TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 434 (Betzold); H.F. 2113 (Smith) ; Clarification of Consulting Actuary Recommending Actuarial Equivalence Determination

DATE: March 28, 2005

Summary of S.F. 434 (Betzold); H.F. 2113 (Smith)

S.F. 434 (Betzold); H.F. 2113 (Smith) amends the definitions of "actuarial equivalent" in the statute chapters of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), the three first class city teacher retirement fund associations, the Minneapolis Employees Retirement Fund (MERF), and the Judges Retirement Plan, replacing references to the actuary retained by the Legislative Commission on Pensions and Retirement with references to the actuary retained jointly by the larger retirement plan administrators.

Background Information on the Provisions of Actuarial Services to the Legislature and the Various Retirement Plans

Since the creation of the Legislative Commission on Pensions and Retirement as an interim commission in 1955, the Commission has retained a consulting actuary to provide necessary actuarial consulting services. In 1955, the various retirement plans only had infrequent actuarial valuations or had no previous actuarial valuations at all and the retirement plans had unclear or irregular relationships with consulting actuarial firms.

For the period 1955-1984, the consulting actuary retained by the Commission functioned chiefly as the actuarial advisor to the Commission, presenting information on actuarial procedures, techniques and principles, recommending improvements in regulation or procedure of an actuarial nature and reviewing actuarial valuations, benefit increase actuarial cost estimates and experience studies for consistency, accuracy and conformance to sound actuarial technique.

Before 1965, actuarial valuations were irregular or infrequent and were frequently limited to total actuarial accrued liability calculations without actuarial contribution requirement determinations (e.g. Minnesota State Retirement System (MSRS) valuations in 1957, 1958, 1959, 1962, 1963, and 1964; Public Employees Retirement Association (PERA) valuations in 1955, 1958, and 1963; Teachers Retirement Association (TRA) valuations in 1958, 1959, and 1964). The first class city general employee retirement plans have been required by statute to prepare annual actuarial valuations only since 1969, with infrequent and sometimes incomplete actuarial valuations before 1969 (e.g. Minneapolis Employees Retirement Fund (MERF) 1958, 1967 and 1968; Duluth Teachers Retirement Fund Association (DTRFA) valuations in 1952 and 1955; Minneapolis Teachers Retirement Fund Association (MTRFA) valuations in 1957 and 1964; and St. Paul Teachers Retirement Fund Association (SPTRFA) valuations in 1958). The Commission, by a special law it recommended, first required the preparation of actuarial valuations by the various statewide retirement plans and their consulting actuaries in 1957. The 1957 special law was not explicit about the actuarial method or assumptions for the preparation of the actuarial valuations, allowing for considerable latitude in interpretation on the part of the retirement fund and its consulting actuary and producing results that were not considered fully appropriate by the 1957 Commission. In 1965, the Commission recommended and the Legislature enacted a statutory actuarial reporting law that specified numerous actuarial procedure elements to address the perceived deficiencies in the 1957 special law.

From 1965 to 1984, the various Minnesota public pension plans were required to have prepared annual actuarial valuations meeting the requirements of Minnesota Statutes, Section 356.215, and they retained consulting actuaries to perform these valuations (the statewide plans in 1965 and the first class city retirement plans in 1969). The consulting actuaries were required to be approved actuaries, meaning that the actuary had minimum credentials (fellowship in the Society of Actuaries) or had a minimum length of experience. The various public pension plans also were required to have prepared experience studies meeting the requirements of Minnesota Statutes, Section 356.215, every four years, covering the prior five year period, which task was also performed by the retained consulting actuaries. The consulting actuaries retained by the various public pension plans each operated under contract with the particular pension plan, with the contract's duration, specific requirements, and compensation unregulated by the Commission or state law.

In 1984, apparently in reaction to various irreconcilable actuarial cost estimates for the "Rule of 85" temporary normal retirement provision proposal supplied by the various actuaries of the various pension plans, and after the Commission apparently considered the possibility of the retention of an actuary as a member of the Commission staff, and with the concurrence of the state Department of Finance, the procedure for the provision of regular actuarial services for the statewide and major local pension plans was changed. Under Minnesota Statutes 1984, Section 3.85, Subdivision 11, the Commission was required to retain a consulting actuarial firm to provide annual actuarial valuations, periodic experience study and periodic benefit increase costing services related to the various statewide and major Minnesota public pension plans. The Commission was also required to establish standards for the preparation of any required actuarial work. The various public pension plans were permitted, but not required, to retain a consulting actuary for the review of the work of the Commission-retained actuary and for other actuarial services.

