September 29, 1998
Room 15, Capitol

23rd 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 9:10 A.M.

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

Commission members absent:
Representative Steve Smith and Senator Roy Terwilliger

Agenda Items Discussed

3. **Commission Interim Topic: Pension Investment Policies and Performance (Second Consideration)**

Senator Morse noted that at the last Commission meeting there was discussion about the State Auditor's Report and some of the investments of the Minneapolis Police Relief Association. The Auditor's office was invited to do a presentation for the Commission with regard to this audit and were present at this meeting. Because of audit staff's time constraints, Sen. Morse agreed to have their presentation come up first at this meeting.

Greg Hierlinger, Deputy State Auditor, introduced Dianne Syverson, Audit Manager for the Minneapolis Police Relief Association audit, and David Salchow, staff auditor for the Minneapolis Police Relief Association audit. Mr. Hierlinger testified that Ms. Syverson would provide an overview of the audit procedures used and Mr. Salchow would review the findings in the Minneapolis Police Relief Association audit report.

Ms. Syverson began to review the general audit procedure followed for a pension fund and how it related to the Minneapolis Police Relief Association. She testified that the purpose of the audit was to gather enough information to form an opinion on the fairness of the financial statements and to evaluate whether management has met its responsibilities with regard to management practices, compliance and internal controls. She reviewed the general process. She referred members to page 4, Exhibit A, the left column in the Minneapolis Police Relief Association audit report and noted that the investments of $373.3 million made up 99% of the total assets of the pension fund. She referred to Exhibit B and noted that the net investment income of $46.8 million made up 85% of the total additions to the plan's net assets and the other 15% were made up by contributions from the employees, employer, and state. She also noted that benefit payments of $25.5 million were 98% of the deductions from the net assets of the fund. Ms. Syverson continued with her review of the audit process. She stated that the audit process involved testing the reliability of the fund's financial information. She noted that investment balances are confirmed 100% during the audit and investments are checked for compliance with the statutory requirements for permissible investments. Finally an audit opinion is prepared, reported to the fund, and a meeting is set up with the client to discuss resolving any issues that may have arisen. Ms. Syverson turned the presentation over to Mr. Salchow.

Mr. Salchow referred members to the management letter for the relief association on page 22 of the Minneapolis Police Relief Association audit report and he began to review the items of non-compliance. He noted that the relief association had assets in a checking account in excess of the amount covered by FDIC insurance and that the auditor's office recommended separating the administrative expense checking account from the account used for benefit payments. The next issue of non-compliance was the Rothschild limited partnership investment of $5 million which exceeded the statutory 20% limit on this type of investment. The relief association held a 21.67%

interest in this venture capital fund in 1996 and a 28.93% interest in 1997. The next issue was a $9.7 million investment in unrated debt by virtue of the relief association's purchase of a promissory note. The auditor's office has requested an Attorney General opinion on whether statutory authority to invest in venture capital investment business through participation in corporations includes the purchase of debt but has not yet received a response. Mr. Salchow reviewed the relief association's non-compliant purchase of revenue bonds issued by the City of Cohasset. He reviewed the Health Insurance Escrow account which was maintained as a separate account operated by the relief association from 9/90 to 12/19/97 with assets of $3,082,488 primarily invested in Technimar promissory notes and stock. After 12/19/97, all of the assets of the Health Insurance Escrow account were transferred to the pension plan account which does not comply with statutory requirements. Discussion followed. Mr. Salchow continued with his review and noted that the audit staff had advised Minneapolis Police Relief Association in June of 1997, at the exit interview for the 1996 audit, that $1.6 million of its payroll and health insurance escrow accounts managed by Rothschild were being invested in promissory notes for Technimar which were risky and inappropriate for those two accounts. The audit staff recommended that the association sell the investments but the association continued to invest the accounts in the same manner and, by December 31, 1997, the investment had grown to $9.8 million. The Minneapolis Police Relief Association stated that they were not aware of the extent of the investment of those two accounts in Technimar until November of 1997 even though the investment transactions were recorded in their monthly bank statements. The Auditor recommended that the association improve monitoring its investment activities. Sen. Morse asked who the auditor met with from the association in the June, 1997 exit interview. Mr. Salchow responded that the exit interview included Al Berryman, the Secretary of the Minneapolis Police Relief Association, and relief association staff and that the auditor provided oral and written comments regarding the inappropriateness of this investment. Senator Morse asked if the auditor provided those comments to the entire relief association board. Mr. Salchow responded that the auditors presumed that information they provided would be sent to the entire board by relief association staff. Discussion continued and concluded with Sen. Morse's comment that a red flag was raised in June of 1997 but there was no correction.

