SF 1452 (Frentz); HF 1291 (Murphy): MSRS Judges Retirement Plan; Reducing the COLA and Removing the COLA Funding Triggers

Prepared by: Chad Burkitt *Date: April 9, 2021*

Introduction

Affected Plan: The Judges Retirement Plan ("Judges Plan") administered by the Minnesota State Retirement System (MSRS)

Laws Amended: Minnesota Statutes, Section 356.415, Subdivision 1f

Brief Description: Reduces the Judges Plan postretirement adjustment (COLA) from 1.75% per year to 1.5% per year, and removes a provision that triggers automatic increases in the Judges Plan COLA when the Judges plan becomes 70% funded and again when the plan becomes 90% funded.

Attachments: COLA Analysis by GRS, dated February 4, 2021
Letter from the Minnesota District Judges Association, dated March 12, 2021

Background

In response to the 2009 financial crisis, the 2010 legislature reduced COLAs in the statewide public pension plans. The Legislature reduced the annual COLA rate for the Judges Plan from 2.5% to 2%, but it included a provision that the rate would return to 2.5% when the plan achieved a funded status of 90% or better.[1] A similar provision was added to statute for each of the other public pension plans. This automatic increase in a plan's COLA rate when a specified funding threshold is reached is referred to in this memo as a "funding trigger."

In 2013, the Legislature enacted substantial changes to the Judges Plan to address severe under funding. The reforms included establishing a new tier of benefits. The new tier (called "Tier II") established a lower pension formula for judges first elected or appointed after the 2013 law went into effect. Among the reforms was a further reduction in the Judges Plan's annual COLA rate from 2% to 1.75%, which applied to all judges regardless of what tier they were in.[2] The legislature also provided for a new funding trigger where if the Judges Plan achieved a funded status of 70%, but less than 90%, the COLA would increase to 2%. The 90% funding trigger also remained in effect.

[1] Laws 2010, Ch. 359, Art. 1, Sec. 76 and 77.
[2] Laws 2013, Ch. 111, Art. 14, Sec. 2 and 3.

As originally enacted, the funding triggers would have caused the COLA to increase the year following an actuarial valuation that valued the Judges Plan at 70% funded or better, or 90% funded or better, as applicable. In 2015, the Legislature further modified the funding triggers by requiring that the plan be valued at or above 70% or 90%, as applicable, in two consecutive years before the higher COLA rate would apply.[3]

In 2018, the Legislature passed another significant pension funding stabilization bill, which included changes to the COLA provisions for the statewide public pension plans. The bill made adjustments to COLA provisions of all of the statewide plans except for the Judges Plan. As a result of the 2018 changes, the Judges Plan is the only statewide plan that still retains the funding triggers put into law in 2010. The Judges Plan also has the highest fixed COLA rate of any of the statewide plans at 1.75%. reduces the COLA to 1.5% starting in 2022 and removes the funding triggers.

Bill Summary

SF 1452 / HF 1291 is in one section that amends Minnesota Statutes, Section 356.415, subdivision 1f. The bill changes the annual COLA increase rate from 1.75% to 1.5%, starting with annuity payments made on or after January 1, 2022.

The bill also strikes paragraphs (b) through (e) of subdivision 1f, which provide for funding triggers that would automatically increase the annual COLA rate to:

- 2% when the plan achieves a funded ratio of 70% in two consecutive years; and
- 2.5% when the plan achieves a funded ratio of 90% in two consecutive years.

The bill also makes minor conforming changes and is effective June 30, 2021.

Analysis

Who is affected?

The bill affects the members of the Judges Plan. The Judges Plan provides benefits to the judges and justices of Minnesota's District Courts, Court of Appeals, and Supreme Court. The plan has the following membership:

Active Members	322
Retired Members	298
Survivors	76
Disabled Retired Members	17
Deferred Members	17
Total Members	**729**

[3] Laws 2015, Ch. 68, Art. 4, Sec. 10.

Financial Impact on the Plan

The following table shows the financial impact to the plan before and after the enactment of the bill: [4]

$ in Millions, Contributions as % of Pay	**Before** (if the bill is not enacted)	**After** (if the bill is enacted)
Actuarial Accrued Liability	$389.4	$381.5
Actuarial Value of Assets	$218.3	$218.3
Funded Ratio	56.1%	57.2%
Actuarially Required Contribution	39.94%	38.41%
Statutory Contribution	41.7%	41.7%
Contribution Sufficiency[5]	1.76%	3.29%

As the table shows, the bill results in a savings of $7.9 million in actuarial accrued liability and an increase in the plan's contribution sufficiency of 1.53%. A projection of future funded ratios performed by MSRS's retained actuarial firm, GRS, shows the plan attaining full funding in 2044, which is four years earlier than is projected under current law.

