December 16, 1991 20th Meeting
Room 5, State Office Building

LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

MINUTES

Representative Leo Reding, Chair of the Legislative Commission on Pensions and Retirement, called the meeting to order at 7:10 P.M.

Commission members present:

Representatives Richard Jefferson, Bob Johnson, Gerald Knickerbocker, Rich O'Connor and Leo Reding
Senators Lawrence Pogemiller, Earl Renneke, Leroy Stumpf, and Gene Waldorf

**Consideration of Potential Revisions in the Structure and Investment Practices of the Minnesota Post Retirement Investment Fund.**

Edward Burek, LCPR Deputy Executive Director, reviewed the staff memo on the History of Automatic Post Retirement Adjustment Procedures. Mr. Burek noted that in 1969 the LCPR created the Minnesota Adjustable Fixed Benefit Fund (MAFB) to provide automatic increases to retirees rather than ad hoc increases. In 1980 the Minnesota Post Retirement Investment Fund (MPRIF) was established. Mr. Burek referred members to a Report of the Task Force on Fund Objectives dated January 1989. He stated that in his opinion, this report was the basis for the proposals to revise the post fund benefit increase mechanism. Mr. Burek stated that the post fund, under current conditions, is invested for yield rather than total return and that orientation leads to lower investment earnings and raises the cost of operating the system. He noted that the task force recommended merging the post fund and basic fund and also recommended an inflation based benefit increase formula.

John Yunker, Program Evaluation Division Office of the Legislative Auditor, referred members to a report titled "State Investment Performance" dated April 1991. Mr. Yunker provided a handout of his slide presentation also titled "State Investment Performance" and dated April 1991. He noted some key points from the report. He stated that Minnesota's pension funds have two unique features, a two fund system (the basic fund and the post fund), and the current post retirement benefit increase formula. The result is a very conservative investment strategy for the post retirement fund which has less than 10% of its assets in stock. He further stated that between the combined basic and post funds, Minnesota is more conservative, about 10% more bonds and about 10% less stocks, than most public and private pension funds. This causes lower earnings of about 35 to 50 million dollars per year. Mr. Yunker posed two policy questions for members to address:

> Should post retirement pension benefit increases be based more on the cost of living (the inflation rate) and less on investment results?
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> Should all of the increased investment returns from a change in the formula go to retirees or should a portion go to other pension objectives?

Mr. Yunker continued with his presentation.

Rep. O'Connor asked what was meant by an atypical system? Did it refer to the separation of the basic and post fund and do other states have a post fund? Mr. Yunker responded that the Minnesota system is atypical in comparison to other states. He also noted that Wisconsin does have a post fund. Rep. O'Connor stated that he did not believe it was necessarily consistent to combine the basic and post fund in order to invest more aggressively. He believes that the post fund could be invested more aggressively without merging with the active fund. Mr. Yunker stated that he is not recommending merging the two funds, the report stated that Minnesota's public pension investment performance lags behind that of other funds. That caused a review of the differences between Minnesota's system and other systems and a questioning of what changes are called for if any.

Sen. Stumpf asked what was the basis for the 35 to 50 million annual loss projection. Mr. Yunker stated that the 35 to 50 million represents a comparison to historical stock and bond returns where stocks historically outperform bonds by 5% annually.

Sen. Renneke questioned whether realized or unrealized gains provide the best return. Mr. Yunker responded that with stocks the unrealized gains are usually better and currently the post retirement adjustment is based solely on realized gains. He believes that retirement benefit increases based on investment results should be based on the total returns of stocks and bonds.

Rep. Knickerbocker questioned whether Mr. Yunker's report differentiated between individual stocks, indexed futures and stock mutual funds. Mr. Yunker responded that all references to stocks are based on broad indexes of stocks.

Sen. Waldorf stated that the transparency that showed the change from the high ratio of stocks to bonds to the reverse made it appear that the State Board was cashing out stocks and buying bonds to pay benefits. Was their a justification or requirement for the asset mix to change over time? Mr. Yunker stated that the SBI was not forced to change the asset mix but there was an incentive to change the asset mix due to the way the post retirement formula was weighted.

Lawrence A. Martin, LCPR Executive Director, stated that in 1969 when the two fund system was set up the purpose was to track the basic and post funds separately so that the post fund could pay increases based on the post fund investment earnings. The two fund system was necessary for accounting purposes. The two fund system allows the use of different assumptions. The 5% interest rate assumption on post retirement investments was a policy decision established to provide post retirement increases. The interest rate assumption on the active fund account is 8 1/2%.

Douglas Mewhorter, MSRS Acting Executive Director, reported the MSRS Board's decisions on the three major proposals in the Legislative Auditor's Study. He stated that the MSRS Board supported a change in the post retirement adjustment fund formula to maximize investment earnings and provide post retirement adjustment increases more in step with inflation. The MSRS Board strongly opposed an increase in the 5% interest rate assumption and also opposed merging the active fund and the retiree's fund.

