



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 (Updated First Consideration Commission Staff Memorandum)

DATE: July 17, 2008

### Introduction

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

The interim topic was 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 interested parties and 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.

This Commission meeting is the third consideration of the topic by the Commission. The Commission staff expects Commission consideration on the topic to require two or three additional meetings to complete the project.

This Commission staff issue memorandum is an update of the initial memorandum on the Commission interim study. This memorandum will summarize the history of the Legislative Commission on Pensions and Retirement, summarizes the initial development of the Commission's principles of pension policy, summarizes the 1995 reformulation of the pension policy principles, identifies the pension legislation enacted during the period 1997-2008 that appears to be at variance with the 1995-1996 reformulated pension policy principles, and identifies the 1997-2008 pension legislation that raised issues that are not addressed specifically by the current version of the principles of pension policy. This revised Commission staff issue memorandum is intended to provide a context for additional consideration by the Commission of potential modifications in the principles of pension policy. Subsequent Commission issue memoranda will provide a more detailed policy discussion of the current pension policy principles that Commission members conclude may need revision or restating in light of recent pension legislation and of the policy items that are not currently addressed by the principles of pension policy and that Commission members believe should be addressed.

### History of the Legislative Commission on Pensions and Retirement

- a. Predecessor Commission. The initial special legislative body to review public pension issues was the Interim Commission to Study Minneapolis Pension Systems, created by Laws 1943, Chapter 449. The 1943 Interim Commission was comprised of three members of the Senate and three members of the House of Representatives. All members of this interim commission were from Minneapolis. The 1943 Interim Commission issued a report to the 1945 Legislature, which dealt with the soundness of the various Minneapolis public pension plans, the fairness of the benefits and cost, their comparative position relative to pension plans of other similarly sized cities, and the possibility for consolidating the various plans. From the concurrent resolution of the Legislature reprinted in the report of the 1943 Interim Commission, the commission was created as a means to handle persistent demands for retirement benefit increases in a time other than a busy legislative session and as a means to assemble sufficient actuarial or other experts to investigate the costs of proposed benefit increases. No significant legislation enacted by the 1945 Legislature appears to have resulted from the work of the 1943 Interim Commission.
- b. Interim Pension Commissions. Until 1955, there was no special legislative body with specific jurisdiction over Minnesota public pension plans. In 1955 (Laws 1955, Chapter 829), the Legislature created a legislative commission to report on retirement benefit plans available to government employees. In addition to the Legislative Research Committee, established in 1947, which dealt with various studies and topics, the 1955 Legislature created 24 interim commissions, including the 1955

Public Retirement Interim Commission. According to O. M. Ousdigian, the late retired Executive Director of the Public Employees Retirement Association (PERA), the motivation for the creation of the 1955 Public Retirement Interim Commission was the likelihood of a near term default on benefit payments by PERA and the need to provide PERA and the other major public pension plans with a regularized source of employer funding. The Legislature reportedly modeled the 1955 Public Retirement Interim Commission on the Wisconsin Retirement Laws Commission.

The Public Retirement Interim Commission was reestablished four times over the next five bienniums, in 1957 (Extra Session Laws 1957, Chapter 13), in 1959 (Extra Session Laws 1959, Chapter 82), in 1963 (Laws 1963, Chapter 888, Section 9), and in 1965 (Laws 1965, Chapter 888, Section 5). The various public retirement interim commissions functioned during the interims between the biennial legislative sessions primarily to study pending pension problems, to formulate recommendations on those problems, and to produce a biennial report that contained the recommendations of the Commission as to future legislative enactments relating to the State's various public pension plans. No public retirement interim commission was established by the 1961 Legislature.