Mr. Salchow continued to review the audit findings. He reviewed the appearance of a conflict of interest when a relief association board member traveled to Italy to view an operation similar to Technimar's without knowing who paid for the trip and when two fiduciaries became Technimar board members and thereby had an option to purchase stock at less than full price. He also reviewed a possible conflict of interest for David Welliver, the relief association investment advisor for Technimar, who was being paid commission by Technimar as well as being paid by the relief association for the investment of their money. Mr. Salchow further noted that the relief association's payroll account purchased a promissory note from Garvin, Inc. and that a $175,000 payment on that note was made to Mr. Welliver's investment firm rather than the association and was recorded by the association as a loss. Mr. Welliver purchased a Technimar promissory mortgage note on behalf of the relief association that turned out to be a mortgage for the private residence of Roberto Contreras, an officer of Technimar, and payment on this note were possibly misdirected by Mr. Welliver. He noted that criminal charges may be brought on this last audit finding. Discussion followed.

Rep. Kahn asked if all of the comments from the exit interview are written or are they taped so that there is a complete record of the auditor's dealings with the relief association. Ms. Syverson responded that there is documentation to support the comments made to audit clients. There are also oral written comments and oral comments that are documented in work paper files but the meetings are not taped. Rep. Kahn asked if the comment at the 1996 audit exit interview was oral or written oral when the auditor's office informed the relief association that certain investments were inappropriate. Ms. Syverson responded that the auditor's office provided a written copy of the oral comments on the 1996 audit. Rep. Kahn asked if it was correct to say that those comments would only have been seen by the audit clients and would not have been included in the document made available to everyone that received the 1996 audit report. Ms. Syverson responded that Rep. Kahn was correct and stated that the auditor's work papers are available at their office. Sen. Morse asked if the written oral comments were included in this audit report. Ms. Syverson referred members to the last bullet point on page 108 of the audit report. Discussion followed.

Rep. Mares questioned the auditor's comments dealing with conflict of interest on pages 34 and 35 of the report and asked whether the two fiduciaries who held positions on the Technimar board received payment for those duties. Mr. Salchow stated that the auditor's office was not aware of any information that showed that the two fiduciaries ever served on the Technimar board or received any payment. Rep. Mares questioned the auditor's comments dealing with the 20% limit on venture capital. Mr. Salchow stated that the statute is clear on that point.

Sen. Morse questioned Mr. Hierlinger on the internal audit process after the staff completes the audit work. Mr. Hierlinger responded that the auditor's office has a standard audit review procedure. Each report is reviewed twice, including review by attorneys, it is sent to the client for comments, it goes through a senior management review where it is reviewed for technical purposes, and then it is signed by Mr. Hierlinger and the State Auditor and published. Discussion followed.

Rep. Kahn recapped noting that the Pioneer Press newspaper article of 7/19/98 commented that the State Auditor released in June of 1997 a 1996 audit of the Minneapolis Police Relief Association in which they had cautionary words about Technimar but the cautionary words were not in the published document, they were part of the written oral comments and working papers. Mr. Hierlinger responded affirmatively. She questioned whether all oral and written oral comments could be included in a listing in the report to red flag the items, particularly when there are questions about the clarity and interpretation of the law, so that the Legislature could possibly have acted to clarify or pass new legislation. She also asked about the possibility of taping the exit interviews. Mr. Hierlinger stated that they have not taped these meetings in the past but they will consider it.

