Improved Money Purchase Program. After being revised somewhat by amendments, the bill was laid over. On April 14, 2003, the bill was again discussed, and the Senate author requested that the bill be further studied over the interim, but that study did not occur.

6. 2004 Legislative Session Review of H.F. 282 (Beard); S.F. 213 (Larson). At the Commission's March 9, 2004 meeting, H.F. 282 (Beard); S.F. 213 (Larson) was again heard. At the request of the Senate author, the bill was amended to provide a benefit adjustment for the eligible group of 45 percent of the difference between a formula (high-five annuity) and the value of an IMP benefit, rather than a 25 percent increase in the individual's formula annuity amount. After considerable testimony and discussion, the Commission voted on the bill and the bill was not recommended to pass.
   The bill, as amended by the Commission on March 9, 2004, and which the Commission rejected, is essentially equivalent to the bills currently before the Commission, S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, except that the current bills have a larger eligibility group.

Discussion and Analysis of S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx

S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx provide a benefit adjustment of 45 percent of the difference, if positive, between an Improved Money Purchase (IMP) Program savings clause benefit and a single life annuity formula annuity amount (an annuity computed using the high-five average salary, service credit, and the applicable accrual rate or rates) computed as of the date of initial benefit receipt, for certain active and retired members of the Teachers Retirement Association (TRA). The eligible members are retired and active TRA members who were TRA members during the 1968-1969 school year and were not covered by the IMP savings clause, or who terminated TRA coverage before the 1968-1969 school year and later returned as active TRA members and were eligible to elect various forms of defined contribution and defined benefit TRA coverage available under Minnesota Statutes 1971, Section 354.55.

Many individuals covered by the IMP savings clause received an unexpected windfall when the value of an IMP benefit began to exceed the value of a formula annuity, due to the impact that unusually strong investment markets in the late 1990s had on computed IMP benefits. This caused those who did not choose the IMP or are not covered by the IMP savings clause to seek comparable benefits. S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx are the most recent legislative bills that attempts to enhance benefits to the non-IMP group.

The proposed legislation raises the following pension and related public policy issues for Commission consideration and discussion:

1. Violation of Equity. The Commission may conclude that the current request violates notions of equity by requesting that Commission revisit old issues on which it has already decided on several occasions, and which has been reviewed and rejected by the court system. At several times in the past, the most recent being last year, the Commission and Legislature heard proposals to provide all or part of an IMP benefit to various groups that either initially rejected the IMP benefit or were not eligible. The various bills discussed previously include bills which would have provided an IMP benefit to those who initially rejected it (the 1999 proposal), or a prorated IMP benefit capped to not exceed a cost to TRA of $350 million (the 2000 proposal), or a prorated IMP benefit not to exceed a cost of $300 million (the 2002 proposal), or a 25 percent increase in the formula annuity in lieu of an IMP benefit (the 2003 proposal), or an additional benefit of 45 percent of the difference between an IMP benefit and the formula annuity (the 2004 proposal). In each case, the Commission and the Legislature have rejected these proposals. The current bills are substantively identical to the bill as revised by the Commission in 2004, but with a slightly larger eligibility group.

2. Validating a Perceived Grievance. Rather than providing a full IMP benefit, the current bills would provide an additional benefit equal to 45 percent of the difference between an IMP and formula benefit. Taking action on the current bills may merely validate a perceived grievance, an action which may obligate future Legislatures to eventually provide further benefit adjustments equal to the full difference in value between a formula annuity and an IMP benefit.

3. Validity of Inequality Contention/Need for Remedy. The primary argument that has been made by the proponents of the potential legislation is that pre-1969 teachers who elected a benefit program other than the Improved Money Purchase (IMP) Program savings clause were treated unfairly and unequally and have been denied justice by not now having access to an IMP benefit, although they

previously rejected that benefit, or to some comparable benefit. The proponents suggest that they paid as much or more in member contributions than those pre-1969 teachers who were accorded the "gratuitous" benefit of the Teachers Retirement Fund Association (TRA) IMP savings clause, and that equity demands that unincluded pre-1969 teachers have the same or similar benefit advantages as the IMP teachers. A related argument is that the Variable Annuity Program was abolished in 1989 without affected TRA member consent, and that elimination caused harm which deserves to be remedied.

