

Minnesota Public Pensions

Calculation of Retirement Benefits

This information brief describes the eligibility requirements and the method of calculating retirement benefits for Minnesota public employee pension plans.

A public employee must have a minimum amount of service and must reach a certain age to receive retirement benefits.

Generally, a public employee must have at least three years of service credit in a Minnesota public pension plan to be eligible for retirement benefits. An employee who has met this three-year minimum, known as the vesting period, also must reach a certain age before beginning to receive benefits. The normal retirement age is 65 for most people who started public employment before July 1, 1989, and 66 for most people who started on or after that date. However, members may choose to receive a reduced level of benefits at age 55. Some public safety employees can receive full benefits at age 55 and reduced benefits as early as age 50.

There are various formulas for calculating initial retirement benefits for members of Minnesota public pension funds.

Most retirement benefits are based on a percentage of a person's average salary for the five highest-paid years of successive service (known as the high-five average salary).

The most common formula for determining the annual benefit is:

$$1.7\% \quad \times \quad \text{years of service} \quad \times \quad \text{high-five average salary}$$

For example, a person with 20 years of service and a high-five average salary of \$40,000 would have an annual benefit calculated as follows:

$$1.7\% \quad \times \quad 20 \text{ years} \quad \times \quad \$40,000 \quad = \quad \$13,600/\text{year, for life}$$

There are numerous variations on this common formula. The most significant of these are the following:

- ▶ For most teachers, the multiplier formula is 1.9 percent, instead of 1.7 percent, for years of service after July 1, 2006.
- ▶ Employees who use certain early retirement options receive only 1.2 percent credit for each of their first ten years of service (1.4 percent for most teachers for service after July 1, 2006).
- ▶ The percentages used to calculate retirement benefits for certain law enforcement personnel are higher. Some of these plans do not provide Social Security coverage.

Other factors can affect initial benefit levels.

Some employees retire early.

Public pension plans have a normal retirement age at which the full retirement benefit is payable. This age is 65 for most employees first hired before July 1, 1989, and 66 for most employees first hired after that date. For many public safety personnel, 55 is the normal retirement age.

The plans permit receiving retirement benefits before the normal age, but generally at a reduced level. For example, a person who would receive \$10,000 per year for life if the person retired and began drawing benefits at age 65 might receive only \$9,000 per year for life if the person retired and began drawing benefits at age 63.

There are some special early retirement provisions under which people may retire early without the reduction in benefits that usually applies to early retirement. One of these provisions is known as the Rule of 90. The Rule of 90 refers to a person whose age and years of service totals 90 or more.

Some people leave public employment having met the vesting requirement but not the minimum age requirement for retirement benefits.

These employees are entitled to deferred benefits and can begin to receive these benefits when they reach the minimum age. When a person defers receipt of benefits, the amount of the benefit is augmented from the time the person leaves public service until the person begins receiving the benefit. The augmentation rate is 3 percent of the benefit amount per year until age 55, and 5 percent from age 55 until the time the person begins drawing benefits. (For persons first employed after July 1, 2006, the rate is 2.5 percent both before and after age 55.)

Most Minnesota public pension plans offer different ways of structuring retirement benefits.

A retiree may decide to receive benefits only for the remainder of his or her life. Under these single-life payment forms, all benefits stop when the former employee dies. A common alternative is a joint and survivor option. Under this option, payments in a reduced amount are made for the life of the retired employee **and** for the life of a designated survivor. All optional forms of benefits are of equal expected value at the time the option is selected, because the periodic payment amount is adjusted to account for the probability of a longer payment period. For example, if a person picks a survivor option, the person's annual benefit will be lower than if the person picked a single-life option to account for the longer life expectancy of two people instead of one.

Retired employees receive annual benefit increases.

The formulas described so far apply to the initial calculation of a person's retirement benefit. These benefits may be increased each year after retirement. Each annual increase becomes a permanent addition to the base pension. Increases are based on two components:

- ▶ **Cost-of-living:** Retirees receive an annual benefit increase based on increases in the Consumer Price Index, up to a maximum of 2.5 percent.
- ▶ **Investments:** The State Board of Investment invests a pool of money on behalf of retired employees. If investment returns can both pay for the cost-of-living increase and exceed targets set in law, the excess returns are used to pay postretirement benefit increases. For purposes of this calculation, investment returns are averaged over a period of years.

Effective July 1, 2010, the total annual postretirement adjustment (combining the cost-of-living and the investment-based components) cannot exceed 5 percent.

For more information about public employees, visit the state government operations area of our web site, www.house.mn/hrd/issinfo/gv_state.htm.