- c. Permanent Pension Commission. The 1965 Public Retirement Systems Interim Commission recommended to the Legislature the creation of a permanent Legislative Commission on Pensions, and the 1967 Legislature created the Legislative Retirement Study Commission as a permanent legislative commission (Laws 1967, Chapter 549, coded as Minnesota Statutes, Section 3.85). That Pension Commission was scheduled to terminate its duties on June 30, 1973, under terms of the 1967 legislation. In 1971 (Laws 1971, Chapter 818), the 1973 expiration date for the Pension Commission was eliminated. In 1975, the name of the Pension Commission was changed from the Legislative Retirement Study Commission to the Legislative Commission on Pensions and Retirement (Laws 1975, Chapter 271, Section 3). In 1984, the duties of the Pension Commission were expanded with the addition of authority to issue standards for public pension actuarial work, the addition of the requirement of hiring a major actuarial consulting firm to prepare the regular actuarial valuations of the largest Minnesota public pension plans, and an increase in the Commission budget (Laws 1984, Chapter 564, Sections 1 and 2).
- d. Mid-1990s Reviews of the Pension Commission Role and Function and Their Aftermath. In 1994, largely in response to complaints from former Representative Wayne Simoneau and from a former PERA Executive Director, James Hacking, the Legislative Audit Commission undertook a review of the adequacy of the oversight of local public employee pension plans. The Office of the Legislative Auditor retained an independent consultant, Allan Baumgarten, to conduct the review and prepare a report for the Legislative Audit Commission.

In 1995 (Laws 1995, Chapter 248, Article 2, Section 6) virtually every legislative commission, including the Legislative Commission on Pensions and Retirement, were scheduled to sunset on July 1, 1996, unless the Legislative Coordinating Commission affirmatively elected to continue the operation of the particular commission by January 1, 1996. The Legislative Coordinating Commission elected to continue the operation of the Legislative Commission on Pensions and Retirement in December 1995, after conducting review hearings. The 1997 Legislature (Laws 1997, Chapter 202, Article 2, Section 5) increased the membership of the Legislative Commission on Pensions and Retirement from ten (five House of Representative members and five Senate members) to 12 (six House of Representative members and six Senate members). In 1999 (Laws 1999, Chapter 222, Article 20), the membership of the Legislative Commission on Pensions and Retirement was reduced back to ten members.

In 2004 (Laws 2004, Chapter 223, Section 6), the duty previously assigned to the Commission to select and retain the consulting actuary to prepare the regular actuarial work for the statewide and major local Minnesota public pension plans was reassigned to the various pension plan administrators acting collectively. The reassignment of the consulting actuary retention duty was accompanied by a reduction in the Commission budget.

- e. Institutional Position within the Legislature and Nationally. Within Minnesota, the Legislative Commission on Pensions and Retirement is the second oldest joint legislative agency created by the Minnesota Legislature that is still in operation. The oldest operating Minnesota joint legislative agency is the Office of the Revisor of Statutes, which was established as a temporary entity in 1851, was established as a permanent entity in 1939, initially in the judicial branch, and was transferred to the legislative branch in 1973 (Laws 1973, Chapter 598, Section 2, Subdivision 6).

Nationally, the Minnesota Pension Commission is the second oldest public employee retirement commission. The predecessor to the current Wisconsin Joint Survey Committee on Retirement Systems was created in 1945 and is the oldest pension commission of general jurisdiction. The

Massachusetts Commission, established in 1958, and the Nebraska Commission, established in 1959, are the third and fourth oldest public employee retirement commissions.

- f. Changes in Pension Commission Emphasis. During the early period of the operation of the Pension Commission as a permanent legislative entity, largely 1967 through 1971, the Pension Commission slowly made the transition from an interim commission, with its primary work product focus being the production of a biennial report with policy recommendations, to a legislative policy making body, with its primary work product focus being the processing of proposed pension legislation. The Commission continued to issue a biennial report, prepared during the interim until the early 1980s, but the report evolved to become less of a collection of Commission recommendations about pension law changes, with a supporting policy argument, and to become more of a summary of the actuarial and financial information routinely collected by the Commission. During the period after 1967, proposed pension legislation also began to be handled by the respective legislative bodies on a less fragmented basis, with the jurisdiction over proposed pension legislation assigned typically to a single standing committee rather than the previous practice, where proposed legislation was assigned based on the nature of the employee group (i.e., judicial pensions assigned to the Judiciary Committee, teachers pensions assigned to the Education Committee, or municipal employee pensions assigned to the Local Government Committee). After 1971, during the legislative session, the Commission began to function as a joint meeting of the pension committees or pension subcommittees of the respective legislative bodies. Since the 1980s, the appointment of specific pension subcommittees has become more episodic.

