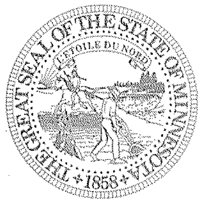
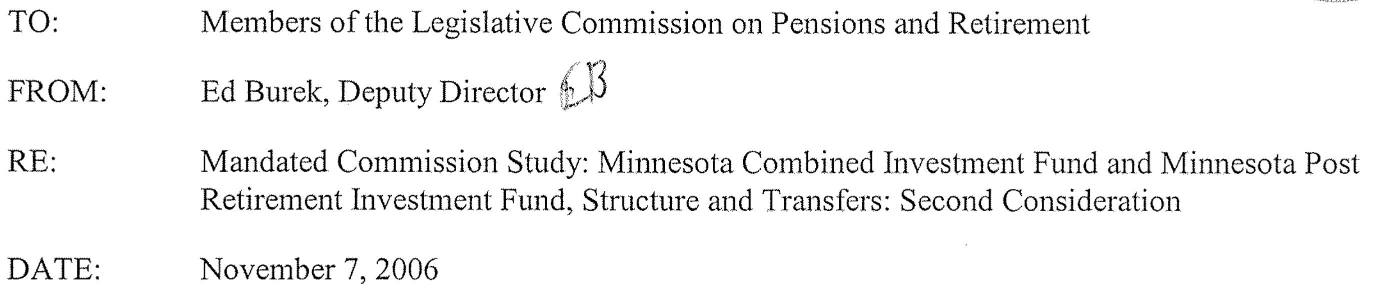
State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT





TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: Mandated Commission Study: Minnesota Combined Investment Fund and Minnesota Post Retirement Investment Fund, Structure and Transfers: Second Consideration

DATE: November 7, 2006

Introduction

This second consideration memo begins by summarizing some of the material collected by Larry Martin for the Pension Commission's other interim study project. In the course of collecting information on teacher plans throughout the 50 states, Mr. Martin noted the fund structure used by these systems. Various parties have criticized Minnesota's use of a two-fund system for its major plans. Those plans are the various Minnesota State Retirement System (MSRS), Public Employees Retirement Association (PERA), and Teachers Retirement Association (TRA) defined benefit plans. With these plans, the Minnesota Combined Investment Fund (Combined Fund) is used to accumulate and invest active and deferred member assets, and the Minnesota Post Retirement Fund (Post Fund), financed by transfers from the Combined Fund at the time of retirement, is used to pay retiree annuities and to provide post-retirement increases. Unquestionably, the Minnesota system is not without serious implications. However, it is far from unique. Systems which accumulate active member assets and transfer them to another account or fund at the time of retirement are common.

This memo also reviews information on transfers made from the Combined Fund by the various MSRS, PERA, and TRA plans to the Post Fund, and reviews the study findings due to topics covered in the first consideration memo and this memo.

Overview of Fund Structure, 50-State Survey

This section comments on material contained in Appendix A, which provides an overview of the fund structure used by teacher plans throughout the 50 states. Any system needs to collect and accumulate assets, and also to pay benefits to those in benefit status. There is a wide range of ways that states have chosen to meet these needs, with approaches ranging from a single fund approach to complex combinations of funds. Minnesota, for the large plans invested by the State Board of Investment, has chosen to accumulate active and deferred member assets in the Combined Fund. Eventually, these accumulated assets will be used to pay the benefits offered by the plan—refunds, service annuities, disability benefits, and survivor benefits. The computed plan normal cost for the various plans that participate in the Combined Fund captures the combined estimated cost of these benefits in that plan, and the plan employee and employer contributions which are deposited in the Combined Fund are intended to cover those costs. Some other states have chosen a far more complicated structure. They may have separate accounts or funds to accumulate assets to meet each type of benefit payment, with a separate account or fund to accumulate assets for retirement annuities, another to meet expected disability benefits, another for survivor benefits, another specifically for post-retirement increases, and yet other accounts or funds for life insurance, defined contribution supplemental accounts, and non-retirement benefits paid to retirees, such as healthcare coverage. Some states also have a separate account to accumulate assets to cover the administrative expenses of the system, or to capture turnover gain amounts. Some states segregate even further, separating employee contributions for some or all of these benefits from the employer contributions. And, similar to our transfers to the Post Fund, it is not uncommon to transfer assets between accounts when an employee moves from active or deferred status to retirement status. Actually, the majority of states follow the practice of transferring assets at the time of retirement.

In addition to Minnesota, the states where asset transfers occur at the time of retirement are Hawaii, Indiana, Kansas, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia, and Wisconsin. In the simplest models where transfers occur, all employer contributions and appropriations are accumulated in an annuity reserve fund, while employee contributions are accumulated in an active employee fund. Then, at the time of retirement, the employee assets are merged with employer-contributed assets by transferring the employee assets to the annuity reserve fund. In many systems, employee and employer contributed

amounts and related investment earnings are kept separate prior to retirement, and both are then merged into a third fund or account at retirement. Many states have more than three funds.

States which use a single fund are Alaska, Iowa, North Dakota, Utah, and Wyoming. States with a single retirement fund, plus a separate retiree healthcare-related fund, are Connecticut and New Mexico. Georgia, Nevada, and South Dakota use a single retirement fund plus a separate administrative or expense fund to accumulate and pay administrative expenses of the system. The remaining systems use more complicated systems of accounts or funds.

Transfers To and From the Post Fund

The primary source of flows to the Post Fund is due to transfer of assets for new annuitants. When an annuity becomes payable to a member of an MSRS, a PERA, or a TRA defined benefit plan, assets representing the full actuarial required reserves for the annuity are transferred out of the applicable plan's participation in the Combined Fund into the Post Fund. The two exceptions are the Elective State Officers Retirement Plan, which covered constitutional officers first elected before July 1, 1997, and the Legislators Retirement Plan. The Elective State Officers Retirement Plan operates entirely on a pay-as-you-go basis. For that plan, retirement plan contributions deducted from pay simply transferred back into the state's general fund. When an individual retired or a survivor benefit became payable, the necessary amounts to cover the monthly annuity payments were appropriated from the state's General Fund. Post-retirement adjustments are indexed to any adjustments provided by the Post Fund. Similarly, there was no pre-retirement fund for the Legislators Retirement Plan. Amounts deducted as employee plan contributions simply cancelled back to the state's General Fund. Before mid-2003, when individuals retired from the Legislators Retirement Plan the full actuarial reserves for the annuity were appropriated from the state's General Fund to the Post Fund. However, since mid-2003, when a Legislators Plan annuity commences, the amounts necessary to cover the immediate benefit payments are appropriated, when needed, to cover the payments. Reserves for the legislative retirements no longer transfer to the Post Fund.

For TRA, PERA, and the remaining MSRS plans, annuitant reserves transfer to the Post Fund by the end of the month in which the benefit commences. In some cases, there may be minor flows into or out of the Post Fund to correct for earlier initial transfers that were based on estimates. A second source of transfer to or from the Post Fund is adjustments for mortality gains or losses.

Table 1 below displays information provided by the State Board of Investment (SBI) on Post Fund transfers by the applicable plans for fiscal years 2003, 2004, and 2005. The MSRS Elected State Officer Plan does not appear in the table because that fund does not participate in the Post Fund. For the Legislators Plan the final column, referred to by SBI as the gross transfers to the Post Fund, is zero in 2004 and 2005 because transfers were no longer made due to change in law. However, the middle column, which indicates adjustments (flows to the Post Fund due to individuals living longer than expected, and flows from the Post Fund due to shorter than expected longevity) does indicate some adjustments for the Legislators Plan related to individuals with assets transferred to the Post Fund in the more distant past.

The first column shows the total Post Fund participation and each plan's share. In 2005, the total participation was $23.7 billion. The plan with the smallest portion of that participation was the Local Government Correctional Service Retirement Plan (PERA-Correctional), with only $3.7 million. That small participation is because the plan has a small membership and is also a rather new plan with few retirees. The next smallest participation is by the MSRS Legislators Plan, followed by the MSRS Judges Plan. The general employee plans have many members, many retirees, and thus a large participation. Of the three general employee plans, the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) is the smallest, with a $3.5 billion participation. The General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) is much larger, with $6.6 billion. The average PERA-General retiree has a smaller pension than the average MSRS-General retiree (according to fiscal year 2005 actuarial reports, the average MSRS-General retiree is receiving a $15,624 annual pension, while the average PERA-General retiree benefit is $12,720 annually), but PERA has far more retirees, over 48,000 compared to 19,200 for MSRS. The largest participation by far is TRA, with $10.5 billion. According to the plan actuarial report, that plan had nearly 36,000 retirees and an average benefit of $27,751.

