

January 14, 1998
Room 15, Capitol

16th 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 9:55 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, LeRoy Stumpf, and Roy Terwilliger (Senators Betzold, Johnson, and Pogemiller and Representative Mares arrived late)

Commission member with an excused absence:

Representative Phyllis Kahn

Agenda Items Discussed

Sen. Morse began the meeting by noting that the Commission was short several members, probably due to the weather. He stated that it was his hope to bring closure to some of the interim issues before the Commission, but he did not plan to continue this meeting past 1:00 P.M.

2. Designated Study: Review of Individual Retirement Account Plans (First Consideration)

Edward Burek, LCPR Deputy Executive Director, referred members to the staff memo on this topic and noted that this memo is a revised version of the memo that the Commission did not get to at the last Commission meeting. He briefly reviewed the IRAP plans that are authorized in the state of Minnesota and a new IRAP plan that passed the Legislature last session but was vetoed by the Governor. The vetoed plan would have extended an IRAP option to various employees of the Minnesota Zoo, the Perpich School for the Arts, the Academy for the Deaf, and the Academy for the Blind. He reviewed the difference between a defined benefit and a defined contribution plan and the employees who might benefit from each. He noted that the benefit an individual receives from a defined contribution plan depends on the investment earnings obtained over time. Mr. Burek reviewed the Minnesota State Colleges and Universities (MNSCU) Individual Retirement Account Plan (IRAP) in more detail. He reviewed the contribution rates for the IRAP plans and stated that contribution rates for IRAP plans generally have to be more generous than the contribution rates for defined benefit plans since defined benefit plans benefit from turnover gains and usually have professionally managed investment assets while defined contribution plans are usually self-directed.

He noted that some higher education employees also have the option to contribute to the Higher Education Supplemental Retirement Plan. That plan was established prior to the 1973 change in TRA to a high five formula rather than a career average formula. The Higher Education Supplemental Retirement Plan was not eliminated when perceived deficiencies in TRA were addressed and Mr. Burek suggested that the Commission might want to consider folding that plan into one of the other plans, for policy reasons. Mr. Burek referred members to Table 1 on page four of the staff memo and noted that the \$70,000 salary specified in the heading of the last column in the table should be \$60,000. He stated that for many of the groups referenced in the table the effective total contribution rate to IRAP and the SRP are over 15% of salary. He stated that for employees of the State Arts Board and Minnesota Historical Society IRAP, the contribution rates are considerably lower and are equal to the contributions that would be made to a defined benefit plan. He also noted that the State Arts Board and Historical Society employees do not have supplemental account coverage. He provided a brief overview of IRAP key provisions and went on to review the assets and asset mix of IRAP compared to TRA. He stated that the combined assets of the Supplemental Retirement Plan and the Higher Education IRAP plan were \$362 million which is approximately 3.6% of TRA's \$10 billion assets. He reviewed the information on investment providers and investment categories listed in Table 3 which was provided by Norwest Bank, the administrators of the MNSCU IRAP plan. He also noted that the Historical Society IRAP has only

recently begun to operate and that plan selected TIAA/CREF as their single provider. Mr. Burek noted that the LCPR Principles of Pension Policy state a preference for defined benefit plans over defined contribution plans partially because defined contribution plans place investment risk on the individual and the employer contribution generally needs to be higher to provide an adequate retirement benefit under that type of plan. He continued to review factors that cause IRAP plans and other defined contribution plans to have higher contribution rates. He also noted that a high number of employees of the Historical Society have elected IRAP plan coverage and that their election may not be based on retirement considerations, it may be based on the short-term flexibility it provides.

Mr. Burek noted that the Commission actuary, Thomas Custis, was asked to quantify the impact on TRA and MSRS due to creation of the Higher Education IRAP plan and the Arts Board and Historical Society IRAP plan. Mr. Custis concluded that the creation of these plans has not caused a noticeable impact on TRA or MSRS, however, an adverse selection effect may cause higher liability estimates and funding requirements in the future since these plans allow individuals to select which plan they will be covered by.

