September 12, 1996
Room 10, State Office Building

21st Meeting

LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

MINUTES

Representative Richard Jefferson, Chair of the Legislative Commission on Pensions and Retirement, called the meeting to order at 12:43 P.M.

Commission members present:
Representatives Richard Jefferson, Bob Johnson, and Tom Osthoff
Senators Lawrence Pogemiller and Roy Terwilliger

Commission members with an excused absence:
Representatives Phyllis Kahn and Steve Smith
Senators Steven Morse, Phil Riveness, and LeRoy Stumpf

1. Mandated Commission Study: Defined Contribution Pension Plans and Defined Benefit Pension Plans (Third Consideration); Presentation by Panel on Public Employee Labor Trends and Related Issues

Lawrence A. Martin, LCPR Executive Director, provided background on the mandated study of defined contribution and defined benefit pension plans. Mr. Martin introduced the two panel members that would make a presentation on public employee labor trends, Dr. Martha McMurry from the State Demographer's Office and Don Hilber from the Department of Economic Security. Mr. Martin noted that Hazel Reinhartt, who was also scheduled to participate on the panel, was ill and would be unable to attend. Rep. Jefferson welcomed the panelists on behalf of the Commission.

Dr. Martha McMurry provided a handout and began her presentation on some of the general statewide labor force trends and specifically the labor trends of state employees. She testified that some major changes are taking place in the labor force today. One of the changes the Demographer's Office is projecting is a pronounced aging of the workforce. In the next ten years they expect to see a dramatic increase in the number of workers between 45 and 64 years of age. Further they expect to see losses in the number of workers in younger age groups. They also do not expect the workforce to grow as fast as it has in the past. In the past 30 years the labor force grew considerably faster than the population. Due to the aging of the baby boomers, the Demographer's Office expects labor force expansion to level off. Another reason for high growth in the labor force over the past 30 years was the entrance of women into the labor force for the first time. Using information obtained from the Department of Administration, Dr. McMurry testified that from 1984 to 1994 the state labor force median age rose from 38 years to 42 years. The Demographer's Office projects that in 2015 we will see a peak in the number of state employees that will retire. She noted that the educational level of state employees seems to be much higher than that of Minnesota's labor force as a whole.

Don Hilber, Research and Statistics Office of the Department of Economic Security, provided a handout and testified that one-third to one-half of all public employees are state employees. He testified that while Dr. McMurry's presentation focused on the supply of labor for the workforce, his presentation will focus on the jobs available. He testified that the source for his data was the U.S. Department of Labor. Mr. Hilber reviewed his handout and noted that on the chart on page two what appears to be a rapid growth in the number of jobs for local government from 1994 to 1995, is the result of defining gaming operations run by Native Americans as local government administrations rather than private sector jobs. Sen. Pogemiller asked whether higher education employees were included in education or state government. Mr. Hilber responded that they were defined as state employees. Mr. Hilber testified that they make projections for the state job outlook every two years and referred to the next page in the handout which projected the job outlook from 1993 to 2001. He noted that on this page, state, local and private education employees are all counted in Education. Mr. Hilber testified that according to this chart, total government and education jobs are only slightly trailing the projected growth in all jobs, public and private. However, recent indications point to a reduced total government and education growth rate relative to all jobs due to the uncertainty in funding for state, local, and education. Mr. Hilber referred to the next page regarding changes in jobs by occupation from 1984 to 1995. He testified that of the approximately 60,000 jobs added, more than three-fourths were in professional and technical occupations which is quite a departure from prior years.

Rep. Jefferson asked what kind of jobs were included in production and maintenance. Mr. Hilber responded that production and maintenance jobs would include skilled unskilled trades, construction, maintenance, and blue collar jobs. Sen. Pogemiller asked where law enforcement positions would fall. Mr. Hilber responded that they would be included in service positions.

Mr. Hilber referred to the next chart and testified that although growth has been uneven, the distribution of all jobs has not changed considerably over the ten year period. Mr. Hilber reviewed measures and uses of turnover data. He testified that the Dept. of Economic Security looks at turnover and growth as the two ways of opening up job opportunities. Their statistics are used in career counseling and job placement services. Mr. Hilber testified that turnover is related to age, training, and money.

