S.F. 451
(Pogemiller)

H.F. 712
(Mares)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	PERA-Correctional Plan
Relevant Provisions of Law:	Minnesota Statutes, Section 353E.03
General Nature of Proposal:	Eliminate a contribution rate increase scheduled to become effective in January 2002
Date of Summary:	March 5, 2001

Specific Proposed Change

- Elimination of Scheduled Contribution Rate Increase. Increases in the employee and employer contribution rates for the PERA-Correctional Plan which were scheduled to go into effect on January 1, 2002, would be eliminated.

Policy Issues Raised by the Proposed Legislation

1. Justification for Change. The issue is whether the proposal before the LCPR is the proper action given the circumstances. The plan shows a modest contribution rate sufficiency for a single year. Among other considerations, the Commission may wish to consider the troubled nature of the current investment markets, which have not yet impacted actuarial reports, and which may lead to increased contribution rate requirements for this plan and several others.

2. Impact on Employing Units and Employees. The estimated calendar year annual payroll for covered plan members beginning in January 2002 is about $83.2 million. The new employer contribution rate scheduled to go into effect in January 2002, is 9.02 percent of payroll. If that does not go into effect, the rate would remain at 8.75 percent of payroll. The difference would amount to $220,000 for the year. The comparable savings for employees given the current rate and the rate scheduled to go into effect in January, the difference would be $150,000 per year.

3. Other PERA-Correctional Plan Proposals. Bills have been introduced to extend PERA-Correctional Plan coverage to probation officers and 911 dispatchers, and to provide a service pension benefit increase to all covered members. Any action taken on those bills would require the Commission to revise any action it may take on the two companion bills currently before the Commission.

4. Consistency Across Plans. The Commission may wish to consider whether any action is justified for this plan when no action is contemplated for other plans where contribution sufficiencies are larger and have persisted over time. If any Commission action is warranted, a consistent policy applied across plans may be a more appropriate approach.

State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek EB

RE: S.F. 451 (Pogemiller); H.F. 712 (Mares): PERA-Correctional Plan; Contribution Rate Reduction

DATE: March 2, 2001

Summary

S.F. 451 (Pogemiller); H.F. 712 (Mares): PERA Local Government Correctional Service Retirement Plan (PERA-Correctional); Contribution Rate Reduction, would eliminate changes in the employee and employer contribution rates for the PERA-Correctional Plan which were scheduled to go into effect on January 1, 2002.

Background

The PERA-Correctional Plan has been in existence for only a few years. It stems from action on the part of county correctional employees who were covered by the PERA-General Plan and who contended that they should receive treatment similar to counterparts covered by the Correctional Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Correctional).

In 1998, the Legislature passed provisions which left these county correctional employees in PERA-General but extended an enhanced duty-related disability benefit provision to "local government correctional service employees." A "local government correctional service employee" was defined as a PERA- General member who is an essential employee working at a county or regional jail or correctional facility and who had at least 75 percent direct inmate contact, as certified by the employer. The enhanced disability benefit created for these employees was equal to 45 percent of the high-five average salary plus 1.8 percent of the high-five, for each year of correctional service in excess of 25 years that is provided after July1, 1998. Because that enhanced disability benefit increased plan cost for these employees, the employee contribution for these covered employees was increased from 4.75 percent, the PERA-General Plan coordinated member employee contribution rate applicable to other employees, to 4.96 percent of salary. The employers contributed 5.06 percent of salary, rather than the 4.75 percent employer contribution that would otherwise apply.

The 1999 Legislature took further steps. In 1999, a separate plan to be administered by PERA on behalf of eligible correctional employees was created, along with a separate retirement fund applicable to the plan, with fund investment to be performed by the State Board of Investment (SBI). The eligible employees for the new plan were employees in county-administered jail or correctional facilities or in regional facilities, who are certified by the employer as having 95 percent inmate contact, and who otherwise would be PERA-General members. Employee and employer contribution rates were set for the new plan based on work by the LCPR-retained actuary. The employee contribution rate was 5.83 percent and the employer contribution rate is 8.75 percent. These are the contribution rates which remain in effect at the current time. The coverage was for prospective service. Retirement annuities are enhanced compared to a general employee plan. For the retirement annuity, the individual would received 1.9 percent of the high-five average salary, rather that 1.7 percent or less in a general employee plan. The normal retirement age is age 55, with early reduced retirement is permitted as early as age 50. In contrast, in general employee plans the normal retirement age is between age 65 or 66, and early reduced retirement is permitted at age 55. Disability benefits are also more generous than in general employee plans. The disability benefit is computed like a retirement benefit but without any reductions, and the minimum duty-related benefit is equivalent to a 25 year service pension. The minimum non-duty related disability benefit is equivalent to a ten year service pension. These new disability benefit provisions replaced the enhanced disability benefit that had passed a year earlier. The plan was made eligible for inclusion in combined service annuities (under Section 356.30). No employing unit was to lose any PERA state aid, which had been enacted in 1997 for the PERA-General Plan, due to any transfer of PERA-General employees to the new PERA-Correctional Plan.

