

November 14, 1996
Room 10, State Office Building

23rd 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 1:17 P.M.

Commission members present:

Representatives Richard Jefferson, Bob Johnson, and Phyllis Kahn
Senators Steven Morse, Lawrence Pogemiller, Phil Riveness, and LeRoy Stumpf

Commission members with an excused absence:

Representatives Tom Osthoff, Steve Smith, and Senator Roy Terwilliger

4. **Mandated Commission Study: Study of Providing Pension Plan Coverage For Educational Breaks in Service For Regional Treatment Center and Related Department of Human Services Employees (Second Consideration)**

Edward Burek, LCPR Deputy Executive Director, briefly reviewed the staff memo on this issue. He stated that the original bill on this topic was drafted for two individuals who had agreements with their employers to terminate employment to allow them to obtain additional education, provided them with a stipend, and agreed to rehire the employees when their educational training was ended. In 1985 MSRS added a leave of absence provision to law and permitted retroactive application of the leave of absence provision due to a controversial opinion by the Attorney General's office. The two individuals referenced in the original bill were not permitted to purchase service credit for their educational leave because they terminated employment. After Commission discussion on this issue during the last Session, it became apparent that several other individuals had situations similar to the original two individuals. The Commission decided to study the topic to try to specify a fair resolution, to try to determine the number of employees that might be involved, and the potential liability in granting this past service credit. Mr. Burek stated that staff invited representatives from the Department of Human Services, the Department of Corrections, and MSRS to testify at this meeting to assist the Commission with regard to this issue and he reviewed the letters sent to them. He stated that Julie Angeles, Department of Corrections, is on a mobility assignment and the individual filling her position was not able to find any records on this situation.

Martha Watson, Director of Human Resources for the Department of Human Services, testified that their records date from 1948 to 1974 and are sketchy with regard to employees who obtained stipends. She further testified that the stipends included tuition and 75% of salary not to exceed a set amount and were given to employees who agreed to achieve a stipulated Masters degree within a two year time period, who signed an agreement to accept employment acceptable to the Commissioner of Public Welfare, and who would work at that position for a specific length of time. The Department had a formal selection process by which it selected recipients of this program, it monitored each recipient's progress and success with the Masters program, it approved the recipient's employment after graduation, and it made sure the recipient worked the required amount of time after schooling was complete. Ms. Watson provided two handouts to the Commission. The first document had information on the federal program providing for staff development. She stated that the only provision the Federal Government had with regard to this program was the requirement that each state have a plan for the educational development of its employees and that the plan include "a provision to obtain an educational leave to enable sub-professional, technical, and professional staff to improve their performance and to advance to more responsible positions." The second document appeared to be an internal procedural document which described the program in more detail. This document stated that county employees that took an educational leave were permitted to accrue service credit for not more than 12 months of the total leave time if the employees continued to pay their monthly retirement premium and if they or their employers paid the employers' monthly premium. State employee provisions were different than the county provisions in that they were only permitted a 12 month educational leave and, if their educational program extended beyond 12 months, the employee was required to resign. Ms. Watson testified that it appears that hundreds of employees participated in this program. The records are inadequate or missing on where these employees came from and whether or how they complied with the provisions of the program.

Rep. Johnson stated that the documentation clearly specified a 12 month leave period, employees received tuition payments, and 75% of their salary. He also stated that for the rest of their careers,

these employees probably received higher salaries based on their additional education and thus will receive higher pension benefits. Discussion followed.

Ms. Watson testified that it would be extremely difficult to identify and notify all the employees involved in this program to determine who did not receive service credit. Sen. Riveness stated that if this became a covered type of service, it would be the responsibility of the employee to decide whether to use it or not so it would not be necessary for the Department to determine who, or how many employees might qualify for this service credit. Ms. Watson responded that part of the issue was determining the potential unfunded liability of providing this service credit and to do that it is necessary to identify the appropriate employees.

Dave Bergstrom, MSRS Executive Director, testified that MSRS has no way to identify individuals who may have used this program, MSRS relies on employees notifying them. If the law had passed with broad application, MSRS would have put an article in their newsletter on the issue, employees would have needed to notify MSRS, MSRS would then have asked employers for documentation showing that the employee was eligible, and MSRS would then have computed the cost. For the two employees who were included in the original legislation, the cost for the employee contribution plus 8-1/2% interest would be approximately \$7,000 each and the value they would be adding would be approximately \$25,000. For the average individual that this might apply to, the value would be in the \$5,000 range for each individual in addition to the employee contribution plus interest.

