October 1, 1998
Room 10 State Office Building

1st Meeting

MERF Subcommittee
of the Legislative Commission on Pensions and Retirement

MINUTES

Representative Richard Jefferson, Chair of the MERF Subcommittee, called the meeting to order at 9:25 A.M.

Subcommittee members present:
Representatives Richard Jefferson and Harry Mares (Representative Phyllis Kahn also attended this meeting)
Senator Lawrence Pogemiller

Subcommittee members absent:
Senator Dean Johnson

Agenda Items Discussed:

1. **MERF Issues; Survivor Benefits, Employer Funding Allocation Issues**
Rep. Jefferson gave an overview of how he would conduct this meeting. He asked Edward Burek, LCPR Deputy Executive Director, to begin by reviewing the staff memo on the topic.

Mr. Burek stated that his review would begin with the August 10, 1998 staff memo on this topic. He stated that the general issue was MERF survivor benefits in death-while-active situations which included all benefits provided to survivors after a MERF covered employee died prior to their retirement. He stated that for MERF long service employees who die prior to retirement with 20 or more years of service, the survivor receives the monthly benefit the employee would have received when the employee retired, a refund of the employee contributions plus interest, and the monthly benefit the survivor receives is escalated based on MERF's investment returns. For MERF short service employees, employees with less than 20 years of service, the benefit is not as generous and does not include an escalator. He stated that an ad hoc increase was provided for the short service employee survivors in 1991. Last session in reviewing short service survivor issues in order to provide another benefit increase, it became apparent that many of MERF laws on this topic were difficult to interpret and sometimes MERF's long term administrative practice may not have been authorized by law. Mr. Burek and Judy Johnson, the MERF Executive Director, drafted S.F. 3038 (Pogemiller); H.F. 3418 (Jefferson) which would have provided MERF survivors with several benefit improvements. Mr. Burek noted that a benefit increase for short service survivors (both pre-1983 and post-1983), clarification of the short service surviving child definition, and a cost allocation procedure for pre-1983 survivor benefit increases passed the Legislature last session with an agreement that the other topics raised by this legislation would be studied further during the interim. He stated that the Subcommittee may want to make sure that the State is not subsidizing any of the additional liability costs for last session's benefit increases.

Rep. Kahn asked why it was necessary to clarify the surviving child definition. Mr. Burek responded that the benefit has terminated in the past when a short service member's surviving child no longer met the definition but the long service surviving child definition includes a child that is dependent on the member for 50% of their support at the time of the member's death no matter what the age of that child and that benefit continues for life. Rep. Kahn asked what was the fiscal impact of that benefit. Rep. Mares stated that he believes physically or mentally challenged dependents, regardless of age, currently have that benefit under Social Security. Discussion followed and Rep. Kahn stated that she would like the MERF definition rewritten along the lines of what Rep. Mares stated the Social Security laws cover.

Judy Johnson, MERF Executive Director, testified that no surviving child has ever drawn a benefit under this provision because the benefit first goes to the surviving spouse. She opposed changing this definition because this is a benefit that members pay for separately and members consider it a life insurance plan. She stated that members have rights to the benefit package they have paid for and their payments go into the survivors insurance fund. She stated that the City has counseled employees that it was not necessary for employees to buy life insurance because a specified percentage of their contributions to MERF went into the survivors insurance fund and the City matched the employees contribution. If the definition were changed, MERF employees are at an age that would make purchasing life insurance to replace this coverage very difficult.

Rep. Jefferson recapped that the benefits provided under the long service survivor benefit are provided by a separate insurance policy that is solely paid for by the employee and does not receive any state contributions. Mr. Johnson responded that this is an insurance fund that is separate from the pension fund, the State has never contributed to it, and Mr. Thomas Custis, Commission retained actuary from Milliman & Robertson, Inc., will testify that the State has never made a contribution to this insurance fund. She stated that this year she requested that Mr. Custis value the survivor fund separately to show that none of the State's contribution to MERF goes into this insurance fund. Mr. Burek stated that he has spoken to Milliman & Robertson, Inc. several times about this issue and he was told that in all of the past actuarial valuations there has not been any distinction between the survivor benefit fund and any of the other obligations of MERF. For actuarial purposes, the MERF funds have been treated as one big commingled pot which is why Commission staff contends that the State has a stake in all of MERF's funds. Ms. Johnson testified that she asked Mr. Custis to separate the funds out for the July 1, 1998 valuation. She also stated that Mr. Custis needs to merge the funds to determine how much each of MERF's employers will need to contribute because the State's contribution has a maximum. Ms. Johnson testified that she pointed out to Mr. Custis that since no State money can go into the survivor fund more money than was necessary has gone into the active fund. Ms. Johnson continued to explain MERF's funding and testified that this year the actuarial tables will clearly separate the funds because the State contribution will be less than $10.455 and the actual limit is $9 million. She further testified that the 1998 actuarial valuation will show the State contribution to MERF next year will be $5.7 million. Mr. Burek stated that, in reviewing the sheets Ms. Johnson has provided, he does have concerns that the liability amount may not be an accurate number. He will need reassurance that the liabilities allocated to the survivor fund are appropriate and that the State is not at risk for whatever action MERF takes with the survivor benefit fund. Discussion followed.