Rep. Jefferson asked if Mr. Hilber included employees who left other public service to work for the state in the turnover calculations. Mr. Hilber responded that they do not since their only purpose is to identify opportunities for individuals. Sen. Pogemiller referred to the distribution of jobs pie chart and expressed surprise at the increase in managerial and administrative positions and the slight decrease in administrative support positions. He stated that he thought government had flattened out in the last decade and questioned whether changes in job descriptions might be responsible. He also asked whether this occurrence reflected similar experience in the private sector. Mr. Hilber responded that he was also surprised particularly with only a slight decrease in administrative support positions. In the private sector, the decrease in administrative support would be much sharper.

Rep. Osthoff questioned how the job growth and turnover rates are computed. If, for instance, he had three part-time jobs in a year, each lasting four months would he be counted as three employees. Mr. Hilber responded that they do not break down full-time jobs and part-time jobs, they simply do a head count of jobs. Discussion followed.

Edward Burek, LCPR Deputy Executive Director, stated that Dr. McMurry noted that the state labor force is aging which usually favors defined benefit plans. However, the bar chart on changes in jobs by occupation shows large increases in professional and technical jobs which usually have a higher turnover rate and might favor defined contribution plans. Mr. Burek asked for comments from the panel regarding which type of plan would be the best. Mr. Hilber stated that given the definition of turnover used by this Commission, it appears that defined contribution plans would be favored. Discussion followed.

Rep. Jefferson introduced and welcomed Rep. Tom Osthoff as a new Pension Commission member and asked Rep. Osthoff to provide his background. Rep. Osthoff stated that his district is 66A in St. Paul between Como Lake and Phalen Lake and he has been a legislator for 22 years. He also noted that he has been a member of the Government Operations Committee for most of that time and he has an interest in pensions.

Rep. Osthoff asked the panel how should the Commission use this information. Dr. McMurry responded that in 20 years a large number of employees will retire so the Commission should be planning ahead to handle that situation. Discussion followed.

Sen. Pogemiller asked if job growth in the public sector is tracking with population growth. Dr. McMurry responded that jobs are growing faster than the population.

Rep. Osthoff asked how Minnesota ranks nationally in job growth. Mr. Hilber stated that Minnesota probably grew a little faster than the nation as a whole in the last ten years because we did not suffer as serious a recession as the rest of the nation. Rep. Osthoff asked specifically about government growth. Mr. Hilber stated that he could get the information relating specifically to Minnesota government job growth but that he didn't have the information now.

Rep. Johnson asked if public employees were projected to follow the trend of private employees and change careers several times during their employment histories or will public employees continue to retain public employment throughout their careers? He noted that frequently changing careers has a dramatic effect on reducing an employee's retirement benefit potential. He recommended that the Commission and fund directors consider the type of pension plan that would most benefit the type of employee with a high turnover rate. Rep. Osthoff commented that there seems to be two different kinds of employees. The professional employee that probably could handle their own investments and the clerk who goes through several jobs but still needs a defined benefit plan because they are not qualified to select the best investments to optimize their retirement benefit. Dr. McMurry responded that she does not have information on whether government employees will change careers as private employees are projected to do. Mr. Hilber stated that as professional government employment positions increase they will have increased mobility opportunities but they do not have data on that situation.

Mr. Martin asked what role retirement coverage plays in recruiting and retaining employees. Mr. Hilber stated that he does not have data on that situation but it seems logical that good benefits would help to motivate employees.

Sen. Terwilliger noted that he has frequently heard that public sector benefits are better than private sector benefits but data has not been available. He would like to get a comparison between public and private benefits. Mr. Hilber testified that they are starting to survey private employee benefits and they expect that by June of 1997 they may be able to provide a comparison of public and private employee benefits. Sen. Terwilliger asked if there would be a way to differentiate between large employers and small employers. Mr. Hilber stated that they would distinguish between industry type and size of employer.

Rep. Osthoff asked if the survey of private industry would include top level management benefits or only lower level employees. Mr. Hilber stated that their survey would contain considerable detail regarding types of benefits and they would be dividing employees into groups based on whether they are salaried, unclassified or other. Discussion followed.

