SF 2405 (Rosen); HF 2514 (O'Driscoll): MSRS Unclassified Plan; Extends the grandfather provision regarding the actuarial assumptions used to compute an annuity

Prepared by: Chad Burkitt, Analyst *Date: April 30, 2021*

Introduction

Affected Plan: Unclassified Plan, Minnesota State Retirement System (MSRS)

Laws Amended: Minnesota Statutes, Section 352D.06, Subdivision 1

Brief Description: The bill extends, until a date to be determined, the application of factors used in converting a lump sum to an annuity under the Unclassified Plan. The date that the extension ends is left blank to allow the Commission to determine that date by amendment. These annuity factors would have been replaced by less generous factors in 2017, without the legislation passed in 2017. For some employees, the factors would again have been replaced by less generous factors in 2020, without the legislation passed in 2020.

Attachment: 2017 LCPR staff memo regarding change in factors for the Unclassified Plan

LCPR21-024 staff summary of draft bill considered by the Commission on March 23, 2021

Email from Erin Leonard, Executive Director, MSRS, dated April 12, 2021

Background

Draft Bill LCPR21-024 Heard at the March 23rd Commission Meeting

SF 2405 / HF 2514 is a modified version of the draft bill LCPR21-024 that was heard by the Commission on March 23, 2021. The draft bill extended to certain Unclassified Plan members the application of more favorable, pre-2017, annuity factors used in converting an account in the Unclassified Plan to an annuity, if elected by a member at retirement. During the hearing, Chair Rosen directed staff to revise the draft bill in two important respects:

1. This bill leaves a blank, to be filled in by the Commission, for the date on which the application of the pre-2017 annuity factors will expire.

2. The extension in the bill applies only to members of the Unclassified Plan who are currently eligible for the pre-2017 annuity factors.

LCPR21-024 would have made additional members of the Unclassified Plan eligible for the pre-2017 annuity factors and would have extended the application of the factors until July 1, 2028.

Recent Legislative History

The Unclassified Plan is a defined contribution plan that allows members to convert their account balance at retirement to a lifetime annuity paid from the State Employees Retirement Fund (MSRS General Plan). The amount of the annuity is determined by multiplying the account balance by an annuity factor.[1] The annuity factor is based in part on the age and life expectancy of the member.

In 2016, changes in mortality (life expectancy) and other assumptions prompted MSRS to adjust the annuity factors used to convert a balance in an Unclassified Plan account to a lifetime annuity. The adjusted factors were significantly less generous and resulted in an average reduction in the monthly benefit amount of about 7.3% when compared to the old factors. Wishing to delay the effects of this change for members nearing retirement, in 2017, the legislature amended Section 352D.06, Subdivision 1, to permit certain employees to continue to elect an annuity computed using the old, pre-2017, factors.[2] The employees that were grandfathered under the provision were those who retired when they were at least age 63 or had at least 26 years of covered service and retired between July 1, 2017, and July 1, 2020.

In 2020, the legislature again amended subdivision 1 to further delay the application of the adjusted factors.[3] Under the 2020 law, employees that terminated employment between July 1, 2020, and July 1, 2021, and who were age 63 and with at least 26 years of service as of June 30, 2020, could also use the old annuity factors. Under current law, all employees terminating employment after June 30, 2021, who elect an annuity distribution will receive an annuity computed using the less generous factors.

For additional background information, see the attached 2017 LCPR Staff Memo.

Description of the Bill

This bill extends the application of the pre-2017 factors, described above, by expanding who is eligible and for how long eligible employees can use the old annuity factors. Under the bill, an employee is eligible if the employee terminates employment after June 30, 2020 and before a date to be determined by the Commission, if on June 30, 2020, the employee:

1. was at least age 63; or

2. had at least 26 years of covered service.

An employee who terminates employment before the end of the extension and defers collecting his or her benefit will be able to elect an annuity using the old annuity factors regardless of how long the

[1] Minn. Stat. § 352D.06, Subd. 1
[2] Laws 2017, 1st Special Session, Ch. 4, Art. 2, Sec. 43
[3] Laws 2020, Ch. 108, Art. 18, Sec. 1

former employee waits to begin receiving the annuity. The bill also strikes the paragraph added in 2017 that no longer applies. The bill is effective the day following final enactment.

Analysis and Discussion

Who is Affected?

This bill only applies to those Unclassified Plan members who are currently eligible for the more favorable factors under the 2020 law. MSRS identified 259 active employees who are currently eligible for the more favorable factors under the 2020 law. The eligible members can be broken into the following categories:

Breakdown of Eligible Members by Type

Executive and Judicial Branch Members	161
Legislators *(current and former representatives and senators)*	40
Senate Staff	27
House of Representatives Staff	22
Joint Legislative Staff	9
Total	**259**

Whether an eligible member benefits from this legislation depends on whether the member "terminates employment" before the date to be determined by the Commission. In 2020, MSRS reported that on average 57 Unclassified Plan members who meet the age 63 or 26 years of service requirements retire each year.