Financial Impact on Plan Members

If the bill is enacted, current and future retired members will experience a compounding increase in their retirement benefit at an annual rate of 1.5% instead of 1.75%. In 2020, the plan's average retirement benefit was $5,901 per month.[6] The following table shows the effect of the bill on the average monthly benefit:

Average monthly benefit = $5,901	**Before** (1.75% COLA)	**After** (1.5% COLA)	**Change**
Average monthly benefit after 1 year of COLA increase	$6,004.27	$5,989.52	($14.75) (0.25%)
Average monthly benefit after 20 years of COLA increases	$8,348.61	$7,947.79	($400.81) (4.8%)

[4] The valuation of the funded ratio and of the proposed changes in the bill assumes new actuarial assumptions that were not yet adopted at the time of the most recent valuation of the Plan. Thus, some figures may not match those in the July 1, 2020, valuation of the Judges Plan. *See* GRS, Minnesota State Retirement System Judges Retirement Fund – COLA Analysis, Feb. 4, 2021.

[5] "Contribution sufficiency" means contributions in excess of what is required to achieve full funding by 2048.

[6] A Tier I Judge at age 65, with 20 years of service, and a high-5 salary of $161,000 would receive a monthly benefit of $8,586. All else being equal, a Tier II Judge would receive a monthly benefit of $6,708. In the table, the "average retirement benefit" was determined by dividing the "Total Average Benefit" amount of $70,812, from the plan's most recent actuarial valuation report, by 12 months. See Judges Retirement Fund Actuarial Valuation Report as of July 1, 2020, p. 17.

As mentioned above, the bill removes automatic funding triggers that would increase the COLA from 1.75% to 2% and then to 2.5% upon the plan attaining 70% funded and 90% funded, respectively. MSRS's actuarial firm, GRS, estimates that under current law the funding trigger would increase the COLA from 1.75% to 2% in 2042, and from 2% to 2.5% in 2059.

Comparison to Other Statewide Public Pension Plans

The Judges Plan is the only statewide plan that currently has funding triggers. It also has the highest fixed annual COLA rate of any of the statewide plans. As the poorest funded of the public pension plans, the Judges Plan is the least able to afford the highest COLA rate. The table below compares the COLA and the funded ratios of public pension plans in the State, including the statewide plans and the St. Paul Teachers Retirement Fund Association.

Pension Plan	COLA Rate	Funded Ratio[7]
MSRS Judges Plan	1.75%	53.83%[8]
MSRS General Plan[9]	1% through 2023 and 1.5% thereafter	91.25%
MSRS Correctional Plan	1.5%	73.23%
MSRS State Patrol Plan	1%	76.6%
Public Employees Retirement Association (PERA) General Plan	½ of inflation but not more than 1.5% or less than 1%	79.06%
PERA Police and Fire Plan	1%	87.19%
PERA Correctional Plan	COLA equal to inflation but not more than 2.5% or less than 1%	96.67%
Teachers Retirement Association	1% through 2023, 1.1% in 2024, 1.2% in 2025, 1.3% in 2026, 1.4% in 2027, and 1.5% in 2028 and thereafter.	75.48%
St. Paul Teachers Retirement Fund Association	1%	61.35%

The differences in the COLA rate between the different plans is due to several factors and is not limited only to the funded ratio of each plan. However, given the disparity between the funded ratios of the plans and the plans' COLA benefits, the Commission may wish to consider whether it is equitable for the Judges Plan to continue to pay a 1.75% COLA benefit.

[7] "Funded ratio" is the ratio of market value of assets to accrued liability, as reported in the most recent actuarial valuation report (as of July 1, 2020) for each plan.

[8] 56.1% is the funded ratio after applying new actuarial assumptions adopted since the last valuation.

[9] The COLA for the General Plan is also used for annuities paid from the MSRS Unclassified Plan and Legislators Plan.

Is it constitutional to reduce COLA benefits for judges?

Minnesota courts have held that the U.S. and Minnesota constitutions limit the Legislature's authority to reduce judges' retirement benefits. It is not clear, however, from existing case law whether these limits would result in this bill being found unconstitutional.

