TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director

RE: Commission Interim Topic: PERA-P&F Early Retirement Reduction Factors and Impact on Police Officer Supply, First Consideration

DATE: February 5, 2014

Introduction

The 2013 Legislature passed changes in the early retirement reduction factors used to compute annuities from the Public Employees Police and Fire Retirement Plan (PERA-P&F) when plan members retire early (before age 55). Because of these changes, the reductions will be higher, and thus the monthly benefit amount will be less, if plan members who are less than the plan normal retirement age choose to retire after June 30, 2014 rather than before. There is some concern that the revised early retirement policy might cause an early retirement bubble during the first half of 2014, if plan members seek to avoid the larger benefit reductions that will apply if they delay retiring. A retirement spike, if it occurs, might lead to a temporary shortage of police officers and possibly firefighters throughout the state.

This memo provides an introduction to the Commission's consideration of this public safety staffing concern. The memo discusses the changes in PERA-P&F early retirement provisions as enacted in 2013, as well as some other changes in PERA-P&F which might impact retirement decisions. The memo also includes information on the number of PERA-P&F members who, given their age, are eligible for early retirement if they chose to take that option.

PERA-P&F Early Retirement Provisions

The PERA-P&F early retirement provision (Minn. Stat. Sec. 353.651, Subd. 4) has been revised a few times in the last few years as part of PERA efforts to address the plan's low funding ratio and contribution deficiencies. The normal retirement age in the PERA-P&F plan is age 55. At that age, members can retire without reduction. Members can retire as early as age 50, but with a benefit reduced to compensate, at least to an extent, for early retirement. Leading into the 2013 Legislative Session, the early retirement provision specified that if a person became a plan member before July 1, 2007, and retires before normal retirement age, the benefit will be reduced by 0.1% for each month that the member is under age 55 at the time of retirement. Under that provision, early retirements are highly subsidized. The person who retires a year before normal retirement age can be expected to live just as long as the person retiring at normal retirement age, but the person who retires a year early will be receiving benefits for a year longer. To make these benefits actuarially equivalent (having the same present value), the early retiree's benefit would need to be reduced to compensate for the longer period of receipt. The necessary reduction is probably about 6%, possibly more, but under the plan provisions the benefit to the early retiree will only be reduced by 1.2%. (0.1% for each month that the member is under normal retirement age results in a reduction of 1.2%).

To get a better feel for the numbers, we can look at a few estimates based on PERA-P&F data. The PERA-P&F accrual rate (the percentage of the high-five average salary that the individual receives for each year of service) is 3%. According to the latest PERA-P&F actuarial valuation, the average salary for plan members aged 50 through 54 was slightly over $82,000. Assuming an $82,000 high-five average salary and 30 years of service at the time of retirement, the early retiree's benefit before any reduction would be $73,800 *($82,000 x 0.03 x 30 = $73,800).*

Table 1 looks at the impact of the various possible reductions. For comparison, reductions computed using a 6% annual rate are included, as an approximation for an actuarial reduction. The net benefit after application of the PERA-P&F early retirement reduction, 0.1% per month or 1.2% per year under normal retirement age at the retirement date, creates a modest reduction, regardless of the age at early retirement. The net benefits would be much lower if any reduction approaching an actuarial reduction were applied.

Table 1
Early Retirement Benefits, Current Law 1.2% Reduction

Age at Retirement	Unreduced Benefit [1]	Benefit After PERA-P&F Early Retirement Reduction [2]	Appropriate Benefit Under an Actuarial Reduction [3]
50	$73,800	$69,372	$51,660
51	73,800	70,258	56,088
52	73,800	71,143	60,516
53	73,800	72,029	64,944
54	73,800	72,914	69,372

The 2013 legislation phases out the highly subsidized early retirement reduction, but the phase-out is long. The 1.2% per year factor remains fully available to those members who take early retirement before July 1, 2014 (a slightly longer window is available to county sheriffs, intended to permit retirement without having the person leave service before the end of the elected term). For PERA-P&F members who retire before age 55, and after July 1, 2019, the reduction factor will be 5% per year for each year that the person is less than age 55 at the time of retirement. These early retirements will likely still be subsidized, although the subsidy will be modest compared to the provision currently applicable. Between June 30, 2014, and July 1, 2019, early retirees will be subject to a blending of the current 1.2% per year rate and the 5% rate. For those who retire soon after July 2014, the annual rate will be modestly above 1.2%. For those who retire halfway into the July 2014-July 2019 interval, the applicable rate will be midway between the 1.2% and 5% rate, or about 3.1%. For those who retire a little before July 2019, the rate will be just a little below 5%. For those who retire early in July 2019 or after, the applicable rate is 5%.