It follows that the plans with the largest participation will also have the largest gross transfers to the Post Fund. The MSRS-General transfer was $260 million, PERA-General's was $381 million, and TRA's was $609 million. The smallest transfer was for PERA- Correctional, with a $1.7 million transfer. Although

this is small in dollar terms, it is very large compared to that plan's total participation of only $3.7 million. Again, that reflects that this plan is quite new (its laws were enacted and codified in 1999), with few current retirees. Also, many of those who have retired with some PERA-Correctional coverage may have most of their career covered by PERA-General, which would cover the largest portion of the total annuity.

Regarding gains or losses that result in additional transfers to the Post Fund, or transfers back to the applicable plan within the Combined Fund, the second column indicates a net total transfer back from the Post Fund of $85 million in 2005. In 2004 and 2003, the treatment of gains and losses caused additional transfers to the Post Fund, with $30.2 million transferring in 2004 and $82.4 million in 2005.

Table 1

Fiscal Years 2003, 2004, and 2005
Post Fund Participation

FY	Plan	Participation Per Financial Statements	Actuarial Gain and Loss Adjustments *Gain Flows from Post Fund (Loss) Flows to Post Fund*	Gross Reserves Transferred to Post Fund
2003	MSRS-General	$2,959,517,312.29	$8,280,847.55	$221,387,399.57
2003	MSRS-Correctional	$185,948,798.77	($663,901.03)	$27,096,403.58
2003	Judges	$89,791,847.43	$1,714,669.73	$4,031,548.29
2003	Legislators	$38,267,118.07	$73,404.55	$4,901,909.86
2003	State Patrol	$315,247,433.61	($3,324,486.47)	$17,971,239.53
2003	PERA-General	$5,655,063,326.72	($44,167,176.21)	$331,167,485.06
2003	PERA-Correctional	$1,267,961.68	($2,013.77)	$766,707.79
2003	PERA-P&F	$1,995,331,105.75	($59,249,337.35)	$143,020,170.39
2003	TRA	$9,145,980,281.78	$14,930,251.33	$516,735,769.34
	FY Total	$20,386,415,186.10	($82,407,741.67)	$1,267,078,633.41
2004	MSRS-General	$3,244,126,036.82	$53,709,413.00	$302,451,862.55
2004	MSRS-Correctional	$225,518,571.33	($8,751,331.21)	$27,535,127.97
2004	Judges	$97,000,360.02	($1,573,253.00)	$5,417,568.73
2004	Legislators	$40,694,832.39	($1,231,837.00)	($0.45)
2004	State Patrol	$341,427,366.64	$2,339,716.84	$21,943,132.53
2004	PERA-General	$6,244,887,066.29	($93,877,619.92)	$401,808,317.11
2004	PERA-Correctional	$2,223,493.09	($84,781.00)	$861,018.17
2004	PERA-P&F	$2,165,865,199.35	$33,449,284.77	$145,261,929.11
2004	TRA	$9,969,709,838.98	($14,148,702.48)	$598,860,222.22
	FY Total	$22,331,452,764.91	($30,169,110.00)	$1,504,139,177.94
2005	MSRS-General	$3,542,488,695.88	($12,432,898.40)	$259,687,694.00
2005	MSRS-Correctional	$229,319,581.31	$25,227,648.65	$30,850,284.79
2005	Judges	$97,100,475.56	$1,551,119.24	$4,093,145.00
2005	Legislators	$42,773,703.13	($4,777,615.46)	$0.00
2005	State Patrol	$362,770,507.78	($7,008,233.16)	$15,674,783.84
2005	PERA-General	$6,564,063,267.77	$12,738,334.34	$380,714,370.72
2005	PERA-Correctional	$3,742,214.69	$116,162.35	$1,691,152.99
2005	PERA-P&F	$2,309,948,626.08	$10,213,613.20	$140,846,362.87
2005	TRA	$10,498,224,171.78	$59,781,204.36	$608,627,345.88
	FY Total	$23,650,431,243.98	$85,409,335.12	$1,442,185,140.09

Contributions to Post Fund shown on this table will have minor differences from published reports of TRA, MSRS, and PERA due to adjustments. Participation is calculated per Minnesota Statutes, Section 11A.18, Subdivision 7.

Source: Data provided by the State Board of Investment.

<u>Comments on Asset Transfer Recommendations from the Minnesota Taxpayers Association Report, Public Pensions in Minnesota: Re-Definable Benefits and Under-Reported Performance</u>

Under existing law, when an individual retires, the full actuarial reserves to support the individual's annuity, assuming a six percent return prior to payout, is transferred from the applicable plan's participation in the Combined Fund to the Post Fund. Because of the post-retirement adjustment system in place and the investment markets which resulted in very high permanent post-retirement adjustments in the late 1990s followed by a market crash in the early 2000s, the Post Fund has about $4 billion in unfunded liabilities.

The recent Minnesota Taxpayers Association report includes recommendations for revising transfer requirements to the Post Fund, but those recommendations are unclear. That report does assume that the Combined Fund/Post Fund structure will continue into the indefinite future but, because of the vague nature of the transfer recommendations in the report, it is unclear whether the recommendations can work within that system. What is clear is that the report has no recommendations which effectively address the Post Fund's current funding situation. Actually, the recommendations can be viewed as placing the current retirees at further risk, since the report contains no recommendations to appropriate money or allow additional transfer amounts to the Post Fund while recommending, at least in certain circumstances, that the transfers required by existing law should be reduced. The Minnesota Taxpayers Association report does propose to allow only capped inflation-match increases and to do away with any further investment-based adjustments. But that change, if implemented, would have no impact on the Post Fund's current unfunded liability because that unfunded liability precludes any increase beyond the partial inflation match.

One unclear area is the Minnesota Taxpayers Association-recommended transfer treatment that should occur when a pension plan has unfunded liabilities but the Post Fund is more than 100 percent funded. Under these circumstances the text suggests some form of reduced transfer to the Post Fund, but the report gives no direction for determining the reduced transfer amount. Pages 40 and 41 (copies attached) of the Minnesota Taxpayers Association report discuss the situation as it existed in the 1990s, when at least some of the participating plans had funding ratios less than 100 percent, and thus had unfunded liabilities, while the Post Fund had excess assets. The report states (referring to the Combined Fund participation as the "Basic Fund") that "When unfunded liabilities exist in the Basic Funds, the 'robbing Peter to pay Paul' nature of Basic to Post Fund transfers places stress on Basic Fund health." The report noted that state law does not permit transferring excess Post Fund assets back to the applicable pension plan to cover its unfunded liability, but suggests that the same effect, at least over time, could be achieved by transferring fractional reserves, rather than full reserves, to the Post Fund when retirements occur. "Transferring only the fractional reserves necessary to keep the Post Fund 'whole' upon an employee's retirement, however, would accomplish the same purpose of protecting the health of the Basic Funds when the Post Fund is in a surplus situation." Nothing is specified about how these "fractional reserves" will be computed or what is meant by keeping the Post Fund "whole." The Minnesota Taxpayers Association report also does not adequately address the implications that these fractional transfers would have for all Post Fund participants. Fractional transfers by some plans would spread risk to others, and would impact the increases provided to all and the financial support for those increases. Post Fund increases are financed by the dollar amount of investment gains, whether the benefit increase is a capped inflation-match or a further adjustment. Reducing a transfer will reduce the Post Fund assets, which in turn reduces the amount of any investment gain. Therefore, the suggestion of some form of fractional reserve transfers raises equity issues, and might have legal ramifications.

In the report's formal recommendation section, pages 59 and 60 (copies attached), the Minnesota Taxpayers Association presumably is attempting to suggest transfer requirements that should apply under a variety of Basic Fund and Post Fund funding situations, where one or both are either underfunded, fully funded, or overfunded. If the Basic and Post Funds have unfunded liabilities no recommendation is made, although perhaps one was intended but inadvertently omitted. If the Basic Fund is underfunded and the Post Fund is fully funded, the Minnesota Taxpayers Association report advises transferring only fractional reserves. As noted above, this recommendation fails to fully consider the impact this has on other plans and other retirees, and if the Post Fund is fully funded but not overfunded, then technically the fractional transfer would immediately cause the Post Fund to be less than fully funded. When the Basic Fund plans are fully funded but the Post Fund is underfunded, then the report advises transfer of full reserves. This is the treatment currently required in all cases under current law, and the report does nothing to address the current unfunded liability of the Post Fund beyond the mechanisms in current law. When the Basic Fund has a surplus and the Post Fund also does, again no recommendation is made regarding transfer requirements. In this situation the report does recommend reducing employee and employer contribution rates and consideration of giving at least some portion of any excess to retirees in the form of a lump sum payment that does not compound, or some form of supplemental defined contribution account.