Over the last two decades, the Pension Commission has evolved into its current manner of operation, processing proposed pension legislation during the legislative session in advance of the applicable standing committee bill hearing deadline and undertaking a schedule of study topics during the interim between legislative sessions. By longstanding agreement, the standing committees with jurisdiction over pensions, currently the House Committee on Governmental Operations, Reform, Technology and Elections and the Senate Committee on State and Local Government Operations, do not typically schedule proposed pension legislation for a hearing until it has been reviewed and recommended by the Pension Commission. The Pension Commission regularly schedules hearings on proposed pension legislation prior to the established initial bill hearing deadline and processes a considerable portion of the proposed pension legislation that is introduced annually. The Pension Commission generally reviews about 85 percent of the proposed pension legislation introduced during a legislative session and recommends for forwarding to the relevant standing committees about one-half of proposed pension legislation introduced. During the interim between legislative sessions, the Commission selects an agenda of public pension topics for study and considers those topics at regular or periodic Commission meetings during the interim. The public pension topics for interim study largely arise out of proposed pension legislation from the prior legislative session, where the proposed legislation did not receive final Commission action because it required additional technical work, required additional actuarial work, or required more extensive debate and consideration than would be possible during the legislative session. Pension Commission consideration of proposed legislation typically includes the preparation of a Commission staff policy issue memorandum based significantly on the Commission's Principles of Pension Policy.

#### Principles of Pension Policy

The Principles of Pension Policy document, as reformulated by the Commission during the 1995-1996 and 1996-1997 interims, and adopted in December 1996, is attached as Appendix A.

#### 1997-2008 Pension Legislation Potentially at Variance with the Commission's Principles of Pension Policy

- a. In General. As last reformulated in 1995-1996 by the Commission, the Principles of Pension Policy have 39 substantive principles and five procedural principles. Of those 39 substantive principles, pension legislation during the 1997-2008 sessions directly touched upon at least 21 principles. With respect to 18 substantive principles, this recent pension legislation suggests a potential departure from or a potential need for a modification in the applicable principle.
- b. Principles for Potential Review.
1. Principle II.A.1. Purpose of Minnesota Public Pension Plans indicates, among other items, that Minnesota public pension plans exist to assist in the systematic out-transitioning of existing public employees at the normally expected conclusion of their working careers in providing retirement benefits.

One item of 1997-2008 pension legislation is potentially at variance with the principle. In 2008, the exemption amount for reemployed annuitants covered by the Teachers Retirement Association (TRA) or by a first class city teacher retirement fund association was increased dramatically, from the Social Security earnings test amount (\$13,580 for ages under the Social Security full unreduced benefit receipt age in 2008) to \$46,000, consciously attempting to blur the line between employment and retirement and essentially permitting coincidental full-time employment and retirement benefit receipt (Laws 2008, Ch. 349, Art. 3, Sec. 8, 10, and 12). The payment of retirement annuities to full-time or near full-time teachers will reduce or eliminated that out-transitioning assistance.

2. Principle II.B.1. Creation of New Pension Plans indicates a general disfavor for 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.

Three items of 1997-2008 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 (PERA-Correctional) (*Laws 1999, Ch. 222, Art. 2*).
- 3) In 2008, a voluntary statewide volunteer firefighters' retirement plan advisory board was created as a first step in creating a voluntary statewide volunteer firefighters' retirement plan (*Laws 2008, Ch. 349, Art. 14, Sec. 12*).

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) plan 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. The voluntary statewide volunteer firefighters' retirement plan advisory board, scheduled to dissolve on August 1, 2009, is intended to draft legislative recommendations for establishing, organizing, and administering a statewide lump sum retirement plan for volunteer firefighters.

3. Principle II.B.3. Consolidation of Public Pension Plans 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.

There were three items of 1997-2008 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 phasing out into a municipal trust fund upon having fewer than 100 active members (*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 2006 total members (active, retired or survivor) rather than fewer than 100 (*Laws 2005, First Special Session, Ch. 8, Art. 11, Sec. 9*).

The Minneapolis Firefighters Relief Association legislation and the Minneapolis Police Relief Association legislation departed from the eventual elimination of the local pension plan that had

been previously mandated. The general volunteer firefighter relief association consolidation authority does not result in county or regional consolidated pension plans.

4. Principle II.C.1. General Preference for Defined Benefit Plans over Defined Contribution Plans 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.

There were two items of 1997-2008 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), 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 PERA Defined Contribution Plan (*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 be a reaction to a perception about the nature of the pre-1997 coverage. 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.

