TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director LAM

RE: Designated Commission Interim Study; Review of the Commission's Principles of Pension Policy Based on 1997-2007 Pension Legislation (Second Consideration)

DATE: November 29, 2007

Introduction

As an interim topic for consideration, the Commission chair, Representative Mary Murphy, has designated a review of the Commission's Principles of Pension Policy in light of pension legislation enacted during the period 1997-2007. 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 second scheduled consideration of the topic by the Commission. The initial consideration occurred during the August 20, 2007 Commission meeting. The Commission staff anticipates that the topic will necessitate three or four Commission staff issue memoranda.

This Commission staff issue memorandum is the second 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 1997-2007 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.

This Commission staff issue memorandum provides 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 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.B.1. Creation of New Pension Plans

a. Principle II.B.1. contains a general policy disfavoring the creation of new public employee pension plans, indicating that public employers should not be permitted to create new plans on their own initiative without legislative authorization and that new volunteer firefighter pension plans should be created on a county or comparable regional basis. Specifically, the principle states:

> II.B.1. Creation of New Pension Plans
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> a. Minnesota public employers, on their own initiative, without legislative authorization, should not be permitted to establish or maintain new public pension plans, except for volunteer firefighter relief associations.
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> b. New pension plans for volunteer firefighters should be organized on a county or comparable regional basis if possible.

Principle II.B.3.a. augments Principle II.B.1., addressing the subject of pension plan consolidation, as follows:

> II.B.3. Consolidation of Public Pension Plans by a Minnesota Public Employer
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> a. The State, with the second largest number of public employee pension plans in the nation, would benefit from a more rational public pension plan structure.

b. Recent Variant Public Pension Legislation. Two items of 1997-2007 pension legislation are potentially at variance with the thrust of the principle, even if they are not directly at variance with the language of the specific principle:

1. In 1999, the Special Deputy State Fire Marshal – Fire/Arson Investigator Retirement Plan was created within the Minnesota State Retirement System *(Laws 1999, Ch. 222, Art. 15)*.
2. Also in 1999, the Local Government Correctional Employees Retirement Plan was created within the Public Employees Retirement Association *(Laws 1989, Ch. 222, Art. 2)*.

The MSRS Arson Investigator Plan provides a larger retirement benefit (2.0 percent benefit accrual rate) at an earlier age (age 55) than the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), with a 70 percent increase in member contributions and with a 105 percent increase in employer contributions. The Local Government Correctional Employees Retirement Plan of the Public Employees Retirement Association (PERA-Correctional) provides a larger retirement benefit (1.9 percent benefit accrual rate) at an earlier age (age 55) than the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), with a 23 percent increase in member contributions and with a 70 percent increase in employer contributions.

c. Policy Analysis and Discussion. The established reason for creating and maintaining Minnesota public pension plans identified by the Commission historically is to augment the 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 out-transitioning of existing public employees at the conclusion of their normally expected working careers. The Minnesota public pension system does this by providing retirement annuities and other casualty or ancillary benefit coverage that are deemed adequate in view of both the various public employers and public employees and that are deemed affordable for public employees and public employers.

Since the early 1970s, Minnesota Statutes, Sections 356.24 and 356.25, have prohibited local governments, political subdivisions, and state agencies from creating or supporting new public employee pension plans other than volunteer firefighter relief associations. During the period since the early 1970s, the Legislature has created numerous additional public pension plans, as follows:

Defined Benefit Plans
- MSRS Correctional Employees Retirement Plan (1973)
- Uniform Judicial Retirement Plan (1973 – replacing the prior judicial retirement plan)
- Military Affairs Department Personnel Retirement Plan (1980)
- Transportation Department Pilots Retirement Plan (1982)
- Local Government Correctional Employees Retirement Plan (1987 – optional, limited to seven counties, and not implemented)
- Special Deputy State Fire Marshal—Fire/Arson Investigator Retirement Plan (1999)
- Local Government Correctional Employees Retirement Plan (1999 – established as statewide mandatory plan)

Defined Contribution Plans
- MSRS Unclassified State Employees Retirement Plan (1971 – initially for executive branch department heads and legislative employees; 1987 – made the mandatory coverage for newly elected constitutional officers and legislators)
- State Deferred Compensation Plan (created in 1971; expanded in 1975; revamped in 1988)
- PERA Defined Contribution Plan (1987 – initially for ambulance personnel and local government medical doctors; 2003 – expanded to primarily cover local government elected officials)
- Minnesota State Colleges and Universities System (MnSCU) Individual Retirement Account Plan (1988 – established for state university and community college faculty; 1995 – expanded to cover vocational college faculty)
- Employer Matching Contributions to Tax-Sheltered Annuity Plans (1992 – initially limited to small number of plans selected by the State Board of Investment; 2000 – expanded to unlimited number of plans)
- Ambulance Service Personnel Longevity Award and Incentive Program (1993)
- State Arts Board, Humanities Commission and Minnesota Historical Society IRAP (1994)

Considering the Commission experience since the early 1970s, the creation of a new public employee pension plan has been deemed appropriate by the Commission in four instances, as follows:

1. Incorporation of New Public Employers. The creation of a new public pension plan has been deemed appropriate if a new group of employees is incorporated into the public sector and that group does not bear any considerable similarity to the membership of an existing public pension plan, which was the situation leading to the initial creation to the PERA Defined Contribution Plan and the subsequent creation of the Ambulance Service Personnel Longevity Award and Incentive Program, both involving local ambulance service personnel.

2. Inadequate or Inappropriate Prior Retirement Coverage. The creation of a new public employee pension plan has been deemed appropriate if the current benefit coverage of an existing group of public employees is deemed inadequate or inappropriate, which was the situation apparently leading to the creation of the Correctional State Employees Retirement Plan of the Minnesota State

Retirement System (MSRS-Correctional), the Military Affairs Department Personnel Retirement Plan, the Transportation Department Pilots Retirement Plan, the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), the Individual Retirement Account Plans (IRAP), the Special Deputy State Fire Marshal-Fire/Arson Investigator Retirement Plan, and the Local Government Correctional Employees Retirement Plan of the Public Employees Retirement Association (PERA-Correctional). For the MSRS-Correctional Plan, the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) was deemed to be inappropriate for quasi-public safety-type employees, where a very early mandatory retirement age provision was also imposed in 1973. For the Military Affairs and Transportation Pilots plans, MSRS-General was deemed inappropriate because of earlier normal or mandatory retirement ages applicable under federal law for the two groups. For the MSRS-Unclassified Program, MSRS-General coverage was deemed to be inappropriate because the pre-1987 ten-year vesting requirement could not be met by various state employees in politically sensitive jobs with high turnover. The IRAP was added as an alternative to the Teachers Retirement Association (TRA) for higher education faculty members because of portability concerns for the employment-mobile in a national market and because defined contribution plan coverage is the norm in higher education. The Arson Investigator Plan replaced MSRS-General and the PERA-Correctional replaced the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) because general employee coverage was deemed to be inappropriate for quasi-public safety-type employees.

3. Consolidation of Other Plans. The creation of a new public employee pension plan also has been deemed appropriate as a mechanism for the consolidation of other smaller public employee pension plans, which was the situation leading to the creation of the Uniform Judicial Retirement Plan. Retirement coverage was extended to judges on an incremental basis, with the creation of a Probate and County Court Judges Retirement Plan in 1931, the creation of a Supreme Court Justices Retirement Plan in 1943, the creation of a District Court Judges Retirement Plan in 1949, the creation of a Supreme Court and District Court Survivors Plan in 1961, and the creation of a Probate and County Court Survivors Plan in 1967. In 1973, promoted by the District Court Judges Association, a single judicial retirement plan was created for all newly appointed or elected judges and for judges electing to shift coverage. As the prior plans have become obsolete, they have been eliminated.

4. Provision of Supplemental Retirement Coverage. The creation of a new public employee pension plan has been deemed appropriate as a mechanism for providing supplemental retirement benefit coverage, which was the situation in allowing employer matching contributions to the State Deferred Compensation Plan and to the qualified tax-sheltered annuity programs.

On a numeric count basis, most Minnesota public pension plans, which are principally local volunteer fire relief associations, are single employer pension plans. Although these plans cover the same type of employee with typically the same type of benefit coverage, the determinative factor for retirement coverage is the employment relationship between a particular employer and a group of employees. The largest Minnesota public pension plans on the basis of membership, liabilities, and assets are multiple employer pension plans, where the same broad types of employees employed by a variety of public employers are covered by the same public pension plan. These plans are the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and the Teachers Retirement Association (TRA).

The existence of many Minnesota public pension plans, as single employer pension plans, likely reflects the state's historical experience of gradually extending pension coverage to all public employees through filling-in existing retirement coverage gaps rather than reflecting any overall deliberative policy decision about the best manner in which to provide public sector pension coverage. A substantial number of public pension plans already exist in Minnesota and increasing that number is contrary to the Principles of Pension Policy, especially if a new public pension plan is created by local action rather than legislative enactment. Minnesota is the twelfth largest state in land area, the twentieth largest state in population, the sixth largest state in the total number of local governmental units, twenty-first in the number of public employees per 10,000 population, but has the second largest number of public employee pension plans (824) after the Commonwealth of Pennsylvania (which is thirty-third in land area, fifth in population, second in the number of local governmental units, and fiftieth in the number of public employees per 10,000 population) with a reported 2,365 public pension plans and as restriction on governmental units establishing new pension plans. Comparing the number of public pension plans among the 50 states with various geographical factors does not appear to yield any strong correlation.

In creating the Local Government Correctional Employees Retirement Plan (PERA-Correctional) in 1999, the Commission considered and specifically rejected the alternative of expanding the membership of the Correctional State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Correctional) to include local government correctional employees in part because the initial and current PERA-Correctional benefit levels are more modest than MSRS-Correctional, because the interest groups associated with MSRS-Correctional were uncomfortable with any extension, and because the Association of Minnesota Counties was very concerned about the affordability of the MSRS-Correctional benefit plan. The Commission did not consider any alternative coverage option in 1999 when it created the Special Deputy State Fire Marshal-Fire/Arson Investigator Retirement Plan, where the employee group did not match up well with the coverage groups of any other existing plan.

d. Potential Principle Amendment. The current Principles of Pension Policy are potentially deficient in that they do not provide guidance to future Commissions when considering proposals for the creation of new statewide or specialty public pension plans. The following potential revision of the 1995-1996 Principles is the Commission staff's attempt to capture the identified policy bases for the creation of new public pension plans by the Legislature:

II.B.1. Creation of New Pension Plans

a. Minnesota public employers, on their own initiative, without legislative authorization, should not be permitted to establish or maintain new public pension plans, except for volunteer firefighter relief associations.

b. New public employee retirement plans should only be created to accommodate a group of employees who are newly incorporated into the public sector, to correct inadequate or inappropriate prior retirement coverage that cannot be accommodated within an existing public retirement plan, to effect the consolidation of two or more existing public retirement plans by replacing those plans, or to provide supplemental retirement coverage that cannot be accommodated within an existing public retirement plan.

c. New pension plans for volunteer firefighters should be organized on a county or comparable regional basis if possible.

The amendment retains the existing principle, but draws on the experience of and arguments for and against new retirement plans since the early 1970s by specifying the factual requirements that would need to be established by proponents of the creation of a new Minnesota public pension plan.

Policy Principle Review: Principle II.B.3. Public Pension Plan Consolidation

a. Principle II.B.3. indicates a broad goal of creating a more rational public pension plan structure, given the large number of plans within the State, and suggests that voluntary consolidations of smaller pension plans should be encouraged, with county or regional consolidated plans developed if a statewide plan is deemed to be inappropriate. Specifically, the principle states:

II.B.3. Consolidation of Public Pension Plans by a Minnesota Public Employer

a. The State, with the second largest number of public employee pension plans in the nation, would benefit from a more rational public pension plan structure.

b. The voluntary consolidation of smaller public pension plans should be encouraged, with the development of county or comparable regional public employee pension plans in place of a large number of small local plans to assist in this consolidation if a statewide public pension plan is deemed to be inappropriate.

b. Recent Variant Public Pension Legislation. There were three items of 1997-2007 pension legislation that are potentially at variance with the principle to some degree. One relates to volunteer firefighter relief association consolidations and two deal with the phase-out of local police and paid firefighter relief associations:

1. In 1999, the Minneapolis Firefighters Relief Association was permitted to continue in existence until it has fewer than 100 retirees rather than shifting to a municipal trust fund upon the last active member retirement *(Laws 1999, Ch. 222, Art. 6, Sec. 2)*.

2. In 2000, authority was granted for any two or more volunteer firefighter relief associations to consolidate, building off of the 1996 New Hope-Crystal Volunteer Firefighter Relief Association consolidation legislation *(Laws 2000, Ch. 461, Art. 16, Sec. 2)*.

3. In 2005, the Minneapolis Police Relief Association was permitted to continue in existence until there are fewer than 226 total members (active, retired, or survivor) rather than fewer than 100 *(Laws 2005, First Special Session, Ch. 8, Art. 11, Sec. 9)*.

The 1999 Minneapolis Firefighters Relief Association legislation departed from the eventual elimination of the local pension plan administration that had been previously mandated. The 2005 Minneapolis Police Relief Association legislation made a departure similar to the 1999 Minneapolis Firefighters Relief Association legislation. The 2000 general volunteer firefighter relief association consolidation authority potentially reduces the number of local relief associations by half or more, but will not result in county or comparable regional consolidated volunteer firefighter pension plans.

c. Policy Analysis and Discussion. The Commission's 1980 Principles of Pension Policy provided that the consolidation of smaller pension plans should be emphasized. The 1995-1996 Principles incorporated this policy from the 1980 Principles and indicate a goal of reducing the number of smaller Minnesota public pension plans by consolidating them together or consolidating them into an existing larger Minnesota public pension plan.

Consolidation can run a range of pension plan function transfers. The most modest public pension plan consolidation is the transfer of administrative functions from one public pension plan administration to that of another plan. Administrative consolidations have occurred frequently in Minnesota, including the 1973 elimination of the Highway Patrolman's Retirement Association and the transfer of its administrative functions to the Minnesota State Retirement System (MSRS). MSRS also replaced the State Auditor as the administrative entity for the Legislators Retirement Plan, for the Elective State (Constitutional) Officers Retirement Plan, and for the various judicial retirement plans in 1973 and 1974. A significant public pension plan consolidation is the transfer of investment functions from one public pension plan to another. An investment consolidation occurred in 1969, when the investment of assets representing the required reserves for retirees for the Minneapolis Employees Retirement Fund (MERF) was made the responsibility of the State Board of Investment by incorporating MERF into the Minnesota Adjustable Fixed Benefit Fund, the predecessor to the current Minnesota Post Retirement Investment Fund. That investment consolidation was reversed by legislation in 1981 (Laws 1981, Chapter 298). A more significant public pension plan consolidation is the inclusion of the liabilities of one public pension plan in the liabilities of another retirement fund of another public pension plan. A retirement fund consolidation occurred in 1975 when the Supreme Court and District Court Judges Survivors' Account was incorporated into the Judges Retirement Fund and in 1979 when the County and Probate Court Judges Survivors' Account was incorporated into the Judges Retirement Fund. A total consolidation is the elimination of the benefit plan, investment function, retirement fund, and administration of one retirement plan and its total incorporation into another retirement plan, fund, and administration. Total consolidations have occurred in Minnesota on several occasions, including the 1961 consolidation of the Game Wardens Retirement Plan into the State Police Retirement Plan, the 1969 consolidation of the State Police Retirement Plan into the State Patrol Retirement Plan, the 1967 consolidation of the Attorney General Retirement Plan and the State Auditor Retirement Plan into the Elective State Officers Retirement Plan, the 1973 consolidation of the Supreme Court Justices Retirement Plan, the District Court Judges Retirement Plan, and the Probate and County Court Judges Retirement Plan into the Uniform Judicial Retirement Plan, the 1978 consolidation of the Metropolitan Transit Operating Division Retirement Plan into the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the 1978 consolidation of the University of Minnesota Police Pension Plan into the Public Employees Police and Fire Plan (PERA-P&F), the 1973 consolidation of the St. Paul Bureau of Health Relief Association into the Public Employees Retirement Association (PERA), the 1978 consolidation of the Brooklyn Center Police Relief Association into PERA-P&F, the 1978 consolidation of the Cloquet Fire Department Relief Association into PERA-P&F, the 1985 consolidations of the Moorhead Firefighters Relief Association and the Moorhead Police Relief Association into PERA-P&F, the 1999 merger of the 44 local police and paid firefighter relief association consolidation accounts into PERA-P&F, and the 2006 consolidation of the Minneapolis Teachers Retirement Fund Association (MTRFA) into the Teachers Retirement Association (TRA). Consolidations of the 44 local police and paid firefighter relief associations between 1987-1998 under Minnesota Statutes, Chapter 353A, range from administrative consolidations to virtually total consolidations depending on the number of relief association members electing the PERA-P&F benefit plan provisions. Consolidation of two volunteer firefighter relief associations into a single relief association (for New Hope and Crystal, and for Norwood and Young America) was approved twice by the Legislature.

Minnesota has the second largest number of public pension plans, with approximately 800, following the Commonwealth of Pennsylvania, which has in excess of 2,500 public pension plans. Consolidation, along with the phase-outs of retirement plans through the closure of the plan to new members, are the primary mechanisms for reducing the number of public pension plans and rationalizing pension coverage for various types of public employees. Other than consolidations by local police or salaried firefighter relief associations under Minnesota Statutes, Chapter 353A, there have not been any consolidations of smaller public pension plans into larger statewide public pension plans since 1985.

Running contrary to consolidations and phase-outs, in recent years, additional public pension programs have been created, such as the Military Affairs Department Personnel Retirement Plan in 1980, the Transportation Department Pilots Retirement Plan in 1982, the Local Government Correctional Service Retirement Plan in 1987 (unimplemented by any of the seven applicable counties prior to its repeal in 1997) the Minnesota State Colleges and Universities System (MnSCU) Individual Retirement Account Plan in 1988, the Public Employees Defined Contribution Retirement Plan in 1987, the Ambulance Service Personnel Longevity Award and Incentive Program in 1993, the State Arts Board, Humanities Commission and Historical Society Individual Retirement Account Plan in 1994, the Special Deputy State Fire Marshal—Fire/Arson Investigator Retirement Plan in 1999, and the Local Government Correctional Employees Retirement Plan in 1999.

The Minneapolis Firefighters Relief Association, under Minnesota Statutes, Section 423A.01, Subdivision 2, Clause (3), would have ceased as a separate plan administration and legal entity upon the retirement of the last active member and would become a municipal trust fund, but that administrative change was delayed until the relief association has fewer than 100 benefit recipients under the 1999 legislation. In 2005, the Minneapolis Firefighters Relief Association had 31 active members, with an average age of 54.8 years and with an average length of service of 29.2 years. Based on the recent experience of five or six retirements per year, the last active member should retire within the next seven years. With a total membership of 623 and with the recent experience of between 14 and 27 deaths per year, the plan would unlikely drop below 100 members for up to 37 years. Similarly, under Minnesota Statutes, Section 423A.01, Subdivision 2, Clause (3), the Minneapolis Police Relief Association would have ceased independent plan administration and conversion to a municipal trust fund upon the retirement of the last active member, but that administrative change was delayed until the relief association has fewer than 100 members under Laws 1992, Chapter 471, Article 1, Section 5, and revised until the relief association has fewer than 226 members under First Special Session Laws 2005, Chapter 8, Article 11, Section 9. In 2006, the Minneapolis Police Relief Association had 15 active members, with an average age of 58.8 years and with an average length of service of 34.5 years. Based on the recent experience to two retirements per year, the last active member should retire within the next eight years. With a total membership of 899 and with the recent experience of 22 deaths per year, the plan would unlikely drop below 226 members for almost 31 years.

After authorizing the New Hope Volunteer Firefighters Relief Association-Crystal Volunteer Firefighters Relief Association consolidation, and the Norwood Volunteer Firefighters Relief Association-Young America Volunteer Firefighters Relief Association consolidations in special legislation, at the request of the Minnesota Area Relief Association Coalition, an organization representing a number of volunteer firefighter relief associations, the Legislature has now authorized in general legislation any two volunteer firefighter relief associations serving contiguous fire districts to consolidate into a single relief association, even though the resulting relief association is unlikely to result in county-wide or regional volunteer firefighter relief associations. To the best knowledge of the Commission staff, no volunteer firefighter relief associations have utilized the general consolidation authority, although a modification in the pre-consolidation service pension amount credited after the consolidation was approved for a potential Aurora, Biwabik City, Hoyt Lakes and Palo volunteer firefighter relief association consolidation in First Special Session Laws 2005, Chapter 8, Article 11, Section 16.

d. Potential Principle Amendment. The current Principles of Pension Policy are at variance with the recent practice in extending the life of the Minneapolis Firefighters Relief Association and in authorizing the general consolidations of volunteer firefighter relief associations into resulting pension plans other than on a county or regional level.

If the Commission determines that the 1999 Minneapolis Firefighters Relief Association continuation legislation and the 2000 volunteer firefighter relief association consolidation legislation represent policies that should guide future Commission deliberations, the Commission staff offers the following revisions of the 1995-1996 Principles:

II.B.3. Consolidation of Public Pension Plans by a Minnesota Public Employer

a. The State of Minnesota, with the second largest number of public employee pension plans in the nation, would benefit from a more rational public pension plan structure that also balances the with state's commitment to decentralized governmental structures.

b. The voluntary consolidation of smaller public pension plans into appropriately situated larger public pension plans should be encouraged, ~~with~~ including the development of county or comparable regional public employee pension plans in place of a large number of small local plans to assist in this consolidation if the creation or the expansion of a statewide public pension plan is deemed to be inappropriate.

c. While the phase-out of public employee pension plans that are determined to have become obsolete for ongoing pension coverage should be encouraged, the actual elimination of the related public pension plan administrations should be determined on a case-by-case basis.

Policy Principal Review: Principle II.C.1. General Preference for Defined Benefit Plans Over Defined Contribution Plans

a. Principle II.C.1. reflects the current development of Minnesota public pension plans, with defined benefit pension plans predominating and with defined contribution pension plans limited to situations to provide portability, to reflect politically vulnerable public employment, or to implement supplemental plan coverage. Specifically, the principle states:

II.C.1. General Preference for Defined Benefit Plans Over Defined Contribution Plans

a. Defined benefit plans, where they currently exist, should remain as the primary retirement coverage for Minnesota public employees.

b. Defined contribution plans are particularly appropriate where interstate portability or private sector-public sector portability is a primary consideration of the public employee group, where the public employee group lacks civil service or analogous employment protections, or where the defined contribution plan is a supplemental pension plan.

b. Recent Variant Public Pension Legislation. There were two items of 1997-2007 pension legislation that are potentially at variance with the principle to some degree. One relates to replacement pension coverage for a group of public officials previously having public pension coverage while the other relates to pension coverage for a group of public sector individuals without prior pension coverage:

1. In 1997, newly elected legislators and constitutional officers and incumbent legislators and constitutional officers who elected Social Security coverage were made members of the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), which is a defined contribution plan *(Laws 1997, Ch. 233, Art. 2)*.