Table 2, below, can be used to provide a sense of the impact of the 2013 Session changes. Table 2 is the same as Table 1 except that the final column is the benefit after application of a 5% per year reduction, which shows what our hypothetical early retiree would receive when the 5% per year reduction is in full effect rather than the current 1.2% reduction. For example, for the member who retires at age 50 before July 2014, that person would receive $69,372 per year under the current early retirement reduction. If we had a person, however, with the same salary and years of service, but that individual retires in July 2019 or later, that person would receive $55,350 rather than $69,372. If our hypothetical age 50 early retiree retired midway into the July 1, 2014-July 1, 2019 interval, the benefit would be midway between those two amounts (about $62,360). The closer to July 2014 that the person retires, the closer the benefits will be to the 1.2% per year reduction column. The closer the individual retires to July 2019, the closer the benefits will be to those shown in the final 5% reduction column.

Table 2
Early Retirement Benefits, 1.2% Reduction and 5% Reduction

Age at Retirement	Unreduced Benefit [1]	Benefit After PERA-P&F Early Retirement 1.2% Reduction	5% Reduction
50	$73,800	$69,372	$55,350
51	73,800	70,258	59,040
52	73,800	71,143	62,730
53	73,800	72,029	66,420
54	73,800	72,914	70,110

PERA-P&F Post-Retirement Provision Changes

In addition to the 2013 Session PERA-P&F early retirement reduction changes, there was another change in PERA-P&F law that may impact retirement behavior. The PERA-P&F post-retirement provision was also revised by lowering post-retirement adjustments and, for new retirees, delaying the date of first receipt. Until funding stability is restored, rather than receiving up to 1.5% per year increases, postretirement increases will be 1% per year. Furthermore, for those who retire after June 1, 2014, the individual must be retired three years to receive a full 1% adjustment, and at least 25 months to receive a prorated adjustment. For those who retire earlier, the person must be retired one year for a full adjustment and one month for a prorated adjustment. The very modest post-retirement increases place all PERA-P&F retirees at considerable risk of benefit erosion due to inflation. New retirees are at even more risk, due to the longer delay in first receipt of an adjustment.

[1] *Based on $82,000 high-five average salary and 30 years of service.*
[2] *Net benefit after applying reduction of 0.1% per month (1.2% per year) due to early retirement.*
[3] *Net benefit if 6% per year reduction (an approximation of an actuarial reduction) is applied.*

Age Distribution of PERA-P&F Active Members

The distribution of active member page from the 2013 PERA-P&F actuarial valuation is attached as Attachment A. It can provide Commission members with a sense of the number of active PERA-P&F members in the early retirement age group, age 50-54, and those age 45 to 49, who will soon be entering that age group. The plan had 10,922 active members. Of the active members, 1,294, or about 12% of the total active membership, are in the age 50-54 age group. The active members age 45-49 comprise about 18% of the total active membership group.

Observations

A bubble in PERA-P&F early retirements, if it occurs, may create some police and fire shortages in some communities. However, it is difficult to predict if a sudden uptick in early retirements will occur. There are arguments both for and against that occurring. Early retirement reductions will be larger for those who retire early if they delay beyond July 2014. But plan members might conclude that the terms are not noticeably more harsh, particularly if in the first year or two of the phase-in to the higher rates. Furthermore, by working longer the plan member will earn more service credit and possibly higher salary, boosting the benefit. Thus, a sudden spike in retirements might not occur.

Another argument suggesting that any increase in early retirements will be minimal is that the revised PERA-P&F post-retirement adjustment provisions favor a delay in retirements, despite the phasing-in of the harsher early retirement reduction factor. PERA-P&F retirees are in retirement status far longer than general plan retirees, where the typical age at retirement is far greater than in public safety plans. This means that PERA-P&F retirees are more subject to benefit erosion during retirement than general plan retirees. This is further heighted by the recent reduction in the PERA-P&F post-retirement adjustments to 1%, coupled with the lack of Social Security coverage for the public safety employment. Because of the uncertainty and vulnerability during retirement, plan members might respond by working longer in PERA-P&F covered positions than would otherwise be the case.

Further complicating any prediction is that many PERA-P&F members transition to other employment after retiring from the plan. Whether individuals retire early will be in part dependent on the availability of other employment. If other employment is readily available, that may increase PERA-P&F retirements, including early retirements, as the retirees seek to build an eventual benefit from the Social Security system. A reasonably long period of other employment after leaving PERA-P&F may cause PERA-P&F retirees to be less concerned about PERA-P&F benefit erosion during retirement, despite the long period in benefit receipt. The individuals may have sufficient income derived from personal savings, Social Security from non-PERA-P&F-covered employment, or other pensions to lessen dependency on the PERA-P&F benefit during old age.

Conclusion

This memo describes changes in PERA-P&F early retirement provisions and in the plan's post-retirement provisions which impact the probability of early retirement. Because of somewhat conflicting incentives caused by recent legislated changes, and due to the unusual nature of public safety employment, it is difficult to reason from this limited information whether a bubble of PERA-P&F early retirements will occur.

