Background Information on Teacher Retirement Plans

1. Creation of Teacher Retirement Plans. After police officers and firefighters in some of the larger cities in the state, teachers were the first group of public employees in Minnesota to achieve public pension coverage. Teacher retirement funds in cities with a population greater than 10,000 (first, second, or third class cities) were authorized by the Legislature in 1909 (Laws 1909, Ch. 343, Sec. 1), but no cities other than the first class cities created teacher retirement funds. A statewide teachers' retirement plan, the Teachers Insurance and Retirement Fund, was created by the Legislature in 1915. The three first class city teacher retirement funds that had been established a few years earlier were left as freestanding organizations, while the Teachers Insurance and Retirement Fund provided coverage for teachers outside of the first class cities. The Teachers Insurance and Retirement Fund was replaced by the Teachers Retirement Association (TRA) in 1931. In 2006, the Minneapolis Teachers Retirement Fund Association (MTRFA) was merged into TRA. Currently, public pension plan coverage for K-12 public school teachers is provided by teacher retirement fund associations for teachers employed in Duluth (the Duluth Teachers Retirement Fund Association (DTRFA)) and in St. Paul (the St. Paul Teachers Retirement Fund Association (SPTRFA)), and by TRA for all Minnesota public school teachers outside of those two cities.

2. Organization. The remaining first class city teacher fund associations are nonprofit corporations. As Minnesota nonprofit corporations, these associations are governed by articles of incorporation and corporate bylaws. However, in recent decades, when coordinated employee plans (discussed below) were created in the first class city teacher fund associations, these provisions were created in state law and coded in statute. Board responsibilities, fiduciary responsibilities, and investment authority are also specified in law. Increasingly, these associations are becoming governed by state law.

   The benefit provisions of the early first class city teacher fund association pension plans, which are referred to as basic plans, were specified in the bylaws. Amendments to the articles of incorporation or bylaws require membership approval at an annual meeting. Each retirement fund association has a separate board. These boards tend to be composed of active teacher representatives, retired teacher representatives, and probably school district representatives, but there is no state representative on the remaining first class city teacher fund association boards, despite receiving considerable state aid. The activities of each association are handled by an executive secretary or an executive director and a separate administrative staff, all hired by the board or its agent, the executive secretary or executive director. These boards, through their executive directors and staff, are responsible for all administrative activities, which includes the proper determination of benefits, and for the investment of all retirement fund assets.

   In the 1970s or earlier, coordinated programs (plans in which the individual has Social Security coverage in retirement in addition to the benefit provided by the teacher pension fund plan) were established in many Minnesota public pension systems, including the first class city teacher fund associations and TRA. These coordinated plans pay a lower benefit than a basic plan (one in which the individual is not covered under the Social Security system due to the current covered employment) in recognition that the individual also receives Social Security monthly benefits in retirement, but the coordinated teacher plan contribution rates are correspondingly lower. The coordinated plan benefits provided by DTRFA, SPTRFA, and TRA are specified in statute, rather than in bylaws. In recent decades, the Legislature has also placed controls on the basic plans, by not permitting changes in the applicable bylaws specifying those benefits unless authorized by the Legislature.

   While the remaining first class city teacher fund associations are nonprofit corporations, TRA's status in unclear. It is not a nonprofit corporation, but we also find no language to indicate that it is a state agency. TRA's board composition is similar to those of the first class city teacher fund associations, except that TRA's board does have state representatives, the Commissioner of Education and the Commissioner of Management and Budget, or their designees. TRA's board functions similarly to those of the first class city teacher fund association boards, except that TRA does not invest its own fund assets. These are invested by the State Board of Investment.

3. Teacher Plan Retirement and Post-Retirement Benefits. When coordinated plans were first established in the then-existing three local teacher plans, the legislation was patterned closely after TRA coordinated plan law. Over the years, at times the coordinated plans of the local teacher plans and TRA departed slightly, due to benefits initially enacted for one plan but not others. At the current time, benefits at retirement are slightly higher in TRA than in the two first class city teacher plans.

