TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 430 (Betzold); H.F. 2089 (Smith); Reporting Detail for Public Pension Plan Administrative Expense in Annual Financial Reports

DATE: March 28, 2005

Summary of S.F. 430 (Betzold); H.F. 2089 (Smith)

S.F. 430 (Betzold); H.F. 2089 (Smith) amends Minnesota Statutes, Section 356.20, Subdivision 4, the provision of law that specifies the contents of the annual financial reports of public pension plans, by adding a requirement for itemized reporting of pension plan administrative expenses.

Background Information on Public Pension Plan Financial Reporting

In 1965 (Laws 1965, Chapter 359, Section 1), financial reporting by Minnesota public pension plans was first required. The reporting law, currently coded as Minnesota Statutes, Section 356.20, requires the governing or managing board of all statewide defined benefit retirement plans, the four local general employees retirement plans, the University of Minnesota faculty supplemental retirement plans, and all local public safety retirement plans to prepare and file an annual financial report within six months of the end of each fiscal year. The annual financial report is required to be signed by the presiding officer of the applicable retirement board and by the chief administrative officer of the plan.

The annual financial report is required to contain audited financial statements and disclosures that indicate the financial operations and position of the retirement plan, prepared under generally accepted governmental accounting principles that are applied on a consistent basis. The financial report is required to include an actuarial disclosure item based on the actuarial valuation prepared by the officially retained consulting actuary containing the actuarial accrued liability, assets, and unfunded actuarial accrued liability. The reporting of plan assets must be allocated into nine specified asset classes and must disclose asset values at cost, at market, and at actuarial value. The financial reporting also must include a determination of the pension benefit obligation for benefit recipients and active members. The plan management also must include additional disclosure items necessary to portray the true condition of the pension plan's financial condition.

For the various local public safety employee relief associations, the financial reporting filed with the State Auditor's Office to receive fire State aid or police State aid is deemed to meet the financial reporting requirements.

The annual financial reporting law has been amended several times over its 40-year history. In 1969 (Laws 1969, Chapter 249, Section 1), the number of public pension plans required to file annual financial reports was increased from five statewide retirement plans (the State Employees Retirement Association, the Public Employees Retirement Association, the Teachers Retirement Association, the Highway Patrolmen's Retirement Plan, and the State Police Officers Retirement Plan) to ten retirement plans, with the addition of the Duluth Teachers Retirement Fund Association (DTRFA), the Minneapolis Teachers Retirement Fund Association (MTRFA), the St. Paul Teachers Retirement Fund Association (SPTRFA), the St. Paul Bureau of Health Relief Association, and the Minneapolis Municipal Employees Retirement Plan (MERF). In 1971 (Laws 1971, Chapter 7, Sections 1, 2, and 3), the Twin City Lines Employee Retirement Plan was added to the reporting requirement, the State Police Officers Retirement Plan (which merged into the Highway Patrolmen's Retirement Plan in 1969) was deleted from the reporting requirement, and the actuarial exhibit of the financial report was required to be prepared under the actuarial reporting law, Minnesota Statutes, Section 356.21 (now Minnesota Statutes, Section 356.215). Additionally, in 1971 (Laws 1971, Chapter 197, Section 4), a deferred yield adjustment account was required to the established in each covered retirement plan, for handling gains and losses on the sale or other disposition of debt securities. Also in 1971 (Laws 1971, Chapter 281, Sections 1 and 2), the University of Minnesota Police Retirement Plan and the University of Minnesota Faculty Retirement Plan were newly required to file an annual financial report and financial reporting was also required of the successor of any public employee retirement plan and of any newly formed public employee retirement plan. In 1975 (Laws 1975, Chapter 192, Sections 1 and 2), the reference to the St. Paul Bureau of Health Relief Association (which merged into PERA-General in 1969) was eliminated. In 1978 (Laws 1978, Chapter 538, Section 6, and Laws 1978, Chapter 563, Sections 6 through 8), the reference to the Twin City Lines Employees Retirement Plan was eliminated, reflecting its merger with the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), references to the Judges Retirement Plan and local police and paid firefighter relief associations were added. In 1981 (Laws 1981, Chapter 224, Section 168), the filing requirement for the University of Minnesota Police Retirement Plan was eliminated, reflecting its merger with the Public Employees Police and Fire Retirement Plan (PERA-P&F), and the filing requirement was extended to the University of Minnesota Faculty Supplemental retirement Plan, PERA-P&F, the MSRS-Correctional State Employees Retirement Plan (MSRS-Correctional), and the various volunteer firefighter relief associations. In 1984 (Laws 1984, Chapter 383, Section 5, and Laws 1984, Chapter 564, Section 42), the deferred yield adjustment account requirement for handling gains and losses on the sale of debt securities was eliminated and financial reporting was required to conform with standards adopted by the Legislative Commission on Pensions and Retirement. In 1985 (First Special Session Laws 1985, Chapter 7, Section 26), the financial reporting requirements were amended to add an investment portfolio mix exhibit, to add additional measures of the retirement plan's unfunded actuarial accrued liability, and to add an itemization of current benefit obligation.

