December 10, 1997
Room 15, Capitol

15th Meeting

LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

MINUTES

Senator Steven Morse, Chair of the Legislative Commission on Pensions and Retirement, called the meeting to order at 9:15 A.M.

Commission members present:
Representatives Mike Delmont, Richard Jefferson, Harry Mares, Mary Murphy, and Steve Smith
Senators Don Betzold, Dean Johnson, Steven Morse, Lawrence Pogemiller, and LeRoy Stumpf

Commission members with an excused absence:
Senator Roy Terwilliger and Representative Phyllis Kahn

Sen. Morse began the meeting by noting that all thirteen of the 1997 actuarial valuations have now been completed and he asked Lawrence A. Martin, LCPR Executive Director, to review them for members.

Mr. Martin began the review with a comparison of the 1996 and 1997 actuarial valuation results. He stated that all three of the major plans (MSRS, PERA, and TRA), have improved their actuarial funding ratios and MSRS and TRA have now achieved better than a 100% funding ratio. PERA still has an amortization requirement because they still have a deficiency. Sen. Morse questioned how much of the improved funding was due to investment performance and what impact did the benefit changes passed in the last session have on the major plans' funding status. Mr. Martin responded that the benefit improvements passed last session reduced TRA's liability by $200 million, and increased MSRS and PERA's liability by about $260 million combined which caused a net increase in the unfunded liability of these plans of about $60 million. He further noted that changes in the actuarial assumptions which were effective for the 1997 valuations and favorable investment returns had a positive impact on the funding status of the plans. Mr. Martin noted that TRA's valuation was just received on December 9th. He stated that the TRA actuary and the Commission actuary are still having discussions and the TRA liability may increase when the actuaries reach agreement on data processing issues. Sen. Morse asked what year the State began the process of working towards fully funding these pension plans. Mr. Martin responded that in 1957 the Legislature passed the first version of the actuarial funding law and set 1997 as the year to achieve full funding. Sen. Pogemiller asked what will happen when investment returns are not as high as they have been. Mr. Martin stated that it would take a seven or eight year downturn in investment markets and the investment return would have to be less than the 8.5% assumption rate to cancel the gain achieved over recent years. Sen. Morse asked what was TRA's investment gain. Mr. Martin responded that the TRA investment gain was $660 million over and above the 8.5% investment assumption. Mr. Martin noted that an additional factor in the improved funding status of the plans was that salaries did not increase at the general 5% level provided for in the actuarial assumptions and this provided a $116 million gain in the funding of the plans.

Sen. Morse asked who paid the amortization contribution noted in the 1996 TRA column. Mr. Martin stated that the employer would have made that contribution but since TRA is now fully funded, they will no longer have an amortization requirement. Sen. Morse stated that it might now be possible to reduce the employer contribution for TRA closer to the employee contribution and still save $40 million dollars in school district costs. Mr. Martin noted that the tentative agenda for the next meeting includes a topic relating to the way assets are valued for actuarial purposes.

Gary Austin, TRA Executive Director, testified regarding the funding status of TRA. Mr. Austin testified that currently TRA's employee contribution rate is 5.0% with a matching employer contribution rate of 5.0% and an employer additional contribution rate of 1.64%. Under the Uniformity Bill, once TRA reaches full funding the employer additional contribution rate of 1.64% will be eliminated and that will be effective March 31, 1998.

Mr. Martin briefly referred to the other actuarial valuation data provided. He noted that MTRFA and StPTRFA had reductions in their funding levels because the benefit increases that they provided outweighed the market appreciation that they experienced. He continued reviewing the actuarial valuation data.

Sen. Pogemiller asked why most of the plans that now have a funding surplus also seem to have an increase in their administrative expenses and he noted that for TRA, the administrative expense increase was almost $1 million. Mr. Austin testified that he believed that the increase in administrative expense might be due to higher performance based investment fees. Sen. Morse stated that PERA is in a similar situation to TRA but PERA's administrative expense has gone down. Mr. Austin testified that TRA is in the midst of a five year major reengineering program and their internal administrative expenses have gone up considerably due to consulting fees and system development costs. Several members requested a copy of the TRA reengineering program and information on the costs involved in this five year program.