The Minnesota Supreme Court has relied on three constitutional provisions in determining that retirement benefits for the judiciary are constitutionally protected. The first constitutional provision is the prohibition on passing any law impairing the obligation of a contract.[10] The second constitutional provision is found in Article VI, Section 5, of the Minnesota Constitution and states in relevant part: "The compensation of all judges shall be prescribed by the legislature and shall not be diminished during their term of office." The third constitutional provision is the separation of powers clause found in Article III, Section 1, of the Minnesota Constitution, which states:

> *"The powers of government shall be divided into three distinct departments: legislative, executive and judicial. No person or persons belonging to or constituting one of these departments shall exercise any of the powers properly belonging to either of the others except in the instances expressly provided in this constitution."*

Sylvestre v. State

The court first recognized constitutional protections for judicial retirement benefits in *Sylvestre v. State,* 142, 214 N.W.2d 658 (1973). In 1967, the Legislature amended a provision in the judicial retirement statutes which provided that judges would receive in retirement "one-half of the salary allotted to the office."[11] The amended statute provided that judges would receive in retirement "one-half of the compensation allotted for the office at the time of his retirement."[12] The effect of the change was that retired judges, who had previously received increases in their pension during retirement equal to one-half of the salary increases that sitting judges received, would no longer receive an increase.

In *Sylvestre,* the Court relied on the three constitutional provisions described above to find that the amended statute was unconstitutional as applied to judges who were first elected or appointed prior to enactment of the new statute. The Court especially relied on a contractual theory that the retirement provisions amounted to an offer in a unilateral contract which judges accepted by serving as judges until they had met the eligibility requirements for the benefits. The Court further held that part performance of a unilateral contract, such as by accepting an appointment as a judge, bound the offeror (the state) from revoking or altering the contract. The Court also stated:

> *". . . retirement compensation constitutes deferred payment of part of the judge's salary, . . . which cannot be diminished during his continence in office; and upon his retirement the contract is fully performed. He is then entitled to be paid what the state promised him when he took*

[10] *See* U.S. Constitution, Art. 1, Sec. 10; and Minnesota Constitution, Art. 1, Sec. 11 (prohibiting the impairment of contractual obligations).

[11] Minnesota Statutes 1965, Sec. 490.102, Subd. 2.

[12] Ex. Sess. L. 1967, Ch. 38, Sec. 5.

> *office. . . . Any other construction would impair the independence of the judiciary as a separate, coequal branch of government under our concept of a separation of powers among the three branches of government. Retirement pay of a judge, so long as he is performing his part of the contract, is as much protected by the constitutional proscription against reduction as the compensation which he actually receives while in service."*

Despite this clear holding that retirement benefits for current and retired judges cannot be reduced, *Sylvestre* would likely not be considered precedent for finding this bill to be unconstitutional for several reasons. One reason is that the Judges Plan has since been significantly modified so that COLAs are now considered a separate benefit, which was not the case when the Court considered *Sylvestre*. Another reason is that those subsequent modifications, including COLA reductions, have not been found unconstitutional even though some applied to sitting and retired judges. However, the holding that judicial retirement benefits are contractual in nature remains Minnesota law and has been upheld in subsequent cases.[13]

Is the bill unconstitutional under a contractual theory?

The Minnesota Supreme Court has adopted the three-part test established by the U.S. Supreme Court in the 1983 case, *Energy Reserves Group v. Kansas Power & Light,* to determine if a statute results in an unconstitutional impairment of a contract.[14] In the 1986 case, *Saetre v. State*,[15] the Minnesota Supreme Court applied the *Energy Reserves* test to evaluate an impairment of contract claim by a judge appealing the constitutionality of the statute mandating retirement at age 70. Therefore, it is likely that a court would use the *Energy Reserves* test to evaluate whether the statutory changes in the bill amounts to an impairment of contract . The test is as follows:[16]

1. Does the state's action (in this case, the bill if enacted) substantially impair a contractual obligation?

2. If there is substantial impairment, has the state demonstrated a significant and legitimate public purpose behind the legislation?

3. In the light of this public purpose, is the adjustment of the rights and responsibilities of the contracting parties based upon reasonable conditions and of a character appropriate to the public purpose justifying the legislation's adoption?