In 1987 (Laws 1987, Chapter 259, Sections 53 and 54), the due date for financial reporting was reset to accommodate the delivery date of the applicable, the investment portfolio mix was modified to include the itemization of a retirement plan's participation in the Minnesota Post Retirement Investment Fund, and the current liabilities exhibit was modified to include disability benefit payments. In 1991 (Laws 1991, Chapter 269, Article 3, Section 2), substantially revised the contents of the annual financial report, requiring conformity with generally accepted accounting principles, revised the investment portfolio mix exhibit with valuations at cost and at market, and revised the pension benefit obligation exhibit itemization to allocate member and employer-financed benefits for vested and non-vested members. In 1999 (Laws 1999, Chapter 222, Article 2, Section 16), the annual financial reporting requirement was last amended and was extended to the newly created Local Government Correctional Employees Retirement Plan of the Public Employees Retirement Association (PERA-Correctional).

Discussion and Analysis

S.F. 430 (Betzold); H.F. 2089 (Smith) adds an itemization of 21 components of administrative expenses to the annual financial reporting requirement applicable to Minnesota public employee retirement plans.

S.F. 430 (Betzold); H.F. 2089 (Smith) raises several pension and related public policy issues that may merit Commission consideration and discussion by the Legislative Commission on Pensions and Retirement, as follows:

1. Appropriateness of Specifying an Additional Reporting Requirement. The policy issue is the appropriateness of requiring the state's 14 largest public employee retirement plans to report the administrative expenses of the plan in some detail. Generally, Minnesota public pension plans have reported specific components of their administrative expenses in their annual financial reporting under Minnesota Statutes, Section 356.20. However, that practice has not always been observed. The St. Paul Teachers Retirement Fund Association (SPTRFA) dropped any itemization of its administrative expenses in its comprehensive annual financial report after the June 30, 1992, annual financial report, following the enactment of the administrative expense surcharge under Minnesota Statutes, Section 354A.12, Subdivision 3d (enacted in Laws 1993, Chapter 357, Section 6). The June 30, 1993, SPTRFA annual financial report did not indicate the rationale for the elimination of the administrative expense itemization, although the imposition of an excess administrative expense surcharge on active and retired members undoubtedly increased scrutiny of and controversy over plan administrative expenses and the plan management may have been reacting to the resulting scrutiny and controversy by limiting the amount of information made available to the membership. The other teacher retirement plan covered by the administrative expense surcharge, the Minneapolis Teachers Retirement Fund Association (MTRFA), continues to provide an itemization of its administrative expenses. Conducting the business of the retirement plan in the open and providing full disclosure is consistent with the governmental nature of these organizations and seems to be consistent with Minnesota governmental data practices.

2. Need for Consistency in Administrative Expense Reporting Itemization. The policy issue is the need for consistency in the itemization of administrative expenses in annual financial reporting. With consistent categorization over time as well as between retirement plans, policy makers, plan members, and other interested parties would be better able to compare those expenses and pursue questions about the direction and magnitude of those expenses. To demonstrate the disadvantages of the current unregulated system of administrative expense reporting itemization, the following sets forth the July 1, 2002 – June 30, 2003, fiscal year administrative expenses of the Duluth Teachers Retirement Fund Association (DTRFA), the Minneapolis Teachers Retirement Fund Association (MTRFA), and the Teachers Retirement Association (TRA):

	DTRFA	MTRFA	TRA

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Investment Expenses - Securities			
Total Money Manager and Custodian Fees	932,274	1,660,156	18,958,150
Salaries	26,300	123,867	
Payroll Taxes	1718	8,828	
Employee Benefits		19,479	
Telephone & Electricity		2,748	
Office Supplies		1,238	
Office Rent		22,679	
Insurance	3,462	32,100	
Depreciation		6,310	
Travel		15,474	
Business Expense		-491	
Audit		4,968	
Legal Fees		112,863	
Consulting		5,400	
Miscellaneous		31,919	
Total Investment Expenses – Securities	963,954	2,047,538	18,958,150
Investment Expenses – Real Estate			
Salaries		11,125	
Payroll Taxes		794	
Employee Benefits		1,752	
Postage & Mailing		0	
Telephone & Electricity		595	
Office Supplies		112	
Office Rent		2,039	
Insurance		0	
Depreciation		567	
Business Expense		2	
Legal Fees		30,901	
Audit		447	
Property Taxes	10,011	10,927	
Miscellaneous		-707	
Total Investment Expenses – Real Estate		58,554	
Total Investment Expenses		2,106,092	
Administrative Expenses			
Salaries	219,355	311,344	4,337,978
Payroll Taxes		22,132	321,431
Employee Benefits		48,839	224,845
Postage & Mailing		36,653	333,077
Telephone & Electricity		7,531	88,686
Printing & Binding		16,720	221,789
Office Supplies		6,954	62,935
Telephone			504,442
Building and Operating Expenses			46,421
Rental of Office Machines/Furnishings			5,030
Deferred Bond Charge Amortization			656,679
Bond Interest Expense			1,498
Department Head Expenses			21,105
Employee Training			16,611
Office Relocation			98,531
State Indirect Costs			1,373
Workers' Compensation			1,938
Board Substitute Teachers			446
Loss on Disposal of Equipment		56,862	5,998
Office Rent			
Bank Charges	1,882		
Dues and Periodicals	2,684		7,307
Meetings, Conventions & Travel	41,592		
Printing, Postage & Office Supplies	15,656		
Repairs and Service Contracts	3,833		148,936
Supplies – Building	12,720		
Insurance	25,671	36,113	765,304
Date Processing	5,155	75,358	
Depreciation	40,076	15,820	628,407
Travel		16,822	58,145
Mileage and Parking		2,026	
Business Expense		24,369	
Legal Fees	23,378	28,497	82,284
Actuarial	39,187	83,323	116,474
Audit	26,760	12,455	37,769
Consulting	1,800		
Computer Support Services			524,502
Management Consultant Services			262,146
Medical Services			41,686
Systems Development			3,533,053
Miscellaneous	1,326	2,357	1,522
Total Administrative Expenses		804,175	