Whether proponents of the potential legislation made the same or greater contributions than teachers with access to the TRA IMP savings clause is not an argument to which the Commission has given credence in the past, since pension programs are large averaging pools involving all types of cross-subsidies. The issue of some members subsidizing other members has never alone been sufficient to spark remedial legislation.

The IMP savings clause was adopted in 1973 when the TRA benefit program election period was shortened and made essentially irrelevant by the improvements that occurred in the formula program that year. Savings clauses are a common legislative device to avoid inadvertently harming some plan participants who have an unusual set of circumstances. Providing actual or potential TRA IMP selectors with a savings clause to accompany their mandatory transfer to the formula plan follows normal legislative practice. If there was a problem with the 1973 savings clause, it was the failure of the Legislature to sunset the savings clause at a reasonable date shortly after 1973.

Although it may now be claimed that the elimination of the TRA Variable Annuity Program in 1989 caused harm, the Legislature was reacting to years of complaints from teachers who chose the Variable Annuity Program option in the 1960s or 1970s. By the 1980s, these same teachers were complaining that the Variable Annuity benefit would be inferior to a formula benefit. They wanted the Legislature to relieve them of the consequences of having elected Variable Annuity benefits. In 1989, the Variable Annuity Program elimination and the transfer to the formula annuity program were viewed as a desirable benefit improvement and was sought by TRA and its membership. Language containing the elimination of that program was never presented to the Legislative Commission on Pensions and Retirement during the 1989 Session and was belatedly added to the House Floor Amendment that became the 1989 Omnibus Pension Bill.

Finally, as noted previously, the claim of the pre-1969 teachers who are not covered by the IMP savings clause has been litigated in *Jacobson v. TRA* and was rejected by the courts. The Ramsey County District Court concluded that the plaintiffs were time barred from pursuing the potential cause of action. Although the case was decided on a procedural issue rather than directly on its substantive merits, TRA had substantive defenses to raise in the event that the case was fully litigated and there is no reason necessarily to assume that the plaintiffs could have prevailed if they had brought their suit in a timely manner.

4. <u>Actuarial Cost of the Potential Proposed Legislation</u>. The policy issue is the actuarial cost to be borne by TRA if the proposed legislation is enacted. The proposed benefit adjustment will apply to about 3,800 current TRA retirees and about 330 active TRA members who may not retire until some time in the more distant future. TRA recently provided the following estimate of the cost. TRA estimated the cost in two stages. First, TRA estimated the cost if the eligible individuals received a full IMP benefit rather than a formula annuity. That total cost, shown in the chart below, would be $471.4 million. The cost estimate does not include any individuals who retired before 1998. TRA indicates that computing amounts for that group would be prohibitive in terms of time spent, since it would require TRA to review 20,000 to 30,000 files and, in TRA's view, the impact on the cost estimate would not be great, since TRA believes few of those retirees would have an IMP benefit in excess of the formula benefit. The cost, if eligible individuals were to receive the full difference between the formula and IMP annuities, and if the IMP would provide a higher benefit, is shown in Table 1 below.