5. Principle II.C.4. Appropriate Normal Retirement Ages suggests that the normal (unreduced for early retirement) retirement ages should be set based on the employability limits of average public employees and will be different for public safety employees when compared with general employees.

There were two items of 1997-2008 pension legislation that is potentially at variance with the principle to some degree.

- 1) In 1997, eight years after setting the general employee retirement plan normal retirement age for post-1989 hires indexed to the Social Security unreduced benefit receipt age, with a maximum of age 67, the maximum 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 about any change in the employability limits of the average post-1989 hires that would substantiate the need for the change.
  - 2) In 2008, the exemption amount for reemployed annuitants covered by the Teachers Retirement Association (TRA) or by a first class city teacher retirement fund association was increased dramatically, from the Social Security earnings test amount (\$13,580 for ages under the Social Security full unreduced benefit receipt age in 2008) to \$46,000, consciously attempting to blur the line between employment and retirement and essentially permitting coincidental full-time employment and retirement benefit receipt (*Laws 2008, Ch. 349, Art. 3, Sec. 8, 10, and 12*).
6. Principle II.C.5. Appropriate Early Retirement Reductions suggests 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 on an actuarial equivalent basis.

Three items of 1997-2008 pension legislation are potentially at variance with the principle to some degree:

- 1) In 1997, the 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, 6, and 8*).

- 3) In 2008, the exemption amount for reemployed annuitants covered by the Teachers Retirement Association (TRA) or by a first class city teacher retirement fund association was increased dramatically, from the Social Security earnings test amount (\$13,580 for ages under the Social Security full unreduced benefit receipt age in 2008) to \$46,000, consciously attempting to blur the line between employment and retirement and essentially permitting coincidental full-time employment and retirement benefit receipt (*Laws 2008, Ch. 349, Art. 3, Sec. 8, 10, and 12*).

The State Patrol Retirement Plan and PERA-P&F early retirement reduction factors are so slight after the 1999 change that the only logical next step to provide a benefit increase would be to reset the normal retirement age for the two plans at age 50 rather than age 55. The expanded exemption amount from the application of early retirement reduction factors for teacher retirement plans provides no encouragement for retirement at a predictable time and permits the receipt of pension benefits coincidentally while remaining a full-time employee or virtually a full-time employee.

7. Principle II.C.6. Uniformity and Equal Treatment Among Plans suggests there should be equal treatment in terms of the relationship between benefits and contributions among the various plans and, as nearly as practicable, within the confines of plan demographics, retirement benefits and member contributions should be uniform.

Two items of 1997-2008 pension legislation are potentially at variance with the principle.

- 1) In 2006, accompanying the consolidation of the former Minneapolis Teachers Retirement Fund Association (MTRFA) into the statewide Teachers Retirement Association (TRA), the prospective (post-July 1, 2006) TRA benefit accrual rate was increased from 1.7 percent of the final average salary to 1.9 percent of the final average salary, without a similar benefit increase for any other teacher retirement plan or any other general employee retirement plan (*Laws 2006, Ch. 277, Art. 3, Sec. 8*).
- 2) In 2008, the reemployed annuitant earnings exemption amount was significantly increased for TRA and for the first class city teacher retirement fund associations, but no comparable exemption amount increase was implemented for other statewide public employee retirement plans (*Laws 2008, Ch. 349, Art. 3, Sec. 8, 10, and 12*).

In neither instance did the pension legislation specify any basis for distinguishing between the retirement plan or plans that received the benefit change and the retirement plans that did not.

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

Three items of 1997-2008 pension legislation are potentially at variance with the principle to some degree.

- 1) In 2001, 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*).
- 2) In 2006, a special interim study by the Commission was mandated, comparing various retirement benefit plan provisions of Minnesota teacher retirement plans with those of other states (*Laws 2006, Ch. 277, Art. 7, Sec. 1*).
- 3) In 2008, another special study of Minnesota teacher retirement benefit coverage was mandated, again reviewing teacher retirement adequacy by comparing benefit levels with those in other states (*Laws 2008, Ch. 349, Art. 1, Sec. 7*).

The Minneapolis Fire 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, although marital status is not a factor in the policy principle. The teacher retirement adequacy studies appear to be premised on a sense by active plan members that