Findings, Observations

In recent decades, except for a few plans involving elected officials, statutes require the state's three largest public pension systems, MSRS, PERA, and TRA, to have active member and deferred member assets of defined benefit plans invested through a commingled fund, the Combined Fund. At the time of retirement, the full actuarial reserves to pay the annuities were transferred to the Minnesota Adjustable Fixed Benefit Fund, or more recently, the Post Fund. The Post Fund statute includes procedures intended to automatically provide post-retirement adjustments generated by Post Fund investment gains. Under

current law, the assets transferred to the Post Fund are sufficient to pay the benefit computed at the time of retirement providing the Post Fund captures a consistent six percent return. A Consumer Price Index (CPI) inflation match, not to exceed 2.5 percent per year, can be supported if the fund consistently earns an 8.5 percent return, with the difference between an 8.5 percent return and a 6.0 percent return used to support the new, higher annuity amount resulting from the inflation match. Further investment-related post-retirement adjustments are payable based on excess asset reserves generated by returns above 8.5 percent, spread over five years.

In determining whether retirees are being kept whole during retirement, what is needed is a good measure of inflation applicable to retirees. The inflation index used in the Post Fund provision to measure inflation is not a measure focusing on older people; rather it is a general index, the Consumer Price Index for Urban Wage Earners and Clerical Workers All Items Index, computed by the United States Department of Labor Bureau of Labor Statistics. Older Minnesotans may face different inflation rates because they purchase a different basket of goods than younger people. Medical care expenditures and housing costs for a typical retiree could differ from that of a younger employed worker. An argument can also be made that the amounts needed to keep a retiree whole will vary at different stages of retirement. Individuals in the early stage of retirement might do more traveling than a typical active employee. Inflation applicable for this early stage of retirement perhaps should be influenced more by inflation for travel-related expenditures. At the next stage of retirement, medical costs might take a larger share of the retiree's budget, although for any given retiree this would depend on the individual's own health relative to others of comparable age, and the degree to which these expenses are covered by Medicare or some other insurance or program. At the final stage of retirement the individual might be dependent upon institutional care, and the pension and related post-retirement increases may merely be displacing amounts that otherwise would be covered by public assistance programs. Given that none of us are "typical," and that any percentage increase provided to Post Fund annuities will apply to everyone covered by that fund (some fairly young, others quite elderly, and with a wide range of healthcare cost coverage) the CPI measure that current is used in the Post Fund law may be as reasonable as any other. The remainder of this section assumes that the CPI measure in the Post Fund provision is a valid measure of inflation facing retirees.

In reviewing inflation over time and the post-retirement adjustments generated by this system plus various ad hoc increases, we found that:

- Investment market performance and post-retirement increases generated by this system are not well correlated with inflation, as measured by the CPI.

Therefore,

- The post-retirement adjustments provided through the Post Fund and its predecessor did not serve to maintain consistent purchasing power. Those who have retired in the past have either been overcompensated or undercompensated.

- The Legislative Commission on Pensions and Retirement's Principles of Pension Policy include a statement that benefit levels should be adequate at the time of retirement and should be kept adequate by adjusting the benefit to compensate for the rate of inflation, as measured by a valid economic indicator. To date, the post-retirement increases provided by the Post Fund and its predecessor have not been consistent with this principle.

If the Commission no longer wishes to adhere to this principle, the Commission may wish to revise its Principles of Pension Policy. If the Commission continues to believe that retirees should be kept whole during retirement, rather than suffering diminished purchasing power or receiving windfall gains, then the Commission may wish to consider, at least in the longer term, increasing the level of inflation match in the Post Fund (currently the inflation match is capped at 2.5 percent) or developing an equivalent approach through an entirely new system.

In some periods inflation was relatively high, while post-retirement adjustments generated by the system or provided by the Legislature were too modest to keep retirees whole. In other periods, inflation was low while the systems were generating investment performance-based adjustments that were far in excess of inflation. As a result:

- Rather than acting to keep retirees whole, the post-retirement adjustment systems created groups of winners and losers, depending on what happened to investment markets in the years after the given retirees retired.

- Many retirees have received windfalls, with current benefit levels considerably in excess of that necessary to compensate for retirement. But the outcome is very dependent on when individuals happened to retire. Retirees who suffered declines in purchasing power soon after retirement, due to a combination of weak markets and relatively high inflation, were harmed. Despite very generous percentage increases later in retirement, it took many years, in some cases, decades, for these individuals to again reach the same purchasing power they had in the first year of retirement, assuming they survived throughout the period.

Regarding specific cohorts of retirees, in my first consideration memo I noted the following:

- 1970 retirees. Individuals who retired in 1970 initially received post-retirement increases in excess of that necessary to keep them whole, but this quickly reversed. By 1978 they were receiving benefits which were below an inflation-matching amount. It was not until 1995 that this group again reached a benefit level providing purchasing power comparable to what they had in the first year of retirement. This was a full 25 years after retirement. Further increases since 1995 have provided this group with benefit levels considerably in excess of that needed to match inflation, but few survived to enjoy these benefits. An individual who retired at age 60 in 1970 would be 96 today.

- 1975 retirees. Individuals who retired in 1975 had benefits lagging inflation by 1977. They did not regain the same purchasing power they had in their first year of retirement until 1998, the 23rd year of retirement.

- 1980 retirees. This group worked through the later 1970s and thus avoided the loss in purchasing power suffered by those who retired in 1970 or 1975. The 1980 retirees lost some ground in the first few years of retirement, but by 1986 they were receiving benefits in excess of an inflation matching level. Currently, this group's benefits are considerably in excess of that needed to keep them whole.

- 1985 retirees. This group started retirement at the beginning of a good investment period, and with the first post-retirement adjustment in 1986 their benefit was more generous than that necessary to match inflation, and that has been true throughout their retirement. The current benefit level is considerably in excess of the inflation-matching benefit.

- 1990, 1995 retirees. These groups were also treated well by the markets. Their benefit levels have matched or exceeded an inflation matching benefit throughout retirement, and were boosted noticeably by the very large increases provided by the Post Fund in the late 1990s.

- 2000 retirees. This group remains modestly ahead of inflation. This group received some increases in excess of inflation the early 2000s, fueled by the investment returns of the late 1990s as the asset value generated by those returns was allocated forward by the five-yearly-account procedure of the Post Fund.

The current situation presents formidable challenges. As the stock market plummeted during the early 2000s, the Post Fund lost considerable asset value and no longer had the full reserves needed to cover the annuities. The Post Fund has approximately $4 billion in unfunded liabilities. The Post Fund went from an asset surplus situation where the surplus assets could be allocated toward current and future investment performance-based increases, to a situation where $4 billion in unfunded liabilities must be retired before any increases above the capped 2.5 percent inflation match can be paid. We note that:

- The Post Fund unfunded liability must be retired through investment returns earned in the markets. Current law does not authorize any contributions or transfers to the Post Fund to retire unfunded liability.

With a fully funded Post Fund, an 8.5 percent return would be necessary to cover the six percent return needed to sustain the reserves for the existing annuities and to cover the 2.5 percent inflation match. When Post Fund assets are less than the full reserves needed to support the existing annuities, which is the current situation, a rate of return on the existing assets *in excess of 8.5 percent* will be needed. Even without considering the need to retire the unfunded liability, the Post Fund would need to generate additional assets equal to the assets that an 8.5 percent return would generate on a fully funded Post Fund. When the need to retire the unfunded is also considered, to make much headway a return considerably in excess of 8.5 percent will be needed. Pension plan administrators have indicated that:

- With an extraordinarily high and consistent Post Fund return, the Post Fund would still be unable to provide any investment performance-based increase for at least another decade. If returns were just modestly above 8.5 percent, it could take more than two decades before the unfunded liability is retired and another investment performance-based increase can be paid.

Therefore:

- At the current time and for the foreseeable future, retirees from MSRS, PERA, and TRA plans are vulnerable to inflation eroding their pensions. If inflation exceeds 2.5 percent, the Post Fund will be unable to provide any increase beyond the mandated 2.5 percent match required by law.

The most vulnerable groups are the recent retirees and those who soon will retire. Those who retired since 2000 have little cushion. If there is an increase in inflation their benefits could quickly fall below an inflation-matching level. Those about to retire could quickly face benefit erosion. Earlier groups of retirees have a cushion, since their benefits are generally well above an inflation-matching level. However, these groups will not focus on past generous increases during the late 1980s and throughout the 1990s, but rather upon the erosion of the benefit levels they recently received.

