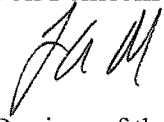


TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director 

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

DATE: July 18, 2008

### Introduction

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(Laws 1994, Ch. 602, Sec. 2), when the Minnesota State Colleges and Universities System (MnSCU), as the employer, on a select basis, was permitted to retain a retiring faculty member for up to two-thirds of full time to cover short-term course load needs or expertise needs. As a limited practice, initiated by one employer with respect to a relatively small employee group, the 1994 authority had modest policy implications. The 2008 change, covering a sizable employee group and no longer wholly a management tool, does raise significant concurrent retirement-employment policy concerns.

- d. Potential Principle Amendment. If the Commission no longer believes that out-transitioning of public employees reaching the conclusion of their normally expected active employment period is a valid goal for Minnesota public pension plan design and phased retirement is an appropriate replacement purpose, the following is the Commission staff's attempt to replace out-transitioning with phased retirement as part of the specified purposes for Minnesota public pension plan design:

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

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

Alternatively, if the Commission wishes to retain out-transitioning as a public pension plan purpose and also wishes to accommodate a phase-out into retirement rather than a precipitous shift from full-time employment to no substantial gainful employment, the following is the Commission staff's attempt to adapt the current principle statement to include phase-outs into retirement:

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

10 Minnesota public pension plans exist to augment the Minnesota public employer's  
11 personnel and compensation system by assisting in the recruitment of new qualified  
12 public employees, the retention of existing qualified public employees, and the systematic  
13 outtransitioning of existing public employees at the normally expected conclusion of their  
14 working careers or the systematic phasing-out of existing employees who are nearing the  
15 normally expected conclusion of their full-time working careers by providing, in  
16 combination with federal Social Security coverage, personal savings and other relevant  
17 financial sources, retirement income that is adequate and affordable.

Policy Principle Review: Principle II.B.1. Creation of New Pension Plans

- e. 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.

- f. Recent Variant Public Pension Legislation. 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 firefighter 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 firefighter 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.

- g. 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 MSRS General State Employees Retirement Plan (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.