2. In 1999, the Kandiyohi County and Litchfield City Volunteer Rescue Squad members were made eligible for the Defined Contribution Plan administered by the Public Employees Retirement Association (PERA-Defined Contribution) *(Laws 1999, Ch. 222, Art. 20)*.

The legislator and constitutional officer change was not clearly motivated by the employment factors cited in the principle, but appears to have been in part or in whole a reaction to a public perception about the nature of the pre-1997 retirement coverage provided to legislators and constitutional officers. The 1997 shift in retirement coverage from defined benefit plan coverage to defined contribution plan coverage for legislators and constitutional officers was not proposed by the affected groups, but was included in a package of benefit changes, mostly increases, assembled by the administrators of the three large statewide retirement systems, the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA) and the Teachers Retirement Association (TRA), and was argued to be a reform element in the package. There was enough discomfort with the change for legislators and constitutional officers to require as part of the enacted legislation that the Commission study the change during the 1997-1998 Interim and recommend its reversal or its modification if the Commission found that defined contribution retirement plan coverage was not appropriate for elected officials. Portability, lack of employment stability, or supplemental retirement coverage did not drive the 1997 legislation. The Kandiyohi-Litchfield Rescue Squad personnel situation also appears to lack any of the factors specified in the principle, but appears to be a function of financial considerations and a desire to avoid the creation of unfunded actuarial accrued liabilities.

c. Policy Analysis and Discussion. The difference between defined contribution retirement plans and defined benefit retirement plans depends which of two plan elements is fixed or made predeterminable and which element is variable. The two plan elements are the level or amount of the benefits to be provided and the level of contributions to be required.

In a defined contribution retirement plan, the level of contributions or the amount of member and/or employer funding is specified or fixed in some manner, making the level of eventual benefits and/or their duration the variable element. Most commonly, in a defined contribution plan, the funding of the plan is specified as a percentage of the covered payroll of plan members. Those contributions, allocated to individual accounts and frequently invested based on individual selection, along with any investment return obtained, constitute the benefit that will be available to the plan member upon the termination of employment or retirement. Most commonly, the individual account balance is payable in a lump sum upon the termination of plan coverage or is available to be transferred to an insurance company for the purchase of a retirement annuity. Some retirement plans that generally are classified as defined contribution plans permit the individual account balance amount to be converted into a retirement annuity within the retirement plan at a specified annuity conversion factor, although the resulting assumption of that retirement annuity mortality risk actually defines the post-retirement benefit amount and subjects the retirement plan to potential future mortality and investment return experience losses and a chance for an unfunded actuarial accrued liability, akin to a defined benefit plan.

In a defined benefit retirement plan, the level of benefits at the time of retirement or after retirement is specified or fixed in some manner, making the level of contributions or the amount of funding from period to period the variable element. Most commonly, in a defined benefit plan, the retirement benefit is specified as a percentage of the final salary or of the final average salary and is specified on a per year of credited service rendered. Thus, the plan defined benefit retirement plan tracks and awards allowable service credit and salary credit and amasses a liability for the service and salary credit rendered to date that requires the periodic calculation and assessment by an actuary. The resulting actuarial valuation report both assesses the amount of actuarial accrued liability that the retirement plan has amassed to date and the amount of total contributions needed for the future plan year or plan years to adequately support the plan financially. Most commonly, in defined benefit plans, any lump sum amount is limited to a pre-retirement employment termination member contribution refund, with the regular retirement benefit only payable as a retirement annuity for life. Generally, a regular retirement annuity is a single lifetime benefit and has optional equivalent value forms that are open for election by the plan member to modify the benefit amount over time, the benefit payment length, or the benefit payment recipient. Retirement plans that are defined benefit plans can take on defined contribution retirement plan aspects, such as determining post-retirement adjustment amounts from the amount of investment gain in whole or in part generated by the plan.

In Minnesota, public pension plans by both absolute plan number and by total plan membership size are predominantly defined benefit pension plans. The following sets forth a listing of defined benefit Minnesota public pension plans and of defined contribution Minnesota public pension plans:

Defined Benefit Plans

1. General State Employee Retirement Plan of the Minnesota State Retirement System (MSRS-General)
2. MSRS Correctional State Employees Retirement Plan (MSRS-Correctional)
3. MSRS Military Affairs Retirement Plan
4. MSRS Transportation Department Pilots Retirement Plan
5. MSRS State Fire Marshal Division Employees Retirement Plan
6. State Patrol Retirement Plan
7. Elective State Officers Retirement Plan
8. Legislators Retirement Plan
9. Judges Retirement Plan
10. General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General)
11. Public Employees Police and Fire Plan (PERA-P&F)
12. PERA Local Government Correctional Employee Retirement Plan (PERA-Correctional)
13. Teachers Retirement Association (TRA)
14. Duluth Teachers Retirement Fund Association (DTRFA)
15. Minneapolis Teachers Retirement Fund Association (MTRFA)
16. St. Paul Teachers Retirement Fund Association (SPTRFA)
17. Minneapolis Employees Retirement Fund (MERF)
18. Local Police Relief Associations (calendar year 2000 total of 2)
19. Local Paid Fire Relief Associations (calendar year 2000 total of 2)
20. Volunteer Firefighter Relief Associations (total of 618)
21. University of Minnesota Faculty Supplemental Plan

Defined Contribution Plans

1. MSRS Unclassified State Employees Retirement Program (MSRS-Unclassified)
2. PERA Defined Contribution Retirement Plan
3. Minnesota State Colleges and Universities System (MnSCU) Individual Retirement Account Plan (IRAP)
4. MnSCU Supplemental Retirement Plan
5. State Arts Board, Humanities Commission and Historical Society IRAP
6. Volunteer Firefighters Relief Associations (calendar year 2000 total of 87)
7. Ambulance Personnel Longevity Plan
8. Hennepin County Supplemental Retirement Plan
9. University of Minnesota Faculty Retirement Plan
10. Public Employee Supplemental Thrift Plan through State Deferred Compensation Plan or various Tax-Sheltered Annuity programs
11. Housing and Redevelopment Agency Retirement Plans
12. Pre-1971 School District Supplemental Retirement Plans (total of 8)

The Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) is the oldest defined contribution retirement plan of those remaining in effect (TRA, DTRFA, the former MTRFA, SPTRFA, and MERF all converted from a defined contribution retirement plan to a defined benefit retirement plan, largely in the 1960s). The MSRS-Unclassified Program principally covers individuals who are employed in potentially politically sensitive positions where employment longevity was not guaranteed with satisfactory pr better service and the state employee consequently may not meet the vesting period then in effect, which was ten years of allowable service credit before 1987. The program was created at the request of the state agency and department heads. It includes the option for members who do achieve ten or more years of state employment to receive a MSRS-General defined benefit plan retirement annuity.

The PERA Defined Contribution Plan now largely functions to provide pension coverage for local public officials who were not eligible for PERA-General coverage or who elected not to become a PERA-General member, growing out of a predecessor defined contribution plan for local ambulance service personnel. The PERA-Defined Contribution Plan does not include an option to convert to a PERA-General defined benefit plan retirement annuity.

d. Potential Principle Amendment. The 1997 inclusion of new legislators and new constitutional officers in the Unclassified State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Unclassified) and the 1999 inclusion of Kandiyohi County and Litchfield City volunteer rescue squad members in the Defined Contribution Plan of the Public Employees Retirement Association (PERA-Defined Contribution) were apparently motivated by reasons other than the coverage type selection purposes specified in the principles.

If the Commission wishes to incorporate the apparent reasons behind the 1997 and 1999 legislation, the Commission staff offers the following revisions to the 1995-1996 Principles:

> II.C.1. General Preference for Defined Benefit Plans Over Defined Contribution Plans
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> a. Unless compelling considerations dictate otherwise, defined benefit plans, where they currently exist, should remain as the primary retirement coverage for Minnesota public employees.
>
> b. Defined contribution plans are particularly appropriate where interstate portability or private sector-public sector portability is a primary consideration of the applicable public employee group, where the public employee group lacks civil service or analogous employment protections and their public employment tenure may not constitute a full career, where the public employee group consists solely of elected officials, where financial considerations affecting the coverage group is such that the creation of unfunded actuarial accrued liabilities should be avoided, or where the defined contribution plan is a supplemental pension plan.

Policy Principle Review: Principle II.C.4. Appropriate Normal Retirement Ages

a. Principle II.C.4. indicates that the normal (unreduced for early retirement) retirement ages should be set based on the employability limits of average public employees and should be different for public safety employees when compared with general employees. Specifically, the principle states:

> II.C.4. Appropriate Normal Retirement Ages
>
> The normal retirement age should be set in a reasonable relationship to the employability limits of the average public employee and should differentiate between regular public employees and protective and public safety employees.

b. Recent Variant Public Pension Legislation. There was one item of 1997-2007 pension legislation that is potentially at variance with the principle to some degree. In 1997, eight years after setting the general employee retirement plan normal retirement age for post-1989 hires at an age indexed to the Social Security unreduced benefit receipt age, with a maximum of age 67, the maximum normal retirement age was reduced to age 66 *(Laws 1997, Ch. 233, Art. 1, Sec. 17, 37, and 47, and Art. 3, Sec. 1)*. No testimony was offered to the Commission in 1997 about any change in the employability limits of the average post-1989 hires that would substantiate the need for the change consistent with the Pension Policy Principles.

c. Policy Analysis and Discussion. The 1995-1996 Principles largely continue the 1980 Principles with respect to establishing normal retirement ages, emphasizing the setting of normal retirement ages at the usual employability limits, but without any of the age specificity included in the 1980 Principles.

Age 65 has come to be the traditional age at which many employees are expected to retire. It is, however, unclear why this age has become the regularly expected retirement age for Social Security and for many public retirement plans. Age 65, however, does not appear to represent an empirically determined conclusion about when most employees retire that was drawn from the experience of employees before the creation of Social Security and the significant expansion of employment based pension coverage in the 1930s. Before the 1930s, retirement for most people appears to have been a function of a physical inability to continue in employment, at whatever age that occurred. Early employee retirement plans were frequently referred to as superannuation plans. Until recent decades, the most impoverished sector of the population was older folks. The age 65 normal retirement age is frequently ascribed to Chancellor Otto Von Bismark of Germany, who is reported to have set age 65 as the normal retirement age for the retirement coverage provided to the Prussian army.

Since the 1960s, in both larger corporate pension plans and public employee pension plans, the trend appears to have been to institute normal retirement ages earlier than age 65. In the counter direction, based on considerations of lengthening expected life spans and of the related cost of providing benefits for ever lengthening retirement periods, as part of 1986 amendments, Social Security has instituted a later full benefit retirement age, as follows:

Social Security

Year of Birth	Normal Retirement Age	Year of Birth	Normal Retirement Age
Before 1938	Age 65	1943-1954	Age 66
1938	Age 65, 2 months	1955	Age 66, 2 months
1939	Age 65, 4 months	1956	Age 66, 4 months
1940	Age 65, 6 months	1957	Age 66, 6 months
1941	Age 65, 8 months	1958	Age 66, 8 months
1942	Age 65, 10 months	1959	Age 66, 10 months
		1960 and later	Age 67

Minnesota public pension plans currently reflect some generalized uniformity in normal retirement ages consistent with the Principles. The following compares the normal retirement ages applicable to the various Minnesota public pension plans:

Retirement Plan Normal Retirement Age Provisions - General Employee Plans

1. General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General)
   - Hired before July 1, 1989: Age 65; or age 62 with 30 years of service; or "Rule of 90"
   - Hired after June 30, 1989: Social Security full benefit age, not to exceed age 66
2. Public Employees Retirement Association (PERA)
   - Hired before July 1, 1989: Age 65; or age 62 with 30 years of service; or "Rule of 90"
   - Hired after June 30, 1989: Social Security full benefit age, not to exceed age 66
3. Teachers Retirement Association (TRA)
   - Hired before July 1, 1989: Age 65; or age 62 with 30 years of service; or "Rule of 90"
   - Hired after June 30, 1989: Social Security full benefit age, not to exceed age 66
4. Duluth Teachers Retirement Fund Association (DTRFA)
   a. Old Law Plan: Age 60
   b. New Law Plan
      - Hired before July 1, 1989: Age 65; or age 62 with 30 years of service; or "Rule of 90"
      - Hired after June 30, 1989: Social Security full benefit age, not to exceed age 66
5. Minneapolis Teachers Retirement Fund Association (MTRFA)
   a. Basic Program: Age 60; or any age with 30 years of service
   b. Coordinated Program
      - Hired before July 1, 1989: Age 65; or age 62 with 30 years of service; or "Rule of 90"
      - Hired after June 30, 1989: Social Security full benefit age, not to exceed age 66
6. St. Paul Teachers Retirement Fund Association (SPTRFA)
   a. Basic Program: Age 65; or age 60 with 25 years of service; or "Rule of 90"
   b. Coordinated Program
      - Hired before July 1, 1989: Age 65; or age 62 with 30 years of service; or "Rule of 90"
      - Hired after June 30, 1989: Social Security full benefit age, not to exceed age 66
7. Minneapolis Employees Retirement Fund (MERF)
   - Age 65; or age 60 with 10 years of service; or any age with 30 years of service
8. Legislators Retirement Plan
   - Age 62
9. Elective State Officers Retirement Plan
   - Age 62
10. MSRS Military Affairs Department Retirement Plan
    - Mandatory federal military retirement age or age 65.
11. Transportation Department Pilots Retirement Plan
    - Age 62
12. MSRS State Fire Marshal Division Employees Retirement Plan
    - Age 55
13. Judges Retirement Plan
    - Age 65

Retirement Plan Normal Retirement Age Provisions - Public Safety Plans

1. State Patrol Retirement Plan
   - Age 55
2. MSRS Correctional Employees Retirement Plan (MSRS-Correctional)
   - Age 55
3. Public Employees Police and Fire Fund (PERA-P&F)
   - Age 55
4. PERA Local Government Correctional Retirement Plan
   - Age 55
5. Local Police Relief Associations
   - Age 50
6. Local Paid Firefighters Relief Association
   - Usually Age 50
7. Volunteer Firefighters Relief Association
   - Usually Age 50

The 1986 resetting of the Social Security full retirement benefit receipt age by the U.S. Congress appears to have been motivated more by system financial and federal budgetary concerns and by a need to reduce future benefit outlays to delay the date of a potential system benefit default than by any clearly delineated empirical evidence that American workers were working to later ages. Indeed, the last 20 years appear to evidence a trend for continuing reductions in the retirement age of many workers compared to prior generations of workers. The life expectancy of American workers, however, has been increasing throughout the 20th century and into the 21st century, meaning that workers could delay the start of their retirement period compared to prior generations and have the same retirement duration. Although the potential employability limits of general employees appear to be lengthening, it is not clear that the same phenomenon is true for public safety employees who are engaged in the most hazardous aspects of that employment.

d. Potential Principle Amendment. The 1997 legislation that limited the Social Security full benefit age indexed normal retirement age for general employees hired after 1989 to age 66, was set without any apparent evidence about the change in the employability limits of general employees, and differs from the 1995-1996 pension policy principles.

If the Commission wishes to modify the 1995-1996 Principles in a manner consistent with the 1997 legislation, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.C.4. Appropriate Normal Retirement Ages

The normal retirement age should differentiate between regular public employees and protective and public safety employees and should be set in a reasonable relationship to the employability limits of the average public employee, but not at an age greater than age 66 for general public employees ~~and should differentiate between regular public employees and protective and public safety employees~~.

Policy Principle Review: Principle II.C.5. Appropriate Early Retirement Reductions

a. Principle II.C.5. indicates that Minnesota public pension plans should not subsidize early retirement benefits and that, unless it is a part of an appropriately designed early retirement incentive, the early retirement reduction should be required to be on an actuarial equivalent basis. Specifically, the principle states:

II.C.5. Appropriate Early Retirement Reductions

Public employee pension plans should not subsidize early retirement benefits and, except for appropriately designed early retirement incentive programs, retirement benefits should be actuarially reduced for retirement before any applicable normal retirement age.

b. Recent Variant Public Pension Legislation. Two items of 1997-2007 pension legislation are potentially at variance with the principle to some degree:

1. In 1997, the prior actuarial equivalent early (pre-age 55) retirement reduction for the State Patrol Retirement Plan was replaced by a subsidized reduction factor *(Laws 1997, Ch. 233, Art. 1, Sec. 32)*.
2. In 1999, for the State Patrol Retirement Plan, the MSRS State Correctional Employees Retirement Plan (MSRS-Correctional), and the PERA Police and Fire Retirement Plan (PERA-P&F), the early

(pre-age 55) retirement reduction was subsidized, with the MSRS-Correctional reduction factor changed from an actuarial equivalency reduction and with the State Patrol Retirement Plan and PERA-P&F reduction factor both further subsidized *(Laws 1999, Ch. 222, Art. 13, Sec. 5, and Art. 14, Sec. 1 and 3).*

The State Patrol Retirement Plan and PERA-P&F reduction factors are now so slight after the 1997 and 1999 changes that any further subsidization essentially would constitute resetting the normal retirement age for the two plans at age 50 rather than age 55.

c. Policy Analysis and Discussion. The 1995-1996 Principle indicates that early retirement should not be subsidized by the public pension plan other than as part of an appropriately designed early retirement incentive and that early retirement benefits should be actuarially reduced. The 1995-1996 Principle was a slight modification of the 1980 Principles, which indicated that retirement benefits should be reduced on an actuarially equivalent basis for retirement at an age earlier than the normal retirement age, except for retirement by long service (30 years) employees at age 62. That long service early retirement eligibility was first authorized by the Legislature in 1973.

A defined benefit retirement plan functions to provide the greatest benefit value (and to incur its greatest actuarial accrued liability) at the normal retirement age. The use of actuarial equivalent early retirement reduction factors is intended to provide a benefit at an earlier age and, presumably, for a longer period of time without increasing that pension value and without increasing the corresponding actuarial accrued liability.

The Minnesota public pension plans currently do not uniformly require actuarial equivalent early retirement reduction factors, thereby generally subsidizing early retirement by actually providing the public employee retiring before the normal retirement age with a greater pension value (and imposing on the pension plan a greater actuarial liability) than would occur at the normal retirement age. The 1997 and 1999 public safety employee retirement plan early retirement reduction factor legislation was further subsidization. The following surveys the various early retirement reduction rates currently imposed by the various Minnesota public pension plans:

Reduction Method	Plans Involved
Actuarial equivalent value of annuity deferred to the normal retirement age and augmented at three percent per year of imputed deferral.	• General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) "level benefit" tier • Public Employees Retirement Association (PERA) "level benefit" tier • Teachers Retirement Association (TRA) "level benefit" tier • Duluth Teachers Retirement Fund Association (DTRFA) Old Law or New Law Plan "level benefit" tier • St. Paul Teachers Retirement Fund Association (SPTRFA) Basic or Coordinated Program "level benefit" tier • Legislators Retirement Plan
One-half of one percent per month (six percent per year) that the retiree is under the normal retirement age.	• Elective State Officers Retirement Plan • Judges Retirement Plan
One-quarter of one percent per month (three percent per year) that the retiree is under the normal retirement age.	• MSRS-General "Rule of 90" tier • PERA "Rule of 90" tier • TRA "Rule of 90" tier • DTRFA Old Law or New Law Plan "Rule of 90" tier • SPTRFA Basic or Coordinated Program "Rule of 90" tier
Two-tenths of one percent per month (2.4 percent per year) that the retiree is under age 55.	• State Correctional Employees Retirement Plan (MSRS-Correctional)
One-tenth of one percent per month (1.2 percent per year) that the retiree is under age 55.	• State Patrol Retirement Plan • Public Employee Police and Fire Retirement Plan (PERA-P&F)
Defined contribution plan (two dollar bill and annuity) benefit for early retirement.	• Minneapolis Employees Retirement Fund (MERF)

The wide variety of the reductions imposed by the various retirement plans and the extent of subsidizations provided should significantly call the continuing recitation of this policy principle into question.

d. Potential Principle Amendment. Since the principle had already eroded before its 1995-1996 restatement and the 1997 and 1999 legislation have further reduced conformity with the principle, the language of the principle may merit substantive revision.

If the Commission desires to revise the principle in a manner that reflects the current state of benefit reduction practice in the area of early retirement, the Commission staff offers the following potential revision to the 1995-1996 Principles:

> II.C.5. Appropriate Early Retirement Reductions
>
> Unless the retirement plan had a subsidized early retirement age benefit before the 2008 legislative session, public employee pension plans should not subsidize early retirement benefits and, except for appropriately designed early retirement incentive programs, retirement benefits should be actuarially reduced for retirement before any applicable normal retirement age. Where a retirement plan had a subsidized early retirement age benefit before the 2008 legislative session, any further subsidization should only be enacted when required to achieve uniformity with comparable statewide retirement plans or where unique policy considerations demand it.

Policy Principle Review: Principle II.C.7. Adequacy of Benefits at Retirement

a. Principle II.C.7. generally suggests that normal retirement benefits for active members should respond to economic changes, should be adequate as of the date of retirement, measured on the basis of the retiree's final salary with 30 years of service as a reasonable public employment career, and at the normal retirement age, and should reflect any Social Security benefit earned during public employment. Specifically, the principle states:

> II.C.7. Adequacy of Benefits at Retirement
>
> a. Benefit adequacy requires that retirement benefits respond to changes in the economy.
>
> b. The retirement benefit should be adequate at the time of retirement.
>
> c. Except for local police or firefighter relief associations, the retirement benefit should be related to an individual's final average salary, determined on the basis of the highest five successive years' average salary unless a different averaging period is designated by the Legislature.
>
> d. Except for local police or firefighter relief associations, the measure of retirement benefit adequacy should be at a minimum of thirty years service, which would be a reasonable public employment career, and at the generally applicable normal retirement age.
>
> e. Retirement benefit adequacy must be a function of the Minnesota public pension plan benefit and any Social Security benefit payable on account of Minnesota public employment.

b. Recent Variant Public Pension Legislation. One item of 1997-2007 pension legislation is potentially at variance with the principle to some degree. For the Minneapolis Firefighters Relief Association, a retirement benefit increase was provided to retirees who are single, with the increase based on that unmarried status *(First Special Session Laws 2001, Ch. 10, Art. 15, Sec. 5)*. The benefit increase appears to have been motivated by a desire by single retirees to gain the advantages of a prior benefit increase that was granted to married retirees, due to the automatic survivor coverage previously provided by the relief association and its conversion into an optional annuity form. Marital status is not a factor in the policy principle.

c. Policy Analysis and Discussion. The 1995-1996 Principles of Pension Policy essentially continue the 1980 Principles that provide that the retirement benefit provided by a Minnesota public pension plan should be adequate during the period of retirement and that benefit adequacy at the time of retirement should be measured for an employee at age 65 with 30 years of service credit. A principal factor, but not the sole factor, in determining an adequate retirement benefit is the benefit accrual rate or rates that apply.