Following the 1984 Legislative Session, the Commission held a competitive bidding process to select its consulting actuarial firm. A five member (three House members, two Senate members) Commission subcommittee, chaired by Representative John Sarna, undertook the process. A Request for Proposal was prepared and was provided to 17 actuarial firms on July 30, 1984. Ten actuarial firms submitted proposals to the Commission subcommittee by the September 7, 1984 deadline date. The Commission subcommittee directed the Commission staff and actuary (then James Bordewick) to make the initial evaluation of the written proposals. Four finalists were selected to make in-person presentations to the Commission subcommittee, which occurred on November 8, 9 and 13, 1984. The four finalists were Milliman & Robertson, Inc., Peat, Marwick, Mitchell & Co., Towers, Perrin, Forster & Crosby, and The Wyatt Company. The Commission subcommittee recommended The Wyatt Company to the full Commission following evaluation of the in-person presentations and the Commission selected The Wyatt Company as the Commission retained actuary on a unanimous vote. On December 31, 1984, a contract for the provision of actuarial services between The Wyatt Company and the Commission was executed by Representative John Sarna and Mr. Allen Grosh. The contract provided for the development and updating of standards for actuarial work, the preparation of annual actuarial valuations, the preparation of annual cash flow projections and the provision of other consulting. Karen Dudley, the Commission Executive director, drafted the initial contract in 1984, with the assistance of Joel Michael of the House Research Department and John Asmussen of the Office of the Legislative Auditor. The contract was potentially effective for a three-year period if the arrangement was reaffirmed by the Commission during each of the second and third option years. The Commission exercised its option to continue the contract with The Wyatt Company for Fiscal Year 1987 and Fiscal Year 1988 respectively.

In 1987, as part of that year’s State Departments appropriation bill, the cost of the annual actuarial valuations and periodic experience studies, previously borne almost entirely by the Commission out of its budget, was assessed against the various retirement funds on the basis of proportional membership.

In 1988, the Commission considered the question of the contract for the provision of actuarial services in light of the expiration of the contract with The Wyatt Company on June 30, 1988 and the Commission approved a recommendation by Representative Wayne Simoneau that the contract with The Wyatt Company, due for expiration on June 30, 1988, be extended to June 30, 1990, with a substantial redrafting of the contract language and a resetting of some actuarial compensation rates as recommended by Representative Simoneau.

In 1990, after a controversy over the actuarial services fees charged by the Wyatt Company that was raised by Jim Hacking, the Executive Director of the Public Employees Retirement Association (PERA) and after a request from Representative Wayne Simoneau to the Legislative Audit Commission for an audit of the Wyatt Company’s contract with the Legislative Commission on Pensions and Retirement, the Commission rebid the actuarial services contract and the actuarial consulting firm of Milliman & Robertson, Inc., was retained by the Commission chosen from a group of seven bidders (four finalists). The actuarial services contract with Milliman & Robertson, Inc., was extended for one year in 1993 and in 1994, was renewed for two years after rebidding with one competitor in 1995, was extended for one year in 1997, was renewed for four years after rebidding without any other bidder competing in 1998, and was renewed for two years after rebidding with one competitor in 2002. In 2000 (Laws 200, Chapter 461, Article 1, Section 1), the method for computing the recoupment amount for the Legislative Commission on Pensions and Retirement from the various retirement plans, eliminating the 1988 formula based on system status, plan status, and relative membership size in favor of an allocation based on the actuarial firm’s records on the time spent on each plan’s valuation.

In 2002, an issue arose between Milliman USA, the renamed actuarial firm of Milliman & Robertson, Inc., and the Commission over liability limitations, third-party reliance on actuarial work, and mandatory dispute arbitration. The issue limited the 2002 contract with Milliman USA to the two years that

Milliman USA was willing to commit to without a positive resolution of the liability limitation and related issues. In 2004 (Laws 2004, Chapter 223), the actuarial services issues from 2002 and reductions in appropriations to the Commission resulted in the Executive committee of the Commission recommending and the Commission approving legislation, subsequently enacted, providing for a replacement of a consulting actuarial firm retained by the Commission by a consulting actuarial firm retained jointly by the seven largest retirement system administrators, acting jointly, with the ratification of the choice by the Commission. The joint retirement administrators retained The Segal Company as the consulting actuarial firm.