Rep. Jefferson asked how many children were drawing this benefit. Ms. Johnson responded that four children are receiving benefits under the short service survivor benefit program up to the $900 cap and they are not covered by Social Security. Rep. Jefferson asked what refund a survivor receives. Ms. Johnson stated that the survivor receives a refund of the member contribution plus interest.

Mr. Burek referred members to the table on pages three and four of the staff memo and reviewed the differences between PERA Basic survivor benefits and MERF survivor benefits. Rep. Kahn asked why the $900 cap on MERF survivor benefits was not shown. Ms. Johnson responded that the cap is $900 per family on MERF short service survivors. She referred members to the second page of the Short Term Service Surviving Widows document that she had provided to show the difference between the MERF benefit and the PERA benefit. Rep. Kahn asked where the $900 cap would fit into the bottom box in the table on page 3 that Mr. Burek was referring to. Mr. Burek stated that the $900 cap would apply to the survivors in paragraph (a). Mr. Johnson stated that the cap applies to both (a) and (b). She referred members to the pages following the MERF and PERA comparison which showed the actual survivors, the refunds they received, and their current monthly benefit. Rep. Jefferson asked whether this was public information. Ms. Johnson responded that she was only giving this information to the Legislature and she did not provide Social Security numbers. She testified that the additional cost of providing a cola for these survivors was $600,000 in actuarial liability. She further testified that there would be no increase in the normal cost because the survivor fund is already receiving contributions in excess of the normal cost of that fund. Mr. Burek clarified that there would be an increase in liability but there will be no need to increase contributions and there will be no impact on the State if the liability is contained in the survivor benefit fund. Ms. Johnson agreed. Mr. Burek asked where the $900 cap appears in statute. Ms. Johnson stated that it has been in statutes since 1983 and it is under Minnesota Statutes, Section 422A.23, Paragraph (c). Mr. Burek asked if the package that passed last year mentioned this $900 cap. Ms. Johnson stated a 15% cola was provided for post-1983 survivors last session and pre-1983 survivors were not subject to the $900 cap since their benefit was only increased from $500 to $750. She further stated that the $900 cap clause was not amended last year. Mr. Burek stated that he believes that the legislation passed last session might be in conflict with the $900 cap law. Ms. Johnson stated that the cap is the starting point of the post 1983 survivors pension benefits and she does not believe there is a conflict. She also stated that she does not have a problem with Mr. Burek drafting legislation to clarify that provision. Ms. Johnson reviewed the funding of the Survivor Benefit Reserve Account page in the handout she provided and noted that the assets of the fund have increased by about 52% while the liabilities have increased only 8% since 1993. She stated that at full market value on July 1, 1998, that fund is 117.5% funded and on an actuarial value it is 99.7% funded. She reviewed the new Milliman & Robertson, Inc. tables which will appear in future actuarial valuations.

Mr. Burek continued with his review of the table in the staff memo and noted that there is no escalator for short service survivors but long service survivors do have an escalator. He noted that MERF law reads that the escalator should be based on the SBI Post Fund results but MERF has based the escalator on the MERF Retirement Benefit Fund. Ms. Johnson testified that the language referring to the SBI Post Fund was a drafting error that occurred at the time that MERF began investing its own assets. She would support correcting that error next session. Mr. Burek referred members to the tables in the staff memo dated September 29, 1998. Table 1 showed the increases in the SBI Post Fund and MERF Retirement Benefit Fund. Table 2 showed the value of $1000, over time, given the SBI adjustments and also given the MERF adjustments. The table also provided the adjustment factor needed to equalize the benefit. Discussion followed.

Rep. Kahn questioned the refund of member contributions for the death-while-active survivors with regard to its original establishment as a defined contribution plan. Ms. Johnson responded that the MERF benefit package was established as a defined contribution plan with a separate benefit that was payable with insurance-like premiums and a third fund which was a disability fund that MERF plans to eliminate. Ms. Johnson stated that MERF members make contributions to two separate funds, .75% to the survivor fund, in case a member dies prior to retirement, and 9.25% to the benefit fund for retirement purposes. If an active member quits, they get a refund of their contributions to the MERF retirement fund. If an active member dies, their survivor's benefit comes out of the survivors insurance fund and not the MERF retirement fund so the survivor gets a refund of the member contributions to the MERF retirement fund and the MERF retirement fund gets a mortality gain based on the employer contributions. Rep. Jefferson asked if the .75% employee contribution to the survivor fund was matched. Ms. Johnson responded that their is an employer matching contribution based on payroll and it is split out by the City when they send a check to MERF. Discussion followed.

