



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director *JAM*

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

- 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 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

- 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:

1 II.B.1. Creation of New Pension Plans

- 2 a. Minnesota public employers, on their own initiative, without legislative  
3 authorization, should not be permitted to establish or maintain new public  
4 pension plans, except for volunteer firefighter relief associations.
- 5 b. New public employee retirement plans should only be created to  
6 accommodate a group of employees who are newly incorporated into the  
7 public sector, to correct inadequate or inappropriate prior retirement coverage  
8 that cannot be accommodated within an existing public retirement plan, to  
9 effect the consolidation of two or more existing public retirement plans by  
10 replacing those plans, or to provide supplemental retirement coverage that  
11 cannot be accommodated within an existing public retirement plan.
- 12 c. New pension plans for volunteer firefighters should be organized on a county  
13 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.