Sen. Pogemiller asked if the State Auditor follows up on issues raised by an audit and receives appropriate feed back. Ms. Syverson stated that if issues are raised in an audit, the auditor follows up on them during the audit the following year and the auditor also notes whether the issues are resolved or not. Sen. Pogemiller asked if the issues were resolved in this instance. Mr. Hierlinger stated that the issues under discussion came up during the 1997 audit and will be followed up on during the 1998 audit. Sen. Morse asked if the Minneapolis Police Relief Association had Welliver sign off on whether he had received a copy of the relief association investment policies and was aware of the state laws that governed the relief association investments. Mr. Salchow stated that Welliver had signed off on that disclosure requirement. Rep. Murphy asked if Mr. Welliver was still working. Mr. Salchow stated that the relief association fired Mr. Welliver and his firm as of December, 1997.

Sen. Pogemiller asked about the process if the county attorney proceeds. Mr. Hierlinger stated that there is no set procedure for the State Auditor's office to be involved with the county attorney, however, the county attorney's office has contacted the auditor's office and asked for additional information on this matter.

Rep. Kahn asked if any additional money was put into Technimar after Mr. Welliver was fired. Mr. Salchow responded affirmatively and referred members to page 24 which showed that in March, 1998 the association signed two promissory notes for $150,000 each and in May, 1998 the association agreed to loan an additional $250,000.

Sen. Stumpf recapped that the auditor's office does not gather information on an association on a monthly basis they look at the information once a year. Mr. Hierlinger responded affirmatively. Sen. Stumpf stated that the auditor's office does not have any enforcement action authority they can only turn information over to the appropriate enforcement authorities. Mr. Hierlinger responded affirmatively.

Sen. Pogemiller asked for clarification on the process of turning the audit over to the county attorney and whether there are any other items that the county attorney might act on other than the misrepresentation of the personal mortgage. Deno Howard, Deputy State Auditor, stated that the auditor's office turns over the audit report to the county attorney for possible civil or criminal action. Both the Minneapolis police and fire relief associations have filed civil lawsuits so Ms. Howard is unaware of whether the county attorney will take any action. Ms. Howard stated that it is normal practice to turn over all audits to the appropriate county attorney. Sen. Pogemiller asked if the auditor red flags certain issues for the county attorney. Ms. Howard stated that in this case a cover letter was sent noting some items. Sen. Pogemiller asked if the Pension Commission was sent a copy of the cover letter. Ms. Howard stated that she did not believe the Commission was copied on the letter to the county attorney. Sen. Morse asked the auditor to provide a copy of the letter to the Hennepin County Attorney to the Commission and he requested that the auditor's office maintain closer contact with Pension Commission staff. He also requested that in the future, the auditor's office send a copy of all written oral comments and a summary of any oral comments relating to pension fund audits to the Pension Commission staff. Discussion followed.