Sen. Pogemiller asked if the Legislature changed the law to state that MERF post fund increases must be based on MERF investment returns rather than SBI returns, would there be a legal liability. Mr. Burek responded affirmatively. Ms. Johnson stated that MERF would accept that liability. She stated that when laws are conflicting there has to be a reasonable interpretation. The Retirement Benefit Fund must be 100% funded at all times but if MERF followed the law it would not be and there is no mechanism in law to get the fund to 100%. ERISA and the fiduciary law make it clear that members are to be treated equally, their assets are invested in one place and they earn a rate of return that has nothing to do with SBI's earnings. She further stated that a case could be made that this was a drafting error. Sen. Pogemiller asked Ms. Johnson if she considered this to be a drafting error. Ms. Johnson answered affirmatively and testified that prior to the year the law was passed to permit MERF to invest its own assets, there were references in several places in MERF law referring to paying benefits based on the SBI post fund. When the law was changed, all the references to the SBI post fund were changed except for this one which provided a strong argument for this reference being missed and that this is a drafting error. Mr. Burek agreed that this probably was a drafting error. He further stated that an argument against this being a drafting error would be that it may have been intentional to leave this provision in law to keep from disrupting individuals who were already receiving benefits based on the SBI post fund. He noted that Ms. Johnson testified that survivor benefits are paid from the survivor insurance fund so the argument that the Retirement Benefit Fund must be 100% funded and would not be if survivor benefits were paid based on the SBI post fund investment return is irrelevant. Ms. Johnson agreed with that point. Mr. Burek further pointed out that with regard to MERF members not being treated equally if the law was followed, Ms. Johnson has testified that the survivor insurance fund is totally separate so it follows that this is not a MERF fund benefit it is a survivor fund benefit. Ms. Johnson testified that if MERF paid benefits based on SBI post fund returns it would set a precedent. Discussion followed.

Sen. Pogemiller recommended that Minnesota Statutes, Section 422A.23, Subdivision 10 be repealed and that language authorizing MERF to pay benefit increases based on the MERF Retirement Benefit Fund investment return be authorized.

Mr. Burek referred members to page five of the August 10, 1998 staff memo and began to review the other issues that arose from the Pogemiller/Jefferson bill last session that members may wish to deal with. He noted that MERF is authorized to pay interest on refunds but no interest rate amount is specified in MERF law. MERF pays 5% interest on member contribution refunds in death-while-active survivor cases while other public pension funds pay 6%. He further noted that MERF does not refund the .5% of pay that is contributed to the survivor benefit fund when they provide a member contribution refund.

Sen. Pogemiller recommended clarifying MERF law so that only the member contribution made to the retired benefit fund and not the portion allocated to the survivor insurance fund should be refunded when it is appropriate to provide a member contribution refund.

Rep. Jefferson questioned whether members wanted to increase the interest rate paid to MERF members on contribution refunds. Ms. Johnson testified that MERF provides a 3% augmentation rate for deferred members, PERA provides 5% augmentation; MERF requires 6% interest on the repayment of refunds, PERA requires 8.5% interest on the repayment of refunds; MERF pays 5% interest on member contribution refunds, PERA pays 6% interest on member contribution refunds. She testified that PERA charges 8.5% interest to repay a refund because that is their earnings assumption rate on their active fund. MERF has been working on a proposal to change MERF's active fund earnings assumption to 8.5% and would be willing to raise the other two interest rates at MERF at that time to provide some conformity with other plans. Ms. Johnson testified that only MERF's salary assumption will remain different. MERF's salary assumption is 4%, which is supported by MERF members' experience, while the PERA salary assumption is 6%.

Sen. Pogemiller recommended changing the MERF active account earnings assumption to 8.5%, to increase the MERF deferred augmentation rate to 5%, and to increase the interest rate on contribution refunds to 6% after the Commission fully reviews MERF's proposal and if it is supported after discussion with the Commission-retained actuary.

Mr. Burek reviewed a benefit of $60 per year of service in death-while-active situations for members with ten or more years of service which MERF does not pay if there is a surviving spouse or dependent child. He stated that MERF law does not say who this benefit should be paid to. Ms. Johnson testified that the benefit goes to a designated beneficiary but not to a surviving spouse or dependent child. She supported this clarification

Sen. Pogemiller recommended clarifying in law who is eligible for the $60 per year of service benefit in death-while-active situations and that the benefit is not payable if other benefits are paid.