Conclusion

This study, mandated by Laws 2006, Chapter 277, Article 8, Section 1, requires the Legislative Commission on Pensions and Retirement to study the structure of the Combined Fund and Post Fund, including transfer requirements between the two. The scope of this study largely is a subset of the scope of the second Commission study, required by Laws 2006, Chapter 277, Article 7, Section 1, which is to consider the implications of procedures providing benefit increases, as well as cost, budget, and aid implications, of the Post Fund, procedures used by other large Minnesota public plans, and those used by teacher plans throughout the United States. Given the overlap between these two studies, no formal recommendations are made in the current report. Recommendations, if any, will be made as a result of the second study required by Laws 2006, Chapter 277, Article 7, Section 1.

Appendix A

Statewide Teacher Retirement Plans: Comparison of Retirement Fund and Account Structure

State	Retirement Fund and Account Structure
Alabama Teachers Retirement System (Retirement Systems of Alabama)	Statutory funds are the annuity savings fund, the teacher retirement system expense fund, and the term life insurance fund. The annuity savings fund is credited with member contributions. The pension accumulation fund is credited with all other pension benefit reserves other than the annuity savings fund. The expense fund is credited with turnover gains. The term life insurance fund is credited with special employer contributions for this purpose. Additional funds are the pre-retirement death benefit account and deferred retirement option plan reserve. (CAFR Financial Section, pp. 25, 26; Alabama Stat. Sec. 16-25-21)
Alaska Teachers Retirement System (Alaska Division of Retirement and Benefits)	Single teacher retirement trust fund. (CAFR Financial Statement Notes, p. 12)
Arizona State Retirement System	Single retirement system trust fund, with an ASRS depository separate from any other state monies or funds. Subsidiary accounts exist for administration, retirement, and investment. A long-term disability trust fund also exists and a health insurance premium benefits account also exists. (Arizona Stat. Sec. 38-712; Sec. 38-720)
Arkansas Teacher Retirement System	Statutory accounts within the retirement fund are the member deposit account, the employer accumulation account, the retirement reserve account, the survivor benefit account, and the income expense account. The member deposit account is credited with member contributions. The employer accumulation account is credited with employer contributions. The retirement reserve account is credited with the reserves for a retirement benefit. The survivor benefit account is credited with the reserves for a survivor benefit. The income expense account is credited with all investment income and with employer administrative expense contributions. (Arkansas Stat. Sec. 24-7-405 through Sec. 24-7-410)
California State Teachers Retirement System	In addition to a defined benefit program, there is a defined benefit supplement program, a cash balance benefit program, a voluntary investment program, a teacher's health benefit fund, and a teacher's replacement benefits program fund. Additionally, there is a tax-sheltered annuity fund and a supplemental benefit maintenance account. The defined benefit supplement program is funded from a portion of the regular member contributions and the full member contribution on service in excess of one year during any fiscal year. The cash balance benefit program is for "less than half-time" school employees. The voluntary investment program is a tax-deferred defined contribution program. The teachers' health benefit fund is a Medicare premium payment program. The teachers' replacement benefits program fund is a means to provide benefits in excess of Section 415 of the federal Internal Revenue Code. The supplemental benefit maintenance account funds an additional post-retirement adjustment if 80% of a retiree's purchasing power is not replaced by the other post-retirement adjustment mechanism. (CAFR Financial Statement Notes, pp. 23, 24, & 25; California Education Code, Sec. 22951.5; Sec. 22954)
Colorado Public Employees Retirement Association	The system has division (state and school, municipal, and judicial) trust funds, a health care trust fund, a life insurance reserve trust fund and a voluntary investment program. The health care trust fund relates to a monthly medical insurance premium subsidy program. The voluntary investment program is an Internal Revenue Code Section 401(k) retirement savings program. There is also a common operating fund, which is credited with proportional shares of the system budget. Within each division trust fund, there exists a member contribution reserve, an employer contribution reserve, a survivor benefit reserve, and an annual increase reserve. (Colorado Stat. Sec. 24-51-208)
Connecticut Teachers Retirement System	Retirement plan trust fund and health insurance fund exist. (Connecticut Stat. Sec. 10-183m; Sec. 10-183t)
Delaware State Employees Retirement Plan	A retirement trust fund, a post-retirement benefit fund, and a post-retirement health insurance premium fund exist. (Delaware Stat. Sec. 5541; Sec. 5548; & Sec. 5550)
Florida Retirement System	Statutory funds, reserves, and accounts are the annuity savings trust fund, the pension accumulation trust fund, the expense trust fund, and the survivors' benefit trust fund. Member contributions are required to be credited to the annuity savings trust fund. Transfers from the annuity savings trust fund to the pension accumulation trust fund occur upon retirement. Employer contributions also are credited to the pension accumulation trust fund. A portion of investment return on the annuity savings trust fund is credited to the expense trust fund. The survivors' benefit trust fund is funded by a portion of member contributions and a portion of employer contributions. (Florida Stat. Sec. 238.09; Sec. 238.10)
Georgia Teachers Retirement System	In addition to the retirement trust fund, there is a statutory requirement for an expense fund, to which a portion of state appropriations are creditable. (Georgia Stat. Sec. 47-4-29)

State	Retirement Fund and Account Structure
Hawaii Employees Retirement System	Statutory funds and accounts are the annuity savings fund, the pension accumulation fund, and the expense fund. Member contributions are required to be credited to the annuity savings fund, with the accumulated contributions transferred to the pension accumulation fund upon retirement. Employer contributions are required to be credited to the pension accumulation fund. The expense fund is required to be credited with the amount the board estimates necessary to fund the expense of the system, charged against the investment earnings of the system when reviewed by the legislature and approved by the governor. (Hawaii Stat. Sec. 88-109; Sec. 88-112; Sec. 88-113; Sec. 88-114; Sec. 88-116)
Idaho Public Employee Retirement System	There is a special retirement fund in the state treasury, with additional reserves in the form of a clearing account, a portfolio investment expense account, an administrative account, and a supplemental retirement account. The clearing account is the general body of plan assets. The investment expense account is dedicated to the payment of investment expenses. The administration account is dedicated for the payment of non-investment system expenses. The supplemental retirement account is credited with extraordinary gains on the investment portfolio that fund an additional post-retirement adjustment. (Idaho Stat. Sec. 59-1311)
Illinois Teachers Retirement System	The system has three funds or accounts. The benefit trust reserve is credited with most member and employer contributions and functions as the general clearing account for the retirement plan. The retirement annuity reserve is funded by contributions from annuitants electing the coverage of a minimum retirement annuity amount and sufficient state funding and is dedicated to minimum retirement annuity amounts. The teachers' health insurance fund is credited with a portion of member and employer contributions and funds the Teacher Retirement Insurance Program. (Illinois Stat. Sec. 40 ILCS 5/16-182; Sec. 40 ILCS 5/16-184; Sec. 40 ILCS 5/16-185; Sec. 40 ILCS 5/16-186.3; Sec. 40 ILCS 5/16-187)
Indiana Teachers Retirement Fund	Statutory funds and accounts are a pre-1996 account and a 1996 account, with each account segregated into an annuity savings account and a retirement allowance account. The pre-1996 account also contains a pension stabilization fund to cover cash flow requirements. The Annual Financial Report indicates that there are five established reserves, the member reserve, the benefits in force reserve, the employer reserve, the undistributed investment income reserve, and the unreserved fund balance. The member reserve is credited with member contributions and investment income. The benefits in force reserve is credited with member contributions for annuitants transferred from the member reserve, transfers from the employer reserve, contains the pension stabilization fund, and has an unfunded liability. The employer reserve contains the accumulated employer contributions and investment income and has an unfunded liability. The undistributed investment income reserve is created with all investment earnings, with subsequent transfers. The unreserved fund balance is the unfunded liability for retirees and non-retired members. (Indiana Stat. Sec. 5-10.4-2-1; Sec. 5-10.4-2-2; Sec. 5-10.4-2-3; Sec. 5-10.4-2-4; Sec. 5-10.4-2-5; Sec. 5-10.4-2-6)
Iowa Public Employees Retirement System	The retirement plan has a single retirement fund and no statutory internal funds or sub-accounts. (Iowa Stat. Sec. 97B.7)
Kansas Public Employees Retirement System	Statutory funds, reserves, and accounts are the members' accumulated contribution reserve, the retirement benefit accumulation reserve, the retirement benefit payment reserve, and the expense reserve. The member's accumulated contribution reserve is credited with member contributions and a portion of investment earnings. The retirement benefit accumulation reserve is credited with a portion of employer contributions and a portion of investment earnings. The retirement benefit payment reserve is credited with transfers from the members' accumulated contribution reserve and the retirement benefit accumulation reserve upon retirement, plus a portion of investment earnings. The expense reserve contains funds to offset the budgeted administrative expenses of the system and a portion of investment earnings. The retirement benefit accumulation reserve contains the unfunded liability of the system. The retirement benefit payment reserve is fully funded. The system administrative budget is subject to legislative approval. Additionally, the financial report indicates that there is an optional term life insurance reserve for accumulating employee contributions for the optional coverage. Also, there is a retirant dividend payment reserve for the payment of an additional post-retirement adjustment. (Kansas Stat. Sec. 74-4922; Sec. 74-4927c; Sec. 74-4927; Sec. 74-49,110; Sec. 74-49,111)
Kentucky Teachers Retirement System	Statutory funds, reserves, and accounts are the expense fund, the teachers' savings fund, the state accumulation fund, the allowance reserve fund, the medical insurance fund, the guarantee fund, the school employee annuity fund, the supplemental retirement benefit fund, and the life insurance benefit fund. The expense fund is credited with up to 4% of the investment earnings during the prior year and is used to pay administrative expenses. The teachers' savings fund accumulates member contributions and regular interest transferred from the guarantee fund, with turnover gains transferred back to the guarantee fund. The state accumulation fund is credited with state annuity and survivor benefit appropriations, is credited with interest from the guarantee fund and pays transfers to the allowance reserve fund upon retirement or death. The allowance reserve fund is credited with transfers from the teachers' savings fund and the state accumulation fund and pays retirement annuities and benefits. The medical insurance fund is credited with a portion of member and employer contributions and interest, as well as the employer medical insurance fund stabilization contribution and pays medical insurance benefits. The guarantee fund is credited with the plan's investment earnings and pays uniform interest to other funds as well as covering any cash flow shortages. The school employee annuity fund is a voluntary tax-sheltered annuity program under federal Internal Revenue Code Section 403(b). The supplemental retirement benefit fund covers excess benefits under federal Internal Revenue Code Section 403(b). The supplemental retirement benefit fund covers excess benefits under federal Internal Revenue Code Section 415. The life insurance benefit fund accumulates amounts related to the life insurance benefit of the plan. (Kentucky Stat. Sec. 161.420)

