August 19, 1998
Room 15, Capitol

22nd 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 9:16 A.M. He noted that he had appointed Representative Jefferson to Chair a subcommittee to review MERF survivor benefit issues. He also stated that he anticipates having the State Auditor give a presentation to the Commission with regard to the Minneapolis Police Relief Association audit.

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 absent:
Representative Phyllis Kahn and Senator Roy Terwilliger

Agenda Items Discussed

3. **Commission Interim Topic: Pension Investment Policies and Performance (First Consideration)**
Edward Burek, LCPR Deputy Executive Director, provided a brief overview of the items in member's packets on this issue. He noted that the packets included a staff memo, the investment policy statements for the funds being reviewed, the laws applicable to those funds' investments, and correspondence between Commission staff, MERF and the State Auditor. He stated that this initial staff memo dealt with the investment authority and investment policies of the State Board of Investment, the first class city teacher plans, MERF, the four remaining non-consolidated police and paid fire plans, and the Bloomington Volunteer Firefighters Relief Association. He also noted that he would provide copies of the findings and recommendation section of the State Auditor's report on Minneapolis Police. He noted that at the next meeting on this issue, the memo would continue with these fund's investment policies and also cover their investment returns.

Mr. Burek referred members to Table 1 in the staff memo. He stated that it showed the assets of the funds included in the study and also showed that SBI's assets make up almost 90% of the assets being studied. He stated that all Minnesota public pension plans are covered by the fiduciary responsibility law. He then reviewed key provisions in that law. He specifically noted that the fiduciary responsibility law requires all public pension plan administrators to annually provide each of their investment advisors and brokers with a written statement of all of the investment restrictions contained in state law that pertain to that particular fund, the fund must receive a written acknowledgment of receipt from those advisors and brokers and must certify that they will comply with those restrictions for all investments made on behalf of that public pension fund.

Mr. Burek reviewed the investment restrictions for each of the pension funds included in the study and the permissible investments for each type of pension fund. He noted that SBI is the only Minnesota public pension fund given explicit authority to invest in unrated and below-investment grade bonds. He further noted that SBI's investment in those debt instruments, commonly called junk bonds, cannot exceed 5% of their assets. Rep. Delmont questioned the potential meaning of international securities other than foreign stocks and bonds. Mr. Burek told members that the language in Minnesota Statutes, Section 11A.24, Subdivision 7, was non-specific. He then reviewed the background on the Legislature's 1994 authorization for SBI to invest in junk bonds and the Legislature's intent to limit this authority strictly to SBI by establishing Minnesota Statutes, Section 356A.06, Subdivision 7, as the investment authority for all other public pension plans in the state. He noted MERF's prohibition on in-house investing. In response to a question from Rep. Delmont, Mr. Burek reviewed the background on MERF's real estate and home mortgage investments. He then reviewed the investment authority for the first class city teacher plans and noted that the laws for MTRFA are somewhat different than the laws for DTRFA and StPTRFA.

For the MTRFA Annuity Reserve Fund assets, the applicable law is Minnesota Statutes, Section 11A.24, probably due to an error in revising cross-references in 1994. However, MTRFA does not have a separate annuity reserve fund so it is impossible to tell if their assets are being invested in accordance with the laws applicable to that fund. Discussion followed and Sen. Morse asked if the Commission staff knew how much money MTRFA had invested in junk bonds. Mr. Burek stated that MTRFA's target allocation is to invest one-third of the MTRFA bond portfolio in junk bonds. Sen. Morse asked if the law restricted MTRFA to a 35% cap on investing in below investment grade bonds. Mr. Burek stated that the law is not clear on that issue. He stated that 11A.24 permits SBI and MTRFA to make direct investments in unrated and below investment grade bonds providing they do not exceed 5% of their total portfolio. He referred members to Minnesota Statutes, Section 356A.06, Subdivision 7, Paragraph (g), Clause (iii) and stated that this statute permits investments in mutual funds. The funds believe that this section authorizes investments in unrated and below investment grade securities through mutual funds because there is no cross-reference to previous language restricting the funds from investing in those securities. He referred members to letters to and from the State Auditor's Office and to MERF on this topic. He recommended open discussion of these issues and a clarification of the laws.