Rep. Kahn asked whether MSRS's retroactive application of the 1985 leave of absence provision based on an Attorney General's opinion could have been changed by statute subsequently to specify that it should not have applied retroactively. Mr. Bergstrom responded that the provision could have been changed to prospective only coverage with a possible one year or three year retroactive timeframe. He also suggested that at this time a possible solution might be to permit current employees, for the next three to five year timeframe, to buyback the service credit by paying the employee and employer contribution plus 8.5% interest and after that time period to require payment of full actuarial value.

Mr. Martin noted that LCPR staff does not usually get copies of Attorney General's opinions that relate to pensions. He suggested that the Commission may want to require that copies of all Attorney General opinions that relate to public pension issues be filed with the Commission staff. Rep. Kahn asked Mr. Martin to bring this up during the next Session.

Rep. Jefferson noted that a quorum was now present and asked if the Commission wanted to make a recommendation on this issue.

Rep. Johnson moved to recommend against permitting purchases of service for these educational leave/stipend recipients and to file a report with that recommendation with the Legislature. **MOTION PREVAILED.**

1. Approval of Meeting Minutes; Meeting of October 3, 1996

Sen. Riveness moved approval of the meeting minutes of the October 3, 1996, Commission meetings. Sen. Stumpf referred members to the first paragraph on page two of the minutes and asked if Sen. Morse could clarify the statement that the Permanent School Fund was required by statute to be invested in cash. Sen. Morse asked if someone from the State Board of Investment could clarify whether it is required by statute or simply policy to be invested in cash. James Heidelberg, Manager of Public Programs for SBI, testified that the permanent school fund is invested 100% in fixed income, primarily bonds with some cash. Sen. Morse asked whether the fund is invested this way due to state law or by policy decision. Howard Bicker, SBI Executive Director, testified that SBI has requested in the past that the Permanent School Fund Task Force and the Education Committees permit the permanent school fund to be invested in stock but budgetary restraints prevent it. Sen. Morse reviewed how this item came up at the Commission meeting of October 3, 1996, and stated that it seems that investment of the Permanent School Fund is not set in statute and suggested that this issue should be reviewed next session. Mr. Bicker testified that once the Permanent School Fund reaches a certain ceiling, SBI is authorized to invest a portion of it in equity. Rep. Kahn suggested that the Commission recommend that the Senate and House Government Operations Committees review the State's overall investment policies as she is also concerned with the investment of the Environmental Trust Fund. Mr. Bicker testified that SBI did have discussions with LCMR regarding the Environmental Trust Fund and that fund does have a 50% equity exposure. He further testified that if a bond is purchased for one of these funds and is sold at a profit, the bond profit becomes principle and does not become spendable income. He testified that according to the Attorney General's Office, the Minnesota Constitution requires that anything other than interest and dividends be considered

principal. Discussion followed.

Rep. Jefferson stated that these minutes should reflect that Sen. Stumpf asked Sen. Morse for clarification of his statement on page two, paragraph one of the October 3, 1996 meeting minutes and the clarification is that the Permanent School Fund is 100% invested in fixed income by policy decision. Sen. Riveness renewed his motion to approve the October 3, 1996 minutes as clarified.

MOTION PREVAILED.

2. **Report From the Special Task Force on Investment Performance Attribution**

Edward Burek, LCPR Deputy Executive Director, reviewed the action taken at an earlier meeting that day by the Special Task Force on Investment Performance Attribution. Mr. Burek stated that the Task Force made significant changes in draft legislation, LCPR96-92, and he suggested that he review the Task Force recommendations rather than the draft. Rep. Kahn recommended delaying acceptance of the Task Force report until the next Commission meeting to enable staff to redraft legislation with the Task Force recommendations. Rep. Jefferson stated that he would prefer to accept the report without the proposed legislation at this point.

Mr. Burek briefly reviewed background on the role of the Task Force. He then reviewed the recommendations of the Task Force. The recommendation is that all pension plans receiving public funding that are defined benefit plans or split-the-pie volunteer fire plans should provide data to the State Auditor's Office. That data includes information on the market value of investments and plan cash flow data (injection and withdrawal data), that would permit the State Auditor's Office to compute total portfolio time-weighted rates of return for that pension fund. The recommendation also includes the requirement that the data collected be sufficient to permit computation of the investment performance attribution report. The State Board of Investment has the primary reporting responsibility for MSRS, PERA, and TRA, as well as police, paid fire and volunteer fire plans that are wholly invested with SBI except for the cash equivalent of six months worth of expense money. The Task Force further recommended that the major parties involved in defined contribution plans work out the reporting requirements for those plans. The Task Force recommended that the penalty for non-compliance with reporting requirements be the withholding of state aid and if the non-compliance continued beyond a specific date, the penalty would be total loss of state aid for that year.