Brian Rice, an attorney with Best and Flanagan, and Richard Nelson, President of the Minneapolis Police Relief Association, came to testify on behalf of the police relief association. Mr. Rice testified that the Minneapolis Police Relief Association would be working with the State Auditor's Office over the next several months to resolve the issues raised in this audit. He also testified that the two fiduciaries did not sit on the Technimar board. Mr. Rice began to respond to each of the audit findings. He testified on the first item, the Minneapolis Police will deal with the uncollateralized deposits issue. He testified on the item dealing with participation in the limited partnership investment in excess of the 20% limitation in 1996 and 1997, that Mr. Welliver mislead the state auditor and the relief association with regard to the relief association's level of participation. The relief association has filed a lawsuit alleging fraud on the part of Mr. Welliver on this item since Mr. Welliver indicated at the time of the investment that $25 million had already been raised and a $7.6 million investment by an Italian firm named Bretton was actually a loan and not an investment. Mr. Rice testified that on the issue of the promissory note, the oral written comments from the 1996 audit were only provided to Mr. Berryman, the Secretary of the Minneapolis Police Relief Association, and the relief association staff. Mr. Rice wrote to the Auditor and requested that future oral written comments be included with the audit. He testified that this item may have been handled differently if others were aware of the oral written comments. He testified that the auditor's comments stated that these promissory notes were probably legal but, in his opinion, they were probably illegal. Mr. Rice would support legislation that Sen. Pogemiller requested at the last Commission meeting to clarify investment authority. Mr. Rice testified that the police relief association bought the $2 million City of Cohasset bond for $1.9 million to prevent Technimar from going into a Chapter 7 liquidation and to protect the investments that Mr. Welliver had already made. Purchase of this bond gave them a first secured position on $16 million of equipment and a $2 million guarantee from the IRRRB. He stated that the auditor's office stated that the unsecured promissory note mentioned earlier was probably legal but this secured bond was illegal. He disagrees with their interpretation. Sen. Morse questioned who issued the bond and was it backed by the issuer. Mr. Rice stated that the City of Cohasset issued the bond but is not the backer of the bond. Sen. Morse read the statute that said the bond had to be backed by the full faith and credit of the issuer. Mr. Rice referred to other language in the subdivision that mentions other government issues and he testified that the IRRRB backs up the bonds of all the range cities. Sen. Morse noted that the statute seems to be clear and does not seem to allow this bond purchase. Mr. Rice believes the statute permits this purchase because the bond is backed by the IRRRB. Sen. Morse asked if in this case the IRRRB considers itself to be a state agency. Mr. Rice agreed to provide members with a copy of the IRRRB guarantee which appeared to show that it considered itself a state agency. Discussion followed. Mr. Rice testified that there is no statutory requirement that the Health Insurance Escrow Account must be a separate account. The assets of that account have been commingled with the association fund since its establishment in 1990. He further testified that the Minneapolis Police Relief Association is working on several different ways to improve the monitoring of their fund. Mr. Rice stressed that neither Mr. Berryman nor Mr. Bridgeman were ever elected officially to the Technimar board and neither sat on the Technimar board. The Minneapolis Police Relief Association board approved allowing them to sit on the Technimar board with two conditions, that they would not receive any remuneration for sitting on the board and that Technimar obtain more than $1 million director and officer insurance policies. Technimar did obtain the insurance but the two relief association officers never officially sat on the Technimar board. With regard to Mr. Welliver profiting from the commissions paid by the relief association for investing in Technimar while Mr. Welliver also received commissions for selling Technimar venture capital shares will be dealt with in Minneapolis Police Relief Association's investment policy document. Mr. Rice does not believe the auditor's office is correct in its comments about the limited partnership agreement, item 97-9. Mr. Rice's response to item 97-10 was that the relief association was defrauded and they have contacted the Hennepin County Attorney to investigate that item.

Rep. Kahn stated that the 1996 State Auditor's report on the Minneapolis Police Relief Association was not strong enough with regard to the association. Discussion followed. Sen. Pogemiller stated that both the State Auditor and the Minneapolis Police Relief Association were mislead by

Welliver. He asked how the Legislature could improve the vendor's responsibility in these circumstances. Sen. Morse stated that he was concerned about the structure of the oversight of the board since so much of the decision making was handed off to investment managers. Mr. Rice testified that the police relief association is going to hire a consultant to manage the managers.

Dick Nelson, President of the Minneapolis Police Relief Association, testified that the relief association is doing everything it can to cooperate with the City and the county attorney to resolve these issues.

