DCP vs. Coordinated Plan

City managers/administrators and physicians entering public service in Minnesota have the alternative of coverage under two distinctly different retirement plans administered by the Public Employees Retirement Association of Minnesota—the Defined Contribution Plan (DCP) and the Coordinated Plan.

The Defined Contribution Plan provides for a percentage of salary contribution by both you and your employer. You choose how this money is invested and the benefit is determined by the performance of those investments. The Coordinated Plan is a traditional pension plan whereby both you and your employer make contributions each pay period and the benefit is determined by a formula based on your years of public service and average salary during your highest consecutive five-year salary. While the Coordinated Plan provides for lifetime benefits with annual adjustments, the DCP benefit is a lump-sum amount you can reinvest as you see fit.

Eligibility

Upon employment, city managers automatically become members of the Coordinated Plan. However, they may withdraw from this plan to participate in the DCP, or no PERA plan at all. The election to withdraw from the Coordinated Plan must be made within the first six months of employment. Current managers who opted out of the Coordinated Plan may still enroll in the DCP.

To qualify for either plan, physicians must be an employee of a governmental agency, not an independent contractor providing services to the facility. Physicians have 90 days from the commencement of public service to decide between the two plans. If they do not elect to enroll in the DCP within 90 days, they must be enrolled in the Coordinated Plan. Once a plan is chosen, the decision is irrevocable.

Defined Contribution Plan

The Defined Contribution Plan (DCP) administered by PERA is a tax-deferred retirement savings program in which participants determine how employee and employer contributions are to be invested. Total contributions plus investment performance determine the ultimate benefit, which is payable any time after termination of public service.

How It Works

Physicians contribute 5.0 percent of their salaries and their employers contribute 5.0 percent to the plan. For city managers, the current member and employer contribution rates are 6.5 percent of salary. Salary includes only compensation received for services rendered, including overtime. It does not include compensation for or reimbursement of expenses. Nor does it include compensation received for services rendered to another employer.

DCP participants designate a percentage of total contributions to be placed in one or more of seven accounts of the Minnesota Supplemental Investment Fund administered by the Minnesota State Board of Investment (SBI). Investment goals of the accounts and the returns they have actually achieved are described in *Investment Options, Minnesota Supplemental Investment Fund*, published annually by the SBI. This publication is posted on both PERA's and SBI's websites.

Employee and Employer contributions are combined and used to purchase shares in the accounts chosen by the participant. Except for the money market and fixed interest options, whose shares are always one dollar each, shares are purchased at market prices.

Interest paid by the money market and fixed return accounts is reinvested in additional shares of the respective accounts. Interest and dividends earned by the stocks and bonds held in the other five accounts are used to purchase additional stocks and bonds in those accounts. These purchases and the gains and losses in market value of the securities held in the accounts are reflected in the value of the accounts' shares, much like a mutual fund.

Participants may change investment selections at any time and may also transfer all or portions of previously purchased shares from one account to another. Some special restrictions apply, however, to transferring funds to other accounts from the fixed interest fund. (These restrictions are explained in the brochure *Changing Investment Selections*.)

Benefits

Upon termination of public service, members are entitled to a lump-sum payment of the value of their shares. The same is true for beneficiary(ies) upon the death of a participant. The final value of the shares purchased with employee and employer contributions is determined by economic and market conditions. Thus, PERA and the State of Minnesota cannot guarantee that the value of an account will not decrease to a level below the original purchase price of the shares.

If a member qualifies for permanent disability under Minnesota Statutes governing PERA, he or she has the option of receiving monthly payments from the account instead of a lump-sum distribution. The amount of the monthly payments must be in $100 increments and cannot exceed ten times the combined employee and employer contributions for the month preceding the disability. The benefit ends when the disability status ends or when the account is depleted, whichever is sooner.

Proceeds of an account are payable 30 days or more after the date of termination from public employment, approval for disability benefits, or death.

A member or someone acting on his or her behalf, must file an application for withdrawal of the funds with PERA before payment can be made. Upon the death of a participant, the value of all accounts is payable, upon application, to designated beneficiaries or, if none, the individual's estate.

The lump-sum benefit payment may be rolled over to another tax-qualified plan or used to purchase an annuity from an insurance company. PERA will, if instructed, send the payment to an insurance company licensed to do business in Minnesota for the purpose of purchasing an annuity.

The Defined Contribution Plan And Taxes

Participants do not pay taxes on employee and employer contributions to the DCP. However, because the DCP is a qualified tax-deferred program, the entire value of the account becomes taxable upon withdrawal, unless it is rolled over to another tax-qualified plan. If taken out prior to age 59½ and not rolled over, with a few exceptions, the withdrawal is also subject to an additional 10 percent tax surcharge.

Because the DCP is tax-qualified, enrollment in the plan may, depending upon income level, eliminate the tax deductibility of contributions to an individual retirement account (IRA). We recommend discussing the tax implications of retirement plan participation with a tax advisor or consult IRS Publication 590.