Table 1
Cost of Providing Full Difference Between
Formula Annuity or IMP Benefit

Retirement Date by Calendar Year	Total Retirees	# of Retirees Formula Higher than IMP	# of Retirees IMP Higher than Formula	Approximate Cost to Pay Higher IMP Benefit
1998	828	144	684	$ 32,670,000
1999	904	63	841	$ 70,680,000
2000	800	36	764	$ 89,730,000
2001	634	31	603	$ 99,670,000
2002	488	22	466	$ 79,850,000
2003	295	20	275	$ 38,630,000

Retirement Date by Calendar Year	Total Retirees	# of Retirees Formula Higher than IMP	# of Retirees IMP Higher than Formula	Approximate Cost to Pay Higher IMP Benefit
2004	194	42	152	$ 15,620,000
Total Retired Members	4,143	358	3,785	$ 426,850,000
Total Active Members		100	330	$ 44,540,000
Grand Total			4,115	$ 471,390,000

Source: Teachers Retirement Association (TRA)

TRA then indicated that under the bill individuals receive an additional benefit of 45 percent of the difference between the formula and IMP benefit if the IMP is higher. Therefore, the cost of this specific proposal is 45 percent of $471.4 million, or $212.1 million. Table 2 below is a chart of the cost of providing some given fraction of the difference, in case the Commission wishes to consider some percentage other than 45 percent.

Table 2
Approximate Cost of Paying Additional Benefit Equal to Various Portions of the Higher IMP Benefit

Approximate Cost to Pay Higher IMP Benefit in $ Millions	Percentage	Cost of Applicable Percentage in $ Millions
$ 471.4	100	$ 471.40
$ 471.4	95	$ 447.83
$ 471.4	90	$ 424.26
$ 471.4	85	$ 400.69
$ 471.4	80	$ 377.12
$ 471.4	75	$ 353.55
$ 471.4	70	$ 329.98
$ 471.4	65	$ 306.41
$ 471.4	60	$ 282.84
$ 471.4	55	$ 259.27
$ 471.4	50	$ 235.70
$ 471.4	45	$ 212.13
$ 471.4	40	$ 188.56
$ 471.4	35	$ 164.99
$ 471.4	30	$ 141.42
$ 471.4	25	$ 117.85
$ 471.4	20	$ 94.28
$ 471.4	15	$ 70.71
$ 471.4	10	$ 47.14
$ 471.4	5	$ 23.57
$ 471.4	0	$ 0

The results of the cost estimate can be incorporated into the most recent TRA actuarial valuation results to provide a rough estimate of the impact of the proposed legislation on the fund. When the actuarial cost estimate was done for the similar bill last year, it was assumed that the active members who are eligible for a benefit increase under the bills would retire, and it was assumed that the salary of those who retire due to the bills was $59,850, which is roughly consistent with the table in the most recent actuarial report indicating the current salary of active members nearing retirement age. In Table 3 which follows it is assumed that these eligible individuals retire, and that the salary of those individuals is $62,842, which is the previous salary estimate plus five percent.

The bills have an impact on TRA, moving the plan from one which is fully funded (a funding ratio of 100.01 percent), to a plan which has an unfunded liability of about $211 million. One of the impacts of this change is to revise the full funding date. In the 2004 actuarial valuation and in a few previous valuations, there were some assets in excess of full funding, and that excess was used to reduce required contributions through negative amortization. The negative amortization uses rolling 30-year periods, placing the full funding date in the 2004 valuation at 2034. In contrast, an unfunded liability, which these bills would create, requires the unfunded to be amortized by 2020. Table 3 that follows builds the impact of that funding date change into the amortization factor.

Table 3
Teachers Retirement Association
Estimate of Bill Impact on TRA Actuarial Condition

	July 1, 2004 Actuarial Valuation Results	Estimated Impact of Proposed Legislation	Resulting TRA Actuarial Condition
Membership			
Active Members	72,008	(330)	71,678