Mr. Burek then reviewed the areas where differences exist between the Commission staff's identification of the appropriate laws and the documents obtained from the pension funds. He noted that the Minneapolis Police Relief Association policy statement incorrectly refers to the SBI law as authorizing the permissible investments for Minneapolis Police. Rep. Mares asked if 11A.24, the SBI law, applied to any of the police or paid fire funds. Mr. Burek stated that 11A.24 does not apply to any of the police and paid fire funds. Sen. Morse asked how it works if the investment managers for public pension funds are required to sign a written acknowledgment that they will comply with the appropriate State laws for investing the assets for public pension funds if the funds don't give the managers the correct information. Mr. Burek responded that the funds may not be providing their investment managers with the correct references and so the acknowledgment process would be ineffective if it was being followed at all. Mr. Burek stated that the DTRFA policy statement had references to various prudent person standards including Minnesota Statutes, Section 501B.81. The issue that reference raises is that Chapter 501 deals with "trusts" and the investment authority for a trust is in direct conflict with the investment authority for a public pension fund. Mr. Burek noted that MERF's investment policy statement included language giving criteria for when it is appropriate to use in-house staff to manage assets even though State law prohibits MERF from managing assets in-house. Discussion followed. Sen. Morse stated that he was surprised to see the lack of completeness and accuracy for some of the larger, more sophisticated public pension funds with regard to identifying the appropriate provisions in law. Rep. Delmont questioned whether better communication with the pension funds would have eliminated some of the incomplete and inaccurate investment authority and policy statements. Sen. Morse stated that he feels it is the Commission's responsibility to periodically check on how these funds are complying with all aspects of the laws governing them but he does not feel it should have to be done annually. Lawrence A. Martin, LCPR Executive Director, stated that the last time the Commission studied the investment policies of these funds was in 1986, when the Program Evaluation Division of the Legislative Auditor's Office did a study on them. Rep. Mares stated that the staff memo showed that many of the funds being studied may not have adapted their investment policies to show the 1994 change in law. He went on to state that he believes the Commission should have done a better job of seeing that the law was properly implemented. Sen. Morse asked Rep. Mares if he was suggesting that the Commission find another method to inform the pension fund directors that the Legislature has changed the law. Rep. Mares stated that he was suggesting that the Commission study the implementation of significant changes in a more timely manner rather than waiting four years. Sen. Morse stated that the pension fund directors are professionals and are responsible for monitoring the changes to laws affecting their plans. Mr. Burek stated that there may be problems communicating changes in the law with the smaller volunteer firefighter plans, however, it would be difficult to make the argument that the plans included in this study were not aware of the change in the law.

Sen. Pogemiller stated that it is clear that the investment restriction laws have not been properly implemented by the funds. He also noted that even SBI does not have a short readable investment policy statement. He asked staff to draft legislation that would put all the pension fund investment authority in one place and clarify the issue. He recommended that the funds wait until legislative debate and action occurs prior to any further investments in below grade securities.

Mr. Burek then reviewed the chart indicating the Content of Investment Policy Statements and he noted that SBI, the first class city teacher plans, and MERF have covered most of the elements that should be included in an investment policy statement. The police and paid fire plans and the Bloomington Volunteer Fire Relief Association investment policy statements are very incomplete.

Mr. Burek reviewed the issue of Technimar and the Minneapolis police and fire relief associations. He referred members to the Findings and Recommendations from the State Auditor's Report on the Minneapolis Police Relief Association. He noted that Commission staff had invited someone from the State Auditor's Office to give the Commission a presentation on the report and that the Auditor's office had initially agreed and then declined but did agree to provide a presentation at a future Commission meeting. Mr. Burek stated some of the key issues raised by the Auditor were that Minneapolis Police had greater than a 20% ownership interest in a venture capital investment, they purchased short-term promissory notes which were unrated investments and which may be illegal depending on an Attorney General opinion being sought by the State Auditor, and the relief association purchased taxable, industrial development revenue bonds that were issued by the City of Cohasset to purchase equipment for Technimar. The relief association purchased the bonds to prevent them from going into default which may not be legal nor prudent. Mr. Burek reviewed the management practices included in the State Auditor's Report. The Auditor indicated that the Minneapolis Police Relief Association was advised at the time of the previous audit of the high risk in purchasing promissory notes and the relief association had agreed to dispose of them. However, the current audit showed that instead of disposing of the investment the association increased it from $1,660,000 to $9,780,000. The Auditor recommended that the association improve its monitoring activities. The Auditor mentioned potential conflict of interest activities by relief association officers.

Sen. Morse stated that he would like to hear a presentation by the State Auditor's office on the Minneapolis Police Relief Association at the next Commission meeting or possibly prior to the September 29, 1998 meeting. He asked for any comments from the audience on the staff memo or the State Auditor's report. There were no comments.