State	Retirement Fund and Account Structure
Louisiana Teachers Retirement System	Statutory funds, reserves, and accounts are the annuity savings fund, the employee experience account, the pension accumulation fund, the pension reserve fund, the supplemental benefit fund, and the expense fund. The annuity savings fund accumulates member contributions. The pension accumulation fund accumulates employer pension contributions. The pension reserve fund holds the reserves for benefits transferred from the annuity savings fund and the pension accumulation fund. The supplemental benefit fund is credited with transfers from the pension accumulation fund and is used to pay a supplemental benefit amount. The expense fund is used to pay the administrative expenses of the system and is funded from a board-determined deduction from plan investment earnings. The employee experience account is funded from a plan investment income deduction and is used to fund an automatic post-retirement adjustment annually. (Louisiana Stat. Sec. 873; Sec. 875; Sec. 879; Sec. 880; Sec. 882; Sec. 883.1)
Maine State Retirement System	Statutory funds, reserves, and accounts are the member's contribution fund, the retirement allowance fund, the expense fund, the survivors' benefit fund, the state retiree health insurance fund, the state retired teachers health insurance fund, and the disability retirement benefit fund. The member contribution fund accumulates member contribution deductions, the retirement allowance fund contains all benefit reserves not contained in the member contribution fund, the survivors' benefit fund, and the disability retirement benefit fund. The expense fund is credited with a portion of the employer contribution needed to pay plan administrative expenses. The survivors' benefit fund accumulates reserves for survivor benefits. The state retiree health insurance fund accumulates assets for the payment of health insurance premiums, with new accumulations discontinued in 1995. The state retired teachers' health insurance fund accumulates assets for the payment of teacher health insurance premiums, with new accumulations discontinued in 1995. The disability retirement benefit fund accumulates reserves for disability benefits. (Maine Stat. Sec. 17152; Sec. 17201; Sec. 17251; Sec. 17301; Sec. 17351; Sec. 17401; Sec. 17411; Sec. 17421)
Maryland Teachers Retirement System	Statutory funds, reserves, and accounts are the accumulation fund, the annuity savings fund, and expense fund. The annuity savings fund accumulates member contributions and associated investment earnings. The accumulation fund is credited with employer contributions and with transfers from the annuity savings fund upon a retiree's retirement. The expense fund is credited with a proportional share of the retirement system's total expense. (Maryland Stat. Sec. 21-123; Sec. 21-301; Sec. 21-302; Sec. 21-303; Sec. 21-311; Sec. 21-315)
Massachusetts Teacher Retirement System	Statutory funds, reserves, and accounts are the annuity savings fund, the annuity reserve fund, the pension fund, the special fund for military service credit, the expense fund, the pension reserve fund, and the Commonwealth's pension liability fund. The annuity savings fund accumulates regular and additional member deductions and is credited with regular interest. The annuity reserve fund is the fund to which reserves in the annuity savings fund are transferred upon the retirement of a member and from which benefits are payable. The pension fund accumulates employer contributions and receives transfers from the pension reserve fund or the Commonwealth's pension liability fund. The special fund for military service credit is credited with state appropriations representing regular deductions for members on military leave. The expense fund is credited with an appropriation for the plan's administrative expenses. The pension reserve fund is a reserve for future liabilities to be funded from actuarial investment gains and monies recovered for fringe benefits from federal grants. The Commonwealth's pension liability fund is the assets of the plan other than the annuity savings fund, the annuity reserve fund, and the expense fund. Al plan assets are invested through the Pension Reserves Investment Trust Fund by the Pension Reserves Investment Management Board. (Mass. Stat. Ch. 32, Sec. 22)
Michigan Public Schools Employees Retirement System	Statutory funds, reserves, and accounts are the reserve for employee contributions, the reserve for employer contributions, the reserve for administrative expenses, the general fund, the reserve for member investment plan, the reserve for health benefits, the health advance funding sub-account, the reserve for retired benefit payments, the reserve for undistributed investment income, and the pension stabilization sub-account. The reserve for employee contributions is credited with service credit purchases and refund repayments. The reserve for employer contributions is credited with all employer contributions, except for health benefit payments, plus interest, and unclaimed amounts transferred from the reserve for employee contributions. The reserve for administrative expenses is credited with the administrative expense requirements of the plan transferred from the reserve for undistributed investment income. The general fund is credited with plan revenue not clearly payable to any other fund and is disbursed as directed by the retirement board. The reserve for member investment plan accumulates the member contributions to the optional retirement plan and interest. The reserve for health benefits accumulates employer contributions for the plan health benefits. The health advance funding sub-account is credited with employer health contributions once the reserve for health benefits is fully funded. The reserve for retired benefit payments is the source for benefit payments and is funded from transfers from the reserve for employer contributions. The reserve for undistributed investment income is credited with all plan investment earnings and funds interest transfers to other reserves. The pension stabilization sub-account is credited with the amount of assets of the plan in excess of full funding. (Michigan Stat. Sec. 38-1329; Sec. 38.1330, Sec. 38-1331; Sec. 38-1332; Sec. 38-1333; Sec. 38-1334; Sec. 38-1335; Sec. 38-1336)
Mississippi Public Employees Retirement System	Statutory funds, reserves, and accounts are the annuity savings account, the annuity reserve, the employer's accumulation account, and the expense account. The annuity savings account accumulates member contributions and interest. The annuity reserve is the actuarial value of retirement benefits in force, including transfers from the annuity savings account upon retirement. The employer's accumulation account accumulates employer contributions and funds transfers upon retirement to the annuity reserve. The expense account is credited with legislative appropriations to meet administrative expenses of the system and a portion of employer contributions established for this purpose. (Mississippi Stat. Sec. 25-11-123)