Rep. Jefferson thanked Dr. McMurry and Mr. Hilber for their participation in this meeting.

2. **Time-Weighted Rate of Return Investment Performance Reporting: Discussion of Public Pension Plan Investment Returns (Second Consideration); Presentation by Panels of Interested Pension Fund Administrators**

Mr. Burek stated that two memos were included in Commission members packets on this issue. He provided a brief overview of the issues raised in the memos and discussed at the last meeting.

Rep. Osthoff clarified that on Table 10, when Mr. Burek said that many of the funds lost money he meant in comparison to the benchmark fund but none of the funds listed actually lost money. Mr. Burek agreed. Rep. Osthoff asked if there was a table that compared the investment gains with inflation. Mr. Burek responded that a table with that comparison could be prepared but we do not currently have that information.

Eugene Waschbusch, StPTRFA Executive Secretary, testified that time-weighted rates of return are important. He also believes that more emphasis should be placed on asset allocation or strategic allocation since improper asset allocation can cause the loss of a high percentage of the potential investment gain that could be achieved. He testified that StPTRFA's Board has an investment policy that includes their investment risk capacity and the ranges they will abide by in allocating their assets. He further testified that the real return is achieved through asset allocation decisions and that is why an investment policy is so important.

Karen Kilberg, MTRFA Executive Director, testified that MTRFA's stock returns appeared to be significantly less than the index specified in the staff memo. After reviewing the MTRFA stock rates of return over the last six years, she realized that the Commission's time-weighted rate of return form, prior to 1993, did not have a separate category for international stock investments so MTRFA included those returns with domestic stock returns. She testified that when domestic equity returns prior to 1993 are calculated without the inclusion of the international equity returns, the domestic equity returns increase dramatically and are comparable to those of the other funds. Ms. Kilberg also testified that MTRFA's active managers use indices that are indicative of the investment strategy the manager is directed to follow. Discussion followed. Mr. Burek noted that the MTRFA stock returns lag the other funds' returns after 1993 when international stocks were not included. Ms. Kilberg responded that MTRFA has an outside investment advisory committee made up of people not associated with MTRFA that meets quarterly and makes recommendations. Since 1993, MTRFA has been restructuring their portfolio, changing their asset allocation, and has hired new active managers. Mr. Burek noted that Ms. Kilberg referred to customized indices that provide benchmarks appropriate for the type of investments made by MTRFA's outside managers. He asked what benchmark MTRFA uses for its total domestic stock portfolio. Ms. Kilberg stated that she could provide that information out of third party reporting they do. She further stated that they take the returns of the S&P 500 and the Russell 2000 and weight them according to the allocation to each of their active managers. Mr.

Burek asked if the total equity portfolio benchmark MTRFA uses was really a weighted average of the customized benchmarks? Ms. Kilberg responded affirmatively.

Rep. Osthoff asked if staff was recommending a standard benchmark for all funds to use. Mr. Burek responded that it was not the intention of staff to recommend standard benchmarks. Discussion followed.

Walter Schirmer, Executive Secretary of the Minneapolis Fire Department Relief Association, testified that they watch their managers very closely and are somewhat conservative. He stated that in 1980, Minneapolis Fire was at a 10% funding level and in 1996 they are at an 85% funding level.

Ulysses Seal, Bloomington Fire Department Relief Association, provided a brief history of Bloomington Fire's investment performance since 1992. He testified that their long term bond position increased from 29% in 1992 to 48% in 1993, it decreased to 42% in 1994. This position was successful in 1992 when it provided a 9.8% annualized return on their fund compared to stock returns which were 7.6% and the bond market which was 12.6%. Since 1989, their annualized returns have been 9.5% and are in accord with their long term position of trying to keep a balanced portfolio and protect their investments from extremes in one market or the other. The trustees of the fund have acted to change their asset allocation by reducing their long term bond position to include more equities. Their current asset allocation is 18% long term bonds, 46% equities, 19% balanced funds, 2% equity real estate, 2% short term bonds, and 6% intermediate bonds. In 1993 48% of the fund was in outside management. Mr. Burek asked what percentage of their fund is currently managed internally. Mr. Seal responded that currently 30% of their fund is managed internally but they are slowly moving away from internal management. Discussion followed.