Service Retirees		34,581	330		34,911
Disabilitants		589	--		589
Survivors		2,479	--		2,479
Deferred Retirees		10,767	--		10,767
Nonvested Former Members		18,223	--		18,223
Total Membership		138,647	--		138,647
Funded Status					
Accrued Liability		$17,518,783,700	$212,100,000		$17,730,883,700
Current Assets		$17,519,909,350	--		$17,519,909,350
Unfunded Accrued Liability		($1,125,650)	$212,100,000		$210,974,350
Funding Ratio	100.01%			98.81%	
Financing Requirements					
Covered Payroll		$3,206,759,440	($20,737,860)		$3,186,021,580
Benefits Payable		$1,008,410,471	$65,000,000		$1,073,410,471
Normal Cost	8.07%	$258,898,450		8.07%	$257,111,942
Administrative Expenses	0.39%	$12,506,362		0.39%	$12,425,484
Normal Cost & Expense	8.46%	$271,404,812		8.46%	$269,537,426
Normal Cost & Expense	8.46%	$271,404,812		8.46%	$269,537,426
Amortization	0.00%	$0	0.57%	0.57%	$18,160,323
Total Requirements	8.46%	$271,404,812	0.57%	9.03%	$287,697,749
Employee Contributions	5.00%	$160,337,972		5.00%	$159,301,079
Employer Contributions	5.00%	$160,337,972		5.00%	$159,301,079
Employer Add'l Cont.	0.00%	$0		0.00%	$0
Direct State Funding	0.00%	$0		0.00%	$0
Other Govt. Funding	0.00%	$0		0.00%	$0
Administrative Assessment	0.00%	$0		0.00%	$0
Total Contributions	10.00%	$320,675,944		10.00%	$318,602,158
Total Requirements	8.46%	$271,404,812	0.57%	9.03%	$287,697,749
Total Contributions	10.00%	$320,675,944		10.00%	$318,602,158
Deficiency (Surplus)	(1.54%)	($49,271,132)		(0.97%)	($30,904,409)
Amortization Target Date	2034		(14)	2020	
Actuary	Segal				

The above table suggests that TRA would have an unfunded liability of about $211 million due to the bills and required contributions would increase due to the need to amortize the unfunded. The total employee and employer contributions, however, remain above the total requirements, and the plan would have a contribution surplus of 0.97 percent of pay, rather than 1.54 percent of pay without the bills.

The above analysis uses the actuarial value of assets. Due to a few years of bad investment markets in the early 2000s, the actuarial value of assets is greater than the actual market value. Table 4 below indicates how the unfunded liabilities would change under the 2004 valuation if market value were used rather than the actuarial value of assets. Rather than having a 100.01 percent funding ratio, the ratio would be 97 percent, and the plan would have an unfunded liability to amortize, even before considering the impact of these bills.

Table 4
Funding Ratio Based on Market Value

TRA Asset Value Comparison:		
2004 Actuarial Value of Assets		$17,519,909,350
2004 Market Value of Assets		$16,984,605,405
	Difference	$535,303,945
2004 Funded Status Comparison:		
Actuarial Accrued Liability		$17,518,783,700
Actuarial Value of Assets		$17,519,909,350
Unfunded Actuarial Accrued Liability		($1,125,650)
	Official Funding Ratio	100.01%
Actuarial Accrued Liability		$17,518,783,700
Market Value of Assets		$16,984,605,405
Recalculated Unfunded Accrued Liability		$534,178,295
	Recalculated Funding Ratio	97%

Table 5 indicates the resulting actuarial impact of the bill on TRA if market value were used rather than actuarial value. The plan would be 95.8 percent funded, and there would be a contribution deficiency of 0.46 percent of payroll, or $14.655 million.