The 2000 Legislature again revised the plan, partly in response to county officials who were concerned about eligibility issues. Presumably, the plan was established to provide special coverage, not provided to general employees, due to the danger of working in contact with inmates. But in practice, the 95 percent-inmate-contact requirement for plan eligibility could be rather arbitrary and did not consistently indicate which employees were at most risk. The 2000 Legislature responded by replacing the 95 percent-inmate-contact requirement with eligibility requirements based on specific duties and specific employee positions. As revised, an eligible employee must be employed in county or regional correctional facilities as correctional guards, correctional officer, joint-jailer/dispatchers, or as a supervisor of correctional guards or of joint jailers/dispatchers. In addition, the individual must be directly responsible for the direct security, custody, and control of inmates and be expected to respond to incidents within the correctional facility. Any individuals already in the plan who no longer qualify under the 2000 legislative session revisions were allowed to remain in the plan for continued service in their current employment position.

As part of the shuffling of employee eligibility provisions, the 2000 Legislature also revised the plan's contribution rates (Laws 2000, Chapter 461, Article 10, Section 2). The statutory contribution rates were to be made equal to the required contribution rates as determined by the actuary in the July 1, 1999, plan actuarial valuation, which had been completed several months previously. According to the July 1, 1999, actuarial valuation, the total contributions made to the plan were deficient by .45 percent of payroll. The total required contributions for the new PERA-Correctional Plan, as determined by the actuary in the July 1, 1999, actuarial valuation, were equal to 15.3 percent of covered payroll, but the rates required by law were only 14.58 percent of payroll. To cover that shortfall, the employee contributions were to increase from 5.83 percent of payroll to 6.01 percent of payroll, and the employer contribution rate was to increase from 8.75 percent of payroll to 9.02 percent. The new rates total to 15.3 percent of payroll.

These contribution rate changes, however, were delayed. Under the effective date provision applicable for this contribution rate change, the change would become effective with the first payroll occurring after January 1, 2002. One reason for the delayed effective date was to give counties sufficient time in their budgeting process to plan for that change.

Discussion

S.F. 451 (Pogemiller); H.F. 712 (Mares): PERA Local Government Correctional Service Retirement Plan (PERA-Correctional); Contribution Rate Reduction, is drafted as a contribution rate change, but it has the effect of leaving the contribution rates that currently are charged in place. It repeals or cancels the increases which otherwise would have gone into effect on January 1, 2002.

An argument for the change is that the most recent PERA-Correctional plan actuarial valuation, for July 1, 2000, computed the total plan required contribution rate to be 14.37 percent of payroll. The contribution rates in current law provide total contributions of 14.58 percent of payroll. Based on the most recent actuarial report, at current contribution rates the plan has a 0.21 percent of payroll contribution rate sufficiency. The argument is that the contribution rate increase scheduled to go into effect on January 1, 2002, is not needed, since even at current contribution rates there is a slight excess.