State	Retirement Fund and Account Structure
Missouri Public School Retirement System	Statutory funds, reserves, and accounts are the employee's contribution fund and the general reserve fund. The employee's contribution fund accumulates member contributions and interest on those amounts. The general reserve fund contains the remainder of plan assets, including transfers from the employee contribution fund upon retirement. (Missouri Stat. Sec. 169.350; Sec. 169.360; Sec. 169.370)
Montana Teachers Retirement System	Statutory funds, reserves, and accounts are the annuity savings fund, the pension accumulation fund, and the expense fund. The annuity savings fund accumulates member contributions and interest. The pension accumulation fund accumulates employer contributions, holds the reserves for all pension benefits, including transfers upon retirement of amounts from the annuity savings fund. The expense fund receives transfers from the pension accumulation fund to defray plan expenses. (Montana Stat. Sec. 19-20-501; Sec. 19-20-605; Sec. 19-20-602)
Nebraska Public Employees Retirement Systems-School System	Statutory funds, reserves, and accounts are the service annuity fund, the expense fund, and the contingent account. The service annuity fund is credited with state contributions to fund benefits for members with prior coverage by the Class V School Employees Retirement Act. The expense fund is funded from transfers from the contingent account and is the source for administrative expense payments. The school retirement fund accumulates state, employer, and member contributions and is the source for all retirement plan benefit payments. The contingent account facilitates the crediting of regular interest, to fund adjusted supplemental retirement benefits, and to cover special requirements of the school retirement fund or expense fund and is credited with the investment earnings of the retirement plan. (Nebraska Stat. Sec. 79-966; Sec. 79-968; Sec. 79-971; Sec. 79-972.01; Sec. 79-973; Sec. 79-974)
Nevada Public Employees Retirement System	The plan has a retirement fund to which are credited all member and employer contributions and investment earnings and has an administrative fund in which are deposited all administrative fees charged against the various retirement funds managed by the retirement system. The retirement board is authorized to establish a fund to cover benefits in excess of the limitations in the federal Internal Revenue Code, Section 415. (Nevada Stat. Sec. 286.220; Sec. 286.230; Sec. 286.241)
New Hampshire Retirement System	Statutory funds, reserves, and accounts are the member annuity savings fund, the state annuity accumulation fund, the special account for additional benefits, and the Section 401(h) subtrust medical special account. The member annuity savings fund accumulates member contributions and interest and the appropriate portion of the fund is transferred to the state annuity accumulation fund upon a member's retirement. The state annuity accumulation fund accumulates reserves for state annuities payable from employer contributions. The special account for additional benefits primarily accumulates investment earnings in excess of the assumed rate plus 0.5% and is used to provide supplemental post-retirement adjustments. The Section 401(h) subtrust is credited with a portion of employer contributions and is used to pay post-retirement medical-health insurance benefits. (New Hampshire Stat. Sec. 100-A:15; Sec. 100-A:16; Sec. 100-A:17; Sec. 100-A:52-a; Sec. 100-A:53b)
New Jersey Teachers Pension and Annuity Fund	Statutory funds, reserves, and accounts are the contingent reserve fund, the annuity savings fund, the retirement reserve fund, the pension fund, the special reserve fund, the interest fund, the benefit enhancement fund, the members' death benefit fund, the contributory group insurance premium fund, and the post-retirement medical premium fund. The contingent reserve fund accumulates the state and employer contributions and bears the accrued liability of the plan. The annuity savings fund accumulates member contributions. The retirement reserve fund exists to pay retirement benefits and is funded from transfers from the annuity savings fund upon retirement and from required amounts from the contingent reserve fund. The pension fund relates to pre-1971 teachers and pre-1956 retirees. The interest fund accumulates investment earnings and is used to allocate interest to other funds. The special reserve fund accumulates investment earnings in excess of the regular interest rate up to 1% of the book value of the total retirement plan. The benefit enhancement fund exists to fund the funding requirements of 2001 and was funded from then-existing excess assets. The members' death benefit fund exists to fund additional death benefits. The contributory group insurance premium fund accumulates excess premium amounts. The post-retirement medical fund exists to pay post-retirement medical benefits and is funded from a portion of employer contributions. (New Jersey Stat. Sec. 18A:66-16; Sec. 18A:66-18; Sec. 18A:66-18.1; Sec. 18A:66-19; Sec. 18A:66-21; Sec. 18A:66-22; Sec. 18A:66-24; Sec. 18A:66-25; Sec. 18A:66-26; Sec. 18A:66-27; Sec. 18A:66-71.3; Sec. 18A:66-77)
New Mexico Educational Retirement Plan	A single retirement trust fund exists for the retirement plan except for post-employment health insurance benefits, which are provided through the retiree health care fund. (CAFR Financial Section, p. 33)
New York State Teachers Retirement System	Statutory funds, reserves, and accounts are the annuity savings fund, the annuity reserve fund, the pension accumulation fund, the pension reserve fund, the supplemental retirement allowance fund, and the expense fund. Administratively established funds or reserves are the group life insurance fund and the CO-ESC member contribution fund. The annuity savings fund accumulates member contributions for members employed before July 26, 1976, with a transfer to the annuity savings fund upon retirement. The annuity reserve fund accumulates reserves for the payment of some pension benefits and bears some of the actuarial liability of the pension plan. The pension accumulation fund contains the reserves for benefits for members employed after 1976 and that are not payable from the supplemental retirement allowance fund or the group life insurance fund. The pension reserve fund is the fund for the payment of benefits from reserves transferred from the pension accumulation fund. The supplemental retirement allowance fund exists to provide the supplemental retirement allowance paid to pre-1994 retirees. The expense fund exists for the payment of plan expenses, with expected investment expenses paid from investment earnings and with expected administrative expenses payable by the commissioner of education. The group life insurance fund provides a group term death benefit. The CO-ESC member contribution fund accumulates the member contributions for some more recent plan entrants. (New York Education Law, Sec. 515; Sec. 516; Sec. 517; Sec. 518; Sec. 518-a; Sec. 519)

State	Retirement Fund and Account Structure
North Carolina Teachers and State Employees Retirement System	Statutory funds, reserves, and accounts are the annuity savings fund, the annuity reserve fund, the pension accumulation fund, the pension reserve fund, and the retiree health benefit fund. The annuity savings fund accumulates the member contributions and is transferred to the pension accumulation fund upon retirement. The pension accumulation fund accumulates all reserves for benefits and employer contributions and the annuity reserve fund and pension reserve fund were merged into the pension accumulation fund in 1959. The retiree health benefit fund accumulates employer contributions for health coverage and investment earnings on those assets. (North Carolina Stat. Sec. 135-7; Sec. 135-8; Sec. 135-39.6)
North Dakota Teachers Fund For Retirement	The retirement plan has a single retirement trust fund. (CAFR Financial Section, pp. 27, 28, & 40)
Ohio State Teachers Retirement System	Statutory funds, reserves, or accounts are the teachers' savings fund, the employers' trust fund, the annuity and pension reserve fund, the survivors' benefit fund, the guarantee fund, the expense fund, and the defined contribution fund. The teachers' savings fund accumulates member contributions and transfers individual account balances upon retirement to the annuity and pension reserve fund. The employers' trust fund is the depository for employer contributions, with transfers to the annuity and pension reserve fund upon retirement. The survivors' benefit fund is the source for survivor benefits and is funded from transfers from the employers' trust fund. The guarantee fund is credited with interest and allocates investment earnings. The expense fund is used to defray administrative and management expenses. The defined contribution fund accumulates member deductions for the board-established defined contribution plan. (Ohio Stat. Sec. 3307.14; Sec. 3307.141)
Oklahoma Teachers Retirement System	Statutory funds, reserves, or accounts are the teachers savings fund, the retirement benefit fund, the interest fund, the permanent retirement fund, the expense fund, the suspense fund, the reserve for investment fluctuations fund, the teachers' deposit fund, the membership annuity reserve fund, the retiree medical benefit fund, and the tax-sheltered annuity fund. The teachers' savings fund accumulates regular member contributions and interest earnings before July 1, 1998, and funds transfers to the retirement benefit fund upon each retirement. The retirement benefit fund consists of the assets needed to make retirement payments to retirees. The interest fund facilitates the allocation of investment earnings among other funds. The permanent retirement fund consists of accumulated gifts, awards, and bequests and also transfers from the suspense fund and functions as a permanent endowment for the retirement system. The expense fund defrays the system administrative and maintenance expenses and is funded from interest fund transfers, from dedicated revenue, and from legislative appropriations. The suspense fund receives transfers representing retirement obligations that cannot be legally discharged. The reserve for investment fluctuations fund is credited with 8% of investment returns until the accumulation reaches 2% of the total assets of the system and is paid out to other funds to reimburse deficits. The teachers' deposit fund accumulates voluntary member contributions under Internal Revenue Code Section 403(b). The membership annuity reserve fund is the accumulated member and state contributions for members retiring before August 2, 1968. The retiree medical benefit fund is a sub-account of the retirement benefit fund and is used to pay monthly retiree health insurance benefits. (Oklahoma Stat. Sec. 70-17-107; Sec. 70-17-108)
Oregon Public Employees Retirement System	Reserves and designations established by the system are the member reserve, the employer contribution designation, the benefit reserve, the undistributed investment earnings designation, the contingency reserve, the employer contingency reserve, the capital preservation reserve, the unallocated earnings designation, the deficit reserve, the pending designation, the retirant health insurance account, the retiree health insurance premium account, and the standard retiree health insurance account. The member reserve accumulates member contributions and investment earnings and funds transfers to the benefit reserve upon retirement. The employer contribution designation accumulates employer contributions and earning allocations and funds transfers to the benefit reserve upon retirement. The benefit reserve exists to pay benefits from transferred contributions and accrued investment earnings. The undistributed investment earnings designation is credited with investment earnings in excess of required minimum interest distributions. The contingency reserve is intended to prevent cash flow problems relating to interest fluctuations, mortality changes, or other unforeseen contingencies. The employer contingency reserve exists to prevent a deficit from the insolvency of an employer. The capital preservation reserve is used to offset capital investment losses. The unallocated earnings designation is the January through June annual net investment earnings pending a subsequent distribution. The deficit reserve is the unfunded liability for certain member account credits under a pre-2003 law. The pending designation is a 2004 calendar year earnings amount not distributed due to pending litigation. The retirant health insurance account is the accumulated employer contributions and investment earnings for the health insurance program. The retiree health insurance premium account exists to fund the retiree health insurance program. The standard retiree health insurance account represents the retiree contributions and investment earnings for the standard retiree health insurance program. (CAFR Financial Section, pp. 27-28; Oregon Stat. Sec. 238.485; Sec. 238.670; Sec. 238.696; Sec. 238.615)
Pennsylvania Public School Employees Retirement System	Statutory funds, reserves, and accounts are the members' savings account, the state accumulation account, the annuity reserve account, and the health insurance account. The members' savings account accumulates member contributions and regular interest, with transfers to the annuity reserve account upon retirement. The state accumulation account accumulates state and employer contributions and interest, with transfers to the annuity reserve account upon retirement. The annuity reserve account exists for the payment of retirement annuities and benefits. The health insurance account exists to fund the health insurance premium assistance program. The health insurance program account accumulates member contributions in connection with the direct health insurance premium program. (CAFR Financial Statement Notes, p. 47; Pennsylvania Stat. Sec. 24:8521; Sec. 24:8522; Sec. 24:8523; Sec. 24:8524; Sec. 24:8525; Sec. 24:8526)