Listed on the Commission agenda for this topic are several testifiers including representatives from PERA, organizations representing cities and counties, organizations representing police officers, and the Minnesota State Colleges and Universities System which helps to educate and train public safety officers. These testifiers should be able to provide the Commission with their insights regarding the likely extent of a public safety officer shortage due to the impact of last year's legislation, and how cities, counties, and training organizations are or intend to respond to the situation.

Membership Data

Distribution of Active Members**

	Years of Service as of June 30, 2013									
Age	**<3***	**3 - 4**	**5 - 9**	**10 - 14**	**15 - 19**	**20 - 24**	**25 - 29**	**30 - 34**	**35+**	**Total**
< 25	167	3								**170**
Avg. Earnings	32,802	46,179								**33,038**
25 - 29	526	262	321							**1,109**
Avg. Earnings	42,654	57,717	65,052							**52,696**
30 - 34	299	204	1,058	219						**1,780**
Avg. Earnings	45,948	60,581	68,979	72,044						**64,525**
35 - 39	126	85	576	887	177					**1,851**
Avg. Earnings	45,094	58,005	68,437	74,489	77,322					**70,119**
40 - 44	89	60	348	689	921	119				**2,226**
Avg. Earnings	39,884	56,930	67,636	74,704	79,232	83,368				**74,064**
45 - 49	38	26	156	341	584	593	183			**1,921**
Avg. Earnings	42,672	54,511	68,060	73,628	81,254	84,886	88,778			**79,542**
50 - 54	18	8	67	140	264	333	392	72		**1,294**
Avg. Earnings	36,060	55,447	69,180	76,959	79,146	84,884	88,755	88,462		**82,553**
55 - 59	7	8	23	48	80	93	102	73	8	**442**
Avg. Earnings	59,621	49,050	62,098	73,292	78,266	84,395	88,861	90,100	101,872	**82,177**
60 - 64	1	2	13	23	28	9	23	14	5	**118**
Avg. Earnings	81,742	21,542	61,129	61,444	72,622	74,477	83,780	96,510	80,909	**73,890**
65 - 69		1	2		1	1	2	1	2	**10**
Avg. Earnings		9,909	69,963		112,607	61,658	82,266	71,716	87,053	**73,445**
70+		1								**1**
Avg. Earnings		23,284								**23,284**
Total	**1,271**	**660**	**2,564**	**2,347**	**2,055**	**1,148**	**702**	**160**	**15**	**10,922**
Avg. Earnings	**42,214**	**58,022**	**68,032**	**74,194**	**79,520**	**84,586**	**88,595**	**89,809**	**92,908**	**71,323**

* *This exhibit does not reflect service earned in other PERA or Combined Service Annuity benefits. It should not be relied upon as an indicator of non-vested status.*

** *This exhibit excludes 18 members who were merged into PERA P&F in 2012 from Minneapolis Police and Minneapolis Fire Retirement Funds whose benefits are not pay related.*

In each cell, the top number is the count of active participants for the age/service combination and the bottom number is average valuation earnings for the fiscal year ending on the valuation date.

2013 Minnesota Statutes

353.651 RETIREMENT ANNUITY UPON SEPARATION FROM PUBLIC SERVICE.

Subd. 4. Early retirement. (a) A person who becomes a public employees police and fire retirement plan member after June 30, 2007, or a former member who is reinstated as a member of the plan after that date, who is at least 50 years of age and is at least partially vested under section 353.01, subdivision 47, upon the termination of public service before July 1, 2014, if the person is other than a county sheriff or after January 4, 2015, if the person is a county sheriff is entitled upon application to a retirement annuity equal to the normal annuity calculated under subdivision 3, reduced by two-tenths of one percent for each month that the member is under age 55 at the time of retirement.

(b) Upon the termination of public service before July 1, 2014, if the person is other than a county sheriff or upon the termination of public service before January 5, 2015, if the person is a county sheriff, any public employees police and fire retirement plan member who first became a member of the plan before July 1, 2007, and who is not specified in paragraph (a), upon attaining at least 50 years of age with at least three years of allowable service is entitled upon application to a retirement annuity equal to the normal annuity calculated under subdivision 3, reduced by one-tenth of one percent for each month that the member is under age 55 at the time of retirement.