J. Michael Stoffel, Executive Secretary of the DTRFA, and James Turchi, President of the DTRFA Board of trustees, were invited to testify. Mr. Stoffel testified in response to comments in the staff memo dated August 17, 1998, page 11, the paragraph after paragraph a, with regard to DTRFA's investment in a building that may be in conflict with the law. Mr. Stoffel testified that Rep. Kevin Knight has represented publicly, both in radio broadcasts and newspaper articles, that DTRFA has violated state law in its investment in real estate for the new office building on Central Entrance in Duluth. This is the most serious charge that can be leveled against a board of trustees. He read a prepared statement from the Duluth teachers board. He testified that the fund has sought and received approvals of compliance with Minnesota statutes for this investment. Aaron Bransky, the counsel for the DTRFA, provided his opinion that Minnesota Statutes, Section 354A.08 allows the DTRFA to invest in real estate and hold title to the property on Central Entrance in Duluth where the fund's own office resides. He stated that Subdivision 7a which starts with the phrase "Except to the extent otherwise authorized by law or bylaws" takes precedence over the provision that limits investments to no more than 20% of the total investment. Rep. Murphy asked whether the bylaws of the DTRFA allow for ownership of a building. Mr. Stoffel responded affirmatively. Discussion followed.

6. Commission Interim Topic: Potential Improvements in Local Correctional Employee Benefit Coverage (Second Consideration)

Sen. Morse stated that because people took time off work to come to this meeting to testify, he was taking this item next. He asked Edward Burek, LCPR Deputy Executive Director, to provide a brief overview of the topic but postponed a review of the staff memo because of the brief time remaining in this meeting. Mr. Burek noted that the Commission was studying this topic because of legislation introduced last session by Rep. Delmont and Sen. Pogemiller to improve benefit coverage for local correctional employees. That bill did not pass in its entirety but the Legislature did pass enhanced duty disability benefits for local correctional employees.

Bob Johnson, representing Teamsters Local 320, introduced Tom Perkins and stated that Dave Fritz, a Hennepin County Correctional officer, could not make this meeting because he could not take time off due to the overcrowded situation in the Hennepin County Jail. Mr. Johnson referred members to page 2 of the June 15, 1998 staff memo provided at the last Commission meeting and read Minnesota Statutes, Section 352.90 regarding the legislature's policy of providing special retirement benefits for certain state correctional employees. He testified that the law he just read could be expanded to include local correctional employees. He stated that there are currently 2500 employees in the MSRS Correctional Plan and there are 1900 PERA Coordinated local correctional officers. He testified that the growth is due to the mid-1970's Community Corrections Act which called for local community correctional alternatives and required the hiring of civilians to staff local correctional facilities. These people have positions of substantial risk but have the same pension coverage as employees whose jobs do not include the same kind of risks. He testified that the bill that will be introduced in the 1999 session will include an early retirement provision and a 2.0% multiplier.

Tom Perkins, a Ramsey County correctional officer and an Executive Officer of Teamsters Local 320, testified that there is currently a crises situation in county jails. He stated that jails are extremely overcrowded, employee morale is low, and mandatory overtime is required. He testified that employees hired after 1989 no longer have access to a "Rule of 90" benefit so between 2015 and 2025, over 50% of local correctional employees will be over the age of 55. He stated that the employee turnover rate is extremely high and that currently at the Hennepin County Adult Detention Center, 50% of the correctional employees have less than two years experience. He testified that rural jails also have severe problems and that often there is only one jailer on duty overnight at those facilities to handle difficult prisoners.

Mr. Johnson testified that last session Milliman & Robertson, Inc. estimated the cost for the two benefits was $2.8 million. Rep. Murphy asked what is the average age for local correctional employees. Mr. Perkins responded that the average age is 26 but Ramsey County has recently hired a 50 year old and three 40 year olds. Rep. Murphy asked if the older employees were bringing this proposal. Mr. Johnson responded that the proposal is being sought by the younger employees. Discussion followed.

1. **Approval of the Minutes of the Commission Meetings of June 17 and August 19, 1998**
Sen. Betzold moved approval of the minutes of the meetings on June 17 and August 19, 1998. **MOTION PREVAILED.**

Sen. Morse stated that because the Commission is falling behind on its interim schedule, he may add another meeting date or schedule more time for the November 18, 1998 meeting.

The meeting adjourned at 12:05.

Jean Liebgott

Jean Liebgott, Secretary