The Commission principles indicate that the Minnesota public pension plans only have an obligation to provide an adequate retirement benefit for career public employees who retire at the normal retirement age and, consequently, do not have an obligation to provide a fully adequate pension benefit to public employees who retire at an earlier age or who retire with less than a full public service career. The Principles indicate that retirement benefit adequacy should be determined on the basis of the person's highest five successive years' average salary and should be measured at the generally applicable normal retirement age with 30 years of service credit. The Principles also indicate that retirement benefit adequacy must be a function of the public pension plan retirement benefit and Social Security benefits earned during public employment.

If pre-retirement income replacement rates are a well-designed measure of benefit adequacy, a replacement ratio target for a 30-years-of-service public employee at the normal retirement age provides a mechanism for determining the appropriate benefit accrual rate or rates.

In 1980-1981, the President's Commission on Pension Policy addressed the question of benefit adequacy, indicating that the replacement of pre-retirement disposable income from all sources is a desirable retirement income goal. That panel indicated that the precise replacement of pre-retirement disposable income was too difficult to quantify, but that a reliable rough sense of the rates for the replacement of gross immediate pre-retirement income can be identified, as follows:

Gross Pre-Retirement	Single Person Replacement of Gross Pre-Retirement Income		Married Couple Replacement of Gross Pre-Retirement Income	
Income	As $ amount	As %	As $ amount	As %
$ 6,500	$ 5,167	79%	$ 5,567	86%
10,000	7,272	73	7,786	78
15,000	9,941	66	10,684	71
20,000	12,282	61	13,185	66
30,000	17,391	58	18,062	60
50,000	25,675	51	27,384	55

Derived from Tables 19 and 20 of Coming of Age: Toward a National Retirement Income Policy, Report of the President's Commission on Pension Policy, prepared by Preston C. Bassett, Consulting Actuary (1980).

More recently, addressing the same question of the replacement percentage of pre-retirement earnings, the National Retirement Income Policy Committee of the American Society of Pension Actuaries, in a 1994 study, recommended that income during retirement from a combination of defined benefit plans, defined contribution plans, and Social Security should provide between 70 percent and 80 percent of pre-retirement earnings.

As part of research published in 1993 for the American Society of Pension Actuaries, a target pre-retirement income replacement ratio was suggested of combining two parts, one part 85 percent of the final year's rate of pay up to an amount equal to 300 percent of the poverty rate and the other part 70 percent of the final year's rate of pay in excess of an amount equal to 300 percent of the poverty rate. Translating the replacement ratio suggested by the 1993 American Society of Pension Actuaries study into a comparable table to that of the 1980-1981 President's Commission on Pension Policy provides the following table:

Gross Pre-Retirement	Single Person Replacement of Gross Pre-Retirement Income		Married Couple Replacement of Gross Pre-Retirement Income	
Income	As $ amount	As %	As $ amount	As %
$ 30,000	$25,000.00	84.0%	$ 25,500.00	85.0%
50,000	39,189.50	78.4	40,620.50	81.2
70,000	53,189.50	76.0	54,620.50	78.0
90,000	67,189.50	74.7	68,620.50	76.2
150,000	109,189.50	72.8	110,620.50	73.7
200,000	144,189.50	72.1	145,620.50	72.8
250,000	179,189.50	71.7	180,620.50	72.2

In 1997, Flora L. Williams and Helen Zhou, of Purdue University and Deloitte & Touche LLP, respectively, in "Income and Expenditures in Two Phases of Retirement," surveyed the basis for generalization in the literature about replacement ratio goals and compared three other research reports, as follows:

	Replacement Rate Percentages		
Pre-Retirement Income	*Employee Benefit Plan Review* Report (1990)	Alexander & Alexander Consulting Group Report (1993)	Bruce A. Palmer, Ph.D. Georgia State University Report (1989)
$15,000	78%	82%	82%
20,000	71	76	
25,000	65		71
35,000	55		
40,000		71	68
45,000	50		
55,000	46		
60,000		72	66
80,000		76	68

Note: While not specifically disclosed in the paper, the results appear to relate to a single individual rather than to a couple.

In 1998, Glenn Cooper and Peter Scherer, in the Organization for Economic Cooperation and Development article "Can We Afford to Grow Old," compare replacement ratios in total and replacement ratios for Social Security-akin programs across various countries, concluding that the replacement target for couples in the United States ranges between 70 percent and 90 percent of the pre-retirement income level.

In 1999, the National Endowment for Financial Education, adapting the work of Kenn Tacchino and Cynthia Saltzman, professors at Widener College, suggested that retiree expenses decrease as retirees get older, suggested that a blended income replacement rate is an appropriate measure, and indicated an 80 percent replacement rate at retirement translates to a 69.3 percent replacement rate if the retiree lives for 30 years after retirement.

In 2003, Karen Ellers Lahey, Doseong Kim, and Melinda L. Newman, in the article "Household Income, Asset Allocation, and the Retirement Decision" in the Financial Services Review concluded that the applicable literature on the retirement income replacement target indicates a result between 70 percent and 90 percent.

In 2004, the California State Teachers Retirement System (CalSTRS) conducted a study of the necessary replacement ratio for its retirees, concluding that a range of between 81 percent and 88 percent of pre-retirement income is necessary if the former employer provides the same health care insurance funding to retirees as provided to current employees and a higher percentage replacement if the former employer does not provide the same level of health care insurance funding for retirees.

Also in 2004, Aon Consulting and the Georgia State University released its sixth update of a study of retirement income needs for a retired couple, with an age 65 wage earner and an age 62 spouse. The following compares the 2004 results with the Aon Consulting/Georgia State University 2001 results:

Pre-Retirement Income Level	2001 Replacement Ratio	2004 Replacement Ratio
$20,000	83%	89%
30,000	78	84
40,000	76	80
50,000	74	77
60,000	75	75
70,000	75	76
80,000	75	77
90,000	76	78
150,000	85	85
200,000	86	88
250,000	87	88

Source: Replacement Ratio Study: A Measurement Tool for Retirement Planning.

In 2005, John E. Bartel of Bartel Associates LLC, conducted a replacement ratio study presentation for the League of California Cities that summarized the results of a 2001 California Public Employee Retirement System (CalPERS) target replacement ratio study, summarized the 2004 Aon/Georgia State University replacement ratio study and compared the two for both general California employees and public safety California employees. The CalPERS replacement ratio study indicated a range of ratios (with and without Social Security and public safety), as follows:

Pre-Retirement Income Level	Target Replacement Ratio Range	With Social Security Actual Replacement Ratio Range	Without Social Security Actual Replacement Ratio Range
$ 30,000	73-81%	95-107%	70-81%
40,000	67-75	90-100	68-75
50,000	64-71	86-95	66-71
60,000	61-73	80-89	65-70
70,000	57-65	75-83	64-68
80,000	56-63	70-80	63-67
90,000	55-62	66-78	62-66

The Bartel analysis concludes that for CalPERS plans without Social Security coverage, the actual replacement ratio is a close match to the CalPERS target, but falls below the 2004 Aon/Georgia State University study replacement result for general employees and is a close match for public safety employees, and that for CalPERS plans with Social Security coverage, the actual replacement ratio significantly exceeds the CalPERS target, but is a close match to the 2004 Aon/Georgia State University study replacement result for general employees and greatly exceeds the Aon/Georgia State University study replacement result for public safety employees. The CalPERS study and the Bartel analysis looked only at the Social Security benefit derived from public employment, if any, and the public pension plan coverage, without considering any benefit derived from personal savings and investments.

Although the replacement ratio approach is conceptually simple and is relatively easy to translate into a benefit accrual rate or rates, it is not the only way to measure adequacy at the time of retirement and does not necessarily address the relationship between retirement age benefit adequacy and retirement benefit adequacy needs after retirement.

All of the replacement ratio results summarized above suggest that the target or appropriate ratio differs over the range of compensation, generally with the highest replacement ratio being at the lowest compensation portion of the range, differs based on age, and differs based on marital status. These differences are largely based on features of the Social Security program, which is part of virtually all private sector retirement benefit coverage and which is generally applicable to public sector retirement benefit coverage. Social Security, created in the depths of the Great Depression of the early 1930s, attempted to eliminate old people as the greatest segment of the population in poverty by providing older workers and their spouses with a subsistence income.

While Social Security attempts to provide a subsistence income safety net, the purest rendition of a pre-retirement income replacement ratio represents an attempt to maintain the pre-retirement standard of living. While the Minnesota Legislative Commission on Pensions and Retirement has not specifically articulated its retirement benefit adequacy goal, in practice, the Commission's goal has been to provide a reasonable margin above subsistence that, combined with personal savings or other investments, would allow the retired individual or couple to retain a reasonable standard of living in retirement after completing a normal working career.

The President's Commission on Pension Policy also attempted to provide a sense of the relative role of the three sources of retirement income in providing an adequate benefit in the form of the replacement of pre-retirement disposable income. The three sources of retirement income are Social Security, employee pension coverage, and personal savings and investments. That panel's 1981 report included a chart that attempted to provide a general sense of the relative contribution to an adequate retirement benefit that should be made from the three sources, as follows:

Relative Contribution to an Adequate Retirement Benefit
from Various Sources of Retirement Income

Gross Pre-Retirement Income	Social Security	Employee Pension Plan	Personal Savings and Investments
$15,000	58%	42%	0%
20,000	54	46	0
25,000	54	46	0
30,000	52	44	4
35,000	49	44	7
40,000	46	46	8
45,000	43	47	10
50,000	42	46	12
55,000	40	45	15
60,000	39	41	20

Derived from Chart 7 of Coming of Age: Toward a National Retirement Income Policy, Report of the President's Commission on Pension Policy (1981)

The table reflects the weighting of benefit coverage in favor of the lower compensated employees present in Social Security coverage and reflects a policy decision that personal savings should provide an ever greater proportion of total retirement income at higher compensation levels. The table also reflects an ever-smaller replacement percentage required from Social Security and the employee pension plan as gross income increases.

The pre-retirement replacement ratio model of retirement benefit adequacy also has been challenged by commentators based on a more differentiated or nuanced view of income needs during retirement. The replacement ratio model assumes that the need for retirement income is unchanged during retirement, requiring only that the cost of living be replaced or substantially replaced after retirement. Some commentators have applied the life cycle hypothesis of consumption levels to the notion of retirement adequacy. In 1997, in "Income and Expenditures in Two Phases of Retirement," Flora L. Williams and Helen Zhou reviewed the empirical bases for the "common guideline" of a 70 percent pre-retirement income replacement ratio, finding that there was little empirical evidence to support that guideline, and reviewed consumption pattern surveys for periods ages 45-75 and over, identifying two retirement phases (phase 1: ages 65-74 and phase 2: ages 75 and over) with decidedly different expenditure levels. In 2005, in "Age Bonding: A Model for Planning Retirement Needs," Somnath Basu suggests that expenditure patterns need to be analyzed for the 30-year period that a retiree is likely to receive benefits, looking at each of the three decades, and finds that leisure expenses are initially high and decline over the retirement period, that health care expenses initially rival leisure expenditures and grow significantly over the retirement period, that basic living expenses are initially the greatest portion of expenditures and halve over the retirement period, and that taxes are initially the second greatest expenditure item and remain relatively constant over the retirement period. In 2006, in "Change in Retirement Adequacy, 1995-2001: Accounting for Stages of Retirement," Chen-Chung Chen and Sherman D. Hanna criticize prior retirement adequacy studies has having ignored the complexities of retirement stages and suggest multiple stages, which is any period during retirement when real income is constant. In Spring 2006, the Society of Actuaries issued a call for papers on the topic of retirement spending and changing needs during the retirement period, indicating that the prior uniform pre-retirement income replacement model fails to recognize early retirement, post-retirement employment during the initial retirement period, the payment of lump sum retirement benefits, and the general elimination of early retirement subsidies, especially health care insurance coverage. The Society of Actuaries indicated that it will review submitted papers, present the papers at a conference in May 2007, and then publish the papers later in 2007.

d. Potential Principle Amendment. The 1995-1996 Principles of Pension Policy do not specifically address the role of marital status in determining the adequacy of a pension benefit at the time of retirement, which relates to the 2001 additional retirement benefit granted for Minneapolis Firefighters Relief Association retirees who were single.

If the Commission desires to clarify the principle, and make some other grammatical and language usage improvements, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.C.7. Adequacy of Benefits at Retirement

a. Benefit adequacy requires that retirement benefits respond to economic changes ~~in the economy~~ that affect public employees prior to retirement.

b. The retirement benefit should be adequate at the time of retirement.

c. Except for local police or firefighter relief associations, the retirement benefit should be related to an individual's final average salary, ~~determined on the basis of~~ which should be the highest five successive years' average salary unless a different averaging period is designated by the Legislature.

d. Except for local police or firefighter relief associations, the measure of retirement benefit adequacy should be ~~at~~ determined based on a public employment career of a minimum of thirty years of service, which would be a reasonable public employment career, and at the generally applicable normal retirement age.

e. Retirement benefit adequacy must be a function of the combination of the Minnesota public pension plan benefit and any Social Security benefit payable on account of Minnesota public employment.

f. Retirement benefit adequacy should be determined on the basis of a single life annuity.

Policy Principle Review: Principle II.C.8. Post-Retirement Benefit Adequacy

a. Principle II.C.8. indicates that the primary purpose for post-retirement adjustments is to replace the impact of inflation on previously adequate retirement benefits, that the adjustment mechanism should be funded on an actuarial basis, and that the inflation measure should be based on a valid recognized economic indicator. Specifically, the principle states:

II.C.8. Post-Retirement Benefit Adequacy

a. The retirement benefit should be adequate during the period of retirement.

b. Post-retirement benefit adequacy should function to replace the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement.

c. The system of periodic post-retirement increases should be funded on an actuarial basis.

d. In order to replace inflation, the post-retirement adjustment system should follow a valid recognized economic indicator.

b. Recent Variant Public Pension Legislation. Six items of 1997-2007 pension legislation are potentially at variance with the principle to some degree:

1. In 1997, the Consumer Price Index component of the Minnesota Post Retirement Investment Fund statewide post-retirement adjustment mechanism was reduced by one percent as part of the funding for an increase in the benefit accrual rates of the various statewide retirement plans *(Laws 1997, Ch. 233, Art. 1, Sec. 5).*
2. Also in 1997, the thirteenth check lump sum post-retirement adjustment mechanism of the St. Paul Teachers Retirement Fund Association (SPTRFA) was replaced by an annual annuitized post-retirement adjustment mechanism, funded from SPTRFA investment actuarial gains *(Laws 1997, Ch. 233, Art. 3, Sec. 7 and 10).*
3. Additionally, in 1997, the Minneapolis Police Relief Association and the Minneapolis Firefighters Relief Association thirteenth check post-retirement adjustment mechanism was modified, increasing the amount of investment gain for distribution and expanding the definition of excess income *(Laws 1997, Ch. 233, Art. 4, Sec. 1, 8-10, and 13-16).*
4. In 1999, a "thirteenth check" post-retirement adjustment mechanism based on relief association investment actuarial gains was created in addition to the existing post-retirement escalator (indexation to the salary of a top grade police officer) for the Fairmont Police Relief Association *(Laws 1999, Ch. 222, Art. 3, Sec. 3).*
5. In 2000, additional "thirteenth check" post-retirement adjustment mechanisms funded from a portion of relief association assets in excess of a 110 percent funding ratio were created for the Minneapolis Police Relief Association and the Minneapolis Firefighters Relief Association *(Laws 2000, Ch. 461, Art. 17, Sec. 1-2 and 7-9).*
6. In 2006, effective July 1, 2010, total post-retirement increases applicable to all plans invested through the Minnesota Post Retirement Investment Fund cannot exceed five percent annually *(Laws 2006, Ch. 277, Art. 1, Sec. 1 and 3).*

c. Policy Analysis and Discussion. The 1995-1996 Principles of Pension Policy reaffirmed the post-retirement adjustment preferences of the 1980 Principles, which specified that a public retirement benefit should remain adequate during the period of retirement, and extended the policy by indicating that post-retirement benefit adequacy should offset the effects of inflation, that any post-retirement adjustment mechanism should follow a valid recognized economic indicator, and that the post-retirement adjustment mechanism should be funded on an actuarial basis.

Thus, the Principles indicate a goal of maintaining the adequacy of the public pension plan retirement benefit after the retirement, building on an assumption that the retirement benefit was adequate at the time of retirement. Post-retirement adjustments are essentially of two types, either making an inadequate retirement benefit adequate or more adequate during the course of retirement or functioning to retain the adequacy of an already adequate retirement benefit throughout the period of retirement. If a post-retirement adjustment is needed to gain retirement benefit adequacy which was previously lacking, that purpose is best accomplished by an ad hoc post-retirement adjustment. If a post-retirement adjustment is needed to maintain retirement benefit adequacy, that purpose is best accomplished by an automatic annual or periodic post-retirement adjustment mechanism.

The need to provide ad hoc post-retirement adjustments largely arises out of the enactment of implementation of active member retirement benefit increases that redefine what constitutes a retirement benefit that is adequate at the time of retirement. This was the case in the numerous ad hoc post-retirement adjustments that were provided to the statewide pension plan benefit recipients who retired prior to the substantial 1973 statewide retirement plan benefit improvements.

The need to provide automatic post-retirement adjustments generally arises out of actual inflationary forces or expected future inflation. The maintenance of benefit adequacy post-retirement adjustments is principally an outgrowth of the significant inflation that occurred during the late 1960s, 1970s, and early 1980s. The table below indicates the Consumer Price Index for all urban workers, all items, as of December of each year and in average for each year for the period 1913-2001, and demonstrates the relative lack of inflation other than 1916-1920, 1942-1948, 1951, 1969-1982, and 1990:

U.S. Department of Labor, Bureau of Labor Statistics
Consumer Price Index: All Urban Consumers – (CPI-U)
U.S. City Average - All Items (1982-84=100)

Year	Dec.	Avg.	Percent change Dec-Dec	Percent change Avg-Avg
1913	10.0	9.9		
1914	10.1	10.0	1.0	1.0
1915	10.3	10.1	2.0	1.0
1916	11.6	10.9	12.6	7.9
1917	13.7	12.8	18.1	17.4
1918	16.5	15.1	20.4	18.0
1919	18.9	17.3	14.5	14.6
1920	19.4	20.0	2.6	15.6
1921	17.3	17.9	-10.8	-10.5
1922	16.9	16.8	-2.3	-6.1
1923	17.3	17.1	2.4	1.8
1924	17.3	17.1	0.0	0.0
1925	17.9	17.5	3.5	2.3
1926	17.7	17.7	-1.1	1.1
1927	17.3	17.4	-2.3	-1.7
1928	17.1	17.1	-1.2	-1.7
1929	17.2	17.1	0.6	0.0
1930	16.1	16.7	-6.4	-2.3
1931	14.6	15.2	-9.3	-9.0
1932	13.1	13.7	-10.3	-9.9
1933	13.2	13.0	0.8	-5.1
1934	13.4	13.4	1.5	3.1
1935	13.8	13.7	3.0	2.2
1936	14.0	13.9	1.4	1.5
1937	14.4	14.4	2.9	3.6
1938	14.0	14.1	-2.8	-2.1
1939	14.0	13.9	0.0	-1.4
1940	14.1	14.0	0.7	0.7
1941	15.5	14.7	9.9	5.0
1942	16.9	16.3	9.0	10.9
1943	17.4	17.3	3.0	6.1
1944	17.8	17.6	2.3	1.7
1945	18.2	18.0	2.2	2.3
1946	21.5	19.5	18.1	8.3
1947	23.4	22.3	8.8	14.4
1948	24.1	24.1	3.0	8.1
1949	23.6	23.8	-2.1	-1.2
1950	25.0	24.1	5.9	1.3
1951	26.5	26.0	6.0	7.9
1952	26.7	26.5	0.8	1.9
1953	26.9	26.7	0.7	0.8
1954	26.7	26.9	-0.7	0.7
1955	26.8	26.8	0.4	-0.4
1956	27.6	27.2	3.0	1.5
1957	28.4	28.1	2.9	3.3
1958	28.9	28.9	1.8	2.8
1959	29.4	29.1	1.7	0.7
1960	29.8	29.6	1.4	1.7

Year	Dec.	Avg.	Percent change Dec-Dec	Percent change Avg-Avg
1961	30.0	29.9	0.7	1.0
1962	30.4	30.2	1.3	1.0
1963	30.9	30.6	1.6	1.3
1964	31.2	31.0	1.0	1.3
1965	31.8	31.5	1.9	1.6
1966	32.9	32.4	3.5	2.9
1967	33.9	33.4	3.0	3.1
1968	35.5	34.8	4.7	4.2
1969	37.7	36.7	6.2	5.5
1970	39.8	38.8	5.6	5.7
1971	41.1	40.5	3.3	4.4
1972	42.5	41.8	3.4	3.2
1973	46.2	44.4	8.7	6.2
1974	51.9	49.3	12.3	11.0
1975	55.5	53.8	6.9	9.1
1976	58.2	56.9	4.9	5.8
1977	62.1	60.6	6.7	6.5
1978	67.7	65.2	9.0	7.6
1979	76.7	72.6	13.3	11.3
1980	86.3	82.4	12.5	13.5
1981	94.0	90.9	8.9	10.3
1982	97.6	96.5	3.8	6.2
1983	101.3	99.6	3.8	3.2
1984	105.3	103.9	3.9	4.3
1985	109.3	107.6	3.8	3.6
1986	110.5	109.6	1.1	1.9
1987	115.4	113.6	4.4	3.6
1988	120.5	118.3	4.4	4.1
1989	126.1	124.0	4.6	4.8
1990	133.8	130.7	6.1	5.4
1991	137.9	136.2	3.1	4.2
1992	141.9	140.3	2.9	3.0
1993	145.8	144.5	2.7	3.0
1994	149.7	148.2	2.7	2.6
1995	153.5	152.4	2.5	2.8
1996	158.6	156.9	3.3	3.0
1997	161.3	160.5	1.7	2.3
1998	163.9	163.0	1.6	1.6
1999	168.3	166.6	2.7	2.2
2000	174.0	172.2	3.4	3.4
2001	176.7	177.1	1.6	2.8
2002	180.9	179.9	2.4	1.6
2003	184.3	184.0	2.9	2.2
2004	190.3	188.9	3.3	2.7
2005	196.8	195.3	3.4	3.4
2006	201.8	201.6	2.5	3.2
2007	208.3	205.7	3.2	2.0

The significant inflation in the late 1960s led to the creation of the Minnesota Adjustable Fixed Benefit Fund, a predecessor to the Minnesota Post Retirement Investment Fund, in 1969. However, until 1992, the Minnesota Post Retirement Investment Fund had no inflation measure and it based post-retirement adjustments wholly on investment income (dividends, interest and net realized gains or losses) in excess of a five percent post-retirement interest rate assumption. Investment returns and inflation do not necessarily correlate well, as the experience since the 1974 recession indicates. In 1992, with a revision in the Minnesota Post Retirement Investment Fund, the annual automatic post-retirement adjustment was separated into two parts, with one based on the increase in the consumer Price Index (CPI) up to 3.5 percent until 1997 and up to 2.5 percent after 1996, and with one based on the investment performance (total rate of return) in excess of a five percent interest rate plus the actuarial reserves arising from the CPI-based adjustment. The post-1991 version of the Minnesota Post Retirement Investment Fund will only maintain the adequacy of retirement annuities if inflation is under 2.5 percent annually, or if investment performance and greater inflation happen to correlate well, or if the Consumer Price Index overstates actual retiree inflation, as some economists have recently asserted, and if the actual post-retirement adjustments match the actual, but apparently unmeasured, retiree inflation.