Of the approximately 20 decisions by the Minnesota Supreme Court and Court of Appeals applying the *Energy Reserves* test*,* only two resulted in the court finding a statute to be an unconstitutional impairment of a contract. The first was *Christensen v. Minneapolis Municipal Employees Retirement*

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[13] For subsequent cases see *Anderson v. State,* 214 N.W.2d 668 (1973); *Christiansen v. Minneapolis Mun. Emp. Ret. Bd*., 331 N.W.2d 740 (Minn. 1983); *State, County, and Municipal Employees Councils 6, 14, 65, & 96 v. Sundquist* 338 N.W.2d 590 (Minn. 1983); *Saetre v. State*, 398 N.W.2d 538 (Minn. 1986); Page v. Carlson, 488 N.W.2d 274 (Minn. 1992).

[14] *Energy Reserves Group v. Kansas Power & Light,* 459 U.S. 400 (1983).

[15] *Saetre v. State of Minnesota*, 398 N.W.2d 538 (Minn. 1986).

[16] See *Christiansen v. Minneapolis Mun. Emp. Ret. Bd*., 331 N.W.2d 740*,* 750 - 751 (Minn. 1983).

Board,[17] in which the retroactive application of a statute imposing a minimum retirement age was found unconstitutional. The second was *Jacobson v. Anheuser-Busch, Inc.,*[18] in which the retroactive application of a liquor distribution statute was found unconstitutional when applied to a pre-existing agreement. In the remaining cases, the courts have either found that no contract existed, or that one of the three prongs of the *Energy Reserves* test favored the government action.

In applying the *Energy Reserves* test to this bill, it is not clear if COLAs are included in the scope of the implied unilateral contract between the state and the judiciary. As noted in the Background section of this memo, COLAs have changed multiple times since 2008, so it may be reasonable to conclude that COLAs are not included within the scope of any implied unilateral contract. If that is the case, there is no contractual infringement.

However, if a court were to find a contractual right to the current COLA and that the new law acts to substantially impair the state's obligation to pay the current COLA, then it would require the state to show a significant and legitimate public purpose. The only direct application of the *Energy Reserves* test to the Judges Plan is in *Saetre v. State*. In *Saetre,* the court found that a law that required judges to retire upon reaching age 70 had a "significant and legitimate public purpose" and that under the third prong of the *Energy Reserves* test this purpose "[took] precedence over any claim that the legislation substantially [impaired a] judge's contract rights."[19] In *Saetre,* the public purpose being addressed by the legislature was the concern that judges were becoming incompetent or infirm due to age, where a constitutional provision grants specific authority to the legislature to provide for removal from office in such situations.[20]

As stated in the letter, dated March 12, 2021, from the Minnesota District Judges Association to the authors of the bill, the purpose of the bill is "to bring about greater pension stability, make progress against the judges plan and its current deficiency, as well as bring it in line with other state pension fund COLAs." Since that purpose appears less compelling than the purpose in *Saetre*, it is possible that a court might find either that there is no significant and legitimate public purpose or that such purpose does not justify the reduction in the COLA in the Judges Plan .

<u>Is the bill unconstitutional under the prohibition against diminishing judges' compensation?</u>

As stated above, Article VI, Section 5, of the Minnesota Constitution states: "The compensation of all judges shall be prescribed by the legislature and shall not be diminished during their term of office." Neither the Minnesota Supreme Court nor the Court of Appeals has ever relied solely on this provision to find a reduction in Judges Plan benefits unconstitutional. Without additional case law interpreting this provision, we are left with interpreting the plain language of the Constitution. Applying the plain language to this bill, it is likely that if a COLA is "compensation," then reducing the COLA is unconstitutional, at least as applied to sitting judges.

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[17] 331 N.W.2d 740 (Minn. 1983).
[18] *Jacobson v. Anheuser-Busch, Inc.*, 392 N.W.2d 868 (Minn. 1986).
[19] *Saetre,* at 542
[20] *See* Minnesota Constitution, Art. VI, Sec. 9.

As to whether COLA benefits are compensation, in *Sylvestre,* the Court held that "retirement pay constitutes deferred compensation, which cannot be diminished during the continuance in office of a judge."[21] As noted above, this holding has not been applied to COLAs, so there is no controlling case law in Minnesota on this subject.