State	Retirement Fund and Account Structure
Rhode Island Employees Retirement System	Statutory funds, reserves, and accounts are the restricted receipt account, the annuity savings account, the contingent reserve account, and the restricted fund for providing health benefits to retirees. The restricted receipt account exists to pay plan administrative expenses through a deduction from investment earnings. The annuity savings account accumulates member contributions and transfers amounts to the contingent reserve account upon retirement. The contingent reserve account accumulates state contributions and funds all retirement benefit payments. The restricted fund for providing health benefits to retirees exists to fund the retiree health benefits program. (Rhode Island Stat. Sec. 36-8-10.1; Sec. 36-10-1; Sec. 36-10-2; Sec. 36-10-3; Sec. 36-10-4)
South Carolina Retirement System	Statutory funds, reserves, and accounts are the employee annuity savings fund, the employer annuity accumulation fund, and the group life insurance fund. The employee annuity savings fund accumulates member contributions and related investment earnings and funds the transfers to the employer annuity accumulation fund upon retirement. The employer annuity accumulation fund accumulates the employer contributions and related investment earnings and is the source of all retirement annuities and benefits. The group life insurance fund exists to provide life insurance benefits to active and retired members. (South Carolina Stat. Sec. 9-1-1010; Sec. 9-1-1020; Sec. 9-1-1030; Sec. 9-1-1050; Sec. 9-1-1110; Sec. 9-1-1130)
South Dakota Retirement System	With the exception of an expense fund, the retirement system has a single retirement trust fund. The expense fund is credited with 3% of the contributions to the plan annually and is used for the payment of the administrative costs of the system. (South Dakota Stat. Sec. 3-12-61; Sec. 3-12-72)
Tennessee State Employees, Teachers, and Higher Education Employees Pension Plan	The statutory funds, reserves, and accounts are the members' fund and the state accumulation fund. The members' fund accumulates member contributions and related interest earnings and is the source of transfers of amounts to the state accumulation fund upon retirements. The state accumulation fund is the reserve for all benefits payable by the system. (Tennessee Stat. Sec. 8-37-101; Sec. 8-37-201; Sec. 8-37-215; Sec. 8-37-301)
Texas Teacher Retirement System	The statutory funds, reserves, and accounts are the member savings account, the state contribution account, the retired reserve account, the interest account, the expense account, and the deferred retirement option account. The member savings account accumulates member contributions plus regular interest and from the account amounts are transferred to the retired reserve account upon retirement. The state contribution account accumulates state contributions, interest, and related amounts, with transfers to the retired reserve account of needed amounts upon retirement. The retired reserve account functions as the source of all retirement annuity and benefit payments. The interest account accumulates investment earnings. The expense account is funded largely from investment earnings and functions to pay administrative expenses of the system. The deferred retirement option account functions to fund the deferred retirement option program. (Texas Stat. Sec. 825.306; Sec. 825.307; Sec. 825.308; Sec. 825.309; Sec. 825.311; Sec. 825.312; Sec. 825.3121)
Utah Noncontributory Defined Benefit System	There is a single retirement trust fund for the retirement plan. (Utah Retirement Systems CAFR, Financial Statement Notes, p. 46)
Vermont State Teachers Retirement System	Statutory funds, reserves, and accounts are the annuity savings fund, the pension accumulation fund, the annuity reserve fund, the pension reserve fund, and the expense fund. The annuity savings fund accumulates member contributions and, upon retirement, the applicable portion is transferred to the annuity reserve fund. The pension accumulation fund functions to pay all retirement benefits not payable from the annuity savings fund. The expense fund functions to pay the administrative expenses of the retirement plan and receives an appropriation from the state for this purpose. (Vermont Stat. Sec. 16-1944)
Virginia Retirement System	Statutory funds, reserves, and accounts are the members' contribution account, the retirement allowance account, the advance premium deposit reserve, and the retiree health insurance credit reserve. The member contribution account accumulates member contributions and applicable investment earnings, with a transfer upon retirement to the retirement allowance account. The retirement allowance account accumulates employer contributions and related investment earnings, and pays all retirement annuities and benefits. The advance premium deposit reserve accumulates premium contributions during active membership and is charged for death benefits and expenses. The retiree health insurance credit reserve accumulates employer contributions and pays out months insurance premiums. (Virginia Stat. Sec. 51.1-147; Sec. 51.1-148; Sec. 51.1-1140; Sec. 51.1-1401)
Washington Teachers Retirement System	Statutory funds, accounts, and reserves are the teachers' retirement system plan 1 fund, the teachers' retirement system plan 2 and 3 fund, and a department of retirement systems expense fund. The teachers' retirement system plan 1 fund applies to members hired before October 1, 1977. The teachers' retirement system plan 2 and 3 fund applies to members hired after September 30, 1997. The department of retirement systems expense fund is a joint fund with other Washington retirement plans and is funded from the state's general fund based on legislative appropriations. (Washington Stat. Sec. 41.50.075; Sec. 41.50.110; Sec. 41.50.200; Sec. 41.50.215)

State	Retirement Fund and Account Structure
Wisconsin Retirement System	Statutory funds, reserves, and accounts are an administrative account, the core retirement investment trust, the variable retirement investment trust, a transaction amortization account, a market recognition account, a current income account, the employee accumulation reserve, the employer accumulation reserve, the annuity reserve, the Social Security account, the group health insurance account, the income continuation account, the life insurance account, the employee-funded reimbursement account, the accumulated sick leave conversion account, and the health insurance premium credit account. The administrative account funds most of the administrative costs of the Department of Employee Trust Funds. The core retirement investment trust is an investment fund for system assets not held by the variable retirement investment trust and has a transaction amortization account and market recognition account. The variable retirement investment trust is the investment fund for the variable annuity program and must include a current income account. The employee accumulation reserve accumulates employee contributions and employer additional contributions and interest credits, with transfers upon retirement. The employer accumulation reserve accumulates employer contributions and interest and various actuarial gains. The annuity reserve consists of the present value of annuities and benefits in force, with interest credited. The Social Security account functions to transfer Social Security contributions. The insurance accounts function to support each insurance program. The employee-funded reimbursement account plan is a pre-tax benefit program. The accumulated sick leave conversion account is a mechanism to translate accumulated sick leave to health insurance premium credits. The health insurance premium credit account functions to pay health insurance plan premiums. (Wisconsin Stat. Sec. 40.04)
Wyoming Public Employee Pension System	The retirement plan has a single retirement account that contains the entire assets of the plan and bears the total liability of the plan. (Wyoming Stat. Sec. 9-3-407; Sec. 9-3-436)
Minnesota Teachers Retirement Association	Single retirement trust fund with two commingled investment funds, the Minnesota Combined Investment Fund (active member reserves) and the Minnesota Post Retirement Investment Fund (retired member reserves). (Minnesota Stat. Sec. 11A.14; Sec. 354.42, Subd. 1a; Sec. 354.63)
Duluth Teachers Retirement Fund Association	Single retirement trust fund for the pension plan. Voluntary tax-sheltered program has a bond fund, an equity fund, or a money market fund. (Minnesota Stat. Sec. 354A.021)
St. Paul Teachers Retirement Fund Association	Single retirement trust fund with a separate reserve to which have been credited net asset amounts representing local police and paid fire amortization state aid paid to the retirement plan and excluded from assets on which post-retirement adjustments may be calculated. (Minnesota Stat. Sec. 3354A.021)