Other post-retirement adjustment mechanisms similarly have potential inabilities to maintain post-retirement benefit adequacy. The Duluth Teachers Retirement Fund Association (DTRFA) and St. Paul Teachers Retirement Fund Association (SPTRFA) post-retirement adjustment mechanisms are not related to any measure of inflation, but provide compounding increases. The Minneapolis Employees Retirement Fund (MERF) Retirement Benefit Fund duplicates the pre-1997 Minnesota Post Retirement Investment Fund, administered by the MERF Board, and has the same potential shortfalls as the Minnesota Post Retirement Investment Fund. The four remaining local police and paid firefighter relief associations use escalation, where the retirement benefit increase is based on the wage increases granted to a particular public safety employment position, thus dependent on the collective bargaining process. Three of the four local police and paid firefighters relief associations also have additional investment performance-related "thirteenth check" post-retirement adjustments.

d. Potential Principle Amendment. Although the Commission's pension policy principles identify a goal of basing post-retirement adjustments on the change in a valid recognized economic indicator, in practice Minnesota post-retirement adjustment mechanisms have actually been based primarily on actuarial gains (usually investment gains) rather than any measure of inflation and its effect on retiree standards of living. The 1997, 1999, 2000, and 2006 legislative changes relating to post-retirement adjustments continue that same pattern.

If the Commission desires to have this policy principle reflect actual practice during the period 1969-2007, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.C.8. Post-Retirement Benefit ~~Adequacy~~ Increases

a. The retirement benefit should be ~~adequate~~ subject to periodic increases during the period of retirement.

b. Post-retirement benefit ~~adequacy~~ increases should function to ~~replace the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement~~ share any advantageous investment performance of the retirement fund.

c. The ~~system of~~ periodic post-retirement increases should be funded on an actuarial basis.

d. ~~In order to replace inflation,~~ The post-retirement adjustment system should ~~follow a valid recognized economic indicator~~ allocate investment performance in excess of the applicable post-retirement interest assumption in a manner that attempts to smooth out increases over time.

Policy Principle Review: Principle II.C.10. Purchases of Prior Service Credit

a. Principle II.C.10. suggests that the purchase of service credit in a defined benefit plan for prior periods of time should only be permitted if the period is either public employment or is substantially akin to public employment, if the service period for purchase has a significant connection to Minnesota, if the purchase is funded either from member payments or a combination of member and employer payments, if the purchase payment is the full actuarial value without a pension plan subsidy, and if the purchase does not offend equity notions. Specifically, the principle provides:

II.C.10. Purchases of Prior Service Credit

Purchases of public pension plan credit for periods of prior service should be permitted only if, on a case-by-case basis, it is determined that the period to be purchased is public employment or substantially akin to public employment, that the prior service period must have a significant connection to Minnesota, that the purchase payment from the member or from a combination of the member and the employer must equal the actuarial liability to be incurred by the pension plan for the benefit associated with the purchase, appropriately calculated, without the provision of a subsidy from the pension plan, and that the purchase must not violate notions of equity.

b. Recent Variant Public Pension Legislation. Twenty-two items of 1997-2007 pension legislation are potentially at variance with the principle.

1. In 1998, a new service credit purchase payment amount determination process, developed by the consulting actuary retained by the Legislative Commission on Pensions and Retirement at the apparent instigation of the Teachers Retirement Association (TRA), was enacted on a temporary demonstration basis *(Laws 1998, Ch. 390, Art. 4, Sec. 1-2)*.

2. In 1999, TRA and first class city teacher retirement fund association members were granted temporary authority to purchase service credit for previously unpurchased interim military service, prior military service, out-of-state teaching service, maternity leaves, maternity breaks-in-employment parochial and private school teaching service, Peace Corps or VISTA service, and charter school teaching *(Laws 1999, Ch. 222, Art. 16, Sec. 1-12)*.

3. Also, in 1999, Minneapolis Teachers Retirement Fund Association members were granted temporary authority to purchase service credit for previously uncredited part-time teaching service *(Laws 1999, Ch. 222, Art. 16, Sec. 13)*.

4. In 2000, MSRS-General and PERA-General members were granted temporary authority to purchase service credit for previously unpurchased interim military service or for prior military service *(Laws 2000, Ch. 461, Art. 4, Sec. 1, 3, and 4)*.
5. Also in 2000, TRA and first class city teacher retirement fund association members were granted temporary authority to purchase service credit for nonprofit corporation teaching service *(Laws 2000, Ch. 461, Art. 11, Sec. 3 and 5)*.
6. In 2001, the Joint Subcommittee on Claims approved a claim for a St. Paul police officer who previously served in the Department of Public Safety for a service credit purchase and appropriated a substantial portion of the payment requirement *(Laws 2001, Ch. 169, Sec. 5)*.
7. Also in 2001, TRA and first class city teacher retirement fund association members were granted expanded temporary authority to purchase service credit for foreign teaching service and tribal teaching service *(First Special Session Laws 2001, Ch. 10, Art. 5, Sec. 5 and 11)*.
8. Additionally in 2001, Minnesota State Colleges and Universities System (MnSCU) faculty members who were members of the Individual Retirement Account Plan and were deferred vested TRA or first class city teacher retirement fund association members were authorized to purchase defined benefit plan service credit *(First Special Session Laws 2001, Ch. 10, Art. 6, Sec. 9 and 15)*.
9. Also in 2001, TRA and first class city teacher retirement fund association members were granted temporary authority to purchase service credit for prior University of Minnesota teaching service. In 2001, additionally, TRA and first class city teacher retirement fund association members were granted temporary authority to purchase service credit for Development Achievement Center service *(First Special Session Laws 2001, Ch. 10, Art. 6, Sec. 6 and 12)*.
10. Also, in 2001, members of every Minnesota defined benefit plan other than a volunteer firefighter relief association were granted temporary authority to purchase service for family leaves, parental leaves, or parental breaks-in-employment *(First Special Session Laws 2001, Ch. 10, Art. 3, Sec. 2)*.
11. Additionally, 2001, a White Bear Lake school teacher with prior uncredited school district clerical employment was granted service credit for that clerical service at school district expense, without any member contribution requirement *(First Special Session Laws 2001, Ch. 10, Art. 17, Sec. 3)*.
12. In 2001, also, the temporary service credit purchase provisions enacted in 1999 and 2000 were extended for one year *(First Special Session Laws 2001, Ch. 10, Art. 6, Sec. 16)*.
13. In 2002, a further one-year extension in the various 1999-2001 prior service credit purchase provision was granted *(Laws 2002, Ch. 392, Art. 7, Sec. 1)*.
14. In 2003, another extension in the expiration date for the various 1999-2001 prior service credit purchase provisions was provided *(Laws 2003, First Special Session, Ch. 12, Art. 6, Sec. 1-5 and 7)*.
15. In 2004, the full actuarial value service credit provisions for military service for the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA), and the Teachers Retirement Association (TRA), were extended to 2006 *(Laws 2004, Ch. 267, Art. 17, Sec. 1, 3, 4, 6, and 7)*.
16. In 2005, members of the Judges Retirement Plan were permitted to obtain service credit for a leave of absence of any duration with the payment of an amount equal to the plan normal cost applied to the judge's salary upon return from the leave, plus interest, and the authority expires one year after the conclusion of the leave *(Laws 2005, First Special Session, Ch. 8, Art. 2, Sec. 2 and 8)*.
17. Also in 2005, as part of newly enacted authority for the acquisition of service credit for strike periods, payment of equivalent contribution amounts plus interest were permitted within the first year after the strike, with a full actuarial value service credit purchase required after the first year and no service credit acquisition authorized after five years has elapsed since the conclusion of the strike *(Laws 2005, First Special Session, Ch. 8, Art. 2, Sec. 1, 5-8)*.
18. Again in 2005, the military service full actuarial value service credit purchase provisions were extended from 2006 to 2007 *(Laws 2005, First Special Session, Ch. 8, Art. 2, Sec. 3-4)*.
19. Additionally in 2005, the full actuarial value service credit purchase methodology was refined and clarified with the addition of a recognition of Combined Service Annuity portability impacts in the calculation and the establishment of a minimum purchase payment amount *(Laws 2005, First Special Session, Ch. 8, Art. 10, Sec. 65)*.
20. In 2006, some individuals transferred from coverage by the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) to the Correctional State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Correctional) were

permitted to transfer past service credit with the individual's financial responsibility limited to the increment of additional required member contributions and leaving the remaining unfunded actuarial accrued liability attributable to the service credit transfer to be amortized by the employing unit within the existing contribution structure *(Laws 2006, Ch. 271, Art. 2, Sec. 12).*

21. In 2007, the MSRS-Correctional/MSRS-General service credit transfer financial requirement was revisited, revised and codified for future application, with additional member and employer funding responsibility for additional contribution increments for pre-July 1, 2007, coverage transfers and m ember and employer full actuarial value funding for post-June 30, 2007, coverage transfers *(Laws 2007, Ch. 134, Art. 3, Sec. 5).*

22. Also in 2007, the Teachers Retirement Association (TRA) procedures for the payment for strike periods and leaves of absence were revised to permit equivalent contribution-rate-based payments during the initial year after the event and a full actuarial value payment thereafter *(Laws 2007, Ch. 134, Art. 2, Sec. 31-35 and 41-42).*

The 1998-1999 prior service credit purchase legislation and subsequent extensions or revisions differ from the policy principles in that the legislation was often generalized authority rather than a case-by-case determination, did not always require that the period of service for purchase be public employment or significantly akin to public employment, did not always require that the purchase period have a significant Minnesota connection, did not always require member participation in the purchase, may involve the provision of a net subsidy from the pension plan to the purchasers, may involve the provision of a substantial subsidy from the pension plan for some types of purchasers, and did not appear to always involve any rigorous formal application of equitable considerations. As a means for the acquisition of service credit outside the normal employment setting, leave of absence and service credit transfer provision blue into service credit purchases, with the funding requirements frequently different for each.

c. Policy Analysis and Discussion. Prior service credit purchases are wholly a phenomenon of defined benefit pension plans, which are pension plans that fix the variable of the pension benefit amount, typically through the use of a formula based on the amount of compensation and on the length of service, and that leave the variable of the pension funding cost to be determined through the actuarial valuation process.

Prior service credit purchases are opportunities for pension plan members to obtain allowable service credit, and, if applicable, covered salary credit, in a pension plan for a period that was not otherwise credited through normal pension plan membership. There is typically a process to be followed in obtaining credit for a prior service credit purchase period, usually involving the payment of some amount to defray all or a portion of the actuarial cost attributable to the purchase and the provision of documentation relating to the service period.

Prior service credit purchases are sought by pension plan members for a variety of reasons, including a desire to gain defined benefit pension plan portability, a desire to obtain a larger pension benefit, or a desire to qualify for a special retirement provision. Public pension service credit purchases also are permitted by pension plan sponsors for a variety of reasons, including a desire to allow some otherwise unobtainable portability, a desire to correct for some service crediting deficiency, or a desire to cover service rendered prior to the creation of the pension plan.

The 1980 Principles did not address prior service credit purchases, but the 1995-1996 Principles codified the policy that the Legislative Commission on Pensions and Retirement (LCPR) had developed during the late 1970s and the 1980s. The 1995-1996 principle on service credit purchases has the following elements:

1. Individual Review. The Commission considers each service credit purchase request separately, whether the request is proposed legislation for a single person or is proposed legislation relating to a group of similarly situated individuals.

2. Public Employment. The period requested for purchase should be a period of public employment, or service that is substantially akin to public employment. This is consistent with the notion that public pension plans should be providing coverage for public employees for periods of time where they were serving the public through public employment or through quasi-public employment. Coverage for a period where an individual provided private sector employment is not consistent with this aspect of the principle.

3. Minnesota Connection. The employment period to be purchased should have a significant Minnesota connection. This is consistent with the notion that Minnesota taxpayers support these public pension plans and bear the investment risk in amassing plan assets. Given the support that

taxpayers provide, it is appropriate that the service have a Minnesota connection, reflecting services provided to the people in the state.

4. <u>Presumption of Active Member Status at the Time of Purchase</u>. There should be contributions from the member, or in combination from the member and employer. There is a consequent presumption that the individual covered by the service purchase request is an active employee. Active plan members contribute to the plan, and certainly once an employee terminates service or retires from public employment, the former public employee no longer has a public employer. If there are unresolved issues of whether an individual should have service credit for a given period, those issues should be resolved before the individual terminates from public service, and certainly before the individual retires. The act of retiring undermines a claim that there is sufficient need for the Legislature to consider the coverage issue. If there were a considerable hardship caused by the lack of service credit for the period under consideration, presumably the individual would not have retired. Entering retirement suggests that the associated pension benefit is adequate without any further increase in the benefit level due to a purchase. Only on very rare occasions have the Commission and the Legislature previously authorized service credit purchases by retirees.

5. <u>Presumption of Purchase in a Defined Benefit Plan</u>. The prior service credit purchase contributions in total should match the associated actuarial liability. The specific procedures in Minnesota statutes and law for computing service credit purchase amounts, Minnesota Statutes, Sections 356.55 and 356.551, presume that the purchase is in a defined benefit plan with a benefit based on the individual's high-five average salary. There is no process in law specifying a procedure for computing a "full actuarial value" purchase in a defined contribution plan, or even defining what that concept means in the context of a service purchase or service credit purchase in a defined contribution plan.

6. <u>Full Actuarial Value Purchase</u>. Within the context of a defined benefit plan, the pension fund should receive a payment from the employee or from the employee and employer in combination, an amount which equals the additional liability placed on the fund due to the purchase. This is referred to as the full actuarial value of the service credit purchase. The procedure used to compute this full actuarial value should be a methodology that accurately estimates the proper amounts. The Commission has purposely departed from the full actuarial value requirement when there is evidence that the pension plan administration created the lack of service credit coverage do to pension plan administration error. In situations of pension plan error, the employee may be required to pay the contributions that would have been required for the relevant time period, plus 8.5 percent interest to adjust for the time value of money and any difference between the payment and the full actuarial value would be absorbed by the pension fund. Where there is clear evidence that the employing unit committed an error which caused the individual to not receive pension plan coverage, the Commission has permitted the employee to make the employee contribution for the relevant time period, plus 8.5 percent interest, and the employer has been mandated to cover the remainder of the computed full actuarial value payment rather than simply permitted to pay that portion of the potential purchase payment total it chooses. If the employer does not directly make the payment following notification by the retirement plan that the employee has made his or her portion of the full payment, the Commission has required that a sufficient amount to cover the remainder of the full actuarial value is deducted from any state aids that would otherwise be transmitted to the employer.

7. <u>No Violation of Equity Considerations</u>. Purchases of service credit should not violate equity considerations. Equity is a resort to general principles of fairness and justice whenever the existing law is inadequate. Requests by existing retirees to purchase additional service credit and have their annuities recomputed could be viewed as being a situation that violated equity considerations. New requests on behalf of individuals who were covered by purchase of service credit authorizations passed by earlier Legislatures but who are dissatisfied with the purchase of service credit terms that were provided at that time can be considered as violating equity considerations. Individuals requesting service credit purchases for periods specifically excluded from plan coverage under the applicable law could also be considered as violating equity considerations, among other policy concerns relating to those considerations. Long delays in seeking remedial action can also be considered a violation of equity considerations. Individuals tend to wait until late in their career before seeking any remedial action for lost service credit. Prompt action, closer to the time period when the service credit problem occurred, would often result in a solution at lower cost and would avoid efforts to try to determine the factual situation by the Commission many years, or even decades, after the event occurred. In general, any issue or factor associated with a service credit purchase request which can be viewed as lacking fairness or being less than impartial can be a basis for rejecting a request.

The general purchase of service credit legislation enacted in 1999, 2000, and 2001 conflicted with the Commission policy as stated in the 1995-1996 Commission Statement of Pension Principles. Perhaps the 1999-2001 service credit purchase legislation should be viewed as reflecting an evolution and a permanent change in Commission policy. The 1999-2001 legislation also may be viewed as temporary provisions to address a short-term labor shortage situation, warranting a temporary waiver of the standard Commission purchase of service credit policy.

d. Potential Principle Amendment. Because of the significant departures from the 1995-1996 pension policy principles that occurred in 1998-2007, if those changes represent a permanent change in policy rather than a temporary interruption in the prior policy, a major revision in the 1995-1996 principle would be appropriate.

If the Commission desires to incorporate the 1998-2007 prior service credit purchase legislation elements into its policy principle on this topic, the Commission staff offers the following potential revision in the 1995-1996 principle:

II.C.10. Purchases of Prior Service Credit

Purchases of public pension plan credit for periods of prior service should be permitted only if~~, on a case-by-case basis,~~ it is determined by the Commission:

- that the period to be purchased is public employment or relates substantially ~~akin~~ to the public ~~employment~~ employee's career,
- ~~that the prior service period must have a significant connection to Minnesota,~~ that the purchase payment amount from the member or from a combination of the member and the current or former employer must equal the actuarial liability to be incurred by the pension plan for the benefit associated with the purchase, appropriately calculated, and without the provision of a subsidy from the pension plan unless an error or an omission by the pension plan was responsible for the loss of service credit,
- that the purchase payment amount must include a minimum payment by the member of the equivalent member contributions, plus compound interest from the purchase period to the date of payment unless the employer committed a particularly egregious error,
- that the purchase payment is the responsibility of the member, with the current or former employer authorized to pay some or all of the portion of the payment amount in excess of the minimum member payment amount, unless the employer has some culpability in the circumstances giving rise to the purchase and then a mandatory employer contribution may be imposed, and
- that the purchase must not violate notions of equity.

Policy Principle Review: Principle II.C.13. Reopening Optional Annuity Elections

a. Principle II.C.13. indicates that retirees with an optional annuity form should not be able to reopen that optional annuity election. Specifically, the principle provides:

II.C.13. Reopening Optional Annuity Elections

Reopenings of optional annuity elections should not be permitted.

b. Recent Variant Public Pension Legislation. One item of 1997-2007 pension legislation is potentially at variance with the principle. In 2000, language that specified that TRA's Social Security leveling optional annuity form is not revocable was removed *(Laws 2000, Ch. 461, Art. 3, Sec. 34)*.

c. Policy Analysis and Discussion. Most statewide and major local Minnesota public pension plans provide a retirement annuity in the form of a single life annuity. This means that the retirement annuity is payable solely for the duration of the retired lifetime of the annuitant. To accommodate the needs and desires of annuitants, most major and statewide Minnesota public pension plans have established optional annuity forms.

An optional annuity form allows the annuitant to potentially extend the time period over which an annuity will be paid and to potentially include other recipients. The recipients must be natural persons, rather than legal persons (trusts or corporations), so that there is an actual lifetime over which the value can be predicted. The optional annuity form is typically provided on an actuarial equivalent basis, so the longer period of potential payment or the inclusion of additional recipients is accounted for by a reduced annuity amount. The most typical optional annuity forms are joint-and-survivor optional annuities or term-certain optional annuities. A joint-and-survivor optional annuity pays a reduced annuity amount to the annuitant, but upon the death of the primary annuitant, all or a portion of the prior monthly benefit continues to be paid for the remaining life of the designated survivor. Joint-and-survivor annuities are often elected by married couples to ensure continued income for the surviving spouse. The amount of the reduction is a function of the actuarial life expectancy of the annuitant, the actuarial life expectancy of the potential survivor, and the extent of the increased benefit payment duration caused by the differences in the ages. A term-certain optional annuity pays a reduced annuity amount to the annuitant, and if the annuitant dies before a designated period of time of receipt has elapsed, an equal annuity amount to the annuitant's survivors or estate for the remaining unelapsed period of time. The amount of the reduction is a function of the actuarial life expectancy of the annuitant and the length of the period of guaranteed annuity payments. An accelerated annuity (or Social Security leveling optional annuity) provides a benefit in a greater amount during the initial years of retirement, followed by a lower benefit amount for the remainder of the retired lifetime. An accelerated annuity or a Social Security leveling optional annuity is typically intended to assist public employees who retire at ages earlier than when Social Security benefits are payable (earliest is age 62) or when full Social Security benefits are payable (age 65 if born earlier than 1938, increasing to age 67 if born later than 1959).

Optional annuity forms are likely elected by retirees or disabilitants for a number of potential motivations. The most clear motivation is a concern about the financial situation of a potential survivor (spouse, child, or other survivor) that underlies the selection of joint and survivor optional annuity forms. The motivation for the pre-age 62 accelerated optional annuity form is presumed to be an equalization of total benefit payouts over time to account for the delay in eligibility for Social Security benefits until age 62. The motivation for selecting term certain optional annuity forms is unclear. Because of its time limitations, the term certain optional annuity forms are not generally considered to be survivor benefits, although some term certain optional annuity forms may be utilized for specialized survivor coverage concerns. The motivation for selecting accelerated annuity forms is the accommodation of retirement ages earlier than the earliest Social Security benefit age of age 62.

The "bounceback" in a joint-and-survivor annuity means that the annuity amount returns from the joint and survivor actuarially reduced amount back to the single life annuity amount if the intended survivor predeceases the annuitant. The bounceback is subsidized because no additional actuarial reduction in the retiree's retirement annuity amount is required for the feature beyond the joint and survivor optional annuity form actuarial equivalence reduction. The bounceback feature has not been included as part of term-certain or other optional annuity forms.