Nyle Zikmund and Jim Hanson, Spring Lake Park Fire Relief Association and MARAC, came to the podium and Mr. Zikmund began testimony. He testified that his comments would cover three topics, volunteer firefighter plans, investment performance, and suggestions for improvements. He testified that unlike other pension plans included in this report, volunteer firefighter plans are not designed to provide a person's full retirement income, they are a tool to help municipalities attract and retain firefighters. Of the 19,000 firefighters in the State of Minnesota, approximately 17,000 are volunteers. He further testified that most volunteer firefighter relief associations pay lump sum benefits so they usually do not invest for the short term. They do, however, balance long term investing with the potential need for short term liquid assets in the event of a scheduled or unscheduled retirement. He made two suggestions for improving volunteer firefighter relief association operations. His first recommendation was to assist the funds in their training efforts and the second was to pass legislation that would allow volunteer fire funds to pool money on either a regional or statewide basis.

Bruce West from the Elk River Fire Relief Association had planned to appear today but another meeting came up that he needed to attend so he asked Mr. Zikmund to make his comments. On behalf of Bruce West, Mr. Zikmund testified that Elk River did not submit their 1995 rate of return form because in 1994 they submitted returns that were problematic, they received a phone call but did not get a follow-up letter so they did not see any value in submitting further returns.

Rep. Johnson questioned who Mr. Zikmund was suggesting provide volunteer firefighter trustee training. Mr. Zikmund testified that MARAC has been working with a private consultant regarding training, they have consulted with the State Auditor's Office, and have talked to legislators regarding legislation that would have the state provide financial support to provide training. Discussion followed.

Mr. Burek stated that according to Table 13, Elk River did not file a 1994 or 1995 return. Since Mr. Burek writes letters on all problematic returns, it was his belief that Elk River might have confused a phone call from the State Auditor's Office regarding their reports with the Commission's time-weighted rate of return forms.

Mr. Burek questioned the wide variability of Spring Lake Park's returns. Mr. Hanson responded that since 1989, the relief association has been diversifying from a 100% long term bond position to a stock and bond position. They are continuing to diversify and their returns should begin to level out and improve. Mr. Burek asked why the original decision to go into long term bonds when many relief associations say that they need their assets to be liquid to pay retirement benefits. Mr. Zikmund testified that Spring Lake Park does not need short gap liquid assets because they are not a monthly plan, and they have a measured cash flow. He further testified that he does not know why their relief association focused on long term bonds prior to 1988. Discussion followed.

Mr. Martin noted that the real investment risk with volunteer fire plans rests with the municipality in the form of greater city contributions if investment return is poor. He questioned Mr. Zikmund regarding how involved city officials are in the management of investments? Mr. Zikmund testified that Eagan city officials are highly involved in the management of their relief association's investments and as for the Spring Lake Park relief association, two of the three cities' officials attend meetings on a regular basis and the three cities' administrators are very involved and knowledgeable about the financial activities of the relief association. Discussion followed.

3. Review of Proposed Reformulation of Commission Principles of Pension Policy (Continuation of Commission Review Begun on January 22, 1996)

Mr. Martin asked the Chair if he wished him to review the reformulated Principles of Pension Policy. Rep. Jefferson and Rep. Osthoff agreed that they were familiar with the staff memo and the Principles of Pension Policy so it was not necessary for staff to provide a review of this topic.

Rep. Osthoff asked if it would be possible to be briefed on draft legislation or the concept of legislation that might come before the Commission prior to its introduction. Rep. Jefferson responded that the Revisor's rules of privacy do not permit revelation of legislation requested by a legislator until the legislator makes it public. Rep. Osthoff requested that he get background on legislation prior to his needing to vote on the legislation.

Rep. Jefferson stated that when staff sends out the agenda, it should be specified that action will be taken on the Principles of Pension Policy at the October 3, 1996, Commission meeting.

The meeting adjourned at 3:35 P.M.

Jean Liebgott

Jean Liebgott, Secretary