There are several arguments for allowing the January 1, 2002, rate increase to go into effect (which presumably would occur if the LCPR recommends no action on S.F. 451 (Pogemiller); H.F. 712 (Mares)). First, we have a new definition of actuarial assets which is being phased-in beginning with the July 1, 2000, actuarial valuations. The long-term effect of that change is not wholly predictable, adding uncertainty to whether a modest contribution rate sufficiency will hold up over time. Even without that actuarial asset change, required contribution rates for a plan as determined by the actuary can often change from one year to the next by one-half percent of pay or more. The margin of sufficiency is slim, perhaps too slim to recommend retention of the existing rates. Second, this is a new plan. It is not unreasonable to expect that required contributions determined in an actuarial report will fluctuate because the plan is not mature. It has no track record. The demographics of the covered plan membership are changing because plan membership is changing, as the counties and the Legislature continue to deal with issues of which employees should be eligible for inclusion in the plan. Third, if current contribution rates are continued, it will be politically difficult to increase the rates later if it is determined, based on several years of deficiency, that rates need to be increased. Legislators are often pressured to increase rates only if increased benefits are also provided, which, in turn, adds even more to the required contribution levels. Third, this plan has had only two actuarial studies performed because it is a new plan first established in 1999. One report suggested a contribution rate deficiency, the other a modest sufficiency. Based on that limited record, it is difficult to justify an action to cut rates scheduled to go into effect for this plan when no comparable action is proposed for other plans which also have contribution sufficiencies. In some cases those sufficiencies have persisted for years. In the case of PERA- P&F, those sufficiencies have persisted for decades. Fourth, the LCPR may wish to consider the current state of the investment markets. PERA-Correctional Plan assets are invested by SBI. SBI, like nearly all other pension fund investment boards, holds portfolios heavily weighted toward equities. Last calendar year the domestic stock market was down about 10 percent. In other words, the return was about negative ten percent. Returns in foreign markets were also negative, in many cases worse than in the domestic market. As of this writing, the stock market for the current calendar year is down nearly seven percent. Given the structure of Minnesota's SBI managed plans, plan assets need to earn an 8.5 percent *positive* return per year. Otherwise, the contribution rates will not be sufficient over the long term to cover liabilities. When plan assets earn less that an 8.5 percent return, the actuarial report will show an investment loss, leading to unfunded liability and increased contribution rate requirements to retire that unfunded liability. The contribution rates scheduled to go into effect in January 2002 may be needed to avoid contribution rate deficiencies in the near future. Finally, LCPR members should be aware that currently there are two other PERA-Correctional Plan bills that have been introduced this session. If the LCPR were to take action on either of those two proposals, it would revise any action that the LCPR may take on the proposal now before the Commission. The other bills are S.F. 1038 (Pogemiller); H.F. 999 (Mares): PERA-Correctional Plan; Extending Plan Coverage to Probation Officers and 911 Dispatchers, and S.F. ____ (   ); H.F. 1056 (Smith): PERA-Correctional Plan; Service Benefit Formula Increase. Acting on either of those bills could lead to contribution rate increases.

If S.F. 451 (Pogemiller); H.F. 712 (Mares): PERA-Correctional Plan; Contribution Rate Modification is recommended to pass, a modest contribution rate increase for the plan, scheduled to go into effect in January 2002 will not occur. Policy issues follow:

1. Justification for Change. The issue is whether the proposal before the LCPR is the proper action given the circumstances. The bills would eliminate a contribution rate increase scheduled to go into effect for the PERA-Correctional Plan in January 2002. Counties may be urging action because they are concerned about additional contribution requirements which may be imposed on local employing units to address the PERA-General deficiency problem. Given the additional financial burden they expect for that fund, they would contend that it is unnecessary and unreasonable to also have a contribution rate increase go into effect in January 2002 for a plan which, based on recent past experience, appears to have a contribution rate *sufficiency*, even at current contribution rates. As argument for allowing the PERA-Correctional Plan contribution rate increases to occur, the LCPR may wish to consider that a few years in the future, it will be far easier to lower rates if that is deemed appropriate based on experience, than to attempt to increase rates by amounts sufficient to recoup damage done by several years of contribution rate shortfalls. The LCPR may wish to consider that the plan is only two years old, with little or no actual experience with which to predict future trends in contribution requirements. The argument to not increase rates is based on a single year showing a very modest contribution rate sufficiency at current rates. The LCPR may also wish to consider the troubled nature of the current investment markets, which have not yet impacted actuarial reports, and which may lead to increased contribution rate requirements for this plan and several others.

2. Impact on Employing Units and Employees. According the latest actuarial valuation, the expected annual payroll for covered plan members for the year beginning July 1, 2000, is $80.8 million. If we assume it would be three percent higher for the calendar year beginning in January 2002, the calendar year annual payroll beginning in January would be about $83.2 million. The new employer contribution rate scheduled to go into effect in January 2002 is 9.02 percent of payroll. If that does not go into effect, the rate would remain at 8.75 percent of payroll. The difference would amount to $220,000 for the year. Any savings, however, would be short-lived if contribution rates prove to be deficient in the near future. The comparable savings for employees given the existing and proposed rates for January 2002 would be $150,000 per year.

3. Other PERA-Correctional Plan Proposals. As noted in the text, bills have been introduced to extend PERA-Correctional Plan coverage to probation officers and 911 dispatchers, and to provide a service pension benefit increase to all covered members. Any action taken on those bills would require the LCPR to revise any action it may take on the two companion bills currently before the Commission.