1. **Approval of Minutes of the November 12, 1997 Commission Meeting**
Senator Betzold moved approval of the November 12, 1997 Commission Meetings. **Motion Prevailed.**

2. **Mandated Study: Retirement Plan Coverage For Legislators and Constitutional Officers**
Mr. Martin reviewed the background on this topic and then began to review the staff memo for today's consideration of the topic. He noted that this memo looked at the funding of these two plans and stated that the Legislators Retirement Plan was currently on a "terminal funding" basis while the Elective State Officers Plan was on a "pay-as-you-go" basis. He stated that the intent of the study was to improve the funding of these two plans. Discussion regarding the actuarial work provided occurred. Mr. Martin noted that the Principles of Pension Policy state that pension funds should be funded on an actuarial funding basis. He briefly reviewed seven of the advantages offered by the actuarial funding of a pension plan and then reviewed the table on page six of the memo which compared the actuarial funding of the two plans to the current funding method. He noted that the current funding method for these two plans provided an inconsistent, choppy result while the actuarial funding of the two plans would provide a smooth and even funding result. Mr. Martin reviewed the six options he had identified for members consideration which were labeled Options A through F.

Sen. Morse suggested from a policy perspective, Option D which would establish a fund for the Legislators Retirement Plan and the Elective State Officers Retirement Plan by transferring past employee contributions, matching them with employer contributions plus interest, and adding regular payments to amortize the unfunded accrued liability by 2020. This would be a combination of Option D and Option E. The plan would be approximately 50% funded and would require an annual transfer of $3.3 million from the General Fund. Sen. Pogemiller requested that staff refine the figures and work up numbers for Option F as well. Discussion followed. Sen. Pogemiller questioned whether the number of retirees from the Legislature could be estimated for the time period after redistricting in 2000-2001 biennium.

David Bergstrom, MSRS Executive Director, testified that MSRS can estimate the number and pension costs for individuals who have terminated legislative service but not for active members of the Legislature. They would be willing to make some assumptions and work with Commission staff to make an estimate.

Sen. Pogemiller stated that establishing a fund for the Legislators Retirement Plan and Elective State Officers Retirement Plan might fit into the Governor's plan to authorize one time projects that enable the State to get its fiscal house in order.

Rep. Jefferson stated that if the Commission acted on this issue he would recommend Option F which would set up the total package. Discussion followed.

Mr. Martin stated that the balance of the staff memo on this issue dealt with potential resolutions of the mandated study. Sen. Morse stated that the funding issue is separate from the resolution of the study. Mr. Martin reviewed the options to resolve the mandated study and after brief discussion members agreed that LCPR staff should refine the figures in the funding package and contact the Governor's office.

3. **Mandated Study: Local Police and Fire Consolidation Account Fold-in (Third Consideration)** Edward Burek, LCPR Deputy Executive Director, reviewed the background and the major objectives of the prior memos on this topic. He noted that this staff memo provided funding information for the consolidation accounts that are not fully funded, provided information regarding the Amortization and Supplemental Amortization Aid received by each fund through 1996 with and without the investment returns, provided 1997 actuarial valuation data for each of the consolidation accounts, and provided options for merging some or all of the consolidation accounts with PERA-P&F and showed the impact that might have on PERA-P&F funding.

Sen. Morse asked which aids were included in the State Aid column in Table 1. Mr. Burek responded that the State Aid column included Amortization Aid, Supplemental Amortization Aid, Fire State Aid, and the First Class City Fire Surcharge. The "Municipal Contribution" column was the amount that municipalities were required by statute to contribute to amortize the unfunded accrued liability of their relief association. It did not include employee contributions. Some or all of the municipal obligation was covered by the state aid amounts. The final column was labeled "Net Municipal Contribution" and showed the "Municipal Contribution" minus the "State Aid." Mr. Burek noted that none of the fire relief associations included in Table 1 were fully funded. He also noted that Table 2 provided the same information for police relief associations.