Discussion of S.F. 434 (Betzold); H.F. 2113 (Smith)

S.F. 434 (Betzold); H.F. 2113 (Smith) updates the various statutory definitions of the term "actuarial equivalent" for several retirement systems and plans, removing a reference to the actuary retained by the Legislative Commission on Pensions and Retirement and replacing that reference with a reference to the actuary retained by the joint retirement system administrators.

The proposed legislation raises several pension and related public policy issues that may merit Commission consideration and discussion, as follows:

1. Appropriateness of the Continued Delegation of Actuarial Equivalency Determinations to Plan Boards and Administrators. The policy issue is the appropriateness of delegating the responsibility of determining actuarial equivalency to the governing boards and the administrators of the various public pension plans. Minnesota public pension plans generally provide a single life annuity as their normal benefit form, and generally provide for the establishment of optional retirement annuity forms that are the actuarial equivalent of the normal form. The actuarial equivalence means that the optional retirement annuity form, frequently a joint and survivor retirement annuity covering two lives rather than one life, has the same actuarially determined present value as the single life annuity. Thus, if a retiree at age 65 has a single life annuity with an actuarial present value of $225,000, the joint and 100 percent survivor optional annuity form covering the retiree and a second person age 63 also should have an actuarial present value of $225,000, with an appropriate reduction in the amount of the annuity payable to each person to achieve that result. A mistake in determining actuarial equivalence will increase or decrease the actuarial accrued liability of the pension plan. The delegation at issue here occurs in the current statutory provisions authorizing optional annuity forms and the definitions of "actuarial equivalent" in the proposed legislation. Without diligence on the part of the pension plan governing boards and administrators and without periodic scrutiny and review by policymakers, the delegation has the potential for causing or intensifying pension plan funding difficulties. The primary check on the delegation is the professionalism and the expertise of the actuary designated to assist in the equivalency determination.

2. Adequacy of the Monitoring of the Accuracy of Actuarial Equivalence Determinations. The policy issue is the adequacy of the current mechanisms and practices of the monitoring of the accuracy of the actuarial equivalence determinations. The determinations depend, for their accuracy, on the reliability of the mortality tables of the pension plans and the interest rate actuarial assumptions, either approved by the Commission or set in statute with input from the consulting actuarial firm producing the "official" actuarial valuations of the plans. The role of the consulting actuary in the process depends on the expertise of the actuary and on the actuary's sense of loyalty and responsibility. The selection process for engaging the actuary, just completed by the Commission in July 2004, with the Commission ratification of the selection of The Segal Company by the plan administrators, should have resolved the issue of expertise. The question of sense of loyalty of the new actuary and the sense of responsibility that the new actuary will have remain to be determined.

3. Future Manner of Providing Actuarial Services. The policy issue is the question of the future manner in which actuarial services for the State of Minnesota and the various Minnesota public pension plans should be provided after the conclusion of the actuarial services contract with The Segal Company on June 30, 2007. Laws 2004, Chapter 223, is an experiment with delegating the responsibility for the selection of the consulting actuary and its outcome is not assured. Initially, in 1957-1959, the retirement plans selected the consulting actuary to perform the "official" actuarial work of the plans, before the qualifications of an "actuary" were fully established or set in statute, and little of the content of actuarial valuations or valuation procedures were regulated by the Commission. In 1965, the Commission standardized the qualifications for an actuary and the content and the significant procedures for preparing actuarial valuations, but left the selection of the "official" actuary to the various retirement plans. After irreconcilable differences arose in actuarial cost estimates for pending legislation in 1984 and the creation of a general sense of distrust of the plan-selected consulting actuaries within the Department of Finance over the period 1978-1984, the duty of selecting the

"official" actuary was delegated to the Legislative Commission on Pensions and Retirement. After an initial rocky period arising largely out of apparent reservations or resentments of the retirement plan administrators to the 1984 changes, the retention of a Commission-retained actuary became generally uneventful, although the Commission was not well-suited organizationally to undertake the bidding process at the end of a legislative session, the working relationship between the Commission and the retained actuary was distant and modest in scope, the emergence of liability limitation and related issues made the selection of a consulting actuary more difficult to undertake, and the steady reductions in the Commission budget over time would have required a choice between adequate actuarial work and adequate Commission staffing. Potentially, the 2004 procedure, with a consulting actuary retained jointly by the various retirement administrators and ratified by the Legislative Commission on Pensions and Retirement, will represent an adequate middle ground between the difficulties of the utilization of several pension plan-retained consulting actuaries that occurred before 1984 and the practical and budgetary problems of the operation of the Commission-retained actuary between 1984 and 2004.