Under Minnesota Statutes, Section 356.371, enacted in 1981, there is a procedure that must be followed in electing an optional retirement annuity. Public pension plans are required to provide the retiree and the retiree's spouse before retirement with a summary of all optional retirement annuity forms with the retirement application, a calculation of the benefit reduction required to take each option, and the procedure to be used to gain more information on optional forms, and to provide the retiree and the retiree's spouse with a post-election notification to the spouse of actual retirement election.

Since optional annuity forms are established to be the actuarial equivalent of a single life annuity at the time of retirement, any reopening of an optional election form will threaten to disrupt the actuarial situation under which the option was calculated. Also, since the optional annuity form election frequently establishes rights to a potential eventual retirement benefit in other people, any reopening of or any modifications in the optional annuity form will affect their rights and, consequently, would be inappropriate.

The 2000 administrative provisions submitted by TRA, as the Commission staff recollects the process, were not subjected to extensive scrutiny or debate by the Commission, so the Commission's intent in recommending the 2000 TRA change is unclear. In the brief explanatory comments provided by TRA for the 2000 optional annuity change, TRA indicated that the 2000 administrative provision "[p]ermits members who choose the age 62 accelerated payment option for their annuity to change this election within the two-month window provided for retirement application cancellations and annuity plan changes established by Board Policy. By deleting the irrevocability of this election, members are treated fairly and uniformly by the policy with this legislative change."

d. <u>Potential Principle Amendment</u>. Because the one legislative item that was inconsistent with the principles was not considered by the Commission in depth, it is unclear whether or not the 2000 legislation represents a clear policy change for the Commission.

If the Commission did intend the 2000 legislation to constitute a broader policy change, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.C.13. Reopening Optional Annuity Elections

Reopenings of optional annuity elections <u>after any normal election window established by the applicable governing board for annuity and benefit applications has elapsed</u> should not be permitted.

Policy Principle Review: Principle II.C.14. Benefit Increase Retroactivity

a. Principle II.C.14. indicates that benefit increases should not be made retroactive to retirees. Specifically, the principle states:

> II.C.14. Benefit Increase Retroactivity
>
> Retroactivity of benefit increases for retirees and other benefit recipients should not be permitted.

b. Recent Variant Public Pension Legislation. At least one item of 1997-2007 pension legislation is potentially at variance with the principle. In 1997, the increase in the service pension amount for the Minneapolis Firefighters Relief Association was made retroactive for existing service pension recipients *(Laws 1997, Ch. 241, Art. 2, Sect. 2 and 10)*.

c. Policy Analysis and Discussion. Benefit increase retroactivity refers to legislatively authorized extensions of benefit changes to persons who are already receiving benefits or to a past period of benefit receipt. Thus, a benefit increase can be extended to a current group of retirees or a benefit change can result in a recomputation of a person's existing benefit, either with or without back payments.

It is the general policy of the Legislature, set forth in statute as Minnesota Statutes, Section 645.21, that all laws are prospective in application unless the Legislature clearly specifies otherwise. In public pension law, the general principle is that the pension law in effect when a person terminates active service is the law under which benefit entitlements are determined.

The Commission does authorize retroactivity in making benefit changes on a case-by-case basis. Retroactivity is usually allowed if equitable considerations weigh in favor of retroactivity and some other pension policy is furthered by the retroactivity. Retroactivity is most frequently granted to correct some error that was not discovered until a person retired or to specially reward a person who identifies an unintended or unreasonable shortcoming in the current benefit plan and works to remedy the shortcoming.

In the developed Commission policy, the Commission is balancing the equitable considerations of the affected group of benefit recipients with the financial impact of making the benefit increase retroactive. Retroactive benefit increases, because they apply solely to retirees, solely increase the unfunded actuarial accrued liability of the pension plan. The magnitude of the increase in the unfunded actuarial accrued liability will depend on the number of the retirees receiving the retroactive benefit increase and their age and likely remaining retired lifetime.

The Commission and the Legislature have varied in their treatment of retirees when granting benefit increases. In 1973, when the statewide public pension plans shifted from the career average salary base to the highest five successive years average salary base, persons retiring before June 1, 1973 (State Patrol) or before July 1, 1973 (all remaining plans) were not included in the salary base change. In 1989, when the statewide public pension plans implemented the "Rule of 90" benefit tier and the "level benefit formula" benefit tier, the benefit increase was made retroactive on a limited basis to May 16, 1989, a date that occurred before the benefit increase was enacted. In that case, the Commission or the Legislature did not specifically indicate the equitable basis for the retroactivity.

If a retirement plan is intended to assist the employer's personnel system in recruiting new qualified employees, retaining existing qualified employees, and systematically out-transitioning employees at the end of their normally expected working lifetime, it is unclear that benefit increase retroactivity furthers any of those purposes. Since it does not further any recognized public pension plan purpose, benefit increase retroactivity is essentially a gift to the affected retirees and gifts provided through the political process are suspect.

d. Potential Principle Amendment. It is unclear whether or not the 1997 retroactive service pension increase for the Minneapolis Firefighters Relief Association represents a principle change by the Commission.

If the Commission did intend to follow a different policy principle than the one expressed in the 1995-1996 Policy Principles as a result of the 1997 legislation, the Commission staff offers the following potential revision to the 1995-1996 Principles:

> II.C.14. Benefit Increase Retroactivity
>
> Retroactivity of benefit increases for retirees and other benefit recipients should not be permitted.
>
> Retroactivity of benefit increases for retirees and other benefit recipients should ~~not~~ only be permitted on a case-by-case basis where circumstances warrant the retroactivity.

Policy Principle Review: Principle II.C.17. Reemployed Annuitant Earnings Limitations

a. Principle II.C.17. indicates that reemployed annuitant earnings limitations should be applied narrowly to individuals who regain post-retirement employment at the same level of government and that the limits should be standardized to the extent possible among public pension plans. Specifically, the principle states:

> II.C.17. Reemployed Annuitant Earnings Limitations
>
> a. Limitations on the earnings by reemployed annuitants should apply only to the reemployment of an annuitant by an employing unit that is a participating employer in the same public pension plan from which the annuitant is receiving a pension benefit.
>
> b. Reemployed annuitant earnings limitations should be standardized to the extent possible among the various Minnesota public pension plans.

b. Recent Variant Public Pension Legislation. Three items of 1997-2007 pension legislation are potentially at variance with the principle:

1. In 2000, the prior benefit forfeiture aspect of the reemployed annuitant earnings limitation was reversed, so that if an MSRS, PERA, TRA, or first class city teacher plan annuity is reduced or terminated in any given year due to reemployment earnings within the given retirement system which exceeds annual maximum earnings allowable for that age for the continued receipt of full benefit amounts under the federal Old Age, Survivors, and Disability Insurance Program (Social Security), the balance of the individual's annuity payments are to be retained in an account in the applicable Minnesota public retirement fund and upon attaining age 65 or thirteen months following termination of the reemployment, whichever is later, the individual may apply for payment of his or her account balance plus six percent interest *(Laws 2000, Ch. 461, Art. 2, Sec. 2, 5, 6, 8, and 10)*.
2. In 2004, annuitants of the Public Employees Police and Fire Retirement Plan (PERA-P&F) who were working for the Metropolitan Airports Commission as police officers were made exempt from the reemployed annuitant earnings limitation for the period January 1, 2004, to June 30, 2007 *(Laws 2004, Ch. 267, Art. 7, Sec. 8)*.
3. In 2007, field investigators of the former Midwest Forensic Pathology, P.A., who were employed before 2007, who are PERA-P&F annuitants, and who are transferred to Anoka County employment were exempted for the reemployed annuitant earnings limitation *(Laws 2007, Ch. 134, Art. 12, Sec. 2)*.

c. Policy Analysis and Discussion.

1. In General. Most Minnesota public pension plan annuitants are potentially subject to reemployed annuitant earnings limitations, either under the Social Security or the public pension plan, or both.
2. Reemployed Annuitant Earnings Limitations under Social Security. Since the creation of the Old Age and Survivors Insurance Program (Social Security) in the 1930s, Social Security benefits have been subject to an employment earnings limitation, known as the earnings test. The Social Security Administration (SSA) maximum salary earnings limitations for continued receipt of full benefit amounts under the federal Old Age, Survivors and Disability Insurance Program are used by the SSA to determine whether Social Security benefits must be reduced because the individual has salary or self-employment income in excess of the maximums permitted under federal law for continued full receipt of those benefits.

   The following table summarizes the annual maximum earnings permissible by Social Security benefit recipients for each year from 1985 onward, which a benefit recipient may receive without incurring a reduction in Social Security benefits. In the table these maximums are referred to as exempt amounts, since they indicate the highest salary earnings, which are exempt from a penalty – a reduction in the Social Security benefits that otherwise would be received. Under Social Security law, the exempt amount differs with the age of the individual. If an individual is under the Social Security full retirement age, once 65 and now between age 65 and age 67, depending on the person's year of birth, but drawing Social Security Old Age Insurance benefits, the maximums are fairly low. The exempt amount for the year in which the Social Security full retirement age is reached is notably higher. The following table has three columns, which are the applicable year, the maximum (exempt) amount under age 65 (before 2000) or under the full normal retirement age (after 1999), and the maximum amount for age 65-69 (before 2000) or for the full normal retirement age year (after 1999):

Year	Under Age 65	Age 65-69	Year	Prior to Year of Full Retirement Age	Year of Full Retirement Age
1985	$5,400	$7,320	1996	$8,280	$12,500
1986	$5,760	$7,800	1997	$8,640	$13,500
1987	$6,000	$8,160	1998	$9,120	$14,500
1988	$6,120	$8,400	1999	$9,600	$15,500
1989	$6,480	$8,880	2000	$10,080	$17,000
1990	$6,840	$9,360	2001	$10,680	$25,000
1991	$7,080	$9,720	2002	$11,280	$30,000
1992	$7,440	$10,200	2003	$11,520	$30,720
1993	$7,680	$10,560	2004	$11,640	$31,080
1994	$8,040	$11,160	2005	$12,000	$31,800
1995	$8,160	$11,280	2006	$12,480	$33,240

If the Social Security benefit recipient is under the full retirement age, the reduction is one dollar of Social Security benefits for each two dollars of earnings in excess of the maximum amount earned. For the year in which the full retirement age is attained, the reduction is one dollar for each three dollars of earnings in excess of the maximum amount earned.

3. Reemployed Annuitant Earnings Limitations under the Minnesota Public Pension Plans. Among Minnesota public pension plans, but unlike Social Security, the public employee must terminate from active public employment with the employing unit to initially qualify to receive the public employee retirement annuity. If the individual's public pension plan has a reemployed annuitant earnings limit provision, the individual often (but not always) will be subject to that reemployed earnings limit if the individual returns to public employment with pension coverage in the same public pension system.

   These reemployed annuitant provisions in Minnesota public pension plans bear a great similarity to the Social Security System but are far less global in scope. Under Social Security, the benefit reductions would be applied to any Social Security benefit recipient under the full retirement age who exceeded the maximum permissible exempt salary earnings, regardless of the employer, applicable for the individual's age. In contrast, if a Minnesota public pension plan has a reemployed annuitant earnings provision, reductions or suspension of the annuity by the plan will occur for those with salary income in excess of exempt amounts only from employment covered by the same pension plan or system. An annuitant from the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) who becomes reemployed in a position covered by the Minnesota State Retirement System (MSRS), the Teachers Retirement Association (TRA), or any other public pension system, would not be subject to the reemployed annuitant provisions in PERA law. Also, no Minnesota public pension plan benefit reductions would occur if the annuitant becomes employed by a governmental employer in another state, by the federal government, or in the private sector.

   Even within the same public pension system, reemployed annuitant reductions may not apply if the individual becomes employed in a position covered by another plan within the system. Typically, the laws have been constructed or interpreted in a way that applies reemployed annuitant earnings provisions if an annuitant from one plan in a system becomes employed by another plan in that same system providing that both plans were originally created within that system. A Public Employees Police and Fire Retirement Plan (PERA-P&F) annuitant who becomes employed in PERA-General covered employment will be subject to PERA's reemployed annuitant provision because PERA-P&F was spun out of PERA-General in 1959. However, a retiree from the State Patrol Retirement Plan who becomes reemployed in an MSRS-General covered position faces no reemployed annuitant penalties because the State Patrol Plan was originally not administered by MSRS, but was moved into MSRS for administrative purposes in 1969. The State Patrol Retirement Plan has no reemployed annuitant earnings provision in the plan, and the provision in MSRS-General law has been interpreted as not applying to State Patrol annuitants.

   Reemployed annuitant earnings limitations in Minnesota law support the requirement that a public employee must terminate the employment relationship in order to receive a retirement benefit. The limitations ensure that politically connected public employees cannot manipulate the personnel system and also maximize their income by drawing a full retirement benefit along with a full salary. In doing this, the reemployed annuitant earnings limitations follow one of the traditional purposes for a retirement plan, which is to assist the personnel system in producing an orderly and systematic out-transitioning of senior employees who have reached the end of their normal working lifetime.

However, when reemployed annuitant earnings limitations do not apply uniformly, when some plans have no limits, when the limitations impact differently when applicable, or when no limitations apply to most reemployed annuitant situations (i.e., a public plan annuitant employed by a private sector employer or by a public sector employer of a different level or branch of government), the basic fairness of the limitations can be questioned.

The following chart provides information on the reemployed annuitant earnings limitation laws in Minnesota's public plans:

Retirement Plan	Applicable Compensation	Limit Threshold	Effect After Threshold Exceeded	Reemployment Period Retirement Coverage	Exceptions
General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General)	Salary or wages from state of from employer of MSRS-General members	Social Security maximums ($12,960 under full Social Security benefit retirement age, $34,440 for full retirement age year)	Suspension of annuity for the balance of the calendar year or until reemployment termination, with the suspended annuity amounts deposited in a separate account, earning six percent compound annual interest, payable at the later of age 65 or one year after the reemployment ends	No retirement coverage	No application to service as temporary legislative employee. Suspension lifted during any sick leave
MSRS Correctional State Employees Retirement Plan (MSRS-Correctional)	Same as MSRS-General	Same as MSRS-General	Same as MSRS-General	Same as MSRS-General	Same as MSRS-General
State Patrol Retirement Plan	No provision	No provision	No provision	No provision	No provision
Legislators Retirement Plan*	No provision	No provision	No provision	No provision	No provision
Elective State Officers Retirement Plan	No provision	No provision	No provision	No provision	No provision
Judges Retirement Plan	No provision	No provision	No provision	No provision	No provision
Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified)	No provision	No provision	No provision	No provision	No provision
Public Employees Retirement Association (PERA)	Salary from governmental subdivision employment or public employee labor union employment	Social Security maximums ($12,960 under full Social Security benefit retirement age, $34,440 for full retirement age year)	Suspension or reduction, whichever produces higher annual amount. Suspension of amount is for the balance of the calendar year or until reemployment termination. Reduction is one-half of the excess over the maximum if under the Social Security full retirement age and one-third of the excess over the maximum if at the Social Security full retirement age. The reduction or suspended amount is deposited in a separate account, earning six percent compound annual interest, payable at the later of age 65 or one year after the reemployment ends.	No retirement coverage	No application to service as a local government elected official
Public Employees Police & Fire Fund (PERA-P&F)	Same as PERA	Same as PERA	Same as PERA	Same as PERA	Same as PERA

Retirement Plan	Applicable Compensation	Limit Threshold	Effect After Threshold Exceeded	Reemployment Period Retirement Coverage	Exceptions
Teachers Retirement Association (TRA)	Income from teaching for employing unit covered by TRA, income from consultant or independent contractor teaching services for employing unit covered by TRA, or income received by comparable position if greater than actual income received	Social Security maximums ($12,960 under full Social Security benefit retirement age, $34,440 for full retirement age year)	Reduction in following calendar year annuity of one-half of the excess over the maximum, with the annuity reduction amount deposited in a separate account earning six percent compound annual interest, payable at the later of age 65 or one year after the reemployment ends	No retirement coverage	No application to interim superintendents during a lifetime limit of three 90-day exemption periods or to reemployed retired Minnesota State Colleges and Universities faculty working between 33.3 and 66.7 percent of full time with salary under $35,000 or application to higher education salary over $35,000 if total higher education salary is greater than $35,000
First Class City Teacher Retirement Fund Associations	Same as TRA, except for applicable employers	Same as TRA	Same as TRA, except reduction is one-third of excess over the maximum	Same as TRA	Same as TRA
Minneapolis Employees Retirement Fund (MERF)	No provision	No provision	No provision	No provision	No provision
Local Police or Salaried Firefighter Relief Associations	Typically no provision	Typically no provision	Typically no provision	Typically no provision	Typically no provision

d. Potential Principle Amendment. The 2000 reemployed annuitant earnings limitation legislation significantly differed from the 1995-1996 Principles by eliminating the prior benefit forfeiture when a public employee exceeded the applicable earnings limitation when reemployed and deferring the reduction amount with interest.

If the Commission desires to reflect that 2000 legislation in the Principles, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.C.17. Reemployed Annuitant Earnings Limitations

a. Limitations on the earnings by reemployed annuitants should apply only to the reemployment of an annuitant by an employing unit that is a participating employer in the same public pension plan from which the annuitant is receiving a pension benefit.

b. The reemployed annuitant earnings limitation amount should not result in a benefit forfeiture, but the excess over the limitation should be deferred until after the reemployment period ends and the deferral amount should bear interest.

c. Reemployed annuitant earnings limitations should be standardized to the extent possible among the various Minnesota public pension plans.

Policy Principle Review: Principle II.C.18. Disability Definitions

a. Principle II.C.18. sets a goal of standardizing disability definitions to the extent possible, recognizing differences in the hazards of various types of employment. Specifically, the principle states:

II.C.18. Disability Definitions

The definitions of what constitutes a disability giving rise to a disability benefit should be standardized to the extent possible, recognizing the differences in the hazards inherent in various types of employment.

b. Recent Variant Public Pension Legislation. There were four items of 1997-2007 pension legislation that are potentially at variance with the principle.

1. In 1998, a special disability benefit was created within the PERA-General Employee Retirement Plan for local government correctional employees *(Laws 1998, Ch. 390, Art. 9, Sec. 3)*.
2. In 1999, that special disability benefit was repealed upon the creation of the PERA Local Government Correctional Employees Retirement Plan (PERA-Correctional) *(Laws 1999, Ch. 222, Art. 2, Sec. 20)*.

3. In 2001, for MSRS-General, for MSRS-Correctional, and for the State Patrol Retirement Plan, the basis for the determination of a disability was broadened to include examinations by psychologists and chiropractors *(First Special Session Laws 2001, Ch. 10, Art. 3, Sec. 6, 7, 11, and 16).*
4. In 2007, the duty disability definitions of the Public Employees Police and Fire Retirement Plan (PERA-P&F) were revised and benefit amounts realigned, attempting to limit enhanced duty disability benefit coverage to disabling events occurring during actual hazardous duty rather than regular employment activities *(Laws 2007, Ch. 134, Art. 4, Sec. 2 and 7).*

c. Policy Analysis and Discussion. Most Minnesota public pension plans provide disability benefit coverage as part of their package of benefits. The exceptions are the Legislators Retirement Plan, the Elective State Officers Retirement Plan, and some volunteer firefighter relief associations. As elected officials, legislators and constitutional officers who entered office before July 1, 1997, and who suffer a disability in office would be entitled to a continuation of salary for the length of their term unless they choose to resign before the end of their term. Volunteer firefighter relief associations are authorized to provide disability, death, or survivor benefits beyond a service pension, at their election.

Disability benefits that are part of the portion of a public pension plan's benefit package are referred to as ancillary benefits or casualty benefits. The ancillary or casualty benefit coverage is funded actuarially large part by the primary age and service retirement annuity coverage provided by the pension plan and supplants or supplements any other employment-related insurance coverage. In many Minnesota public pension plans, the disability benefit represents an early access to or the early payment of the unreduced normal retirement annuity otherwise earned by the person. If not properly regulated, the disability benefit portion of a public pension benefit plan can become a de facto early retirement incentive program.

The following table sets forth a comparison of the number of disabilitants for the various statewide and major local Minnesota public pension plans for the period 1992-2006:

Pension Plan	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
MSRS-General	743	779	800	824	857	905	948	1,007	1,070	1,127	1,218	1,275	1,397	1,434	1,508
PERA-General	781	794	871	959	1,051	1,115	1,223	1,301	1,397	1,468	1,565	1,640	1,760	1,853	1,940
TRA	297	354	345	379	409	425	454	476	509	518	551	558	589	581	630
DTRFA	12	8	8	7	8	7	11	11	6	6	13	14	14	16	17
MTRFA	44	45	48	49	22	21	19	21	20	20	21	23	24	25	--
SPTRFA	33	36	32	35	22	22	24	24	23	23	24	21	28	32	25
MERF	246	244	241	240	230	209	218	216	213	207	205	197	191	185	172
Judges	9	8	8	7	7	6	6	6	4	4	5	6	6	7	9
Legislators	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Elected State Officers	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
MSRS-Correctional	17	20	21	25	33	39	49	60	75	92	115	135	154	150	168
State Patrol	15	15	18	18	18	20	21	23	22	25	29	31	34	35	41
PERA-P&F	93	94	116	146	250	287	251	412	482	543	574	614	700	686	765
PERA-Correctional	--	--	--	--	--	--	--	--	3	17	26	37	50	59	70

The following table sets forth a comparison between the increase in the active membership of the various statewide and major local Minnesota public pension plans and the number of disabilitants for the period 1992-2006:

Pension Plan	1992 Active Membership	2006 Active Membership	14-Year Period Increase	1992 Disabilitants	2006 Disabilitants	14-Year Period Increase
MSRS-General	49,214	48,000	-2.5%	743	1508	103.0%
PERA-General	110,100	144,244	31.0%	781	1940	148.4%
TRA	65,557	79,200	20.8%	297	630	112.1%
DTRFA	1,558	1,174	-24.6%	12	17	41.7%
MTRFA	3,635	--	--	44	--	--
SPTRFA	3,336	4,219	26.8%	33	25	-24.3%
MERF	2,459	335	-86.3%	246	172	-31.1%
Judges	271	303	11.8%	9	9	0.0%
Legislators	200	76	-62.0%	0	0	--
Elected State Officers	6	0	--	0	0	--
MSRS-Correctional	1,573	3,910	148.6%	17	168	888.2%
State Patrol	795	851	7.0%	15	41	173.3%
PERA-P&F	6,980	10,591	51.7%	93	765	722.6%
PERA-Correctional	--	3,531	--	--	70	--

The primary means of regulating disability benefit utilization beyond sound workplace conditions and good personnel management is fashioning an appropriate definition of disability. For the various Minnesota public pension plans other than volunteer firefighter relief associations, where the disability definition is specified in statute or in special law, one of two broad types of disability definitions are used, an occupationally based definition or a non-occupational definition. The occupationally based definition is common among public safety employee pension plans and provides that an employee is disabled if the employee is unable to perform the duties of the person's employment position due to a physical or mental impairment. The non-occupational definition, common among general or non-uniformed employee pension plans, provides that an employee is disabled if the employee is unable to engage in substantial gainful employment of any kind. Social Security uses a non-occupational disability definition for its disability program. The disability definition regulates disability benefit utilization if the interpretation and administration of the definition is consistent, based on an established record, and precise.