Sen. Morse asked what percentage of TRA members selected IRAP coverage. Gary Austin, TRA Executive Director, testified that approximately two to three percent of TRA's members selected IRAP.

Sen. Pogemiller asked what caused this issue to be on the agenda. Sen. Morse stated that last session the Commission recommended and the Legislature passed an omnibus pension bill that included expansion of IRAP, however, the Governor vetoed that bill because of the IRAP provision so the Legislature took the provision out and repassed the bill. He promised to put this item on an agenda to provide interested parties an opportunity to testify.

Gary Janikowski, System Director for Personnel with MNSCU, testified that the reason the MNSCU IRAP program was created was to provide better portability to Higher education employees. He testified that employees who work 25% or more have an opportunity to choose between IRAP or TRA, the selection is irrevocable, and if the employee does not make a selection within 90 days, the default plan is IRAP. He noted that either TRA or Norwest counsels employees.

Senator Morse noted that at 10:40 A.M. a quorum was present.

Terri Johnson, Norwest Bank's Administrative Services Agent for MNSCU's IRAP plan, provided a handout and testified regarding the services Norwest provides MNSCU employees who select the IRAP plan.

Sen. Morse asked how MNSCU handles the State Arts Board employees. Ms. Johnson responded that only three employees have elected the IRAP program currently. Norwest conducts "Train the Trainer" programs for all human resource representatives and Norwest is always available to answer questions.

Russ Stanton, representing the Community College and State University faculty unions, testified in support of the IRAP and SRP plans. He testified that the employees he represents have 10 years of experience with IRAP and 30 years of experience with the SRP and those plans have worked out well for the employees. He further testified that in the last year three years, 764 new faculty members have been hired; of those 19% actively selected TRA, 63% selected IRAP, the remainder did not make an active choice and defaulted to the IRAP plan. Mr. Stanton continued to testify.

Rick Nelson, Northland Community College faculty member, testified in support of the IRAP plan because of the flexibility and portability it provides. Discussion followed.

Gary Austin, TRA Executive Director, testified that in 1969 TRA members had a choice between a defined contribution plan and a defined benefit plan. In 1971 he selected a defined contribution plan. During the 1970's his defined contribution plan provided a negative 37% return. From the 1970's through 1989, TRA worked to help 20,000 of their members get out of that defined contribution plan. He further testified that the historical 401(k) plan average investment return is one and one-half to two percent lower than the aggregate return for a defined benefit plan.

Lloyd Belford, Legislative Chairperson of REAM, testified that several years ago, teachers did not make pension contributions on the extracurricular salary they earned. He also testified in support of defined benefit pension plans to guarantee that a person does not outlive their benefit. Discussion followed regarding pension contributions on extracurricular salary and outliving a defined contribution pension benefit.

Hank Stankiewicz, MEA representative, testified in support of TRA and defined benefit pension plans for K-12 teachers. He testified that MEA opposes any change from a defined benefit pension plan for K-12 teachers to a defined contribution pension plan. Discussion followed.

1. Approval of Minutes of the December 10, 1997 Commission Meeting

Representative Jefferson moved approval of the December 10, 1997 Commission Meeting. **Motion Prevailed.**

3. Public Pension Plan Time Weighted Total Rate of Return (Comments From Public Pension Plan Officials)

Sen. Morse asked if there was anyone in the audience that wished to testify on this topic. No one responded so Sen. Morse laid this item aside.

7. Designated Study: Review of Required Purchase of Prior Service Credit Payment Amount Determination Procedure and Other Prior Service Credit Purchase Topics (Third Consideration)

Lawrence A. Martin, LCPR Executive Director, reviewed the background on this topic. He referred members to page 2 of the current staff memo and stated that he would compare the "boilerplate" calculations of full actuarial value as it has developed since 1978 and the new method for calculating full actuarial value proposed by TRA and calculated by Thomas Custis of Milliman & Robertson, Inc. and how using each method on selected hypothetical situations impacts the actuarial condition of the pension funds. Mr. Martin reviewed the information in Table A in detail. He noted that in 15 of the 59 cases provided in the table, the current boilerplate procedure understated the actuarial accrued liability increase, in eight cases the procedure was equal to the actuarial accrued liability, and in 36 cases the current procedure overstated the actuarial accrued liability. He continued with his review and concluded by stating that the current boilerplate method seems to provide too wide a range between the payment amount and the actuarial liability incurred by the plans. He suggested that the Commission would probably want to make some changes in the calculation method.