(c) A person other than a county sheriff who is a member of the public employees police and fire retirement plan on or after July 1, 2014, or a county sheriff who is a member of the public employees police and fire retirement plan on or after January 5, 2015, and who is at least 50 years old and is at least partially vested under section 353.01, subdivision 47, and whose benefit effective date is after July 1, 2014, if other than a county sheriff or after January 4, 2015, if a county sheriff and on or before July 1, 2019, is entitled upon application to a retirement annuity equal to the normal annuity calculated under subdivision 3, reduced for each month the member is under age 55 at the time of retirement by applying a blended monthly rate that is equivalent to the sum of:

(1) one-sixtieth of the annual rate of five percent, prorated for each month the person's benefit effective date is after July 1, 2014, or after December 31, 2014, whichever applies; and

(2) one-sixtieth of the annual rate provided under paragraph (a) or (b), whichever applies, for each month the person's benefit effective date is before July 1, 2019.

(d) A person other than a county sheriff who is a member of the public employees police and fire retirement plan on or after July 1, 2014, or a county sheriff who is a member of the public employees police and fire retirement plan on or after January 5, 2015, and who is at least 50 years old and is at least partially vested under section 353.01, subdivision 47, whose benefit effective date is after July 1, 2019, is entitled, upon application, to a retirement annuity equal to the normal annuity calculated under subdivision 3, reduced by five percent annually, prorated for each month that the member is under age 55.

2013 Minnesota Statutes

356.415 POSTRETIREMENT ADJUSTMENTS; STATEWIDE RETIREMENT PLANS.

Subd. 1c. Annual postretirement adjustments; PERA-police and fire. (a) Retirement annuity, disability benefit, or survivor benefit recipients of the public employees police and fire retirement plan are entitled to a postretirement adjustment annually on January 1, until funding stability is restored, as follows:

(1) for each annuitant or benefit recipient whose annuity or benefit effective date is on or before June 1, 2014, who has been receiving the annuity or benefit for at least 12 full months as of the immediate preceding June 30, an amount equal to one percent in each year; or

(2) for each annuitant or benefit recipient whose annuity or benefit effective date is on or before June 1, 2014, who has been receiving the annuity or benefit for at least one full month, but not less than 11 months, as of the immediate preceding June 30, an amount equal to 1/12 of one percent for each month of annuity or benefit receipt; and

(3) for each annuitant or benefit recipient whose annuity or benefit effective date is after June 1, 2014, who will have been receiving an annuity or benefit for at least 36 full months as of the immediate preceding June 30, an amount equal to one percent; or

(4) for each annuitant or benefit recipient whose annuity or benefit effective date is after June 1, 2014, who has been receiving the annuity or benefit for at least 25 full months, but less than 36 months as of the immediate preceding June 30, an amount equal to 1/12 of one percent for each full month of annuity or benefit receipt during the fiscal year in which the annuity or benefit was effective.

(b) Retirement annuity, disability benefit, or survivor benefit recipients of the public employees police and fire retirement plan are entitled to a postretirement adjustment annually on each January 1 following the restoration of funding stability as defined under paragraph (c) and during the continuation of funding stability as defined under paragraph (c), as follows:

(1) for each annuitant or benefit recipient who has been receiving the annuity or benefit for at least 36 full months as of the immediate preceding June 30, an amount equal to the percentage increase in the Consumer Price Index for urban wage earners and clerical workers all items index published by the Bureau of Labor Statistics of the United States Department of Labor between the immediate preceding June 30 and the June 30 occurring 12 months previous, but not to exceed 2.5 percent; and

(2) for each annuitant or benefit recipient who has been receiving the annuity or benefit for at least 25 full months, but less than 36 full months, as of the immediate preceding June 30, an amount equal to 1/12 of the percentage increase in the Consumer Price Index for urban wage earners and clerical workers all items index published by the Bureau of Labor Statistics of the United States Department of Labor between the immediate preceding June 30 and the June 30 occurring 12 months previous for each full month of annuity or benefit receipt during the fiscal year in which the annuity or benefit was effective, but not to exceed 1/12 of 2.5 percent for each full month of annuity or benefit receipt during the fiscal year in which the annuity or benefit was effective.

(c) Funding stability is restored when the market value of assets of the public employees police and fire retirement plan equals or exceeds 90 percent of the actuarial accrued liabilities of the applicable plan in the two most recent consecutive actuarial valuations prepared under section 356.215 and under the standards for actuarial work of the Legislative Commission on Pensions and Retirement by the approved actuary retained by the Public Employees Retirement Association under section 356.214.

(d) After having met the definition of funding stability under paragraph (c), a full or prorated increase, as provided in paragraph (a), clause (1), (2), (3), or (4), whichever applies, rather than adjustments under paragraph (b), is again applied in a subsequent year or years if the market value of assets of the public employees police and fire retirement plan equals or is less than:

(1) 85 percent of the actuarial accrued liabilities of the applicable plan for two consecutive actuarial valuations; or

(2) 80 percent of the actuarial accrued liabilities of the applicable plan for the most recent actuarial valuation.

(e) An increase in annuity or benefit payments under this section must be made automatically unless written notice is filed by the annuitant or benefit recipient with the executive director of the Public Employees Retirement Association requesting that the increase not be made.