Rep. Kahn stated that the recommendations of the full Task Force differed from the recommendations of the Subcommittee and she moved that they be laid over until the next Commission meeting so that draft language would be available.

Sen. Riveness suggested that Rep. Kahn's motion reflect support for the recommendations of the Task Force. Rep. Kahn stated that the Task Force made major changes in the draft language and she would be more comfortable if the Commission could see the actual draft legislation prior to taking action. Discussion followed.

Sen. Riveness suggested that the Commission approve the essence of the Task Force report with the stipulation that language would be drafted that would require a common report on annual earnings with quarterly and monthly data retained for retrieval if requested. Rep. Kahn accepted Sen. Riveness' suggestion and renewed the motion with the additional statement that the data retained for retrieval be public information. **MOTION PREVAILED.**

3. **Review of and Commission Action on Proposed Reformulation of Commission Principles of Pension Policy (Continuation of Commission Reviews of January 22, 1996, September 12, 1996, and October 14, 1996)**

Mr. Martin stated that this was the culmination of a long review process that covered many months of meetings by the ad hoc working group. He referred members to the information on this topic in their packets and reviewed the background on the issue. During the 1995 interim, Rep. Jefferson began a thorough review of the Principles of Pension Policy over a three month period involving seven informal meetings with all interested parties. At the direction of the Commission, Rep. Jefferson held an additional meeting of the ad hoc working group on October 14, 1996, to allow all interested parties an opportunity for final revision of the Principles prior to Commission action. The document dated October 22, 1996, is the result of the October 14, 1996, meeting and highlights the changes made at that meeting. Mr. Martin referred members to page two, number ten, in the staff memo and page six, lines 32 to 36, and page seven, lines 1-4 in the draft Principles document. He stated that the working group did not come to agreement on this item and left it for resolution by the full Commission.

Rep. Johnson recommended retaining the old language and deleting the new language because of the unresolved issue of the responsibility of current active employees with regard to past inadequate funding practices.

Rep. Jefferson stated that the ad hoc working group agreed to support the compromise reached on the Principles with the exception of this one item and he opened discussion to Commission members.

Rep. Kahn stated that if the Commission accepted the recommendation to keep the old language, the Commission would preclude its ability to establish legislative solutions similar to those that were designed to improve the funding situation of the MTRFA and StPTRFA. She stated that she believes the new Principles language provides the flexibility to establish programs similar to those established during recent sessions to help fund those teacher plans. Mr. Martin stated that the new language is more general in requiring that some of the financial responsibility should be shared between the employees and employer whereas, the old language is very specific in stating that the employer is responsible for the pre-1977 unfunded actuarial accrued liability and that there should be an equal split between employer and employee for any post-1977 benefit improvements. He further noted that the Legislature has not carefully followed the Principles for benefit improvements passed since 1977.

Sen. Riveness suggested that the Principles read "For general public employees, the employee and employer should make matching contributions. Additional contributions required to amortize the unfunded accrued liability and the administrative expenses of the defined benefit pension plan may be a combination of employer and employee contributions." Rep. Johnson agreed with the suggestion made by Sen. Riveness. Discussion followed.

Rose Hermodson, Minnesota Federation of Teachers, testified that her organization, as well as the Minnesota Education Association, are concerned about any requirement that new employees share in the burden of past unfunded actuarial accrued liabilities.

J. Michael Stoffel, DTRFA Executive Secretary, testified in support of modifying the language to delineate the allocation of the funding burden between current unfunded liability and future unfunded liability. He testified that the concern from his member's standpoint is that if the new language on this point is accepted, it might cause the employee contribution to increase and inappropriately require the employee to pay for past benefit improvements. The unfunded liability is made up of many different things, such as insufficient or omitted employer contributions, employer sponsored benefit increases or early retirement incentives like those that occurred in 1993, and the Rule of 85, which was basically an employer sponsored early retirement incentive. To shift that unfunded accrued liability to current employees would be unfair. Mr. Stoffel testified that the unfunded liability is also due to the cost of benefits granted by the employer to certain individuals or small and large groups of individuals, through special legislation like the Rule of 90 and age 65 retirement benefits which are available to some employees but not to all employees. He testified that to shift some of the unfunded liability that already exists and which was in many cases due to employer sponsored benefit improvements or relating to former unfunded obligations by the employer to current employees is an issue. He also testified that a change in actuarial assumptions could cause an increase in unfunded liability. He further stated that actual experience compared to assumed experience could increase unfunded liability and that this occurs every year in the annual actuarial valuations as investment gains and losses, salary gains and losses, and mortality gains and losses. He testified that requiring the employee to pay for these types of unfunded liability is somewhat unfair. He supports requiring the employer to be responsible for the unfunded liability to date and splitting equally between employee and employer any future benefit improvement liability.