Mr. Burek continued to review the memo and referred members to Table 3 which showed the accumulated amortization and supplemental amortization aids plus investment earnings and the 1996 assets of all of the consolidated relief associations. He stated that Table 3 showed that the two aids have played a significant role in helping to fund these plans and represent a significant portion of their 1996 assets. Table 4 indicated the most current funding status of the consolidated relief associations based on the 1997 actuarial valuations and ranked from most funded to least funded. Mr. Burek then began to review the merger options for the consolidation accounts into PERA-P&F and he stated that Table 5 indicated the results of merging all of the consolidated accounts into PERA-P&F. He noted that the total unfunded liability was about $4 million for the consolidation accounts that still have an unfunded liability and that merging all of the consolidation accounts into one fund would still leave PERA-P&F with a funding sufficiency in excess of $414 million. Mr. Burek continued to review the merger options. Sen. Morse stated that PERA administers all of these accounts and SBI invests all of their funds so the question is whether to continue keeping these accounts separate or merge some or all of them into one account. Mr. Burek noted that if the Commission does not take action on the options to merge any or all of the consolidation accounts, the Commission should still consider the huge funding surplus in PERA-P&F since there is no policy reason for maintaining a surplus in assets of that magnitude. He stated that PERA-P&F has had contribution sufficencies for more than 30 years. He noted that any action taken to revise PERA-P&F contributions would affect other state aid systems and would change the amount that flowed to them. An example he cited was the Additional Amortization Aid program established a few years ago which was funded by the excess police state aid. A reduction in the PERA-P&F employer contribution rate would increase the excess police state aid and after deducting $1 million for the Volunteer Ambulance Longevity Award Program, half of the remainder cancels to the General Fund and the other half finances additional amortization aid. He reviewed some of the other results of changing PERA-P&F contribution rates or merging the consolidation accounts. He stated that if the consolidation accounts were merged with PERA-P&F, it would eliminate any unfunded liability in those accounts, the amortization and supplemental amortization aid amounts would be increased to the remaining free standing relief associations (Fairmont Police, Minneapolis Police and Fire, and Virginia Fire), the higher unallocated aid would be distributed to MTRFA, StPTRFA, and to the minimum volunteer firefighters funding program.

Sen. Morse asked about the benefits for members of the consolidation accounts that have not opted PERA-P&F coverage as yet. Mr. Burek stated that the actuary calculates the highest cost scenario for active members who have not selected an option for the local plan or PERA-P&F. Sen. Morse asked what happens if PERA-P&F benefits change as far as members who have not selected an option. Mr. Burek stated that if a member selects the local plan benefit either as an active member or retains the local plan benefit as a retiree, their benefit corresponds to whatever that local plan benefit provided prior to consolidation. Sen. Morse asked whether each municipality needs to approve any benefit improvement to PERA-P&F for members of their local plan who select PERA-P&F. Mr. Burek answered affirmatively. Sen. Morse asked how that would work if the consolidation accounts were merged with PERA-P&F. Mr. Burek responded that if all the consolidation accounts were merged with PERA-P&F they would all be fully funded, and, presumably, benefit increases to PERA-P&F would not increase the liability or responsibility of the municipalities so local approval would not be required. Sen. Morse asked what currently happens to the excess funds in the consolidation accounts that are more than 100% funded. Mr. Burek responded that under current law, when the last surviving member of a plan dies, any assets remaining in the separate account revert back to the municipality and the municipality must use that money for police or firefighting purposes. Mr. Burek continued to review the final merger options. Discussion followed.

Sen. Morse stated that he would like to have an informal meeting with the affected parties on this issue prior to putting the issue on a future Pension Commission agenda and he invited Commission members to attend that meeting if their schedules permitted.

Rep. Delmont asked if a municipality was required to contribute to a fund that was fully funded. Mr. Burek responded that the municipality was still required to make the employer contribution to the fund but it would not have to pay any supplemental or additional contributions. Discussion followed regarding allowing time at a future meeting for interested parties to testify on this issue.