Mr. Burek stated that MERF does not pay benefits from the survivor benefit fund for deferred members but this is not clearly stated in MERF law. He suggested that Subcommittee members may want to clarify whether the benefit is solely for death-while-active members or whether it should include deferred members. Ms. Johnson stated that she has no short service membership that would be impacted by clarifying in law the MERF practice in these situations and she would support including long service deferred members in the survivor benefit fund if they died on deferred status prior to retiring if it was determined that PERA provides benefits to survivors of deferred members.

Sen. Pogemiller recommended clarifying the law with regard to short service and long service deferred members of MERF.

Mr. Burek reviewed the short service and long service surviving child definitions and asked members whether they wanted to recommend clarifying a maximum age for a long service member's surviving child. Ms. Johnson testified that long service members consider this benefit to be a life insurance provision for their surviving children. Commission members recommended not taking any action on this provision.

Mr. Burek reviewed the dependent parent survivor benefit which requires paying a benefit which is the actuarial equivalent of the benefit the member would have received if the member had retired. This could provide a very large benefit if a dependent parent was very old and therefore had a short life expectancy. If that dependent parent lived well beyond their normal life expectancy, MERF could accrue a significant liability. Ms. Johnson testified that it is difficult to prove dependency of a parent and MERF has never paid a benefit under this provision. Commission members recommended not taking any action on this provision.

Mr. Burek referred members to Table 3 in the September 29, 1998 staff memo and reviewed the value of the member contribution refund in comparison to the value of a post retirement adjustment for short service members. He stated that the table showed that the value of MERF's average short service refund was equal to 14 years of post retirement adjustments on a $9,000 benefit and the value of MERF's highest refund was equal to 21 years of post retirement adjustments. He stated that the refund of member contributions plus interest for short service member survivors is a substantial benefit, has considerable value, and could be considered a substitute for a benefit escalator. Ms. Johnson testified that the older widows did not receive $30,000 refunds and are already long past the time when their refund would have equaled the value of a post retirement adjustment and the younger widows have had their benefit capped by the $900 maximum so they could not have achieved equality with a post retirement adjustment with the benefit they have received. She testified that the cost to add a post retirement adjustment benefit for these short service member survivors was $600,000. Rep. Kahn referred members to page eight of the August 10, 1998 staff memo which stated that the 1997 MERF actuarial valuation showed MERF would have a funding deficiency in 1998. She asked if changing the interest rate assumption would improve MERF's funding, eliminate that deficiency, and pay for this benefit improvement. Ms. Johnson testified that the deficiency is already eliminated because of investment gains. She also testified that according to the actuary, contributions will not have to be increased to pay the $600,000. This benefit would increase the liability but it is already being paid for by the payment of the normal cost. Discussion followed and Ms. Johnson reviewed MERF's future contributions from various entities for the next few years. She stated that a $9 million cap on state contributions was enacted but the actual 1999 state contribution requirement will be $7.8 million. She also testified that she believes that the 1999 state contribution will be the last contribution the state will be required to make.

Rep. Mares recommended providing an escalator for short service member death-while-active survivors.

Mr. Burek referred members to page eight of the staff memo dealing with MERF internal employer accounts and state contribution issues. He stated that MERF has been administered like a group of consolidation accounts rather than a unified plan which has caused some problems that Subcommittee members may want to deal with. MERF has kept separate track of each employer's assets, contributions, and liabilities but when employees from one employing unit retire and MERF needs to transfer the assets for those retirements to the Retirement Benefit Fund, that employer account may not have sufficient assets to cover the transfer. MERF then borrows from the assets of another employing unit and the original employing unit will have negative assets. This has caused confusion among MERF's employing units and there have been errors in properly accounting for all the transactions. He referred members to a handout from MERF with regard to how MERF proposes to handle this issue. Ms. Johnson testified that the issue between the city and county has been resolved and that the July 1, 1998 actuarial valuation will serve as the basis for billing the city through the year 2000. The only employer remaining with negative assets is the Metropolitan Council. The Metropolitan Council had offered an early retirement incentive that caused an 80% retirement rate while other MERF employers had a 30% retirement rate. The Metropolitan Council has agreed to support legislation to establish a 30 day notice system whereby the Met Council would be notified whenever their account had negative assets so they could be paid with interest.

Sen. Pogemiller recommended that the method of handling negative assets at MERF be established as outlined by Ms. Johnson.

Mr. Burek questioned the interest rate that would be charged on payment of negative assets. Ms. Johnson stated that the interest rate would be 6%. Mr. Burek noted that part of the legislation the Subcommittee has already recommended that he draft included increasing the interest rate assumption to 8.5%. Ms. Johnson agreed that if that change occurred, the negative asset interest would also need to be 8.5%.

Rep. Jefferson stated that the draft legislation recommended by the Subcommittee would be circulated to the Subcommittee and Ms. Johnson prior to being reviewed by the full Commission.

The meeting adjourned at 12:15 P.M.

Jean Liebgott

Jean Liebgott, Secretary