   The benefit to a member at retirement is determined by a formula, with the retiring teacher receiving an annual benefit which is a fraction of the high-five average salary. (Typically, the high-five average salary is defined as the average salary over a five-year period that produces the highest average.) For each year of service, a retiring DTRFA or SPTRFA member retiring at approximately age 65 receives

1.7% of the high-five average salary for each year of service, assuming the member is a coordinated member. TRA's benefit is slightly higher because TRA coordinated members were granted a benefit improvement when the MTRFA merged into TRA. For TRA, if the individual retires at approximately age 65 the individual receives 1.9% of the high-five average salary for each year of service provided after June 30, 2006, and 1.7% for prior years of service.

Basic members of teacher plans receive a somewhat higher percentage than those of coordinated members, because basic members do not accrue credit toward Social Security benefits due to the teaching service. However, very few active basic members remain in these plans. The DTRFA has no basic members. As of the July 1, 2010, actuarial valuation, SPTRFA had 69 basic members, compared to 3,768 coordinated members. TRA has over 77,000 active members in total, and no remaining long-term TRA basic members. It does have some basic members who transferred into TRA from the MTRFA merger.

Post-retirement adjustment procedures for all benefit recipients from these plans were recently revised, following worsening financial condition due to the market collapse of 2008 and early 2009. TRA had provided a 2.5% annual increase. Instead, in 2011 and 2012 TRA will provide no increase. In 2013 and thereafter, a 2.0% increase will be provided until financial stability is achieved, defined as when the fund's market value is at least 90% of the fund's accrued liabilities. The previous DTRFA procedure, payment of an annual 2.0% increase plus additional amounts if the fund's five-year return exceeded 8.5%, is replaced with no increase at all until the DTRFA funding ratio, based on market value, is at least 80%. A 1.0% increase will be provided when the funding ratio is at least 80% but less than 90%. After a 90% ratio is achieved, the plan's post-retirement adjustments will match inflation up to 5%. The SPTRFA waived any increase in 2011. After that, a 2.0% increase will be paid.

4. <u>Benefit Differences between General Employee Plans</u>. Longstanding legislative policy sought consistency between plans covering similar employees. Consistency reflects notions of fairness. Similar employees should be treated comparably.

   The current situation is at odds with longstanding policy. Public retirement plans can be divided into two broad groups, public safety plans and general employee plans. Currently there are differences in benefits at retirement and post-retirement between plans, particularly in general employee plans. Public safety plans currently differ regarding post-retirement adjustments. General employee plans differ both in benefits at retirement and post-retirement. General employee plans include teacher plans; the Minnesota State Retirement System General Plan (MSRS-General), which covers most state employees; and the Public Employees Retirement Association General Plan (PERA-General), which covers local and county nonpublic safety employees including non-teacher school district employees (janitors, cafeteria staff, school bus drivers, and similar employees). Regarding the general employee plans, MSRS-General, PERA-General, and the two first class city teacher plans provide benefits at retirement that generally are comparable across these plans. The exception is TRA. The TRA accrual rate benefit increase at the time of the 2006 merger of MTRFA into TRA placed that plan out in front of the other general employee plans.

   In the past, a benefit improvement in a general employee plan has lead to comparable changes in the remaining general employee plans. The situation has been similar in the public safety plan group. If differences in teacher plans or other general employee plans remain, this may be an important legislative consideration in any potential proposal to merge one or both of the remaining first class city teacher plans into TRA. The Legislature may need to consider the cost and other implications of providing those comparable benefits to the members of merged local teacher plans, and also to MSRS-General and PERA-General.

   Long term, the Legislature also may need to address differences in post-retirement adjustments in these plans. Inflation impacts all Minnesota retirees, but at the current time PERA, MSRS, and each teacher plan have different post-retirement adjustment procedures. In part this current situation is due to the Financial Sustainability Provisions passed as Laws 2010, Chapter 359, Article 1, which the pension plan administrations had proposed to address the harm done to the plans by the Great Recession of 2008-2009. Reducing liabilities was the overriding concern of the plan administrations, which resulted in a considerable tradeoff against the objectives of consist, fair treatment.