There are at least two problems with the interpretation and administration of statutory disability definitions that may be part of the cause of any increases in disability benefit utilization in the various statewide pension plans. One problem relates to occupationally based disability definitions, where the public safety employment duties have broadened significantly beyond that of a routine patrol officer or a routine firefighter. If the inability to perform the duties of a person's job is the disability definition and the public safety employment range covers numerous job duties, it is possible that a public safety employee who had performed one set of public safety employment duties and may still be able to perform other law enforcement duties, may qualify as disabled because the person had a particular set of duties immediately before the disabling event. An example would be a canine officer who develops an allergic reaction to dogs. The reverse is also true, where supervisory personnel who do not routinely become involved in altercations with suspected wrongdoers or do not routinely handle fire hoses or climb fire ladders, can be deemed disabled because they cannot perform that general duty of a police officer or a firefighter. The situation can be complicated when the individual does not mesh with the balance of the public safety organization, tempting the organization to use the disability program as a means to eliminate a malcontent by assigning the person to a position where a disability benefit would be available or tempting the individual to find a subsidized path to a career change through the disability program.

The other problem relates to non-occupational disability definitions, where local economic factors have explicitly or implicitly been incorporated into the definition. If the lack of employment opportunities exist in a given geographic area for older employees who have limited education or have limited prior employment experience and that lack of employment opportunities is recognized in interpreting the definition, an injured public employee in one part of the state may be determined to be disabled because the person is unable to find any other gainful employment, even if the person would not be determined unable to engage in any substantial gainful employment in another part of the state.

For volunteer firefighter relief associations, where there is no statutory definition of what constitutes a disability, the disability definitions that are actually utilized are unclear. However, to protect the funding of the volunteer firefighter relief association and reduce potential abuse, Minnesota Statutes, Section 424A.02, Subdivision 9, Paragraph (b), limits the amount of any ancillary retirement benefit coverage to the amount of the service pension earned by the volunteer firefighter. There is little anecdotal evidence of disability abuse among volunteer firefighter relief associations and no reliable quantitative evidence of abuse available.

The 1998 and 1999 legislation shifted a group of employees who were previously covered by a non-occupational disability definition to an occupational disability definition, without a very rigorous demonstration by the advocates of the legislation that the changed definition was the most appropriate for the entire group of employees to be covered by it. The 2001 legislation potentially broke new ground by expanding the body of medical experts who are authorized to make the examinations for submission as evidence in a disability determination, but was made without any direct testimony about its likely impact or importance. The 2007 legislation revised various aspects of an occupational disability program, adding definitions attempting to further narrow enhanced disability benefit coverage to those disabling events that were related to hazardous duty performance rather than more routine duty performance, but will likely take some period of time to identify any unintended results and is unclear as to whether or not it will be a pattern for other public safety retirement plans.

d. Potential Principle Amendment. While the 1995-1996 Principles of Pension Policy suggests that there should be greater standardization in disability definitions while also recognizing the differences that grow out of various employment hazards, the recent experience did not significantly forward that standardization.

If the Commission desires to moderate the tone of its 1995-1996 Principles in this regard, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.C.18. Disability Definitions

> a. The definitions of what constitutes a disability giving rise to a disability benefit for a public employee should be standardized to ~~the extent possible, recognizing~~ a greater degree.
>
> b. Disability definitions should recognize the differences in the hazards inherent in various types of employment and should balance that recognition with sufficient protections to minimize disability benefit utilization abuses.

Policy Principle Review: Principle II.C.20. Future Pension Coverage for Privatized Public Employees

a. Principle II.C.20. provides that privatized public employees should be provided with comparable future replacement pension coverage and should not continue in public pension plan coverage. Specifically, the principle states:

II.C.20. Future Pension Coverage for Privatized Public Employees

> Because of applicable federal regulation, employees of public employers that are privatized should not be allowed to continue public pension plan coverage in the future. Privatized public employees should receive adequate replacement pension coverage and a better resolution of this topic should be raised with appropriate federal government officials.

b. Recent Variant Public Pension Legislation. There were 15 items of 1997-2007 pension legislation that are potentially at variance with the principle to some degree:

1. In 1997, although Laws 1996, Chapter 460, Article 1, established a different approach for privatized employees by creating expanded deferred annuitant eligibility within MSRS-General for privatized University of Minnesota Hospital employees, for the privatizations of the Jackson Medical Center, the Melrose Hospital, the Pine Villa Nursing Home, and the Tracy Municipal Hospital and Clinic, the former members were left with subsequent pension coverage based on the discretion of the privatizing employer *(Laws 1997, Ch. 241, Art. 2, Sec. 16-18, and 21).*
2. Also in 1997, however, the privatized employees at the University of Minnesota Academic Health Clinics were accorded the expanded deferred annuitant eligibility treatment under Laws 1996, Chapter 460, Article 1 *(Laws 1997, Ch. 241, Art. 7, Sec. 2-3).*
3. In 1999, for the Glencoe Area Health Center, the Luverne Public Hospital, the Waconia-Ridgeview Medical Center, and Metro II, special expanded deferred annuitant eligibility within PERA-General was created *(Laws 1999, Ch. 222, Art. 1, Sec. 1-8 and 10).*
4. In 2000, employees previously considered to be nonpublic of the Spring Lake Park Fire Department and of Indian tribal governments were made eligible for PERA-General or PERA-P&F coverage *(Laws 2000, Ch. 461, Art. 7, Sec. 2, 3, and 6).*
5. Also in 2000, for the St. Paul Civic Center Authority, special expanded deferred annuitant eligibility treatment was extended to the privatized employees. In 2001, enhanced disability benefit eligibility was added to the 1996/1999 enhanced deferred annuitant eligibility legislation for MSRS-General and PERA-General *(First Special Session Laws 2001, Ch. 10, Art. 9).*
6. In 2002, the Kanabec County Hospital was added to the 1999 PERA-General enhanced deferred annuitant eligibility provision (Laws 2002, Chapter 392, Article 5). Also in 2002, employees who are employed by the Minneapolis Asphalt Plant joint venture and who apparently do not meet the definition of "public employee" were included in Minneapolis Employees Retirement Fund (MERF) or PERA-General coverage *(Laws 2002, Ch. 264).*
7. In 2003, employees of the Red Wing Environmental Learning Center, a nonprofit corporation long associated with the Red Wing School District, were permitted to be certified by the school district as its employees solely for pension coverage purposes *(Laws 2003, First Special Session, Ch. 12, Art. 4, Sec. 2, 6, and 10).*
8. In 2004, Fair Oaks Lodge (Wadena), Kanabec Hospital, RenVilla Nursing Home, and the St. Peter Community Healthcare Center, were added to the PERA privatized employee chapter *(Laws 2004, Ch. 267, Art. 12, Sec. 1 and 4).*
9. Also in 2004, employees of the Achieve Program in Anoka County or of the Government Training Office who were employed by either entity on the day prior to privatization, remain as members of PERA-General following the privatization for employment with the successor organization *(Laws 2004, Ch. 267, Art. 12, Sec. 2 and 3).*

10. In 2005, the Bridges Medical Services, the Hutchinson Area Health Care, and the Northfield Hospital were added to the PERA privatized employee chapter *(Laws 2005, First Special Session, Ch. 8, Art. 6, Sec. 1 and 4).*
11. In 2006, the deferred annuity augmentation rates for any new privatizations under the two privatization programs were reduced from 5.5 percent to four percent under age 55 and from 7.5 percent to six percent thereafter *(Laws 2006, Ch. 271, Art. 5, Sec. 1 and 3).*
12. Also in 2006, the City of Cannon Falls Hospital, Clearwater Health Services in Bagley, and Dassel Lakeside Bridges Medical Services, were added to the PERA privatized employee chapter *(Laws 2006, Ch. 271, Art. 5, Sec. 2 and 5).*
13. Additionally in 2006, the authority for the Hutchinson Area Healthcare to be included in the PERA privatized employee Ch. was extended by one year *(Laws 2006, Ch. 271, Art. 5, Sec. 4).*
14. In 2007, the Lakefield Nursing Home, the Lakeview Nursing Home in Gaylord, and the Oakland Park Nursing Home were added to the PERA privatized employee chapter *(Laws 2007, Ch. 134, Art. 5, Sec. 1).*
15. Also in 2007, the higher deferred annuity augmentation rate was grandparented in for the Hutchinson Area Healthcare privatization *(Laws 2007, Ch. 134, Art. 5, Sec. 2).*

c. Policy Analysis and Discussion

1. In General. Most privatizations of public employees in Minnesota through 2007 have involved hospital and other health facility employees and have involved the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General). The retirement coverage provided to public health facility employees and the appropriate handling of future retirement coverage for those employees upon the privatization of their employer have consumed considerable Commission and legislative effort over the years.

2. Legislative History Concerning PERA Membership for Public Hospital and Related Employees. Prior to 1963, employees of public hospitals and related health facilities were covered by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) on a mandatory basis. Legislation enacted in 1951 required every person who received compensation for services performed which was paid in whole or in part from governmental revenue to be a member of PERA-General as a condition of the acceptance of or the continuance in public employment, including public hospital, nursing home and extended health care facility employees (Laws 1951, Chapter 22, Section 10). Only public employees who were elected public officials, or who attained the age of 60 years at the time of employment or who were required to contribute to a local public pension fund or who were employed by a governmental unit which was previously never covered by PERA-General were excluded. For elected public officials and employees who had attained the age of 60 years at the time of employment, membership was optional at the election of the employee. For employees who were employed by a governmental unit which was never previously covered by PERA-General, membership was optional at the election of the governmental subdivision through the adoption of the appropriate resolution.

   In 1963, legislation was enacted which made PERA-General membership optional for public hospital employees (Laws 1963, Chapter 793, Section 3, Subdivision 5, now coded as Minnesota Statutes, Section 355.72, Subdivision 5). In 1963, there was no PERA-General Coordinated Program and no PERA-General covered employees had Social Security coverage by virtue of their public employment. The 1963 legislation made public hospital employees eligible for Social Security coverage, authorizing a separate Social Security employee referendum and Social Security agreement with the federal government. Each public hospital was treated as an individual unit for purposes of the referendum. Public hospital employees were given the option of having coverage by Social Security in lieu of PERA-General Basic Program coverage, or retaining the PERA-General Basic Program coverage or having reduced PERA-General coverage (under a predecessor to the PERA-General Coordinated Program) and Social Security coverage. The Legislative Commission on Pensions and Retirement, then the "Interim Commission on Employee Retirement Systems," was not reestablished by the 1961 Legislature, did not function during the 1961-1962 interim or the 1963 legislative session consequently, and did not study or recommend these legislative changes applicable to public hospital employees.

   In 1967, the authority for public hospital employees to retain or terminate PERA-General coverage at their option was revoked (Laws 1967, Chapter 687, Section 22). The Commission was reestablished on an interim basis by the 1963 and 1965 Legislatures and the Commission did study and recommend this change in the optional membership for public hospital employees.

The question of optional PERA-General membership for public hospital employees also arose in 1969 concerning a specific public hospital, the Duluth Miller Memorial Hospital. Special legislation adopted during the 1969 legislative session redefining the powers and duties of the directors of the hospital included a provision that was alleged by the hospital to have given its employees the option to be members of PERA-General or not (Laws 1969, Chapter 224, Subdivision 1). The question was resolved by an opinion of the Attorney General, which held that the Duluth Miller Memorial Hospital employees did not have the right to terminate PERA-General membership by virtue of the special legislation because of constitutional defects related to the manner in which the legislation was enacted, and the general policy of the legislature towards public hospital employees expressed in the 1967 general legislation on the subject (Opinion of the Attorney General to PERA dated November 10, 1971).

In 1973, PERA-General law was amended to specifically provide that public hospital employees are included within the definition of "public employee" and are members of PERA-General (Laws 1973, Chapter 753, Section 4). In 1975, PERA-General law was amended to remove one additional exception to PERA-General membership applicable to hospital districts by providing that only public hospital districts which were organized or reorganized under Laws 1959, Chapter 570, prior to July 1, 1975, would be excluded from the definition of "governmental subdivision," which determines PERA-General coverage in part (Laws 1975, Chapter 102, Subdivision 1). The exclusion for public hospital districts which were organized or reorganized pursuant to the 1959 legislation was added to PERA-General in 1959 (Laws 1959, Chapter 650, Section 2). Employees of public hospital districts which were organized or reorganized pursuant to the 1959 hospital organization legislation had retirement coverage solely from Social Security (Laws 1959, Chapter 633).

3. Health Care Facility Privatizations. There has been a trend among health care facilities to convert from public sector ownership to private sector ownership or to quasi-public sector ownership. These conversions have involved selling, leasing, or transferring the facility, and transferring the existing employees to that reorganized health care facility. The privatization of health care facilities is occurring both among large and small hospitals, clinics, nursing homes, and related healthcare providers. The privatizations arguably increase organizational flexibility and reduce various costs in an attempt to remain financially competitive. One area of potential savings is that of retirement coverage by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), or other public pension plan, which may be eliminated by the privatization.

When a privatization occurs, the employees generally no longer qualify as public employees for PERA pension purposes. When this occurs, membership in PERA-General terminates, and retirement benefit coverage problems may emerge. Under current PERA-General law, three years of PERA-General coverage is required for vesting. For employees who terminate PERA-General membership without sufficient service to achieve vesting, no deferred retirement annuity right typically is available. The member may elect to take a refund of accumulated member contributions with six percent interest, or the individual may leave the contributions in PERA-General, perhaps in the expectation that the individual will change employment in the future and again become a covered public employee. For a vested employee who terminates PERA-General membership with at least three years of service, there is a choice between a deferred retirement annuity right or a refund. The deferred retirement annuity is augmented by three percent per year under age 55 and five percent per year thereafter until retirement.

When a privatization occurs and employees lose the right to continue coverage by PERA-General, all the employees are impacted. The employee may be terminated from employment at the time of the sale, transfer, or reorganization. Those employees will lose both continued employment and continued retirement coverage. For employees who remain employed after transfer to the newly organized healthcare facility, the privatization interrupts their benefit coverage. If there is no pension plan established by the privatized health care facility, the employees will suffer a loss of overall benefit coverage beyond Social Security. If a plan is provided by the new employer, portability problems between the old and new plan are likely to occur and the overall value of benefit coverage is likely to be reduced.

The Legislature has dealt with healthcare privatizations numerous times and has used several different treatments to address pension coverage issues. At times, in addition to any benefit that the employee may have been eligible for under a public pension plan, the individual was offered an alternative of an enhanced refund (employee plus employer contributions) plus interest. On at least one occasion, the individuals were permitted to remain in PERA, although that practice has not been favored in more recent years. The following is a summary of treatments of privatized public employees through 1994, shortly before the Commission established a policy principle on the topic:

Plan	Law	Action	Comment
PERA-General	Laws 1969, Ch. 224, Sec. 3	Establishing Miller Memorial Hospital	Public, private partnership. Members retained PERA-General coverage due to Attorney General opinion.
PERA-General	Laws 1981, Ch. 155	Withdrawal of PERA coverage from St. Paul Public Housing Agency (SPPHA) employees	Status of SPPHA unclear; acting like public or quasi-public corporation. Coverage transferred from PERA-General to public housing agency pension plan. Employee and employer contributions transferred from PERA-General to SPPHA.
PERA-General	Laws 1984, Ch. 574, Sec. 31	Owatonna City Hospital privatization	Owatonna City Hospital taken over by private corporation. Employees offered refund of employee and employer contribution, or deferred annuity.
PERA-General	Laws 1985, Ch. 261, Sec. 21	Stevens County Memorial Hospital privatization	Stevens County Memorial Hospital taken over by private corporation. Employees offered refund of PERA-General employee and employer contributions, or deferred PERA-General annuity.
PERA-General	Laws 1985, Ch. 261, Sec. 22	St. Paul Model Cities Health Center Project employees privatization	St. Paul Model Cities Health Center Project taken over by private corporation. Employees offered refund of PERA-General employee and employer contribution or deferred PERA-General annuity.
PERA-General	Laws 1986, Ch. 458, Sec. 26	Falls Nursing Home privatization	Falls Nursing Home taken over by private corporation. Employees offered refund of PERA-General employee and employer contributions or deferred PERA-General annuity.
PERA-General	Laws 1986, Ch. 462, Sec. 12	St. Paul Ramsey Hospital employees become employees of a subsidiary corporation	New employees excluded from PERA-General. Existing employees can terminate PERA-General coverage after June 30, 1987.
PERA-General	Laws 1987, Ch. 372, Art. 7, Sec. 3	Albany Community Hospital privatization	Albany Community Hospital taken over by private corporation. Employees offered refund of PERA-General employee and employer contributions or deferred PERA-General annuity.
PERA-General	Laws 1987, Ch. 372, Art. 7, Sec. 4	Canby Community Hospital District #1 privatization	Canby Community Hospital District #1 taken over by private corporation. Employees offered refund of PERA-General employee and employer contributions or deferred PERA-General annuity.
MSRS-General	Laws 1988, Ch. 599	Gillette Children's Hospital assumes nonprofit corporation status	Existing employees retain MSRS coverage. New employees excluded from MSRS.
PERA-General	Laws 1990, Ch. 556, Sec. 7 and 8	Exclusion of hospital districts organized or reorganized on or after July 1, 1975	Upon district notification to PERA-General, the employees of these districts will not become PERA-General members. This authorization removed in 1991 (Laws 1991, Chapter 341, Sec. 2 and 49), but removal does not affect any district which used notification rule while in effect.
MSRS-General	Laws 1993, Ch. 307, Art. 1, Sec. 3	University of Minnesota heating plant facility employee transfer to Foster Wheeler, Inc.	The MSRS-General membership of existing employees who were MSRS-General members were continued for the duration of heating plant employment.
PERA-General	Laws 1994, Ch. 549	St. Paul Ramsey Hospital/Ramsey Health Care, Inc. status change	The PERA-General membership of existing employees who were PERA-General members were continued unless the employee elected to terminate PERA-General membership before July 1, 1995.

During the period 1995 through 2007, primarily two approaches were used:

- Public Pension Plan Membership Discontinuation with Local Employer Option on Future Pension Coverage. In the first model, ongoing PERA-General coverage ends for all employees as of the time of the transfer of the healthcare facility to the new ownership. The new healthcare entity may provide a "PERA-like" plan for individuals who are transferred with the facility and remain as employees of the new entity. For individuals who are terminated at the time of the transfer, and who were not vested in PERA, the city may match any refund with interest that the individual receives from PERA. This model was used with the Olmsted County Medical Center privatization (1995), the Itasca County Medical Center (1995 and 1996), and Jackson Medical Center, Melrose Hospital, Pine Villa Nursing Home, and the Tracy Municipal Hospital and Clinic (1997), and the Luverne Community Hospital (1998).

- Special Continuing Public Pension Plan Rights after Membership Discontinuation. In the second model, termination of coverage by the public plan occurs at the time of the privatization, but the employees who terminated coverage were permitted deferred annuities (even those that were not vested) from the public plan with an augmentation rate that exceeded that used under general law, and the employees were allowed to use service with the new organization to meet age/service requirements for qualifying for the Rule of 90 under the public plan. This approach was used in 1996 (Laws 1996, Chapter 460, Article 1) for the Academic Health Center employees in the University of Minnesota Hospital-Fairview merger. The plan that had previously provided coverage to the transferred employees was the General Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) Plan. The approach was replicated for the University of Minnesota clinics in 1997 (Laws 1997, Chapter 241, Article 7) and was replicated for the Glencoe Area Health Center, the Luverne Public Hospital, the Waconia-Ridgeview Medical Center, and the joint powers organization Metro II in 1999 (Laws 1999, Chapter 222, Article 1), for the St. Paul Civic Center Authority in 2000 (Laws 2000, Chapter 461, Article 8), and for the Kanabec County Hospital in 2002 (Laws 2002, Chapter 392, Article 5).

4. Concern Over Possible Loss of Governmental Plan Status. A legislative decision to continue public pension plan coverage for employees following a privatization is based on equity considerations. Since the shift is not a voluntary one by the employee and the employee can be expected to have similar responsibilities following the change, it is felt that the employee should not be harmed by termination of existing pension coverage.

   However, the Minnesota State Retirement System (MSRS) has expressed concern that if prior coverage is continued, the plan may lose its governmental plan designation because the employees may not qualify as "public employees." The fear is that the plan would be subject to the more complex qualification and reporting standards of the Employee Retirement Income Security Act (ERISA), which governs private section plans. If these ERISA standards are not met, the plan could, in turn, lose its tax-qualified status. This is not a new issue. Prior to the recent University of Minnesota steam plant legislation and the inclusion in PERA of the Minneapolis Community Action Agency, several other groups had been provided coverage which raise the same issue of continued exemption from ERISA.

   ERISA and the federal Internal Revenue Code (see ERISA, Section 3(32)) define a "governmental plan" as a plan "established and maintained for its employees by the government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." The Employee Benefits Security Administration (EBSA), formerly known as the Pension and Welfare Benefits Administration (PWBA), of the federal Department of Labor is the agency charged, in part, with making that determination. The EBSA has taken a fairly broad view of what constitutes an agency or instrumentality of government and has viewed "de minimis" numbers of nonpublic employees in a public plan as not affecting the governmental status of the public pension plan, even without any clear statutory underpinning. The "de minimis" nonpublic participation rule of the EBSA also has been somewhat liberally applied when the nonpublic employees are union representatives of public employees or are former public employees, which is the case in most privatizations. The number of nonpublic employees that still constitute qualifying "de minimis" participation is unclear, but the following summarizes the Commission staff's understanding of the levels of nonpublic employee involvement that have been considered "de minimis" by the PWBA/EBSA in the 17 relevant advisory opinions dealing with the issue during the period 1992-2007:

PWBA/EBSA Advisory Opinion	Number of Nonpublic /Public Empl.	Percentage
2005-21A	2 / 1,150	0.17%
2005-17A	5 / 33,600	0.015
2005-07A	2,380 / 315,000	0.76
2003-12A	168 / 251,573	0.067
2001-11A	5 / 9,000	0.05
2001-07A	3 / 1,620	0.19
2000-08A	540 / 158,000	0.34
2000-06A	150 / 26,050	0.576
2000-04A	3 / 838	0.36
2000-01A	11 / 1,488	0.74
99-15A	1 / 520	0.19
99-10A	28 / 750,000	0.004
99-07A	300 / 25,221	1.19
95-25A	17 / 8,500	0.20
95-15A	236 / 10,987	2.15
95-14A	253 / 183,000	0.14
95-11A	150 / 312,000	0.05

Attachment A summarizes a number of PWBA/EBSA advisory opinions 1992-2007.

d. Potential Principle Amendment. The current Commission policy is premised on the issue raised by the various statewide public pension administrators of unfavorable federal labor and tax consequences from the retention of public pension plan coverage by privatized public employees after their shift to the private sector. Since the threshold for those unfavorable federal consequences have been clarified since 1995 and since the manner in which privatized employees have been treated for public pension coverage purposes since 1995-1996, the policy principle may need to be revisited.