Gary Austin, TRA Executive Director, testified that TRA's substantial unfunded accrued liability was due to insufficient employer contributions dating to before 1970. He stated that TRA started in 1931 as a defined contribution plan to which only the employees made contributions. From 1957 to 1969, employers made contributions to TRA's defined contribution plan but their contributions did not make up for the first 26 years of underfunding. In 1969 TRA became a defined benefit plan, phased in older members, and throughout the 1970's began to accumulate a very large unfunded liability because employers did not provide sufficient funding. In 1983 in recognition of TRA's one and one half billion dollar unfunded liability, the Legislature addressed the funding problem by establishing a 4.48% employer additional contribution.

Rep. Johnson recommended deleting this language from the Principles and addressing this issue with legislation. Discussion followed.

Gene Waschbusch, StPTRFA Executive Secretary, testified that StPTRFA and MTRFA are concerned that the new language might jeopardize their additional State funding.

Sen. Riveness moved that on page 2, line 8, delete "emphasized" and insert "encouraged" and on page

7, line 3, delete "should" and insert "may be required to." **MOTION PREVAILED.**

Sen. Morse stated that on page 1, line 36 and 37, the Principles state that new volunteer firefighter pension plans "should be organized on a county or comparable regional basis if possible." He believes this may prove to be a hurdle to some outstate fire departments who may want to organize a fund. Discussion followed and Sen. Morse suggested that the language should only apply to existing funds. Rep. Kahn suggested that the language state, "Pension plans for volunteer firefighters should be encouraged to organize on a county or comparable regional basis." Sen. Morse suggested deleting page 2, lines 4 to 11. Rep. Kahn stated that if smaller plans consolidated into large county or regional plans they could have better professional management and a more diverse investment portfolio.

Sen. Morse moved that on page 2, line 16, insert "particularly" before "appropriate." **MOTION PREVAILED.** Discussion followed on additional changes recommended by Sen. Morse. On page 7, line 27, he suggested devising additional language that would eliminate windfalls. Mr. Martin stated that the windfall topic had been discussed by the working group and that they were unable to come up with a method that would eliminate windfalls so the issue was left out of the Principles.

Rep. Jefferson moved the Principles of Pension Policy as amended. **MOTION PREVAILED.**

5. **Mandated Commission Study: Report on the Use of Police State Aid to Fund PERA-P&F Pension Coverage For Firefighters (First Consideration)**

Mr. Martin reviewed the background on this issue and referred members to a November 1, 1996, joint report of the Department of Revenue and the Public Employees Retirement Association. He stated that it was necessary for the Department of Revenue and PERA to gather information from a number of jurisdictions in order for the Commission to complete the mandated study. Mr. Martin reviewed the staff memo on this topic and reviewed the history of police state aid. He noted that police state aid in 1977 was \$1,610 per police officer and has risen to \$6,872 per police officer in 1996. Due to the dramatic increase in police state aid, over 90% of jurisdictions in the State now receive more police state aid than their required PERA-P&F contribution. He stated that 1996 legislation changed the excess police state aid program from a program that sent out police state aid payments and then recollected the excess aid to a program that required certification of the correct aid amount and allowing Revenue to deduct the excess aid prior to sending out police state aid payments. As a result of the language in the 1996 legislation, seven local police funds and one metro agency inadvertently had a reduction in their police state aid payments compared to what they would have received under the old process. Mr. Martin noted that language to correct this problem has already been circulated. Discussion followed. Mr. Martin then reviewed Charts A and B. He stated that Chart A, column (17) showed the amount of police aid that would have been paid under the old method and column (19) showed the actual police aid paid in 1996. Mr. Martin stated that on Chart B some of the reasons that there are zeros in column 4 are that about 80 jurisdictions had firefighters that are included in column 3 along with the police officers. He noted that the only way those jurisdictions would have excess police aid would be if the police state aid was greater than the employer contribution for all the police officers and firefighters. The purpose of this study is to determine the impact of removing the paid firefighters from this program.

Sen. Morse asked what was the 1996 total excess police aid amount. Mr. Martin responded that it was eight million dollars. Discussion followed.

Sen. Riveness moved that the Commission recommend to the 1997 Legislature a change in law that would restore the police state aid payments to the funds that lost under the 1996 change in the excess police state program and clarify that it was not the intent of the 1996 excess police state aid law to harm any pension fund. **MOTION PREVAILED.**

Rep. Jefferson thanked all the Commission members for their service on the Commission while he was the Chair and bid good-bye to members that would not be returning.

The meeting adjourned at 4:05 P.M.


Jean Lieb Gott, Secretary