5. <u>Coverage Groups</u>. The primary group covered by TRA and the two teacher retirement fund associations is the teaching and certificated administrative personnel of the applicable school districts. Membership is generally mandatory. The administrative staff of TRA and the first class city teacher retirement fund associations also is included in the membership of the respective retirement fund association. Other school district administrative personnel who do not require state Department of Education certification are covered by PERA-General.

6. State Role in Funding Local Teacher Plans. The state plays a significant role in financing all teacher retirement organizations. A few decades ago, the state directly covered all or part of the employer cost of the local teacher pension fund, either through direct payments to cover the local employer pension cost or by adding additional amounts to the basic state education aids. During the 1990s, the state has further increased its financial commitment to local teacher plans by creating new additional state aids above amounts provided through the education aids system. Details of these trends since the late 1960s are outlined in the remainder of this section.

   In 1967, with the initial passage of a state sales tax, the state's employer contribution to the statewide TRA shifted from a statewide property tax levy (on all taxable property outside the first class cities) to direct general fund financing. The state paid a portion of the employer pension costs. At the same time, the state also began to directly participate in the funding of the first class city teacher retirement funds. The initial state funding of the first class city teacher retirement funds was a specified dollar amount per member, set to equal the proportional state funding provided to TRA.

   In 1969, the aid procedures were changed to provide the first class city teacher funds with the same percentage of payroll amount as provided to TRA-covered employers. The balance of any required employer contributions to the first class city teacher retirement fund associations remained payable from property taxes levied by the respective school district.

   In 1975, legislation abolished the authority for Special School District No. 1, Minneapolis, Independent School District No. 625, St. Paul, and Independent School District No. 709, Duluth, to levy local property taxes for their respective first class city teacher retirement fund associations, provided that the state would bear the total responsibility for funding the employer contribution requirement of the first class city teacher retirement fund associations.

   In 1979, state funding of all teacher retirement plans was increased modestly and the state aid for these local teacher plans was specified for each teacher retirement fund association and each retirement program (basic or coordinated) as a percentage of covered payroll.

   Under 1985 legislation, responsibility for the payment of employer contributions to teachers retirement plans and employer Social Security contributions for TRA and the first class city teacher retirement fund associations was shifted from direct general fund financing to the employing units, effective for the July 1, 1986—June 30, 1987, fiscal year. The responsibility shift was accompanied by the creation of a teacher retirement cost state aid formula, based on the historical retirement costs per pupil. This formula provided employer retirement financing sufficient to cover the same percentage increase in per-pupil retirement costs in each district, with the school district being required to pay from other revenue sources any retirement costs not covered by the aid as the result of higher-than-average compensation levels or salary increases beyond the aid inflation factor, or higher staff-to-pupil ratios than the average.

   In 1993 and 1994, in response to growing recognition that contribution deficiencies in MTRFA and SPTRFA needed to be addressed, statutory contribution rates were revised, various assessments were created, and new state aids were authorized for MTRFA and SPTRFA. The new program was called special direct state aid. Regarding the SPTRFA, the employer additional rates were revised to create, for the 1995-1996 school year and after, a 3.64% of pay employer additional contribution on behalf of all SPTRFA members, identical to that of the statewide TRA. Under the new special direct state aid program, the state would give SPTRFA $500,000 in 1994, increasing by the rate of increase in the general education revenue formula thereafter. No local match was required. SPTRFA members are also required to make an additional member payment to offset a portion of the administrative expenses of SPTRFA that are proportionally greater than those of the statewide TRA.