Table 5
Teachers Retirement Association July 1, 2004, Actuarial Condition
Assuming Market Value of Assets Rather than Actuarial Value

	Resulting TRA Actuarial Condition	
Membership		
Active Members		71,678
Service Retirees		34,911
Disabilitants		589
Survivors		2,479
Deferred Retirees		10,767
Nonvested Former Members		18,223
Total Membership		138,647
Funded Status		
Accrued Liability		$17,730,883,700
Market Value Assets		$16,984,605,405
Unfunded Accrued Liability		$746,278,295
Funding Ratio	95.79%	
Financing Requirements		
Covered Payroll		$3,186,021,580
Benefits Payable		$1,073,410,471
Normal Cost	8.07%	$257,111,942
Administrative Expenses	0.39%	$12,425,484
Normal Cost & Expense	8.46%	$269,537,426
Normal Cost & Expense	8.46%	$269,537,426
Amortization	2.00%	$63,720,431
Total Requirements	10.46%	$333,257,857
Employee Contributions	5.00%	$159,301,079
Employer Contributions	5.00%	$159,301,079
Employer Add'l Cont.	0.00%	$0
Direct State Funding	0.00%	$0
Other Govt. Funding	0.00%	$0
Administrative Assessment	0.00%	$0
Total Contributions	10.00%	$318,602,158
Total Requirements	10.46%	$333,257,857
Total Contributions	10.00%	$318,602,158
Deficiency (Surplus)	(0.46%)	$14,655,699
Amortization Target Date	2020	

5. Funding of Benefit Improvement, Conflict with Pension Policy Statement. The policy issue is the inconsistency of this proposal as drafted with the Commission's Principles of Pension Policy. That policy document states, under "Funding of Post-Retirement Adjustments," that ad hoc post-retirement adjustments should be funded separately from the regular plan funding and not simply added to the plan's accrued liability. The proposed ad hoc increase would be added to the TRA actuarial accrued liability, more than eliminating the current TRA funding asset surplus in doing so. A better funding device under the Commission's Principles of Pension Policy would be to either provide a State General Fund appropriation to cover the cost, or to surcharge TRA employer and/or employee contributions, or to use a combination of both approaches.

6. Precedent. The primary precedents for the proposed ad hoc post-retirement adjustment are the periodic ad hoc post-retirement adjustments that were granted to the pre-1973 retirees of the various statewide retirement plans beginning in 1973, and the ad hoc post-retirement adjustments that were granted to the 1915 Law retired TRA members (pioneer teachers) beginning in 1955 (Laws 1955, Chapter 549) and ending in 1967 (Laws 1967, Chapter 654). The 1915 pioneer teachers also were included in the pre-1973 retiree increases.

   The pre-1973 retirees were granted ad hoc post-retirement adjustments because of their perception that they suffered a grievance when retirement annuities for new retirees after July 1, 1973, roughly doubled compared to the benefit levels payable to the pre-July 1, 1973, retirees. That increase followed from the change from career average salary retirement annuity formulas to use of the high-five average salary formulas. The 1915 law pioneer teachers were granted ad hoc post-retirement adjustments because of their perception of a grievance when their retirement annuities were reduced by 50 percent following the financial collapse of the Teachers Insurance and Retirement Fund in 1931. Full benefits were not restored until 1955. In neither instance were there actual legal grievances, but rather political grievances because of the volume and vehemence of complaints from the group or moral grievances because of the merits of their presented case.

   No ad hoc post-retirement adjustments have been granted to statewide retirement plan retirees since 1989 other than to reflect post-retirement interest rate actuarial assumption changes.

7. Pressure for Benefit Enhancements from Other Groups. S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx provide a benefit enhancement to individuals who, decades ago, actively elected a benefit plan other than the Improved Money Purchase (IMP) Program. Members who had the IMP savings clause received an unexpected windfall due to the investment markets of the 1990s, and the contention is that fairness requires that others, who did not have the IMP savings clause because they did not want the IMP, should receive a comparable benefit. If these bills are recommended to pass, other groups within TRA or other plans may request further benefit adjustments. If any teacher active in the late 1960s is to receive an enhanced benefit, either through the IMP savings clause or S.F. 543 (Larson); H.F. 914 (Beard) and S.F. 838 (Gaither); H.F. xxx, teachers who began their careers in the mid 1970s or later may seek similar adjustments. Benefit increases granted to teachers usually lead to comparable benefit increases in general employee plans, MSRS-General and PERA-General.