Cost to the MSRS General Plan

The cost of this bill is determined by the additional Unclassified Plan account balances that are converted to annuities under the pre-2017 factors because of this bill. The number of members who are eligible for the pre-2017 factors will be greatly affected by the date to be determined by the Commission. The later the date, the greater the number of members will elect to terminate employment and elect an annuity calculated under the pre-2017 annuity factors. If the Commission inserts a one-year extension, to June 30, 2022, MSRS estimates that the cost of this bill would be between $1.3 million and $6.9 million, depending on the number of members who elect to terminate employment and elect to convert their account balances to an annuity. The cost would be borne by the MSRS General Plan.

Amendment to Insert Date

On line 1.21, the bill contains a blank for a date to be determined by the Commission. The date that is to be determined is the date before which a member must "terminate employment" to be eligible to use the pre-2017 annuity factors. Under current law, a member must terminate employment before July 1, 2021. At the March 23rd Commission meeting, members of the Commission discussed two possible dates to insert: January 1, 2022, or July 1, 2022. The Commission can decide to insert either of these dates or any other date into the bill with the motion:

"I move SF 2405 / HF 2514 be amended by deleting the blank on line 1.21 and inserting [date]."

Alternative Options for Retaining Affected Employees

At the March 23rd Commission meeting, MSRS Executive Director Erin Leonard expressed concerns about LCPR21-024. Following the meeting, she provided Commission staff with additional analysis of the effect of the bill. She also outlined additional options that the Commission could consider for retaining legislative staff that are affected by the expiration of the pre-2017 annuity factors. Options include changes in return-to-work policies that could allow a member to collect an annuity but return to employment.

Ms. Leonard's email with the analysis and alternatives is attached.

From: Erin Leonard
Sent: Sunday, April 18, 2021 12:52 PM
To: Susan Lenczewski
Cc: Chad Burkitt; Lisa Diesslin; Holly Dayton
Subject: Additional Unclassified Information

There are currently 259 active employees eligible for the pre-2017 factors based on the language that was adopted at the end of last session. This group includes the following:

- 98 are employees or elected officials in the Legislature (House, Senate, LCC and Legislators)
  - The Legislators (40) include some current members, as well as, those who left earlier this year assuming they collect before June 30.
  - Staff include 22 in House and 27 in Senate
  - 9 from LCC/Library
- 161 are eligible from other entities including state agencies, MetCouncil, and AURI (to name a few).

GRS reviewed the population identified and determined that the total cost if all of the individuals retired using the old factors based on more recent Unclassified Plan account balances would be $6,852,921 if extended one more year. This is the difference in present value if benefits were calculated under the more generous pre-2017 factors using account balance from market close on Thursday, April 8, 2021. The cost fluctuates somewhat depending on the market value of accounts.

- The population includes individuals 55 or older.
- 224 of the 259 are age 60 or older; the increased cost for this population is $5,807,306.
- 146 of the 259 are age 65 or older; the increased cost for this population is $3,238,150.

I think it is worth mentioning that if there are specific employees for which the Legislature is concerned about knowledge transfer or succession planning, there may be other options worth considering. Some potential options may be:

- Allowing employees to retire and then return on temporary or session-only assignments. Those employees with that subsequent coverage would not be part of the plan.
- If employees are over Social Security full retirement age, employees may return without being subject to earnings limits.
- The legislature may want to add language to statute that would authorize the LCC or each legislative entity to establish a phased retirement option or post retirement option for legislative staff. This could be crafted to address the specific concerns in consultation with MSRS to ensure that IRS regulations regarding phased retirement or bona fide break in service requirements are met. This enabling language could be pretty simple with approval required by the Rules Committee or the LCC. This would give the flexibility without increasing the cost to the pension plan. Let me know if you or legislators would like to explore this option further.

Additional data provided during testimony:

1) The factors were changed in July 2017 for most plan members; however a group of 350 employees were grandfathered into the pre-2016 factors as a result of 2017 legislation. This was intended to provide a window to knowledge transfer to new employees and additional time for retirement planning for the individuals.

a. Of the 350 employees, a total of 136 individuals retired using the pre-2016 factors- 114 were part of the original 350 and an additional 22 gained eligibility and retired during the window. During the 3-year timeframe, we had 181 Unclassified Plan retirees. 75% under old factors and 25% under new.
b. Last year this was extended due to the pandemic for one more year, but it only applied to active employees. So far, 17 of our 33 unclassified retirees retired since July 1, rather than retiring June 30th last year. 52% under the old factors 48% under the new factors.

2) The increased liability of extending the pre-2016 factors is absorbed by the General Plan. Essentially, to date, the initial 3 year phase-in has cost over $3 Million, the one year extension approximately $375 thousand, to date.
3) Extending this one additional year, could cost anywhere from $1.3 million to $6.9 million, which bring the total cost of the extension to a range of $4.8 million to $10.4 million.

I believe this summarizes everything in one place. Let me know if you have additional questions.

Thank you,
Erin

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MSRS Minnesota State Retirement System
MNDCP Minnesota Deferred Compensation Plan
HCSP Health Care Savings Plan