4. Consistency Across Plans. The Commission may wish to consider whether any action is justified for this plan when no action is contemplated for other plans where contribution sufficiencies are larger and have persisted over time. Table 1-A, from the March 2, 2001, presentation by the actuary at the LCPR's first meeting of the session, is attached. The last column shows sufficiencies or deficiencies by plan. Several plans have sufficiencies. Of those with a sufficiency (a positive number), the PERA-

Local Correctional Plan sufficiency is the smallest, easily within the variability or "bounce" one sees from year to year in a plan's actuarial valuations. Table 1-B from the same presentation shows several plans where sufficiencies have persisted for at least three years. The plans are PERA-P&F, MSRS-General, MSRS-State Patrol, MSRS-Judges Plan, TRA, and the Duluth Teachers Retirement Fund Association (DRTFA). If it is reasonable to address contribution rates based on sufficiencies, any action on the PERA-Correctional Plan may be the least warranted. If any LCPR action is warranted, a consistent policy applied across plans may be a more appropriate approach.

353E.03, pursuant to Laws 2000, chapter 461, article 10, sections 2 and 3.

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2000 ACTUARIAL VALUATION RESULTS

STATEWIDE PUBLIC SAFETY EMPLOYEE RETIREMENT PLANS

	2000		2000		2000		1999		2000		2000	
	MSRS-Correctional		State Patrol		PERA-P&F		Local Police & Paid Fire Plans		PERA Local Gov't Correctional Plans		Total Public S Employee P	
Membership												
Active Members		3,098		830		9,627		276		2,781		
Service Retirees		616		531		3,991		1,104		9		
Disabilitants		75		22		482		12		3		
Survivors		56		457		1,205		459		0		
Deferred Retirees		419		24		470		9		0		
Nonvested Former Members		163		10		626		0		0		
Total Membership		4,427		1,874		16,401		1,860		2,793		
Funded Status												
Accrued Liability		$359,885,000		$458,384,000		$3,383,187,000		$749,649,588		$10,195,000		$4,96
Current Assets		$386,964,000		$528,573,000		$4,145,351,000		$754,918,279		$11,116,000		$5,82
Unfunded Accrued Liability		($27,079,000)		($70,189,000)		($762,164,000)		($5,268,691)		($921,000)		($86
Funding Ratio	107.52%		115.31%		122.53%		100.70%		109.03%		117.45%	
Financing Requirements												
Covered Payroll		$127,557,000		$51,980,000		$494,134,000		$17,843,137		$80,818,000		$77
Benefits Payable		$12,414,000		$25,789,000		$165,719,000		$45,521,123		$20,000		$24
Normal Cost	14.64%	$18,670,000	22.55%	$11,725,000	19.93%	$98,462,000	24.16%	$4,311,443	14.26%	$11,520,000	18.73%	$14
Administrative Expenses	0.22%	$281,000	0.20%	$104,000	0.14%	$692,000	0.00%	$0	0.16%	$129,000	0.16%	$
Normal Cost & Expense	14.86%	$18,951,000	22.75%	$11,829,000	20.07%	$99,154,000	24.16%	$4,311,443	14.42%	$11,649,000	18.89%	$14
Normal Cost & Expense	14.86%	$18,951,000	22.75%	$11,829,000	20.07%	$99,154,000	24.16%	$4,311,443	14.42%	$11,649,000	18.89%	$14
Amortization	(1.14%)	($1,454,000)	(7.27%)	($3,779,000)	(7.38%)	($36,467,000)	15.51%	$2,767,200	(0.05%)	($40,000)	(5.05%)	($3
Total Requirements	13.72%	$17,497,000	15.48%	$8,050,000	12.68%	$62,687,000	39.67%	$7,078,643	14.37%	$11,609,000	13.84%	$10
Employee Contributions	5.69%	$7,258,000	8.40%	$4,366,000	6.20%	$30,636,000	3.78%	$675,007	5.83%	$4,712,000	6.17%	$4
Employer Contributions	7.98%	$10,179,000	12.60%	$6,550,000	9.30%	$45,954,000	35.89%	$6,403,636	8.75%	$7,072,000	9.86%	$7
Employer Add'l Cont.	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	
Direct State Funding	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	
Other Govt. Funding	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	
Administrative Assessment	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	$0	0.00%	
Total Contributions	13.67%	$17,437,000	21.00%	$10,916,000	15.50%	$76,590,000	39.67%	$7,078,643	14.58%	$11,784,000	16.03%	$12
Total Requirements	13.72%	$17,497,000	15.48%	$8,050,000	12.68%	$62,687,000	39.67%	$7,078,643	14.37%	$11,609,000	13.84%	$10
Total Contributions	13.67%	$17,437,000	21.00%	$10,916,000	15.50%	$76,590,000	39.67%	$7,078,643	14.58%	$11,784,000	16.03%	$12
Deficiency (Surplus)	0.05%	$60,000	(5.52%)	($2,866,000)	(2.82%)	($13,903,000)	0.00%	$0	(0.21%)	($175,000)	(2.19%)	($1