Courts in other jurisdictions that have considered whether a contract right exists in a COLA to the same extent as it exists in the underlying annuity. In most of those cases, the courts have concluded that contract rights do not extend to COLAs even when they do apply to the underlying annuity.[22] However, in the most analogous case*, Honorable Kenneth Fields v. The Elected Officials' Retirement Plan*, the Supreme Court of Arizona upheld a judges right to a statutory COLA formula based on a provision in the Arizona constitution (Ariz. Const. Art. XXIX, Section 1 (C)), which states that "public retirement system benefits shall not be diminished or impaired."[23] In *Fields,* the Arizona Legislature had passed a law that required investment earnings be applied to fund the underlying annuity benefits rather than the COLA and changed the COLA formula so that it was tied to funding (the better funded the plan, the bigger the COLA). As a result, Fields and other retirees received a smaller COLA than they would have under the previous law. The Arizona Supreme Court held that the term "benefits" in the constitutional provision applied to the COLA and as a result the retirees were entitled to the COLA they would have received had the new Arizona law not been passed.

Effect of support from the Minnesota District Judges Association

Finally, in a 1973 decision in *Anderson v. State,* the Minnesota Supreme Court appears to have made allowance for the district court judges to agree to modifications of their retirement benefits.[24] Prior to 1959, a judge who retired mid-term would continue to receive his or her salary until the end of the judge's term, at which point the judge would begin to receive a pension. However, judges were required to attain 15 years of service before being eligible to receive a pension. The district judges became concerned about the necessity of seeking reelection for a full term when they intended to serve only as

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[21] At 155.

[22] E.g., see *Zucker v. United States,* 758 F.2d 637, 640 (Fed. Cir. 1985) (holding that a COLA benefit could be considered separately from the annuity benefit and that no "indefeasible right" vests in the COLA benefit "until received by way of an increased annuity"); *Me. Ass'n of Retirees v. Bd. Of Trs. Of Me. Pub. Emps. Ret. Sys.*, 758 F.3d 23, 31 (1st Cir. 2014) (finding that the statutory language was at best ambiguous, and therefore the retirees could not meet their burden to show that the legislature unmistakably intended to create contractual rights to COLAs according to the formula in effect at the time they retired); *Am. Fed'n of Teachers-N.H. v. State of N.H.*, 167 N.H. 294 , 111 A.3d 63 , 72 (N.H. 2015) (pension plan members did not have vested rights to a COLA where the court was "not persuaded that the statutory language established a contractual obligation to provide a COLA."); *Justus v. State*, 336 P.3d 202 , 211-12 , 2014 CO 75 (Colo. 2014) (statute does not contain "contractual or durational language stating or suggesting a clear legislative intent to bind itself, in perpetuity, to paying . . . a specific COLA formula"); *Bartlett v. Cameron*, 2014- NMSC 002, 316 P.3d 889 , 895 (N.M. 2013) (finding that several amendments to the statute's COLA provision showed the legislature's intent to promote public policy, and not a clear and unambiguous intent to protect a vested contract right to paying a specific COLA); *Puckett v. Lexington-Fayette Urban Cty. Gov't* 833 F.3d 590, 603 (6th Cir. 2016) (rejecting an argument that "COLAs are part of [a] fund's underlying annuities, and are therefore, like the underlying annuity payments, protected against legislative reduction").

[23] *Field v. Elected Officials' Ret. Plan*, 320 P.3d 1160 (2014).

[24] *Anderson v. State* 214 N.W.2d 668 (1973).

long as needed to reach the 15 years of service threshold, at which time they intended to retire. In 1959, the district judges asked the Legislature to address this issue. The Legislature amended the statute to allow the judges to extend their term by up to three years for the purpose of retirement eligibility, but, in the same legislation amended the statute so that retiring judges would waive any right to salary for the remainder of their term and would instead receive the lower pension amount immediately upon retirement.[25]

In *Anderson,* a judge challenged this statute on the grounds that under *Sylvestre* he had a contractual right to the retirement benefits in effect when he was first elected or appointed. The Supreme Court denied his claim on the basis that the 1959 legislation amounted to an "accommodation made between the district judges and the legislature to resolve a unique problem by an agreed relinquishment of preexisting rights."[26]

The Minnesota District Judges Association has expressed support for this bill. It is possible that a court could consider that support as an agreement to the COLA reduction proposed in SF 1452 / HF 1291, and that the court would defer to that agreement as the Supreme Court did in *Anderson.* However, unlike in *Anderson*, under this bill, it does not appear that the judges are getting anything in return, other than an improvement in plan funding.

Legislative Commission on Pensions and Retirement

55 State Office Building 100 Rev. Dr. Martin Luther King Jr. Blvd. St. Paul, MN 55155-1201
Phone: 651-296-2750 TDD: 651-296-9896; Fax: 651-297-3697 www.lcpr.leg.mn

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[25] Laws 1959, Ch. 688, Sec. 2.
[26] At 160.