Thomas Custis, the Commission-retained actuary from Milliman & Robertson, Inc., testified that in measuring the appropriateness of the funding of a pension plan, actuaries deal with large numbers of people and assumptions that are appropriate for large numbers of people. The difficulty comes in dealing with one individual, using assumptions that are appropriate for large numbers of individuals and calculating their purchase of service credit amount and the actuarial accrued liability impact of that purchase. The current calculation method provides a high cost because it uses the worst case scenario by assuming the purchase of service would buy the "Rule of 90" benefit for most individuals interested in purchasing service. The new method calculation uses actuarial accrued liability calculations without assuming worst case scenario. Mr. Custis testified that the Commission should base any change in methods on policy considerations.

Sen. Pogemiller asked if the decision to use the current method in the late 1970's was based on policy considerations. Mr. Martin stated that the decision was not to use the member contribution and employer contribution amount that was in effect when the service credit was rendered because that resulted in the pension funds subsidizing the service credit purchase. The decision was made to use the current boilerplate method which the pension funds were using to calculate the present value of those buybacks. Sen. Pogemiller asked whether there is a consistency problem among the funds in making the calculations. Mr. Martin responded that there is language that directs how the calculation is to be made, however, it is not clear that the funds are all using the same procedure. He referred members to Table A, the age 50/nineteen years of service which showed the purchase payment amount for MTRFA at \$9,600, MSRS-General at \$9,400, and PERA at \$17,200. Mr. Custis testified that he had briefly reviewed PERA's methodology and it seemed to be accurate. He stated that he did not know what factors may have caused the great difference in payment amounts.

Gary Austin provided a handout and referred members to the second to the last page of the LCPR staff memo which provided proposed cost calculations for a person 55 years of age with 29 years of service if they bought back one year of service credit. He reviewed the calculation process for this person and stated that the purchase amount would be \$7,711. He continued to discuss the new methodology and stated that it assumed the person would retire at the same time with or without the purchase of service so it assumed the person would retire prior to reaching the "Rule of 90" benefit stage if the person did not purchase the additional service, thereby greatly reducing the benefit they would receive. He referred members to the handout he had provided and noted that under current law the purchase amount for an individual buying 18 days of service would be \$54,215, while under the proposed method, the purchase amount would be \$1,754. Mr. Austin continued to review examples of the cost of last Session's purchase of service bills under the TRA proposed calculation method.

Sen. Morse asked what would happen if the individuals Mr. Austin reviewed purchased the additional service credit but did not retire when it was projected they would retire. Mr. Austin believed that would be a cost savings for the pension plan. Mr. Custis agreed with Mr. Austin's statement.

Sen. Pogemiller asked whether the pension funds were running a risk with the TRA proposed calculation method. Mr. Custis testified that the TRA proposed methodology provides more consistency between funds, the variable would be the mortality tables for each fund. Sen. Pogemiller asked about the mortality tables. Mr. Martin stated that mortality assumptions are approved by the Commission but are not set in statute.

Sen. Morse asked about the experience the funds have had with individuals who have made past purchases of service with regard to when they actually retired. Mr. Martin stated that a few years ago, the Commission requested that information and was told that it would be difficult for the funds to ascertain that information. Mr. Austin testified that very few people have ever actually purchased the service credit they were authorized to purchase. Mr. Custis testified that anytime assumptions are made for individuals there is a potential for adverse selection. Mr. Austin testified that if the cost of the purchase of service was lower, more people may actually make the purchase. He further stated that some of those people might work past their projected retirement date or may die prior to reaching their projected retirement date. This would provide a cost savings to the pension fund. He continued to testify in support of the TRA proposed method.