The composite Fiscal Year 2003 itemization of administrative expenses for the three teacher retirement plans providing an itemization has 70 different categories, with some consisting of distinct categories and with some being similar to the categories used by another plan. The extent of variability in the categorization greatly limits the usefulness of the current reporting in comparing the administrative practices of and experiences between plans.

3. Potential Cost of the Additional Reporting Requirement. The policy issue is the appropriateness of the imposition of an additional annual financial reporting requirement in the form of a proposed itemization of administrative expenses. Since most of the statewide and major retirement plans currently provide some itemization of administrative expenses, the reporting requirement is not new, but the particular categorization format would be new and an internal reclassification could impose some additional burden. The extent of any additional burden could be addressed in testimony by the various retirement plans, but a uniform categorization of administrative expenses should be a one-time expense if any additional expense in incurred at all. Any additional one-time expense should be balanced against the ability of policy makers, plan members, and other interested parties to better compare administrative expenses between retirement plans as a result of the proposed legislation.

4. Appropriate Size of Retirement Plan Administrative Expenses. The policy issue is the size of the administrative expenses of the various statewide and major local retirement plans and the appropriateness of the trend of those expenses. The following compares five years of administrative expenses (FY 1999 to FY 2003) in total for the various statewide and major local retirement plans, as reported in the applicable actuarial valuations (Table 2) of the plans:

	FY1999	FY2000	Increase Over FY1999	FY2001	Increase Over FY2000	FY2002	Increase Over FY2001	FY2003	Increase Over FY2002
MSRS-General	2,555,000	3,701,000	+44.85%	3,738,000	+1.00%	3,942,000	+5.46%	4,191,000	+6.32%
PERA-General	9,631,000	8,329,000	-13.52%	8,344,000	+0.18%	8,680,000	+4.03%	8,628,000	-0.60%
TRA	7,977,000	8,138,000	+2.02%	13,078,000	+60.70%	12,912,000	-1.27%	13,158,000	+1.91%
DTRFA	358,000	401,000	+12.01%	420,000	+4.74%	448,000	+6.67%	445,000	-0.67%
MTRFA	532,000	587,000	+10.34%	672,000	+14.48%	711,000	+5.80%	804,000	+13.08%
SPTRFA	417,000	447,000	+7.19%	444,000	-0.67%	452,000	+1.80%	499,000	+10.40%
MERF	859,000	742,000	-13.62%	700,000	-5.66%	748,000	+6.86%	737,000	-1.47%
MSRS-Correctional	163,000	243,000	+49.08%	240,000	-1.23%	265,000	+10.42%	286,000	+7.92%
State Patrol	74,000	94,000	+27.02%	90,000	-4.26%	102,000	+13.33%	94,000	-7.84%
PERA-P&F	737,000	679,000	-7.87%	639,000	-5.89%	647,000	+1.25%	675,000	+4.33%
PERA-Correctional	0	111,000	--	130,000	+17.12%	137,000	+5.38%	149,000	+8.76%
Legislators	31,000	34,000	+9.68%	29,000	-14.71%	29,000	0.00%	0	--
Elected State Officers	5,000	2,000	-60.00%	1,000	-50.00%	1,000	0.00%	0	--
Judges	38,000	42,000	+10.53%	41,000	-2.38%	57,000	+39.02%	37,000	0.00%
Total	23,377,000	23,550,000	+0.74%	28,566,000	+21.30%	29,131,000	+1.98%	29,703,000	+1.96%

Over five years, pension plan administrative expenses have grown by about $7 million and now total almost $30 million per year. Virtually every retirement plan has had at least one year of an increase greater than ten percent during the period 1999-2003. It is unclear, during a period of nominal wage inflation and limited general inflation, why increases of these magnitudes have occurred. The Commission should consider taking testimony from the various retirement plan administrators about the recent trend in administrative expenses.