8. Appropriateness of the Base to Which the Increase Percentage is to be Applied. The policy issue is the appropriateness of using the original annuity or benefit amount as the base to which the benefit increase amount will be determined and applied. To Commission staff's best understanding, no prior post-retirement adjustment has been specifically applied to an original benefit base rather than the current benefit base, although post-retirement adjustments granted in the 1950s and 1960s, before regular post-retirement adjustments were utilized, generally were applied to the original benefit amount in fact because the original benefit amount would be the same amount as the current benefit amount. For the applicable TRA retirees who have received their retirement benefits for any length of time, the adjustment will be smaller if applied to the original benefit amount than if applied to the current benefit amount, but the total cost of the adjustment is unlikely to be significantly affected by designating this benefit base. The choice of the benefit base for application of the adjustment amount should be a function of the goal for the adjustment. If enacted, the goal for this adjustment would be to change the perception of some TRA retirees that they were treated unfairly in the amount of their benefit compared to other TRA retirees. If using a smaller base for the adjustment will accomplish this goal, then selecting this base is not problematic. Perhaps this base is used because in prior testimony on previous bills dealing with this pre-1969 teacher group, TRA Executive Director Gary Austin indicated that this proposed base was acceptable.

9. Opposition from TRA and Unions. The issue is the opposition of TRA and teacher unions to past bills to address this IMP-like benefit issue, and the likely opposition to the current proposal.

Potential Amendments for Commission Consideration

1. Amendment LCPR05-043. Amendment LCPR05-043 is a delete-all amendment that provides treatment comparable to the bills as drafted and for the same eligible group, but it places a cap (in an amount to be specified), on TRA's total additional cost, and it adds a requirement that TRA must report to the Commission and various other legislative bodies on the benefit payments made under this section. If the cost of the additional benefit amounts exceeds the cap, the additional benefits would be prorated.

   The Commission may wish to be aware that this cap approach has been used in past bills and the Commission recommended that those bills should not pass. Thus, taking this approach would contradict the actions of previous Commissions. However, more generally, recommending any bill on this issue to pass could be viewed as reversing the position of prior Commissions.

   If the Commission does wish to use amendment LCPR05-043, the Commission may wish to set a maximum cost by inserting an amount into the blank on page 1, line 34. For guidance on setting the cap amount, the Commission may wish to use the information in Table 2. That table indicates that if the eligible individuals receive the additional benefit specified in this bill, 45 percent of the difference between the formula annuity and the IMP if the IMP is higher, then that should cost $212.13 million. The Commission could use that amount as the cap, or a larger or lesser amount.

   If the Commission wishes to revise both the additional benefit percentage and the cap amount, the Commission may choose to select information from Table 2, inserting the cap amount on page 1, line 34, of the amendment, and revising the benefit percentage on page 2, line 14, by verbal amendment.

2. Amendment LCPR05-044 revises the headnote to clarify that the section applies to certain teachers not covered by the IMP savings clause.

3. Amendment LCPR05-246, drawn to the delete everything amendment LCPR05-043, would compensate TRA for the cost of this benefit by appropriations from the state general fund. An initial appropriation would be made on July 1, 2005, equal to 75 percent of the estimated cost of the provided benefit. One

year later, after TRA has dealt with the provision and presumably has a more precise estimate of the cost, any additional amounts necessary to cover the full cost would be transferred to TRA.

4. Amendment LCPR05-247 is identical to LCPR05-246 but it appropriates half the total cost, rather than all of the cost, leaving TRA members and the employers to absorb the remainder.

5. Amendment LCPR05-248 is similar to LCPR05-246, but it is drawn to the bills rather than to the delete-all amendment. If the Commission revises the bills to provide other than a 45 percent benefit, the Commission may wish to strike "$212.1 million" where it appears in the amendment and insert the corresponding amount from Table 2.