Table 16: 2005 Unfunded Liability and Funded Ratio for Selected Statewide Minnesota Public Pension Plans, as of June 30, 2005

	As Presented in Actuarial Reports: Basic and Post Funds			
Pension plan	Assets	Liabilities	Unfunded Liabilities	Funded Ratio
MSRS	$8,081,736,374	$8,455,335,998	$373,599,624	95.58%
PERA	11,843,935,692	15,892,554,615	4,048,618,923	74.53%
TRA	17,752,917,313	18,021,410,061	268,492,748	98.51%
	Basic Funds, Reported Separately			
Pension plan	Assets	Liabilities	Unfunded Liabilities	Funded Ratio
MSRS	$4,593,806,066	$4,967,405,690	$373,599,624	92.48%
PERA	5,330,878,891	9,379,497,814	4,048,618,923	56.84%
TRA	7,314,865,955	7,583,358,703	268,492,748	96.46%
	Post Fund, Reported Separately			
Pension plan	Assets*	Liabilities	Unfunded Liabilities*	Funded Ratio**
MSRS	2,860,000,000	3,487,930,308	628,000,000	82.00%
PERA	5,341,000,000	6,513,056,801	1,172,000,000	82.00%
TRA	8,559,000,000	10,438,051,358	1,879,000,000	82.00%

** Estimated using the 82% funded ratio figure provided by MSRS, PERA and TRA. Rounded to the nearest million.*
*** Figure provided by MSRS, PERA and TRA.*

Segregating active employees from current retirees in pension fund structure also introduces equity problems and elevated levels of taxpayer exposure. This is caused by the requirement that any individual be "fully funded" when their assets are moved from the Basic Fund to the Post Fund when they retire. For example, assume that John Smith, an active PERA employee, plans to retire at the end of 2006. John has accumulated $100,000 in pension benefits (liabilities) in the Basic Fund. Upon retirement, PERA transfers this liability, along with the amount of assets needed to offset that liability ($100,000 discounted by a prorated 6%[55]) to the Post Fund. The amount of assets required to be transferred is approximately $97,000. However, since the Basic Fund is only funded at 56.84%, then John Smith has only $56,840 of assets assigned to him in that fund. Where will the additional $40,160 come from? As it stands now, it will come from other active employees in the Basic Fund, backed by the ability to extract more from taxpayers if needed.

"When unfunded liabilities exist in the Basic Funds, the 'robbing Peter to pay Paul' nature of Basic to Post fund transfers places stress on Basic Fund health."

When unfunded liabilities exist in the Basic Funds, the "robbing Peter to pay Paul" nature of Basic to Post fund transfers places stress on Basic Fund health. Accommodating this stress to ensure payments can be made to current retirees is one thing. Sacrificing fund health at the same time large post retirement benefit increases are being handed out of the Post Fund is a completely different matter. Such was the situation for several years when the PERA Basic fund was working to achieve fully funded status at the same time it was transferring assets it couldn't afford to give up to a Post Fund with surpluses. Retirees benefited while active PERA members and taxpayers have already begun a scheduled string of contribution increases to pay for this generosity. The preservation of any post-retirement benefit increase based on investment returns introduces the possibility of this happening again.

"Repaying" Basic Funds is not allowed under the statutory language governing the Post Fund (MS 11A.18). Transferring only the fractional reserves necessary to keep the Post

[55] The other 2.5% is the inflationary component, and is "fronted" by the Post Fund.

Fund "whole" upon an employee's retirement, however, would accomplish the same purpose of protecting the health of the Basic Funds when the Post Fund is in a surplus situation. Since the Post Fund is not whole at this time and likely won't be in the immediate future, full reserve transfers will probably be necessary to help ensure that obligations to current retirees can be met. Nevertheless, the fact remains that in the 1990's excess transfers helped fuel post retirement benefit increases beyond inflation at the direct expense of enabling the PERA basic fund to return to fully funded status.

Recommended Changes to the Design of Minnesota's Defined Benefit System

- **Permanently end benefit increases based on superior investment returns and provide only capped inflationary adjustments**
  Paying these benefit increases over the majority of the last 12 years has had harmful affects on Minnesota public pension plans:
    - *They have increased liabilities for the plans as a whole with a corresponding increase in taxpayer risk.* The amount paid to current retirees in benefit increases due to investment returns above 8.5% in the last 12 years for the three statewide pension plans in this study almost exactly matches the amount of unfunded liabilities for those plans. Every "investment performance bonus" is permanently built into a retiree's benefit base and creates obligations for the life of the recipient or the recipient's spouse, and can only be paid for by significant investment returns on the retiree's assets that are transferred into the fund. Moreover, when basic funds have unfunded liabilities as they do today, the transfer of assets into the post retirement fund comes at the direct expense of the health of the basic fund. This increases the likelihood of needing additional contribution increases from taxpayers and employees.

    - *They have contributed to generational inequity among retirees.* Those retiring in the 1980s and 1990s have enjoyed significant increases in their pensions benefits. No performance bonuses have been paid out since 2002, so that anyone retiring in 2001 or later has not received the increases of retirees in the previous two decades. The fact that the post-retirement fund is only 82% funded means they will not likely receive any such increases for at least 10 years.

  The current legislative proposal to continue permitting investment-based benefit increases while subjecting them to a cap may reduce the severity of the problem in the future, but the use of investment gains to provide permanent benefit increases is still bad public policy.

- **Develop quantifiable standards of replacement income to be achieved through pension benefits.**
  Currently there is no empirical or quantifiable standard used to evaluate the adequacy of pension benefits or planned benefit increases. Policy makers should develop target replacement income standards from public pensions which factor in the availability of other income sources such as social security and supplemental retirement savings. Future benefit increases should be evaluated against these measurable standards as opposed to the political opportunism created by fund surpluses or from examining what public employees in other states have convinced their legislatures to support.

Recommendations That Apply to Specific Pension Fund Conditions:

When Both the Basic and Post Funds Have Unfunded Liabilities:

Such is the condition today and all indications are that these conditions will continue for some time to come. Our recommendations do not functionally deviate from the effects of current law since post retirement benefits are currently based only on inflationary adjustments with Post fund deficits.

When Basic Funds are Under-funded and Post Fund is Fully Funded:

- **Upon an employee's retirement, transfer only the fractional reserves necessary to keep the Post Fund "whole."**

  If retirees are being kept whole (or more than whole) in the Post Fund, there is no need to transfer all of a new retirees actuarial reserves to a place where they are not needed. By transferring only the amount necessary to keep the Post Fund whole, assets can remain in the basic funds restoring them to health sooner.

When Basic Funds have a surplus and the Post Fund is Underfunded

- **Upon an employee's retirement, transfer full actuarial reserves to the Post Fund and focus attention on reducing contribution rates in the Basic Fund**

When Basic Funds and the Post Fund Have Fund Surpluses
Although a return of these conditions cannot be expected anytime soon, the discipline created by the previous recommendations would speed the restoration of pension fund health. If these conditions return:

- **Focus attention on the reduction of employee and employer contribution rates**
  By focusing on contribution rate reductions in times of fund surpluses, the benefits of sound pension fund management can be shared by taxpayers as well as employees.

- **Provide for self managed accounts or "13th checks" when an established "maximum funded ratio" in the Post Fund is exceeded**
  Since the post fund has no contributions other than investment income, large accruing surpluses should be distributed to retirees. We recommend developing a maximum funding ratio for the post fund which, if exceeded, would trigger benefit increases to retirees. However, we recommend these benefit increases be provided in the form of one time lump sums (otherwise known as "13th checks") or in the creation of self managed investment accounts to avoid creating any new permanent obligations on state taxpayers.

As stated above, our objectives in these recommendations are to preserve the integrity of a defined benefit pension system for public employees and help ensure that there is enough information readily available to taxpayers to participate in discussions of how high these plans are to be on the list of public spending priorities.