Mr. Martin stated that if the Commission's goal was to avoid subsidizing purchases of service, the actuarial accrued liability method would provide that result and the calculation could be done by Milliman & Robertson, Inc. He stated that he is not sure the TRA proposed method provides a purchase payment amount equal to the actuarial accrued liability the pension fund would bear. Sen. Morse agreed that it would not be appropriate to grant a purchase of service that would result in a net increase in liabilities for the fund. Mr. Austin stated that he believes some of the figures in the "Actuarial Accrued Liability Change" column are distorted because of the way Milliman & Robertson, Inc. grouped individuals. He also opposed having the Commission actuary calculate future purchases of service because it would be cumbersome. Mr. Custis testified that Mr. Austin was correct about the numbers in the "Actuarial Accrued Liability Change" column. Without grouping, the first number would probably decrease to about \$1,500 to \$2,000 and the second number would increase to about \$4,500 to \$5,000. He stated that in both cases the numbers would be higher than the TRA proposed method. He stated that the entry age/normal cost actuarial method provides a level cost over the lifetime of the participant but the value of the participant's benefit does not increase in a linear fashion. The benefit increases rapidly in the final years preceding retirement while a reserve is built up in the early years of a person's career. Mr. Custis also noted that if the Commission chose to implement the actuarial accrued liability method, two issues would need to be addressed. The first would be the assumption issue, everytime the assumptions changed, the purchase price for prior service would also change. The second issue was that actuarial calculations are performed on a gender specific basis, however, the law states that individuals can not be charged a purchase price based on gender so the actuarial valuation process would need to be modified for purchases of service. Mr. Custis stated that administratively, for Milliman & Robertson, Inc. to perform the calculations for the purchases of service, it would require them to run the computer system twice, once with the individual data as it is and once as it would be modified.

That could be problematic.


Dave Bergstrom, MSRS Executive Director, testified in support of the TRA alternative method. He would like to have his actuary review the method recommended by Mr. Martin. He further noted that MSRS is currently in the process of calculating purchase of service credits for about 250 part-time revenue employees and it would be difficult to have the Commission-retained actuary do all the computations required. He recommended that a program be set up to allow the funds to perform the calculations internally. He also testified that normally, MSRS has very few purchases of service credit to deal with and, according to the recollection of the MSRS staff, no individual has utilized special law buyback provisions. Mr. Bergstrom testified that MSRS was not able to provide information regarding purchases of prior service when the information was requested because MSRS did not track that information. Sen. Morse requested that Mr. Bergstrom have his actuary review the purchase of service method recommended by Commission staff and report back in a week with the response.

Mary Vanek, PERA Executive Director, testified in support of the TRA alternative method and also stated that she would like the PERA actuary to review the staff recommended method. She stated that PERA has not had any individuals utilize special law buyback provisions unless the employer funded the purchase. Ms. Vanek asked who would bear the cost of having the actuary calculate the purchase of service credit amount? Sen. Morse stated that was still an open question, possibly the individual. Mr. Custis testified that running the calculations one at a time would take approximately three to four hours at the \$150 per hour contract rate, the cost would be \$500 to \$600 each.

Mr. Custis recommended that the policy issue be decided first. He stated that the TRA alternative method is more reasonable than the current boilerplate worst case scenario method and it could be further modified. Sen. Morse asked if there might be a way to streamline the actuarial process. Mr. Custis stated that Milliman & Robertson, Inc. could create a scaled down valuation model that would run on a personal computer allowing the fund administrators to do the calculations themselves, however, creating the model would not be an insignificant task.

Sen. Morse said that the Commission should wait until the fund directors provided written responses on this issue. He also stated that the Commission has scheduled two Friday afternoon meetings during the coming session and there are three mandated reports that need to be completed.

The meeting adjourned at 1:05 P.M.


Jean Liebgott, Secretary