   The 1996 Legislature added a further state aid program to assist MTRFA and SPTRFA. Beginning with the 1996 aid payments, 70% of any unallocated amortization or supplemental amortization state aid not used for police and paid fire relief associations and consolidation accounts was to be redirected to MTRFA and SPTRFA. Of the redirected aid channeled to these two teacher associations, MTRFA would receive 70% and SPTRFA would receive 30% of the allocation. No local match was required for 1996 and 1997, but additional local contributions were required in 1998 and thereafter. For SPTRFA, the St. Paul school district must make a contribution to the fund of $200,000 in fiscal 1998, $400,000 in fiscal 1999, $600,000 in fiscal 2000, and $800,000 in fiscal 2001 and thereafter.

   The 1997 Legislature, as part of a major benefit improvement bill, again revised SPTRFA and MTRFA state aid. Rather than continued receipt of $500,000 in annual state direct aid annually, escalated over time with increases in general education aids, the SPTRFA will receive $4.827 million in fiscal 1998, and $2.827 million annually thereafter, without any local match.

   The 1999 Legislature, as part of legislation merging PERA consolidation accounts into the Public Employees Police and Fire Retirement Plan (PERA-P&F), revised procedures for reallocating additional amortization aid. If aid is released or unallocated because the Minneapolis police and fire

relief associations and Virginia Fire Department Relief Association have no unfunded liability, 49% of any reduction is to be allocated to MTRFA and 21% to SPTRFA, if these two teacher funds had investment performance at least matching a conservatively managed index total portfolio. The 2000 Legislature revised amortization aid provisions to continue these aids until MTRFA and SPTRFA are fully funded.

In 2006 the MTRFA was merged into TRA, and any aids that under prior law are payable to the MTRFA were redirected to TRA. Any state aid to the Minneapolis Employees Retirement Fund (MERF) not required, given MERF funding procedures, was instead allocated toward MTRFA unfunded liabilities. Also, state aid to all school districts, including Minneapolis, was increased by one-half percent.

The 2008 Legislature revised direct state aids to teacher plans. $346,000 was allocated to DTRFA, restarting aid to that association which had terminated when that association became fully funded in 2002. The TRA direct aids on behalf of MTRFA were reduced by that same amount. The SPTRFA aid was reduced by $140,000. Supplemental contributions, which Special School District No. 1, Minneapolis, and the City of Minneapolis must pay to be eligible to receive amortization and supplemental amortization aid not used for local police and paid fire relief associations, must continue to be paid to TRA until TRA is fully funded or until 2037, whichever is earlier, rather than until 2037. Once the SPTRFA funding ratio equals or exceeds that of TRA, the special direct state aid payment to that organization is redirected to TRA.

In 2009, amortization and supplemental amortization aid to the teacher plans was readjusted. DTRFA is newly added to the reallocation, to receive 10% of any reallocated aid. Reallocations to TRA on behalf of the MTRFA and to SPTRFA are reduced.

7. Historic Funding Concerns. Since 1970, or earlier, the MTRFA had a history of funding problems. Causes included investment performance which often lagged the index returns used as performance benchmarks, and underperformance relative to the returns earned by the State Board of Investment, which invests the assets of TRA and other statewide public pension funds. A key contributor to funding problems was a faulty post-retirement adjustment procedure, enacted in 1993 at the request of the MTRFA, which paid out more than could be sustained by the fund. MTRFA assets fell below the amount necessary to fully fund the pensions of its then-existing pensioners. Given the structure of the post-retirement adjustment procedure, once assets fell below that level, it became impossible to improve the plan's funding condition through investment performance. Any investment returns above the plan's assumed actuarial return, 8.5%, flowed out of the fund to the retirees as post-retirement adjustments. Funding ratios continued to deteriorate and contribution deficiencies widened. Faced with eventual default, the MTRFA was merged into TRA in 2006.

   The faulty post-retirement adjustment procedure enacted in 1993 for the former MTRFA was extended to DTRFA in 1995 and to SPTRFA in 1997, at the request of these plan administrations. In recent years both of the two remaining first class city teacher plans have moved away from the problematic post-retirement adjustment procedure. In response to legislative concerns about deterioration of the SPTRFA funding condition, in 2006 a 5% increase cap was placed on SPTRFA post-retirement adjustments, but this was not to be effective until 2010. This cap was due to an amendment by the House State Government Finance Committee. In 2007, the SPTRFA post-retirement adjustment procedure was revised by implementing a temporary two-year procedure under which the post-retirement adjustment would match inflation up to 2.5%, or up to 5.0% if the fund's investment returns were at least 8.5%. In 2009, the SPTRFA post-retirement adjustment provision was again revised, for a two-year period, to provide an inflation match up to 5.0% regardless of investment performance.

