State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

Buyback Subcommittee Meeting
November 17, 1983
Room 22, State Office Bldg.

MINUTES

Rep. Frank Rodriguez opened the meeting.

PRESENT: Representatives Frank Rodriguez, Clawson
Senators Spear, Renneke, Donald Moe

The Chair recognized the Commission actuary, James Bordewick, who was invited to give some considerations in determining the cost of the buyback.

"What I want to discuss are some considerations in determining the cost of a buyback. In my view, there should be two objectives; (1) buybacks should be fair to the fund and also should be fair to the member that is buying it back.

Being fair to the fund means that the fund should be in the same position before and after the buyback--that is, the ratio of assets to liabilities should be the same before and after the buyback. Second, the cost should include any additional cost if the member by using the buyback may select against the fund. If a member buys back a year or two so that the member can retire earlier with greater benefits than he could before the buyback, the cost of the earlier retirement should be included in the cost of the buyback. For example, if a member had a $1,000 monthly benefit, could retire at 63 with full benefits (30 years of service to retire) and by buying back could retire at 62 with full benefits. The $1,000 monthly benefit which would have been $950 if he retired one year early at 62 is now $1,000 payable at age 62. Otherwise, if the member does actually retire, there is a loss to the fund when that member transfers from an active to a retired status. So I think the ideal in determining buybacks is to try to adopt a method which is fair; easy for the systems to administer; easy for the member to understand, and possibly as free of as many assumptions as possible. It's sort of an ideal and I don't think that is can ever be reached whatever method is used. A method is not going to be precise, but I think the method should try to reach some of those objectives that I mentioned earlier.

There are two methods right now that are used for buybacks. One is for the buybacks purchased at retirement. If the benefit formula is 2% of the high 5 pay, the cost of the buyback is determined by determining the cost of that 2% benefit. Well that method is free of assumptions because it's based on actual high five salary and actual retirement age. One of the things that it doesn't do if a member by buying back can retire earlier with full benefits, is include the cost of the benefits that have already been accumulated which will be paid earlier at a full rate rather than at a reduced rate.

Now the second method which is being used is the buyback is the buyback is purchased before retirement where there is an assumption used as to when the member will retire after he buys back the credit. The difference in benefits at that particular retirement age is determined projecting current salary, and the cost is determined as the present value difference in these two benefits discounted back to the current age of the participant. There are a couple of assumptions with this method. One is the assumption when the member is going to retire. Two is what the final high five salary will be. This method does include the cost of selecting against the fund.

One of the methods that I am aware of include any costs for ancillary benefits. Where a member buys back an additional benefit may be payable from death and disability.

One thing which I pose as a question: Is it fair for a member to have to pay back a 100% of the cost when the system is not 100% funded? For example, if the fund is 50% funded, should the member have to pay back a hundred percent if the objective is to keep the fund in the same position before and after the buyback. Here one would be looking at the funded ratio of the system. However, that logic breaks down a little when a member retired and there is a transfer of reserves to the Minnesota Post Retirement Fund. The transfer assumes that there is 100% funding. Some compromise could be made by assuming a funded ratio for both active and retired members.

I guess the way that I
look at the cost of the buyback should be to eliminate assumptions. One assumption which could be eliminated, if the member who is buying back has an idea when he is going to retire. This could be inputed when the cost of buyback is determined. The question arises, what if that member retired earlier or later than the retirement age which was inputed. Well, you can adjust the benefits that member is going to receive if the member does retire earlier or later than he said he would.

Because the funded status of the system may not necessarily be 100%, then that total cost could be broken down into two parts, and the remainder of the total cost which represents the employer cost. For example, the total 100% cost of a buyback is $10,000, and the employee contributions were $2,000 and the plan was 80% funded. Then it would seem that the cost of the buyback would include the $2,000 member contribution, plus 80% of $8,000 which would represent the employer's share of the funded cost.

One would go through this same type of method if the benefit is purchased at retirement. I think, for purposes of determining the cost of the buyback, there are some ancillary benefits for death and disability that do increase the cost of a buyback. These are minority costs and I think they can be eliminated in determining the cost of the buyback.

One final thought--it's an idea--and it allows a little more flexibility for a member to buy back. The buyback could be separated into two options. One is the option where a member buys back both the service and the benefit credit, and the other option is that the member buys back only one service credit so that the member can retire earlier with full benefits. So the question is why not allow a member to buy back service credit which allows earlier retirement but not the benefit credit. For example, a member had 29 years of service at age 62 and can retire with full benefits at age 63, the member buys back one year, so he has 30 years of service to retire at age 62. This would give the member the option to retire at 62, but the benefit would be based on 29 years of credit. The cost of using this type of buyback option is less than when a member buys back both the service credit and the benefit credit. I present that as a consideration in adding more flexibility to buybacks.

In summary, I think that the method which I described is similar to the methods used by many of the systems. Added to this would be possible changes to satisfy the objectives of not changing the funded status of the plan before and after the buyback of determining the cost by a method which would be fair to the member buying back, and possibly by considering an option to only buyback the service credit rather than the service and benefit credit which would add considerable flexibility to the buyback at a lower cost. "

Rep. Rodriguez: "Mr. Bordewick, I am aware that in some kind of plans you are permitted to provide service credit which would effectively permit you to vest your pension without the money being there. In other words, we require 10 years of vesting service, but in other service conditions you can get vested in 8 years under certain conditions. You are suggesting that you buy service and not credit so that you would get actually less, but the cost for buyback would correspondingly be less? "

Bordewick: " Option B will do that. Option A will buy back both the service and the benefit. "

Mr. Bordewick was asked to make himself available for the next Buyback meeting.

Staff Memo: Types of Purchases of Service Credit and Current Methods of Payment" Karen Dudley, Exec. Sec., reviewed the memo. This memo will be taken up again.

Response from the Fund directors:

Harvey Schmidt, Exec. Dir. of TRA, commented on the three different types of arrears/buybacks:

1. Members who signed agreements to pay arrears but did not make the payments by the deadline in 1973. 106 signed agreements.

2. These arrears are related to the additional contributions that teachers were allowed to pay for pre'53 service. Payments were the difference of what they paid and $175. Full payment allowed TRA to give them full service credit for the service that they had already performed.

3. Relates to those under age 25 prior to 1957 who had optional membership.

Paul Groschen, Exec. Dir. of MSRS, stated that he does not have much problem with buybacks. The buybacks that have a window period with deadlines cause the trouble. He commented that the main problem with the buyback that requires employees to pay the full actuarial value of the buyback is the interest rate which is used--5%. If a higher interest rate, such as 8% with current earnings was used, the purchase price to the employee would be substantially reduced.

Mike McLaren, Exec. Dir. of PERA, told the Commission that PERA does not have an official position on buybacks and costs but will have a recommendation later. There is confusion as to who was and who was not a public employee. Trouble finding out the work credits of employees. The fund has to make a determination as to who should be in the plan. Each local unit of government seemed to have developed some of its own Civil Service rules. Mr. McLaren talked about mistakes made 20 years ago. It is a category of buyback where the person was omitted, and the buyback consists of the amount the employee would have made at that time. 80% of the buybacks have been in that category.

Frank Rodriguez
Commission Secretary

Eleanor Diebel
Adm. Sec.