Elton Erdahl, TRA Executive Director, stated that the TRA Board supported the change in investment strategy and the change in the post retirement adjustment fund formula. The TRA Board opposed an increase in the interest rate assumption and opposed merging the active fund with the retiree fund. TRA also opposed using post fund investment earnings for any purpose other than post fund increases. Discussion followed.

Laurie Hacking, PERA Executive Director, stated that the PERA Board supported the change to the post fund formula and opposed merging the funds and changing the interest rate assumption. The Legislative Auditor has identified several problems and the fund directors feel that the proposal addresses those problems. Ms. Hacking noted that the MEA retired members, MFT retired members, MSRS retired members, PERA retired members, MN Retired Educators Association, PERA Post-73 retirees, Public Employees Pension Service Association, MN Association of Professional Employees, and others support this proposal.

Howard Bicker, SBI Executive Director, made a presentation of the post fund proposal for members. He stated that the SBI Board has not taken a position on this issue and he was here only as a technical advisor. Mr. Bicker noted that the problem with the current system is that the benefit increases do not bear any relation to inflation. Mr. Bicker stated that members had questioned why stock investments were 43% in 1980 and only 10% in 1991. Mr. Bicker stated that the need to generate realized gains to provide benefit increases caused the stock to bond ratio to change. If the statute had also permitted the use of unrealized gains, the ratio may not have shifted. Mr. Bicker continued by noting that the proposed change would provide an annual increase equal to 100% of inflation up to a cap of 3.5%. Mr. Bicker continued by reviewing the other components of the proposed formula.

Sen. Waldorf questioned why not amend the statutory requirement with respect to using only realized gains to provide benefit increases. Mr. Bicker responded that the problem was perceived to be a need for inflation sensitivity in benefit increases as well as to permit the use of unrealized gains. Discussion followed.

Robert Whitaker, representative of the Coalition of Retired Public Employees, stated that the Coalition consists of four groups, PERA post-73ers, PERA pre-73ers, REAM, and the Minnesota Retired State Employees Association. The Coalition represents 55,000 to 60,000 retired public employees. The Coalition is opposed to any merger of the two funds and opposed to using post fund gains to reduce the unfunded liability in the active fund. The Coalition also is opposed to increasing the interest assumptions. Mr. Whitaker stated that if the interest assumption was raised by 1%, a retiree with a monthly pension of $1,500 would lose more than $10,000 in a ten year time period. Mr. Whitaker read from an opinion from the Wisconsin Court stating that the pension funds are trust funds and not state funds and they do belong to the retirees. Mr. Whitaker stated that the Coalition, with the exception of the 300 pre-73 retirees, supported the proposed change in the post retirement adjustment formula.

Rep. Reding stated that this proposal would be considered by the Commission again in January as well as the major funds administration bills.

**Comparative Review of Leave of Absence and Related Service Credit Provisions.**
This item was **LAID OVER** to a future meeting.

**Review of State Funded Aid Programs for Police and Fire Pension Programs.**
Lawrence Martin reviewed the staff memo on this topic. Mr. Martin stated that the legislature has not taken a comprehensive look at the aid programs since 1974. Discussion followed.

Rep. Reding questioned the continuation of aid for pension plans that are fully funded. Mr. Martin stated that this was the question that precipitated the whole question of the aid programs. Mr. Martin noted that Minnesota has five different allocation methods to distribute state funded pension aids and it is the task of the Commission to determine whether the policies that created these pension aid programs remain appropriate.

Rep. Reding stated that West St. Paul Police Relief Association is fully funded but has very low benefits. He questioned whether it was proper to penalize a relief association for their fiscal responsibility. Mr. Martin noted that West St. Paul is a relatively new relief association and has a very limited capped escalator whereas most of the other relief associations have an uncapped escalator. Discussion followed.

Dick Nelson, MN Police Pension Council, spoke in support of the current surcharge distribution and its equal apportionment per police officer around the state. Mr. Nelson spoke in opposition to a 1987 reduction in the amount of state aid provided per police officer due to payments made to the State Auditor's office. Mr. Martin clarified Mr. Nelson's comment by stating that in 1987 funds were deducted from the police and fire state aid programs to offset expenditures by the State Auditor for oversight and audits and by the Department of Revenue for the state aid allocation process.

Brian Rice, MN Police Pension Council, commented that the Commission should consider police and fire state aid as basically a local government aid program. He continued with his comments.

Rep. Reding stated that PERA-P&F is funded at 2.46% over normal cost and in his opinion the employee and employer contributions should be decreased proportionately to the normal cost level. Discussion followed.

George Jurgenson, President of the Retired St. Paul Firefighters, spoke in opposition to reducing or changing the aid programs to the police and fire funds. Mr. Jurgenson continued with his comments.

Gus Welter, stated that the first class city surtax is a direct payment by insurance policyholders, it is collected by the state, but it is not state tax money. Sen. Waldorf stated that it is a tax whether it is a surtax or sales tax. Discussion followed.

The meeting adjourned at 10:35 P.M.

Jean Liebgott

Jean Liebgott, Secretary