   The investment markets collapsed in 2008 and 2009, a period referred to as the Great Recession, which sharply reduced the asset values of all pension funds. In response to this strong downturn, the 2010 Legislature was presented with a proposal from the various pension fund administrations (the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA), TRA, and the first class city teacher plans) revising various plan benefit and funding provisions to reduce plan liabilities and improve plan funding. These were enacted as Laws 2010, Chapter 359, Article 1, and titled "Financial Sustainability Provisions." Several changes were include in that article for the DTRFA, including replacement of its problematic post-retirement adjustment procedure with procedure which pays no adjustment until the plan's funding ratio, based on market divided by liabilities, is at least 80%; a 1% adjustment when the ratio is at least 80% but less than 90%. After a 90% ratio is achieved, the DTRFA post-retirement adjustment will match inflation up to 5%. The Financial Sustainability Provisions included only one SPTRFA revision, a one-year waiver of any post-retirement adjustment.

8. Current Funding Condition. The current funding condition of TRA, DTRFA, and the SPTRFA is shown below.

	DTRFA 2011		SPTRFA 2011		TRA 2011	
Membership						
Active Members		1,006		3,578		76,755
Service Retirees		1,216		2,864		49,079
Disabilitants		19		29		602
Survivors		109		319		3,856
Deferred Retirees		290		1,880		13,237
Nonvested Former Members		735		1,698		25,196
Total Membership		3,375		10,368		168,725
Funded Status						
Accrued Liability		$321,065,000		$1,389,875,000		$22,171,493,000
Current Assets		$235,071,975		$972,718,000		$17,132,383,000
Unfunded Accrued Liability		$85,993,025		$417,157,000		$5,039,110,000
Funding Ratio	73.22%		69.99%		77.27%	
Financing Requirements						
Covered Payroll		$54,279,300		$239,501,000		$4,106,922,000
Benefits Payable		$24,067,915		$97,287,000		$1,459,550,000
Normal Cost	6.08%	$3,298,919	7.59%	$18,165,000	8.17%	$335,649,000
Administrative Expenses	0.89%	$483,086	0.29%	$694,000	0.24%	$9,857,000
Normal Cost & Expense	6.97%	$3,782,005	7.88%	$18,859,000	8.41%	$345,506,000
Normal Cost & Expense	6.97%	$3,782,005	7.88%	$18,859,000	8.41%	$345,506,000
Amortization	10.27%	$5,574,484	10.49%	$25,124,000	8.16%	$335,125,000
Total Requirements	17.23%	$9,356,489	18.37%	$43,983,000	16.57%	$680,631,000
Employee Contributions	6.00%	$3,256,758	5.78%	$13,838,000	6.00%	$246,490,000
Employer Contributions	6.29%	$3,414,168	8.63%	$20,661,000	6.16%	$252,854,000
Employer Add'l Cont.	0.00%	$0	0.00%	$0	0.00%	$0
Direct State Funding	1.21%	$658,535	1.69%	$4,057,000	0.53%	$21,510,000
Other Govt. Funding	0.00%	$0	0.00%	$0	0.00%	$0
Administrative Assessment	0.00%	$0	0.00%	$0	0.00%	$0
Total Contributions	13.50%	$7,329,461	16.10%	$38,556,000	12.69%	$520,854,000
Total Requirements	17.23%	$9,356,489	18.37%	$43,983,000	16.57%	$680,631,000
Total Contributions	13.50%	$7,329,461	16.10%	$38,556,000	12.69%	$520,854,000
Deficiency (Surplus)	3.73%	$2,027,028	2.27%	$5,427,000	3.88%	$159,777,000