Sen. Pogemiller stated that the laws need to be clarified and the conflict of interest laws should forbid relief association board members from serving on the boards of firms they have invested in. He also recommended laws requiring that separate funds be established for pension benefits and for health benefits rather than commingling the funds.

2. Commission Interim Topic: Police Pension State Aid Revision/Consolidation Account Amalgamation (First Consideration)

Mr. Martin reviewed the staff memo on this issue and noted that this topic combined two issues reviewed during the last interim. He referred members to the colored chart that showed the allocation of the various state aid programs and noted that the chart will be updated when new state aid numbers are available. He reviewed the options identified by the Commission previously for clarifying and refining the aid programs. He then referred members to the table in the memo which showed the status of funding for the consolidated police and paid fire relief associations. He noted that the Commission had identified the advantages and disadvantages of options to merge the consolidation accounts into PERA-P&F and he briefly reviewed them. He reviewed the changes that have occurred in recent years that will impact this topic. He stated that the change in the excess police state aid program enacted in 1997 will reduce the money going to the General Fund and will greatly increase the money going into the additional amortization state aid program. He noted that the PERA-P&F employee and employer contribution rate will decrease and that will probably increase the excess police state aid which will pass through to the additional amortization state aid program. He also noted that municipalities that have local police or paid fire consolidation accounts have the option of whether or not to implement the benefit increases granted to PERA-P&F since implementation of the benefit increases would reduce the funded condition of the consolidation accounts and require additional funding. The Commission will also need to consider that aspect of a potential merger of the consolidated funds into PERA-P&F.

Sen. Morse asked when the new actuarial valuation numbers would be available. Mr. Martin responded that the complete valuation would not be available until early December but preliminary numbers for PERA-P&F and the consolidation accounts may be available in October or November. Sen. Morse then asked Mr. Martin to explain the last sentence in paragraph 2 on page 8 of the staff memo. Mr. Martin stated that the consolidation law indexed contribution rates to PERA-P&F and so when the contribution rate decreases, municipalities with underfunded consolidation accounts may need to increase their additional municipal contribution to assure full funding by the amortization date. Sen. Morse questioned when the Commission may be able to learn the financial impact of a contribution reduction on municipalities. Mr. Martin responded that the numbers may be available by the next meeting or sometime in October.

Mary Vanek, PERA Executive Director, testified that Mr. Thomas Custis, Milliman & Robertson, Inc., had advised PERA that the consolidation account numbers may not be available until mid-November and the PERA and PERA-P&F draft numbers may be available in mid-October.

5. Commission Interim Topic: MERF Issues; Survivor Benefits, Employer Funding Allocation Issues (First Consideration)

Mr. Burek reviewed the background on this topic and noted that last year legislation was passed that provided a lump sum benefit increase for MERF short service survivors. The bill that was originally introduced raised several additional issues that the authors agreed to have studied over the interim. Some of those issues dealt with interest rates paid on refunds, interest rates on repaying a refund, the appropriate fund on which to base long service post retirement adjustments and short service post retirement adjustments if legislation passes to provide an escalator for short service survivors. He noted that the Commission may also want to study MERF funding and cost allocation methods in light of MERF being a closed fund. Previously, it was a requirement that the full contributions as determined by the actuarial valuation be paid annually but that was changed by putting a cap on the State contribution to MERF and the enactment of a 1997 law that relieved the employing units of the responsibility to cover the full required contribution. Mr. Burek stated that because all of MERF's active members will probably retire well before the 2020 amortization date, employer groups are questioning what their contribution responsibility will be when they have few or no active members. He also noted the controversy over MERF's internal procedures for allocating costs among the various employers with MERF covered employees.

Sen. Morse again noted that he had asked Rep. Jefferson to Chair a subcommittee on this topic. He noted that the other members appointed to the subcommittee are Rep. Mares, Sen. Dean Johnson, and Sen. Pogemiller.

Rep. Murphy asked if the Commission will have costs on the various buybacks when that issue comes before the Commission. Sen. Morse stated that the buyback issue will be on the next agenda.

Sen. Morse stated that the next Commission meeting was scheduled for September 29, 1998 but may be pushed back. He also hoped to meet sooner than that to hear the presentation by the State Auditor's Office on the Minneapolis Police Relief Association Report.

The meeting adjourned at 11:55.

Jean A Liebgott

Jean Liebgott, Secretary