If the Commission decides to review the pension policy principle, the Commission staff offers the following alternative potential revisions to the 1995-1996 Principles:

Revision A (favors continued public plan coverage):

II.C.20. Future Pension Coverage for Privatized Public Employees

~~Because of~~ To the extent that the applicable federal regulation and practice permits, employees of public employers that are privatized should ~~not~~ be allowed to ~~continue~~ retain or obtain appropriate future public pension plan coverage ~~in the future~~. ~~Privatized public employees should receive adequate replacement pension coverage and a better resolution of this topic should be raised with appropriate federal government officials.~~

Revision B (disfavors continued public plan coverage):

II.C.20. Future Pension Coverage for Privatized Public Employees

~~Because of~~ Unless clearly permitted by applicable federal regulation, employees of public employers that are privatized should not be allowed to continue public pension plan coverage in the future. Future employers of privatized public employees should ~~receive~~ be required or strongly encouraged to provide adequate future replacement pension coverage ~~and a better resolution of this topic should be raised with appropriate federal government officials~~.

Policy Principle Review: Principle II.D.2. Actuarial Funding of Pension Benefits

a. Principle II.D.2. indicates that Minnesota public pension plans be funded on an actuarial basis, with its Entry Age Normal Cost Method normal cost, administrative expense, and amortization of unfunded actuarial accrued liability requirements be regularly determined and be funded on a current basis. Specifically, the principle states:

II.D.2. Actuarial Funding of Pension Benefits

a. Retirement benefits in Minnesota defined benefit plans should be funded on an actuarial basis.

b. Currently earned pension plan service credit, as measured by the actuarially determined entry age normal cost of the defined benefit pension plan, should be funded on a current basis.

c. The administrative expenses of the defined benefit pension plan should be funded on a current basis.

d. Existing unfunded actuarial accrued liabilities of the defined benefit pension plan should be amortized over a reasonable period of time, and that amortization period should be related to the average working career of the membership of the pension plan, but not to exceed forty years.

b. Recent Variant Public Pension Legislation. Eleven items of 1997-2007 pension legislation are potentially at variance with the principle:

1. In 1997, a requirement for a quadrennial projection actuarial valuation was added as an alternative measure of the actuarial cost of defined benefit plans *(Laws 1997, Ch. 233, Art. 1, Sec. 2 and 57)*.

2. Also in 1997, a reverse amortization requirement determination was authorized for MSRS-Correctional and for the State Patrol Retirement Plan, both of which had become fully funded *(Laws 1997, Ch. 233, Art. 1, Sec. 59)*.

3. In 2000, retroactive to July 1, 1990, the city contributions toward the normal cost requirements of the Minneapolis Fire and Minneapolis Police Relief Associations were permitted to be underpaid by the amount of any employee contribution amounts allocated to the health insurance escrow account rather than to the given association's special fund and if the second "thirteenth check" is payable, the city normal cost contribution requirement for that year to that association was waived *(Laws 2000, Ch. 461, Art. 17, Sec. 3 and 4)*.

4. In 2000, also, for the Minneapolis Firefighters Relief Association and the Minneapolis Police Relief Association, any post full-funded condition unfunded actuarial accrued liability must be amortized on level-dollar basis over a 15-year period *(Laws 2000, Ch. 461, Art. 17, Sec. 5).*
5. Additionally, in 2000, the actuarial value of assets definition on which unfunded actuarial accrued liability and amortization determinations was made was revised *(Laws 2000, Ch. 461, Art. 1, Sec. 3).*
6. Also in 2000, the reverse amortization requirement determination was extended to all Minnesota public pension plans except the Minneapolis Firefighters Relief Association and the Minneapolis Police Relief Association *(Laws 2000, Ch. 461, Sec. 6).*
7. In 2001, the amortization target date for PERA-General was extended to 2031 *(First Special Session Laws 2001, Ch. 10, Art. 11, Sec. 18).*
8. In 2003, the Legislators Retirement Plan was revised from a terminal funded plan to a "pay as you go" plan, with appropriations to be made form the state general fund to MSRS as necessary to pay benefits *(Laws 2003, First Special Session, Ch. 1, Art. 1, Sec. 3 and 136).*
9. In 2004, the Minneapolis Police Relief Association amortization date was extended from December 31, 2010, to December 31, 2020 *(Laws 2004, Ch. 267, Art. 18).*
10. In 2005, the Bloomington Fire Department Relief Association amortization date was extended from December 31, 2010, to December 31, 2020 *(Laws 2005, First Special Session, Ch. 8, Art. 11, Sec. 1 and 3).*
11. In 2006, the full funding date for the Teachers Retirement Association (TRA) was reset to June 30, 2037 *(Laws 2007, Ch. 277, Art. 3, Sec. 34).*

c. Policy Analysis and Discussion

1. In General. With the creation of public pension plan liabilities, there arises a need to provide financing to match the liabilities as they are created and to create a trust fund for the resulting accumulated assets. The method of financing depends primarily on the nature of the benefit plan as either a defined contribution plan or a defined benefit plan and the amount of liability which is undertaken as a consequence. Since the obligation undertaken with a defined benefit plan is to provide a benefit of a predetermined amount at and after the time of retirement, the financing method will be more complex and will allow more variations. There are a number of possible financing methods which have been developed by actuaries which can be utilized.

2. Basic Concepts in Public Pension Funding. The ten basic concepts underlying the manner in which public pension plans in Minnesota are funded are 1) the actual or ultimate pension cost; 2) the present value; 3) an actuarial method; 4) an actuarial assumption; 5) the actuarial valuation; 6) the normal cost; 7) the pension plan actuarial accrued liability; 8) the assets; 9) unfunded actuarial accrued liability; and 10) the amortization of unfunded actuarial accrued liability.

   1) The actual or ultimate cost of a pension plan is the total amount of any retirement annuities, disability benefits and survivor benefits that are paid by a pension plan to all members plus the total amount of any pension plan administrative costs paid and reduced by the amount of any investment earnings on any accumulated pension plan assets. The actual or ultimate cost will be known only when all pension plan members have died and will result no matter what method of financing is employed to fund pension benefits. The financing or actuarial funding method merely affects the timing of the financing and the amount of the financing burden which will be borne by the pension plan employer or employers.

   2) The present value is the calculated estimate of the value of various future payments in terms of current dollars. Stated another way, present value is computed by identifying all future pension plan payments and discounting or reducing each anticipated payment by the amount of investment earnings which could be obtained between the calculation date and the future date of payment. The present value calculation is the basis of all actuarial cost or funding methods. The present value calculation is the way a pension plan attempts to evaluate its obligation to each active or retired member of the plan and to equate various benefit amounts and payment lengths.

   3) An actuarial method, actuarial cost method or actuarial funding method is a budgeting tool through which the calculated present value of future pension benefits is allocated to particular years as required contribution amounts. The contribution requirement can be met by the employee, the employer or both. As a budgeting tool, virtually any pattern of allocated contributions or recognized liability can be designed and followed. Hence, there are several different actuarial methods which can be chosen. Any actuarial method chosen and implemented will result in the adequate funding of the ultimate or actual pension cost. The difference is the amount of pension cost which is assigned to each year, known as the cost incidence. The goal of

every actuarial cost method is to fund the present value of retirement benefits over the working career of the affected employees. In Minnesota, the actuarial method chosen by the Legislative Commission on Pensions and Retirement and required by statute has been the Entry Age Normal Actuarial Cost Method. Use of this method for all statewide and major Minnesota public pension funds is mandated by Minnesota Statutes, Section 356.215. The key to the Entry Age Normal Actuarial Cost Method is that it recognizes pension plan liability in equal installments or portions over time, measured as a percentage of covered payroll. Other actuarial cost methods produce a different liability accrual or cost incidence pattern, but level cost as a percentage of payroll over time has been chosen by the Minnesota Legislature as the most appropriate budgeting tool for Minnesota public employee pension costs.

4) An actuarial method utilizes actuarial assumptions. Actuarial assumptions are the body of predictions or expectations about the future experience of a pension plan on which actuarial calculations are based, limited, or shaped. Actuarial assumptions can be categorized as either economic assumptions or demographic assumptions. Economic assumptions refer to the general economy or to the broad investment markets. They include the assumption as to future interest or investment income, the assumption as to future individual salary growth, the assumption as to future group covered payroll growth, and the assumption as to future cost of living. Demographic assumptions refer to the particulars or peculiarities of the individuals covered by a pension plan. They include the expected mortality (life expectancy) of the plan members, the expected turnover or withdrawal (termination of employment prior to vesting) of the plan members, the expected retirement age of the plan members, and the expected potential of disablement or pre-retirement death of the plan members. No actuarial result is more reliable than the accuracy of its actuarial assumptions. Actuarial assumptions under Minnesota law are monitored regularly through annual actuarial valuation tabulations of actuarial gains and losses and through the use of quadrennial experience studies and actuarial assumptions are revised as necessary.

5) An actuarial valuation is a periodic computation by a specialized statistician or mathematician, known as an actuary, of the relative financial health of the pension plan in terms of a comparison of liabilities and assets and of the annual future contribution requirements needed to support the pension plan. An actuarial valuation for most Minnesota pension plans is undertaken annually. The actuarial valuations for the major pension plans in Minnesota are prepared by an actuary retained by the major retirement systems with the approval of the Legislative Commission on Pensions and Retirement.

6) Normal cost is that portion of the total present value of future benefits of a pension plan which is allocated to a particular year. Under the Entry Age Normal Actuarial Cost Method used by Minnesota pension plans, normal cost is calculated as a percentage of covered payroll and is calculated as a level percentage amount of the present value of future covered payroll amounts for the existing plan membership for all future years. In simplest terms, normal cost is the value of the pension benefit coverage under the plan then in effect for all active members, without reference to any prior funding problems or unfunded liabilities and expressed as a percentage of covered payroll.

7) Actuarial accrued liability is the total of all prior normal cost requirements, plus interest, to date. The actuarial accrued liability represents that portion of the total present value of future benefits under the budgeting tool of the actuarial cost method which should have been funded or paid for to date.

8) Assets for pension purposes can have a variety of values. In Minnesota, the actuarial value of assets is based generally on the market value of assets over a five-year period. Minnesota Statutes, Section 356.215, specifies an actuarial value of assets that is an attempt to smooth the up and down fluctuations which occur in full market value.

9) A pension plan unfunded actuarial accrued liability represents the difference between the actuarial accrued liability of the pension fund and the actuarial value of pension plan assets. The unfunded actuarial accrued liability is a measure of any past departure from the budgeting tool reflected in the chosen actuarial cost method. An unfunded actuarial accrued liability can occur for any of the following reasons:

- recognition of credit (and hence pension liability) for service rendered prior to the creation of the pension plan;
- insufficient prior pension plan contribution amounts;
- benefit improvements;
- changes in actuarial assumptions to reflect future experience;
- deviations of actual experience from the actuarial assumption; and
- changes in actuarial method.

10) The requirement to amortize the unfunded actuarial accrued liability of a pension plan is the amount in addition to the normal cost of the pension plan which is needed to retire or pay off the unfunded actuarial accrued liability by a specified date. The amortization requirement reflects the additional contribution needed to make up any prior departure from the budgeting tool reflected in the choice of the actuarial cost method and to value a pension plan.

Under Minnesota Statutes, Section 356.215, any unfunded actuarial accrued liability of a pension plan is to be amortized on the basis of a level percentage of covered payroll and to be amortized by a specified date or by a date that is periodically reset based on the relative magnitude of new benefit increases or actuarial assumption changes. In the event of any major benefit increase, any actuarial assumption change or any actuarial method change, a separate 30-year amortization period is established for the new increment of unfunded actuarial accrued liability resulting and a new weight-averaged amortization target date is established.

3. Advantages of Actuarial Funding. Use of an actuarial funding method which spreads costs over time and requires periodic contributions to meet those costs has several advantages over the non-actuarial "pay as you go" approach. Among them are the following:

- No Time Shifting of Current Obligations. The cost of the retirement benefits earned annually by the active public employees is paid by taxpayers in that year. Thus the full cost of employment compensation (salaries and fringe benefits) is recognized as it occurs. These ongoing costs are not shifted forward to future years and possibly to future generations of taxpayers.
- Lower Cost. With the amassing of actuarial reserves on a current financing basis, the assets of the fund are invested and grow through the return on those investments. This minimizes the tax revenues necessary to pay any given level of pension benefits.
- Benefit Security. The periodic contributions and the resulting investment growth on those contributions help assure the benefit security of present and future pension benefit recipients.
- Reliable Pricing of the Retirement Component of Public Employee Compensation. The cost of public employee retirement coverage in relation to public employee compensation is routinely and reliably computed and is generally available.
- Lower Public Sector Borrowing Costs. Properly funding pension plans to reduce and eventually eliminate unfunded liabilities is viewed favorably by rating agencies and helps reduce the cost of public sector bond issues.

Actuarial methods differ in how they allocate costs over time. An advantage of the entry age normal method used by Minnesota's open plans is that the combination of normal cost (to cover currently incurred pension costs) and the amortization payment (to retire past unfunded obligations) is expressed as an equal percentage of payroll over time. Their use reflects a belief that it is fair and prudent for taxpayers in each period and each generation to equally share the burden for pension costs. It is not realistic anymore to assume that future taxpayers can or should cover pension costs reflecting a higher percentage of payroll than current taxpayers must bear for pension costs than it is realistic to assume that future taxpayers can or should cover other ongoing costs of government or expenses of the public sector.

During the 1960s, a different actuarial method, the unit credit method, was occasionally used by Minnesota public pension plan actuaries to value their plans. The use of this method was reviewed by the Legislative Commission on Pensions and Retirement and rejected in favor of the entry age normal cost method. There have been occasional arguments over the years to shift back to this alternative actuarial method, or a variation on it. The unit credit method allocates cost based on current salary or service credit rather than as a constant percentage of payroll. The approach generally produces cost estimates for a young covered group that are less than the cost that would be allocated as a constant percentage of payroll under the entry age normal method. As the group ages, the computed cost is greater than that which would occur through constant percentage of payroll allocation. The unit credit method has two drawbacks. First, by reducing the apparent current costs of providing any given level of pension benefits, more of the cost is allocated to the future. This cost shifting could be viewed as unfair and future taxpayers may be unwilling or unable to cover the increasing percentage of public sector payroll costs that reflect employer pension contributions. Second, the approach may ultimately require more tax dollars than use of the entry age normal approach. If contributions are less than would be the case under a constant percentage of payroll allocation, there are less assets to earn investment returns to help finance the pensions. This further increases the need for later contributions. The dollar that was not contributed early may require far more than a one-dollar contribution many years later to offset this loss. If the dollar had entered the pension fund early, it would earn many years of investment return. It may require two or three dollars contributed many years later to offset the effect of the dollar that was not contributed earlier. It is the dollar plus all the accumulated investment earnings on that dollar that must now be contributed from tax revenue. The attraction of the unit credit method is that it may appear to save current contributions. If short-term budget needs are an overwhelming consideration, this may be viewed by some to be a sufficient reason to adopt it. There is also some hope that it will never be necessary to impose higher contributions in the future, as suggested by a static analysis of this financing approach. The unit credit method may lower the required contributions compared to the entry age normal approach if the covered group is young and the covered employee group has an unchanging age and service distribution over time. If the group averages show increasing age and average service credit over time, however, required annual pension costs could increase dramatically. Aging of the covered group can be expected if there is a downsizing of government, causing fewer new hires, or if job prospects in the private sector are not favorable, causing reduced member turnover.

When pension plan actuarial accrued liabilities exceed pension plan assets, the plan has an unfunded actuarial accrued liability, which represents the cumulative total of past departures from sound full funding practices, such as past actuarial experience losses, past insufficient contributions, past benefit increases, or a combination of the three. If a retirement plan has an unfunded actuarial accrued liability, sound pension funding practices require that the unfunded actuarial accrued liability be paid or amortized over a reasonable period of time.

The amortization of pension plan unfunded actuarial accrued liabilities depend on the amortization period, measured by the amortization target date, and on whether the amortization contribution is calculated as a level dollar amount or as a level percentage of covered pay.

In Minnesota, amortization contribution requirements are calculated as part of the actuarial valuation process under Minnesota Statutes, Section 356.215, Subdivision 11, but only MERF and local police and fire relief association future contribution amounts are required to change in the following year as a consequence of that actuarial work. For all other Minnesota defined benefit retirement plans, the amortization contribution requirement is advisory, used by the Legislative Commission on Pensions and Retirement and the Legislature to set member and employer contribution rates.

Since 1984, Minnesota has used a level percentage of covered payroll amortization rather than the prior level dollar amortization requirement and has reset the amortization target date on several occasions, usually with a period no longer than 30 years.

The following sets forth the current (6/30/2006 actuarial valuation) full funding target dates for the two plans and for the other statewide and major local retirement plans:

Retirement Plan	Amortization Target Date
MSRS-Correctional	2023
PERA-P&F	2020
State Patrol Retirement Plan	2036
Local Government Correctional Retirement Plan (PERA-Correctional)	2023
MSRS General State Employees Retirement Plan (MSRS-General)	2020
PERA General Employees Retirement Plan (PERA-General)	2031
Teachers Retirement Association (TRA)	2037
Minneapolis Employees Retirement Fund (MERF)	2020
Duluth Teachers Retirement Fund Association (DTRFA)	2032
St. Paul Teachers Retirement Fund Association (SPTRFA)	2021
Judges Retirement Plan	2020

The variation in the full funding target dates used for the various retirement plans for the calculation of the amortization contribution rate is in part a function of Minnesota Statutes, Section 356.215, Subdivision 11, which provides for an automatic extension of the amortization period upon a change in the benefit plan, a change in plan actuarial assumptions, or a change in plan actuarial methods, with a weighted averaging of the prior unfunded actuarial accrued liability portion and the prior amortization period and of the added unfunded actuarial accrued liability portion and a new 30-year amortization period, and is in part a function of revised amortization target dates set legislatively upon the occurrence of other events or for other reasons. The theory underlying good actuarial funding suggests that an unfunded actuarial accrued liability should be amortized over a period that does not exceed the average remaining working lifetime of the active membership. The unfunded actuarial accrued liability basically represents past normal cost contributions that were either not recognized, as would occur if actuarial assumptions are incorrect, or were not made in a timely fashion, as would occur if there is a contribution deficiency. Since normal costs should be funded over the working lifetimes of active members, the amortization of the unfunded actuarial accrued liability derived from unpaid normal costs should similarly be funded over the remaining active working lifetime. The following sets forth the current average age of the active membership of the various statewide and major local retirement plans and compares that age with the normal retirement age of the plan, providing some sense of the remaining average active working lifetimes:

Retirement Plan	2006 Average Age (Actives)	Normal Retirement Age	Remaining Period
MSRS-Correctional	40.2	55	14.8
PERA-P&F	39.3	55	15.7
State Patrol	41.0	55	14.0
PERA-Correctional	38.7	55	16.3
MSRS-General	46.2	65	18.8
PERA-General	46.0	65	19.0
TRA	43.3	65	21.7
MERF	56.5	60	3.5
DTRFA	46.3	65	18.7
SPTRFA	44.6	65	20.4
Judges	56.1	65	18.9

The level percentage of covered pay amortization procedure provides potential contribution rate stability over time when compared to the level dollar amortization period over time, but has the effect of deferring much of the actual payments to reduce the principal amount of the unfunded actuarial accrued liability to the second half of the amortization period, with early period payments less than full interest on the unfunded actuarial accrued liability and with the unfunded actuarial accrued liability actually increasing in amount during the early portion of the amortization period.

The following sets forth a comparison of the amortization contribution rate calculated as part of the July 1, 2006, actuarial valuations with the 8.5 percent interest rate actuarial assumption amount:

Plan	Amortization Target Date	Unfunded Actuarial Accrued Liability	$ Calculated Amortization Requirement	8.5% Interest on Unfunded Actuarial Accrued Liability	Difference
MSRS-General	2020	332,404,901	29,774,591	28,254,417	1,520,174
MSRS-Correctional	2023	112,123,450	8,853,308	9,530,493	(677,185)
Judges	2020	50,450,784	4,620,923	4,288,317	332,606
State Patrol	2036	22,488,729	1,213,074	1,911,542	(698,468)
PERA-General	2031	4,242,549,610	231,431,639	360,616,717	(129,185,078)
PERA-Correctional	2023	7,529,873	550,224	640,039	(89,815)
PERA-P&F	2020	242,613,301	20,977,965	20,622,131	355,834
TRA	2036	1,643,499,040	86,764,874	139,697,418	(52,932,544)
DTRFA	2032	51,303,478	3,012,098	4,360,796	(1,348,698)
SPTRFA	2021	419,700,901	36,420,175	35,674,577	745,598
MERF*	2020	127,373,249	14,265,726	7,642,395*	6,623,331

* *Interest only calculated based on 6.00 percent interest actuarial assumption applicable to this plan*

d. Potential Principle Amendment. The recent legislation that varies from the policy principles dealt primarily with a departure from actuarial funding to non-actuarial funding, with amortization periods, with the introduction of reverse amortization methods when there is a funding surplus, and with the manner in which the actuarial value of assets is defined. The departure from full actuarial funding is the elimination of the prior terminal funding obligation for the Legislators Retirement Plan in favor of a "pay as you go" or current disbursements funding requirement. The amortization changes introduced a "reverse" amortization for those pension plans which have assets in excess of their actuarial accrued liabilities, a post-2010, 15-year amortization period was created for the Minneapolis Police Relief Association and the Minneapolis Fire Relief Association to replace an otherwise immediate 2010 amortization requirement, extended the Public Employees Retirement Association General Employees Retirement Plan (PERA-General) amortization period to 2031, extended the Bloomington Fire Department Relief Association amortization period and the Minneapolis Police Relief Association amortization period to 2020, extended the Teachers Retirement Association (TRA) amortization period to 2037, and removed PERA-General and TRA from the automatic amortization date extension mechanism in the event of benefit increases, actuarial assumption changes, or actuarial method changes.

