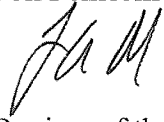


TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director 

RE: Designated Commission Interim Study; Review of the Commission's Principles of Pension Policy Based on 1997-2008 Pension Legislation (Revised Second Consideration)

DATE: July 18, 2008

Introduction

As an interim topic for consideration during the 2007-2008 interim, the Commission chair, Representative Mary Murphy, designated a review of the Commission's Principles of Pension Policy in light of pension legislation enacted during the period 1997-2008. The Commission began consideration of the topic during the 2007-2008 interim but did not complete its consideration of the topic before the start of the legislative session. The Commission chair has designated a continuation of the topic for the 2008-2009 interim.

The interim topic is not a direct outgrowth of any pension legislation during the 2007 legislative session, but represents an opportunity for the Legislative Commission on Pensions and Retirement to provide guidance to future Commissions by reviewing its Principles of Pension Policy in light of pension legislation enacted since the last review of the Principles in 1995-1996.

The Commission meeting is the third scheduled consideration of the topic by the Commission. The initial consideration occurred during the August 20, 2007 Commission meeting. The second consideration of the topic by the Commission occurred on December 6, 2007. The Commission staff anticipates that the topic will necessitate one or two additional Commission staff issue memoranda.

This Commission staff issue memorandum is the fourth issue memorandum related to the interim topic. The initial Commission staff issue memorandum summarized the history of the Legislative Commission on Pensions and Retirement, summarized the initial development of the Principles of Pension Policy by the Commission, summarized the 1995-1996 reformulation by a Commission-sponsored working group of the Principles of Pension Policy, and broadly identified pension legislation enacted during the 1997-2008 legislative sessions that were at some variance with the 1995-1996 pension policy principles or that raised policy areas which were not specifically addressed in the current policy principles.

The second Commission staff issue memorandum provided a more detailed policy discussion of those current pension policy principles that may need either revision or restatement in light of public pension legislation recently recommended by the Commission and enacted by the Legislature. The third Commission staff issue memorandum, accompanying this memorandum, updated the initial issue memorandum based on the 2008 session pension legislation. This memorandum updates the second Commission staff issue memorandum to incorporate a discussion of potential accommodations in the policy principles arising out of the 2008 session pension legislation.

The final Commission staff issue memorandum or memoranda will provide a similar detailed policy analysis of policy areas that are not currently included in the Commission's pension policy principles.

Policy Principle Review: Principle II.A.1. Purpose of Minnesota Public Pension Plans

- a. Principle II.A.1. contains, among other items, an indication that Minnesota public pension plans exist to assist in the systematic out-transitioning of existing public employees at the normally expected conclusion of their working careers in providing retirement benefits. Specifically, the principle states:

II.A.1. Purpose of Minnesota Public Pension Plans

Minnesota public pension plans exist to augment the Minnesota public employer's personnel and compensation system by assisting in the recruitment of new qualified public employees, the retention of existing qualified public employees, and the systematic outtransitioning of existing public employees at the normally expected conclusion of their working careers by providing, in combination with federal Social Security coverage, personal savings and other relevant financial sources, retirement income that is adequate and affordable.

- b. Recent Variant Public Pension Legislation. One item of 1997-2008 pension legislation is potentially at variance with the principle. In 2008, the exemption amount for reemployed annuitants covered by the Teachers Retirement Association (TRA) or by a first class city teacher retirement fund association was

increased dramatically, from the Social Security earnings test amount (\$13,580 for ages under the Social Security full unreduced benefit receipt age in 2008) to \$46,000, consciously attempting to blur the line between employment and retirement and essentially permitting coincidental full-time employment and retirement benefit receipt (Laws 2008, Ch. 349, Art. 3, Sec. 8, 10, and 12). The payment of retirement annuities to full-time or near full-time teachers will reduce or eliminated that out-transitioning assistance.

- c. Policy Analysis and Discussion. The historic reason for creating and maintaining pension plans, in the private sector or the public sector, was to augment an employer's personnel and compensation system by assisting in the recruitment of new qualified employees, in the retention of existing qualified employees, and in the systematic out-transitioning of existing employees at the conclusion of their normally expected working careers. The pension system does this by providing retirement annuities (and frequently other casualty or ancillary benefit coverage) that are deemed adequate in view of the employer and the employees and that are deemed affordable by the employer. This traditional pension plan purpose apparently underlies the development of public pension plans in Minnesota, although the purpose never appears to have been clearly articulated in law. The clearest statement of public pension plan purpose in law is Minnesota Statutes, Section 352C.01, a statement of legislative finding and intent regarding the largely defunct Elective State Officers Retirement Plan.

As the nature of public sector and private sector employment has changed over time and appears to continue to change, it is unclear that the historic purpose for public pension plans remains valid or viable. In the past, the general expectation of employers and employees appears to have been that individuals would spend most or all of their career in a single profession or occupation, frequently with a single employer, and then retire. That expectation appears to be changing and commentators on labor economics and workforce practices suggest that individuals should expect in the future to engage in numerous professions or occupations, both self-employed and employed by a variety of employers, and with a mix of both part-time and full-time employments.

Within Minnesota public pension plans, it is unclear that many candidates for public employment, especially many candidates for entry-level public employment positions, place any substantial value on pension coverage. Indeed, given that Minnesota public pension plans are contributory (meaning that public employees are required to make a member contribution) and most private sector pension plans are non-contributory (meaning that only the employer contributes to the plan,) public pension plan coverage actually may function as a disincentive for candidates for entry level employment to accept public employment, contrary to the traditional recruitment purpose for pension plan creation and maintenance.

With respect to the traditional retention purpose for pension plan creation and maintenance, recent Minnesota public pension plan practice also reflects some conflict. The primary retention aspects of pension coverage are the existence of defined benefit plan coverage and the existence of substantial service credit vesting requirements for retirement annuities and other benefits. In the past 25 years, in creating new pension plans, Minnesota has created more defined contribution pension plans (six) than defined benefit plans (five). Since 1987, in general Minnesota defined benefit plans have shortened their service requirement for vesting considerably from ten years to five years in 1987, and from five years to three years in 1989.

The clearest exercise of a traditional pension plan purpose in Minnesota has been in the out-transitioning purpose, although even this purpose is conflicted. During the 1980s and 1990s, when Minnesota public employees were offered numerous early retirement incentives in order to induce greater senior employee turnover, apparently in order to reduce the size of public employment and accrue corresponding budgetary savings. However, in total, statewide and major Minnesota public pension plan active membership increased by 29 percent during the period 1985-1995 and increased in each year during the period. Also, some prior members of the Legislative Commission on Pensions and Retirement and some previous public pension plan administrators have suggested that Minnesota public pension plans ought to shift from the current practice of requiring termination from active employment as a qualification for a retirement annuity to accommodate a change in employment practices in phasing out into retirement.

If out-transitioning no longer remains a purpose for a Minnesota public pension plan, as may be the situation begun by the 2008 session increases in the threshold reemployed annuitant earnings limitation amounts and the allowance of pre-termination employment continuation agreements among the state's three teacher retirement plans, either the purpose statement will need to be pruned down to recruitment and retention functions or a new third purpose needs to be fashioned and some consideration of the appropriateness of concurrent retirement annuity payments and full-time or near full-time employment will need to occur.

Historically, "double-dipping" or concurrent pension receipt while remaining fully employed has been viewed by past Commissions as an abuse, although the adverse perception has never been reduced to a pension policy principle. The path to the 2008 legislation has its roots in a provision sought and won by the Inter-Faculty Organization, the union representing the state university faculty members, in 1994