4. Designated Study: Funding and Allocation of Police Pension-Related State Aids (Second Consideration)

Lawrence A. Martin, LCPR Executive Director, provided background on this topic and stated that this staff memo would provide members with a flow chart that attempted to summarize the various state aid programs for police pension funds and how they meet the funding requirements of the plans. He stated that the staff memo would also provide information on the problems and weaknesses of the police state aid programs and options to simplify the programs and correct the problems. He referred members to the colored flow chart in their packets and reviewed the data on the chart. He noted that the chart provided a representation of four aid programs, three of which were funded by the State General Fund (Police State Aid, Amortization Aid, and Supplemental Amortization Aid). The other program was the Additional Amortization Aid program, which was a redistribution of a portion of the excess police state aid. The intersecting lines and data on the right side of the chart provide information on where the aid goes. Sen. Morse approved of the flow chart and stated that it was very helpful in assisting him to understand and conceptualize the programs. Mr. Martin noted that there are problems with all four of the aid programs. He noted that with the $48 million police state aid program there were problems with the funding of the program, the initial allocation, the determination of excess police aid, and the tracking of the money at the municipal level. He stated that if the insurance companies do not properly identify auto casualty insurance or pay the proper tax rate, the State may not be collecting the correct amount. As an example, he noted that in 1996, $2.5 million of the $48 million was an adjustment due to catching-up on a tax change that had occurred several years earlier. The other funding source for police state aid was an equivalent tax on self-insured vehicles. The number of dollars collected and the number of vehicles that were subject to the tax do not agree. Mr. Martin stated that the number of police officers certified by municipalities and the number of police officers the POST board certified by jurisdiction do not agree so it was possible that municipalities are overstating or understating their police officer certifications. He also stated that it was possible that municipalities may not even be aware of the amount of police state aid they are receiving. Mr. Martin stated that another problem with the police state aid programs related to the auditing function. Auditing responsibilities are split in some measure between the State Auditor and the Legislative Auditor and within the Legislative Auditor's Office, between the audit team that audits Revenue and the audit team that audits PERA-P&F. Mr. Martin stated that there are smaller problems with the three amortization aid programs and relate mostly to poor design. Those three programs are based on three different unfunded actuarial accrued liability figures for three different years, 1978, 1983, and 1993, and none of those figures represent the current unfunded status. Further, Amortization Aid is paid three times a year while Supplemental Amortization Aid and Additional Amortization Aid are paid once during the year. Mr. Martin continued with his review of the problems with the three amortization aid programs and then reviewed the broad options to simplify or correct the problems in the state aid programs. The three options that were provided in the staff memo were to consolidate the three amortization aid programs, to simplify the funding of the four aid programs, and to simplify the structure of the pension programs and aid programs. Mr. Martin noted that this topic is a designated topic so the Commission is not required to provide a report on this issue. He stated that he would respond to any further information members requested.

Sen. Stumpf asked about the future commitments of some of the aid programs. Mr. Martin referred members to the lower right corner of the flow chart and stated that unused portions of the amortization and supplemental amortization aid have been redirected to the MTRFA, StPTRFA, and Minimum Volunteer Firefighter State Aid Programs. He noted that a portion of the excess police state aid was used to establish the Additional Amortization Aid Program. He also noted that the excess police aid will be reduced over the next three years because a fixed amount of excess police state aid will cancel to the General Fund and all of the remaining excess police aid will then fund the Additional Amortization Aid program. Sen. Morse asked what the amounts were for the portion that cancels back to the General Fund. Mr. Martin stated that in FY 1999 it will be $1.779 million, for FY 2000 it will be $2.077 million, and for FY 2001 it will be $2.404 million. Sen. Pogemiller stated that the General Fund was actually subsidizing the aids by $2 million. Discussion followed regarding the aid programs and members asked if the projections on the growth pattern of the premiums were available. Mr. Martin stated that he did not know what the increases might be for tax premiums. Sen. Morse stated that the Department of Revenue does project increases in tax premiums.

Brian Rice, representing Minneapolis Police and Fire, testified that Revenue does have a model to project insurance tax premium amounts as they do with all sources of revenue for the State. He testified that Revenue assumes a 5% growth rate for insurance tax premiums. Sen. Pogemiller requested that the Commission request the projection from Revenue. Sen. Morse stated that the cancellation to the General Fund amount has been established for the next three fiscal years. Discussion followed regarding the result of fixing the amount that cancels to the General Fund which probably, because of increases in the tax premiums, will reduce the amount the General Fund would have received if it had continued to get half of the excess aid. Mr. Rice testified that the Department of Revenue, to assure that the General Fund would not be negatively impacted by changes to the Additional Amortization Aid Program which is funded by excess police state aid, fixed the amount canceling to the General Fund. If excess police state aid was lower, the City of Minneapolis would have had to increase property taxes but if it was higher, the City would benefit because Minneapolis is the largest recipient of the aid program. Mr. Rice stated that the flow chart was accurate but a footnote regarding the impact of the Minneapolis Police and Fire "thirteenth check" might be helpful.

Sen. Morse noted that the next LCPR meeting would be January 14th and it was his hope that the Commission would wrap up some of the interim studies at that meeting. Discussion followed regarding potential LCPR meetings during the 1998 Session.

Members of the House Pension Subcommittee of the Government Operations Committee were invited to the Pension Commission meeting and Representative Bill Hilty attended this meeting.

The meeting adjourned at 1:10 P.M.

Jean Liebgott

Jean Liebgott, Secretary