Administrative Charges

Two percent of the employer contributions to the DCP (2 cents for each $1.00 contributed) is used by PERA for administrative costs of the plan. In addition, an asset-based charge of 0.25 percent of the value of an account is retained by PERA to help defray the costs of administering the plan. This amounts to $2.50 for each $1,000 of your account value.

Coordinated Plan

Contributions

As a member of the Coordinated Plan, employees contribute 6.5 percent of salary to PERA; employers contribute 7.5 percent of that salary.

Taxes and PERA Contributions

The Coordinated Plan is also a tax qualified plan under Section 401(a) of the Internal Revenue Code. As a result, federal and state taxes on PERA contributions are deferred to the time of withdrawal. Whether a member receives a lump-sum

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refund of employee contributions or a monthly retirement pension, PERA will provide participants with current information about how a refund or pension is taxed at the time they end public service.

As with the DCP, membership in the Coordinated Plan may limit the amount members may contribute tax-deferred to a traditional IRA.

Retirement Qualifications and Calculations

Members are eligible for a monthly pension if they terminate public service, are vested in the plan and are at least 55 years of age. Each month a contribution is reported to PERA, a participant receives one service credit. Members may earn a maximum of 12 service credits in a calendar year.

Pensions are paid in equal monthly installments for a member's lifetime. The qualifications for retirement and the formula used in calculating a pension depend upon the date on which a member was first hired into public service. If hired before July 1, 1989, benefits will be computed two different ways and a member will receive the higher amount. The two pension formulas are explained below.

METHOD 1. For each of the first 10 years of service members earn 1.2 percent of the average of their highest five consecutive years of salary. For each year of service exceeding 10, members earn 1.7 percent. The Rule of 90 allows early retirement with no early retirement reduction of the pension if the sum of a member's age and length of service totals at least 90. Participants who do not qualify for Rule of 90, or are not age 65, can receive a pension reduced by 3 percent for each year they retire before age 65 (or age 62 if they have 30 or more years of service).

METHOD 2. Under this method, the pension is computed using a level formula of 1.7 percent of salary for each year of service. There is no Rule of 90 or 3 percent per year early retirement reduction factor. Instead, there is an actuarial reduction, which is about 6 percent per year, for each year a member retires before full retirement age.

A modified version of Method 2 is used to compute pensions for individuals hired after July 1, 1989, who earned no prior service credit in PERA or other covered Minnesota public pension plans. For these individuals, there will be actuarial early retirement reductions for retirement before age 66

Repayment of a Refund

Individuals who previously left Minnesota public employment and who received a refund have the option to repay all, or in some cases part of, the refund to restore lost service credit with PERA. Members can repay a refund after they have earned an additional six months of service credit as a public pension plan member and may repay the refund up to six months after leaving public service.

Combined Service Pensions

Members may combine service in PERA with service in other covered Minnesota public pension plans. This entitles them to a combined service pension from each of the plans in which they have service. Combined service pensions often provide a higher overall level of retirement income. Please call the PERA office for complete information about combined service.

How Your Pension Will Be Paid

As mentioned earlier, pensions are paid in equal monthly payments over a member's lifetime. If a Single-Life Pension is chosen, all payments will stop upon death and the member's beneficiary(ies) will receive any remaining balance of employee contributions. However, instead of the Single-Life Pension, members may choose a Pension Option which will pay 25, 50, 75 or 100 percent of the value of the member's pension to the person named as a survivor upon the participant's death. If a Pension Option is chosen, the monthly payment will be somewhat smaller than the Single-Life Pension because PERA will make payments over two rather than one lifetime.

Disability Benefits

If after three years of service a member becomes totally and permanently disabled, regardless of age, he or she may be eligible for disability benefits from PERA. In addition, the member may also be eligible for a Social Security disability benefit.

Survivor Benefits

If a member should die before retirement and has at least three years of service, a surviving spouse is eligible for a lifetime benefit or term-certain monthly benefits of 10, 15 or 20 years. All of these options are designed to pay out the same total amount over time. As an alternative, if a spouse is also named as the beneficiary, he or she may choose to receive a lump-sum refund of employee contributions plus 6 percent interest compounded annually, even if a member has less than three years of service.

If a member has no surviving spouse, dependent children under age 20 qualify for term-certain benefits. A surviving spouse and children may also be eligible for benefits from Social Security.

If You Leave Before Retirement

Members who terminate public employment after three or more years of service but before retirement age may leave their contributions with PERA and qualify for a pension any time after reaching age 55.

Regardless of the length of service, a member is entitled to a refund of employee contributions plus interest. He or she may apply for a refund only after termination from public employment. Keep in mind, however, that by taking a refund a member forfeits all future PERA benefits.

This document is available in alternative formats to individuals with disabilities by calling (651) 296-7460 or 1 800 652-9026, or through the Minnesota Relay Service at 1 800 627-3529.

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May 2015

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