If the Commission wishes to have the policy principles reflect these recent legislative changes, the Commission staff offers the following potential revisions to the 1995-1996 Principles:

II.D.2. Actuarial Funding of Pension Benefits

a. Except for statewide retirement plans with small phase-out memberships, retirement benefits in Minnesota defined benefit plans should be funded on an actuarial basis.

b. The accruing liability for currently earned pension plan service credit, as measured by the actuarially determined level percentage of covered salary entry age normal cost of the defined benefit pension plan, should be funded on a current basis.

c. The administrative expenses of the defined benefit pension plan should be funded on a current basis.

d. ~~Existing~~ Retirement plan accrued liabilities and normal cost should be determined using the entry age normal actuarial cost method.

e. Pension plan assets should be valued using a method that approaches market values, but smoothes out short-term volatility.

f. Unfunded actuarial accrued liabilities of ~~the~~ a defined benefit pension plan, determined by subtracting the actuarial value of assets from the actuarial accrued liability, should be amortized over a reasonable period of time, and that amortization period should be related to the average working career of the active membership of the pension plan, but should not ~~to~~ exceed forty years.

g. A portion of any amount by which the actuarial value of assets exceed the actuarial accrued liabilities of a defined benefit plan should be recognized as a credit against the normal cost, and the amount of the credit should be calculated in the same manner as if it were an amortization contribution.

Policy Principle Review. Principle II.D.3. Allocation of Funding Burden Between Members and Employers

a. Principle II.D.3. indicates that retirement benefits should be financed on a shared basis between members and employers, with the member and employer share for normal cost and administrative expenses and some portion of the amortization requirement shared on a matching basis for general employee plans, with the member and employer share of total cost on a 40 percent/60 percent basis for statewide public safety plans, and with the member and employer share of pension cost to be determined on a "case-by-case" basis for local public safety plans. Specifically, the principle states:

II.D.3. Allocation of Funding Burden Between Members and Employers

a. Retirement benefits should be financed on a shared basis between the public employee and the public employer.

b. For general public employees, the employee and employer should make matching contributions to meet the normal cost and the administrative expenses of the defined benefit pension plan and both the employee and the employer may be required to share some financial responsibility for funding the amortization requirement of the defined benefit pension plan.

c. For protective and public safety employees covered by a statewide public pension plan, the employee should pay forty percent of the total actuarial costs of the defined benefit pension plan and the employer should pay sixty percent of the total actuarial costs of the defined benefit pension plan.

d. For protective and public safety employees covered by a local relief association, employee and employer contributions should be considered in light of the special circumstances and history unique to that association. Employees should pay an appropriate portion of the normal cost and administrative expenses of the relief association.

b. Recent Variant Public Pension Legislation. Numerous times during the period 1997-2007, pension plan contributions were established or revised. It is unclear that the contribution setting/resetting process has fully accorded with the principle. The following compares the member contribution rate with the normal cost and expenses of the retirement plan and with the total actuarial requirements of the retirement plan:

Retirement Plan	Member Contrib.	Empl'er Contrib.	Empl'er Add'l. Contrib.	Total Support	Normal Cost & Exp.	Total Actuarial Req.	Member Contrib. as % of Normal Cost & Exp.	Member Contrib. as % of Total Act. Req.
	%	%	%	%	%	%	%	%
General Employee Plans								
MSRS-General (2006)	4.00	4.00	--	8.00	8.73	10.11	45.82	39.56
MSRS-General (Full Implementation)	5.00	5.00	--	10.00	8.73	10.11	57.27	49.46
PERA-General	5.63	5.63	0.50	11.76	7.98	12.90	70.55	43.64
PERA-General (Full Implementation)	6.00	6.00	1.00	13.00	7.98	12.90	75.19	46.51
TRA	5.51	5.23	0.57	11.31	9.76	12.11	56.45	45.50
DTRFA	5.50	5.79	--	11.29	9.95	15.19	55.28	36.21
SPTRFA	5.69	8.59	2.05	16.32	9.47	25.02	60.08	22.74
MSRS-Military Affairs	5.60	5.60	--	11.20	11.52	12.90	48.61	43.41
MSRS-Transportation Pilots	5.60	5.60	--	11.20	10.62	12.00	52.73	46.67
MERF	9.75	39.49	46.08	95.33	22.28	95.32	43.76	10.23
Specialty Plans								
Legislators	9.00	--	--	9.00	18.64	111.24	48.28	8.09
Elected State Officers	--	--	--	--	--	--	--	--
Judges	7.59	20.50	--	28.09	18.08	30.73	41.98	24.70
Public Safety Employee Plans								
MSRS-Correctional	5.69	7.98	--	13.67	17.90	23.34	31.79	24.38
MSRS-Correctional (Full Implementation)	8.60	12.10	--	20.70	17.90	23.34	48.04	36.85
State Patrol	8.40	12.60	--	21.00	24.59	26.69	34.16	31.47
State Patrol (Full Implementation)	10.40	15.60	--	26.00	24.59	26.69	42.29	38.97
PERA-P&F	7.40	11.10	--	18.50	22.43	25.57	40.00	32.99
PERA-P&F (Full Implementation)	9.40	14.10	--	23.50	22.43	25.57	41.91	36.76
PERA-Correctional	5.83	8.75	--	14.58	12.28	12.68	47.48	45.98
MSRS-Arson Investig.	6.78	8.20	--	14.98	12.35	13.73	54.90	49.38

Source: 2006 Valuations. Rates are those in effect for FY2006 or upon full implementation of any increase and blend multiple program rates if there are multiple programs.

The retirement plans vary with respect to whether the total contribution rates equal, are greater than, or are less than the current (2006) actuarial requirements, as follows:

Contribution Rates Equal to Requirements		Contribution Rates In Excess of Requirements		Contribution Rates Less than Requirements	
MERF	(95.32/95.32)	PERA-General	(13.00/12.90)	MSRS-General	(10.00/10.11)
		PERA-Correctional	(14.58/12.68)	TRA	(11.31/12.11)
		MSRS-Arson	(14.98/13.73)	DTRFA	(11.29/15.19)
				SPTRFA	(16.32/25.02)
				MSRS-Military	(11.20/12.90)
				MSRS-Transp.	(11.20/12.00)
				Legislators	(9.00/111.24)
				Elective State Officers	(--/--)
				Judges	(28.09/30.73)
				MSRS-Correctional	(20.70/23.34)
				State Patrol	(21.00/26.69)
				PERA-P&F	(23.50/25.57)

c. Policy Analysis and Discussion. Pension plans are classified as being "contributory" or "noncontributory." Contributory pension plans are pension plans where the plan members are required to make a member contribution, while noncontributory pension plans are pension plans where the plan members are not so required. Among defined benefit pension plans, most public sector pension plans are contributory plans and most private sector pension plans are noncontributory plans. Most defined contribution pension plans, public sector or private sector, are contributory plans.

For contributory pension plans, the funding burden must be allocated between the employers and the plan members. The member contributions represent mandatory savings and the employer contributions represent a cost of conducting business and operations.

Minnesota public pension plans, with the exceptions of the pre-1973 judicial retirement plans and most of the current volunteer firefighter relief associations, have required member contributions historically. When Minnesota public pension plans were not subject to any regular actuarial reporting, typically before 1957, member contributions were set without any real basis for comparison other than between pension plans and were set without any adherence to a discernible policy for the allocation of the relevant cost or value between members and employers. During that pre-1957 period of absent or minimal actuarial reporting, employer contributions were also minimal or nonexistent, leading the 1957-1959 predecessor to the Legislative Commission on Pensions and Retirement to make the various employers responsible for amortizing the amassed unfunded actuarial accrued liabilities at that time through the imposition of employer additional contributions beyond the member and regular employer contributions.

Employer responsibility for amortizing existing unfunded actuarial accrued liabilities was Commission policy until the mid-1970s, after the major benefit increases that were enacted in 1973, when the Commission concluded that the employer contribution levels then in existence were sufficient to meet the employer's responsibility for past unfunded actuarial accrued liabilities. At that time, in 1977, the Commission's Principles of Pension Policy provided that members and employers in general employee plans should allocate the amortization contribution requirement for unfunded actuarial accrued liabilities created after January 1, 1977.

Although Commission policy changed the manner for allocating amortization contributions in 1977, Minnesota Statutes, Section 356.215, was not amended to require an actuarial separation of pre-1977 and post-1976 unfunded actuarial accrued liabilities and no clear implementation of the policy in setting contribution rates occurred. The contribution burden for the unfunded actuarial accrued liabilities attributable to the major benefit increases in 1984, 1989, and 1997 tended to roll to employers and, consequently, the taxpayers. Benefit increases granted to the Teachers Retirement Association (TRA), to the State Patrol Retirement Plan, and to the Duluth Teachers Retirement Fund Association (DTRFA) in 1994 and 1995, respectively, were required to be amortized wholly by the members, but the 1997 benefit increase legislation reset the funding requirements of all three plans, essentially washing out that member funded amortization requirement.

With the various post-1995-1996 benefit increases and contribution changes, which resulted in the varied pattern of the level of funding burden allocation set forth in the chart above, the actual underlying policy on the allocation of a pension plan's funding burden between members and employers is unclear.

Among the reasons that the Commission has pursued detailed and reliable actuarial valuation contents items is to produce a normal cost result that clearly measures the value to active members of the retirement coverage provided active members so that active members can be assessed their appropriate share of that value, to produce an administrative expenses charge that accurately measures the current cost of operating the retirement plan so that active members can be assessed their appropriate share of that expense stream, and to produce an amortization contribution requirement that is generally comparable to similar retirement plans and that generally reflects the remaining average active working lifetime of the active membership so that active members can be assessed their appropriate share of that requirement. Although the normal cost and administrative expense actuarial valuation results still provide a reliable relationship basis for setting member contributions, the incremental legislative changes in determining amortization requirements have left the amortization requirement reported in annual actuarial valuations an uncertain basis for use in setting member contribution rates.

If the amortization date of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) were 2031 rather than 2020, the amortization target date of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), MSRS-General would see its actuarial requirements drop by 0.54 percent of covered payroll, reclassifying it from having a contribution deficiency of 0.11 percent of covered pay to having a contribution sufficiency of 0.43 percent of covered pay. Similarly, if the PERA-General amortization target date was reset to match the current MSRS-General amortization target date, PERA-General would see its actuarial requirements increase by 3.15 percent of covered payroll, reclassifying it from having a contribution sufficiency of 0.10 percent of covered pay to a contribution deficiency of 3.05 percent of covered pay. Both plans have comparable average active member attained ages (46.2 for MSRS-General and 45.8 for PERA-General), leaving a potential remaining active working lifetime of about 20 years before the generally applicable Social Security full benefit receipt age of 66, and arguing for a similar amortization target date that is longer than the current MSRS-General date and shorter than the current PERA-General date.

Without more consistency in determining the amortization requirement portion of total actuarial cost, a policy on allocating total actuarial cost between members and employers could be hollow or meaningless.

d. Potential Principle Amendment. Because the portion of the actuarial cost (normal cost or total actuarial cost) borne by Minnesota public pension plan members varies considerably and does not reflect any clear policy, some attention by the Commission to this policy principle would be appropriate.

If the Commission desires to have the policy principle revised, the Commission staff offers the following potential revision to the 1995-1996 Principles:

II.D.3. Allocation of Funding Burden Between Members and Employers

a. The actuarial cost of retirement ~~benefits~~ benefit coverage should be financed on a shared basis between the public employee and the public employer.

b. For general public ~~employees~~ employee retirement plans that are not closed to new members, the employee and employer should make matching contributions to meet the normal cost and the administrative expenses of the defined benefit pension plan ~~and~~. Both the employee and the employer also may be required to share some financial responsibility for funding the amortization requirement of the defined benefit pension plan.

c. For general public employee retirement plans that are closed to new members, the employee and employer contributions should be set based on the contribution structure of analogous retirement plans.

d. For protective and public safety employees covered by a statewide public pension plan, the employee should pay forty percent of the total actuarial costs of the defined benefit pension plan and the employer should pay sixty percent of the total actuarial costs of the defined benefit pension plan.

~~d~~ e. For protective and public safety employees covered by a local relief association, employee and employer contributions should be considered in light of the special circumstances and history unique to that association. Employees should pay an appropriate portion of the normal cost and administrative expenses of the relief association.

f. Actuarial reporting laws should be structured to permit easy application and monitoring of any contribution policy.

Conclusion

This memorandum continues the Commission review and potential reappraisal of its Principles of Pension Policy by analyzing those items of recent pension legislation that are potentially at variance with the 1995-1996 reformulation of the Principles and explores the potential changes in the document to accommodate those apparent policy changes. The next Commission staff issue memorandum will explore the policy issues surrounding topics not currently addressed by the Principles of Pension Policy and will explore the potential additions to the document to provide policy guidance to future Commissions on those topics.

Attachment A

Summary of Pension and Welfare Benefits Administration (PWBA)/ Employee Benefits Security Administration (EBSA) Advisory Opinions 1992-2007

PWBA/ EBSA Opinion	Date of Advisory Opinion	Governmental Entity or Pension Plan	Advisory Opinion Topic	Advisory Opinion Summary	Additional Comments
2006-05A	7/26/2006	Federal Revenue Employee Benefits System	Plan status when various Reserve Banks stock owned by private banks	Govt. plan based Federal Reserve status as instrumentality of the U. S.	
2005-21A	12/21/2005	Utah Transit Auth. Hourly Empl. Retirement Plan	Plan status with inclusions of on leave public employee union officials	Govt. plan unaffected by inclusion of union employees as de minimis	2 nonpublic members out of 1,150 members
2005-17A	6/22/2005	Massachusetts Public Employees Fund	Plan status with inclusion of fund employees	Govt. plan unaffected by addition of nonpublic employees of fund as de minimis	5 nonpublic employees out of 33,600 members
2005-07A	5/3/2005	Georgia State Health Benefit Plan	Plan status with extension to cover federally qualified health center employees	Govt. plan unaffected by addition of de minimis number of nonpublic employees	Addition of 880 nonpublic employees; total of 2,380 nonpublic out of 315,000 members
2005-01A	2/14/2005	Georgia State Health Benefit Plan	Plan status where Agricultural Commodity Commission employees are included	Govt. plan unaffected because Ag. Commodity Commission employees are governmental	
2004-01A	1/27/2004	Boston Teachers Union Health and Welfare Plan	Plan status where school district declines to appoint employer trustees	Govt. plan by establishment and supervision by school district	
2003-18A	12/23/2003	Glynn-Brunswick Memorial Hospital Authority	Plan status when medical facility includes clinics outside establishing local government	Govt. plan status as governmental authority	
2003-16A	11/21/2003	Lower Colorado River Authority Retirement Plan	Plan status with subsidiary corporate employees	Govt. plan status unaffected by inclusion of employees of subsidiary instrumentality	
2003-12A	9/30/2003	Kentucky Employees Retirement Plan	Plan status with Council of State Governments employees	Govt. plan status with multiple government employers	168 CSG employees out of 251,573 members
2002-11A	10/17/2002	New York City/CWA Local 1180 Annuity Fund	Plan status with non-city employee trustees	Govt. plan status unaffected by union trustees	5 nonpublic actives out of 9,000 actives
2002-10A	9/30/2002	University of California Retirement Plan/Stanford University joint venture	Plan status after private emp. service credit grant	Govt. plan status unaffected by credit grant	Transfer back of prior privatized employees
2002-09A	9/6/2002	Port Authority (NY & NJ) Police Benevolent Assoc. Inc Welfare Fund	Plan status	Govt. plan as govt. agency/instrumentality	Entity prev. not given sov. immunity by US Sup. Ct.
2001-08A	8/7/2001	Spartanburg (SC) Water System/Spartanburg Sanitary Sewer District	Disability, health and dental plan status	Governmental plan from agency status	
2001-07A	7/2/2001	Santa Clara County (CA) Transit District	Coverage of public employee union employees	Govt. plan as agency, de minimis no. of nonpublic	3 nonpublic actives out of 1,620 actives
2000-11A	9/22/2000	New York City Fire Variable Supp. Plan	Supplemental retirement plan status	Govt. plan from govt. coll. bargaining; govt. reps. on Bd.	
2000-08A	6/12/2000	Puerto Rico Employees Retirement System	Coverage of privatized telephone system employees	De minimis numb of nonpublic	540 nonpublic actives out of 158,000 actives
2000-07A	5/17/2000	Ohio Civil Service Empl. Assoc. Benefits Trust	Plan status	Govt. plan estab. by coll. bargaining between govt. & union	
2000-06A	5/17/2000	New York Patrolmen's Benevolent Assoc. Annuity & Health Plan	Plan status; coverage of assoc. employees	Govt. plan by coll. bargaining; de minimis number of nonpublic	150 nonpublic actives out of 26,050 actives
2000-04A	3/30/2000	Tulsa Firefighters Health & Welfare Trust	Plan status; coverage of union employees	Govt. plan by coll. bargaining; de minimis number of nonpublic	3 nonpublic actives out of 838 actives
2000-03A	3/27/2000	Santa Barbara (CA) Housing Authority Pension Plan	Plan status	Govt. plan as public corp. deemed by law govt. agency	
2000-01A	2/18/2000	Alaska Public Employees Local 71 Union Trust Fund	Coverage of union employees	De minimis numb of nonpublic	11 nonpublic potential actives/1,488 actives
99-15A	11/19/1999	East Islip (NY) Teachers Assoc. Welfare Trust	Plan status; coverage of union employees	Govt. plan admin. by employee org.; de minimis number nonpublic	1 nonpublic active out of 520 actives
99-10A	7/26/1999	Western Assoc. of Schools & Colleges/CALPERS	Coverage of employees with unclear pub. status	De minimis numb of nonpublic	28 nonpublic potential actives/750,000 actives
99-07A	5/19/1999	Milwaukee City Employees Retirement Plan	Coverage of privatized sewer system employees	De minimis numb of nonpublic	300 nonpublic actives out of 25,221 actives
99-06A	4/6/1999	KY Magistrates & Commis-sioners Assc. Inc./KY Co. Employees Ret. System	Impact of inclusion of potential nonpublic entity	Entity is govt. agency or instrumentality	County creation, financing makes it govt. agency
99-02A	1/25/1999	Craven Reg. Medical Cntr. Pension Plan/TSA Plan	Status of county agency appt'd nonprofit corp.	Entity is wholly owned instrumentality of govt.	Prior IRS govt. status rulings

PWBA/ EBSA Opinion	Date of Advisory Opinion	Governmental Entity or Pension Plan	Advisory Opinion Topic	Advisory Opinion Summary	Additional Comments
97-26A	11/7/1997	Beaufort (NC) Co. Hospital Assc. Empl. Pension Plan	Plan status	Govt. plan from agency/instrumentality status	Hospital is component unit of county
97-20A	9/8/1997	Miami Beach Fraternal Order of Police Ins. Trust	Plan status	Govt. plan from employee org. admin., public employee cov.	
97-05A	2/12/1997	MN Sheriff's Youth Programs TSA Plan	Plan status	Not govt. plan; independent contractor to govt.	Sheriff org. activity not part of official duties
97-02A	1/6/1997	California State University-Hayward Foundation, Inc./CALPERS	Coverage of employees with unclear public status	Govt. plan from agency/instrumentality status	Univ. Pres. controls majority of Corp. Board
96-22A	10/7/1996	KY Assc. of Counties/KY County Empl. Ret. System	Impact of inclusion of entity in pub. pension plan	Entity is govt. agency or instrumentality	Excluded from Unemp. Comp tax as govt. agency
96-20A	9/30/1996	Denver Fire & Police Health Fund/Denver Fire & Police Pension Assoc.	Plan status	Entities are govt. agencies or instrumentalities	Agency/instrumentality status
96-07A	4/12/1996	Federal Home Loan Bank of Pittsburgh Benefit Plans	Plan status	Entity is instrumentality of federal government	Funding, governance from federal govt.
95-27A	11/8/1995	MN PERA Defined Contribution Plan	Plan status; coverage of private ambulance serv. employees	Govt. plan; may not exceed de minimis no private employees	De minimis number not defined
95-25A	10/3/1995	Los Angeles Police Relief Association	Coverage of assoc. employees by plan	Govt. plan; non-govt. employees insignificant percentage	17 assoc. employees/8,500 actives
95-21A	8/25/1995	Ransom (Franklin Co. KS) Hospital Pension & Benefit Plans	Plan status	Govt. plan from agency/instrumentality status	Hospital donated to county; county operated
95-20A	8/23/1995	Grand Rapids (MI) City Coach Lines/Amalg. Transit Union Pension Plan	Plan status	Govt. plan from agency/instrumentality status	Created by joint powers agreement govt. governance
95-15A	6/26/1995	Central Valley (CA) Schools Health & Welfare Trust	Plan status; coverage of Trust & Union employees	Govt. plan; de minimis no. of nonpublic employees	236 nonpublic actives out of 10,987 actives
95-14A	6/26/1995	Minnesota Public Employees Insurance Plan	Plan status; coverage of union employees	Govt. plan with de minimis no. of nonpublic employees	253 nonpublic eligibles out of 183,000 eligibles
95-11A	6/16/1995	CA Charter School #17/ CA State Teachers Retirement Plan	Impact of inclusion of potential nonpublic employees	Govt. plan with de minimis no. of nonpublic employees	150 potential nonpublic /312,000 actives
94-38A	11/28/1994	Southeast Alabama Gas District Benefit Plans	Plan status	Govt. plan as govt. agency/instrumentality	Govt. entity treatment by SSA & NLRA
94-19A	6/13/1994	Appalachian Regional Commission Pension Plan	Plan status	Govt. plan as agency/instrumentality of fed & state	Govt. governance and financing
94-03A	2/17/1994	Addison (MI) Community Hospital	Plan status	Govt. plan as govt. agency/instrumentality	Hospital was in bankruptcy at filing
94-02A	2/14/1994	District of Columbia Bar Deferred Comp. Plan	Plan status	Govt. plan as agency/instrumentality of D.C.	IRS tax exemption from tax for entity
94-01A	2/2/1994	Birmingham (AL) Housing Authority Retirement Plan	Plan status	Govt. plan as govt. agency/instrumentality	Has govt. powers, funded largely by govt.
93-28A	10/12/1993	Capital Metropolitan (Austin TX) Trans. Auth.	Plan status	Govt. plan as govt. agency/instrumentality	Ruling does not apply to mgmt. firm employees
92-10A	3/24/1992	Northern Wisconsin Schools Empl. Benefit Plan	Plan status	Govt. plan as govt. agency/instrumentality	Trust established by various school districts