**S.F. xxx****H.F. 2577**

(Mullery)

Executive Summary of Commission Staff Materials

<i>Affected Pension Plan(s):</i>	Minneapolis Police Relief Association
<i>Relevant Provisions of Law:</i>	Minnesota Statutes, Chapter 423B
<i>General Nature of Proposal:</i>	Board Salary Increases, Short-Service Retiree Benefit Increases, Junk Bond Investment Authority
<i>Date of Summary:</i>	February 9, 2006

Specific Proposed Changes

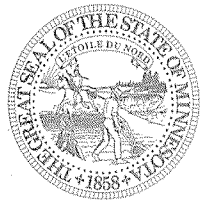
- Modification of eventual trust fund administration.
- Increases Minneapolis Police Relief Association board salaries.
- Provides service pension increase to active and retired members with less than 20 years' service credit.
- Allows Minneapolis Police Relief Association junk bond investments.

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of proposed trust fund management and administration changes.
2. Appropriateness of the proposed increase in the Minneapolis Police Relief Association board president salary.
3. Appropriateness of the proposed increase in Minneapolis Police Relief Association board member salaries.
4. Appropriate portion of Minneapolis Police Relief Association administration expenses attributable to board salaries.
5. Appropriateness of the current practice of funding Minneapolis Police Relief Association administrative expenses as additional unfunded actuarial accrued liability
6. Appropriateness of a continued separate plan administration for the Minneapolis Police Relief Association.
7. Appropriateness of providing a benefit increase for short-service retirees and active members.
8. Actuarial condition of the Minneapolis Police Relief Association; cost of benefit increase.
9. Appropriateness of the proposed benefit increase retroactivity.
10. Appropriateness of authoring junk bond investments
11. Appropriateness of the past poor investment returns by the Minneapolis Police Relief Association.
12. Unclear municipal support.

Potential Amendments

No Commission staff amendments.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director *JAM*

RE: S.F. xxx; H.F. 2577 (Mullery): Minneapolis Police; Various Benefit, Administrative, and Investment Changes

DATE: February 8, 2006

Summary of S.F. xxx; H.F. 2577 (Mullery)

S.F. xxx; H.F. 2577 (Mullery) amends various provisions of Minnesota Statutes, Chapter 423B, the governing law for the Minneapolis Police Relief Association, by making the following changes upon local approval by the City of Minneapolis:

1. Modification of Eventual Trust Fund Administration. Minnesota Statutes, Section 423B.05, Subdivision 3, relating to the eventual conversion of the Minneapolis Police Relief Association board into a city-administered trust fund, is modified to provide that the eventual trust fund board continues to exercise the same authority as the pre-trust fund board, that Minnesota Statutes, Chapter 423B, prevails in trust fund operation over Minnesota Statutes, Section 423A.01, Subdivision 2, governing phasing-out a local relief association, and that the trust members have complete latitude in the selection of the trust fund board (Section 1);
2. Increases Minneapolis Police Relief Association Board Salaries. Minnesota Statutes, Section 423B.07, governing the authorized disbursements from the Minneapolis Police Relief Association, is modified to increase the salary of the board president from three units to seven units and to increase salaries for all other board members from three units to five units (Section 2);
3. Provides Service Pension Increase to Active and Retired Members With Less Than 20 Years' Service Credit. Minnesota Statutes, Section 423B.09, Subdivision 1, governing the Minneapolis Police Relief Association service pension accounts, is amended to provide a one-half unit increase to active members and retired members with less than 20 years of service, applicable for calendar year 2005, and a one-unit increase to active members and retired members with less than 20 years of service, retroactive to January 1, 2006 (Section 3); and
4. Allows Minneapolis Police Relief Association Junk Bond Investments. Minnesota Statutes, Section 423B.23, is added, authorizing the Minneapolis Police Relief Association to invest up to five percent of its assets in below-investment-grade debt securities (Section 4).

Background Information on the Minneapolis Police Relief Association

Background information on the establishment and operation of, the nature of the benefit plan and retirement coverage of, the actuarial and financial reporting by, and the funding problems of the Minneapolis Police Relief Association is presented in Attachment A.

Background Information on the Development of Local Public Safety Relief Associations, Their Phase - Out, and Their Consolidation With PERA-P&F

Background information on the development of local police and paid firefighter relief associations, their phase-out by special law or 1980 statute, and the consolidation of most of the local relief associations into the Public Employees Police and Fire Plan (PERA-P&F) is presented in Attachment B.

Background Information on Local Police or Fire Relief Association Authorized Administrative Expenses

Background information on the administrative expenses authorized for payment by a local police or firefighter relief association is set forth in Attachment C.

Background Information on the 2005 Minneapolis Police Relief Association Legislative Changes

Background information on the benefit and funding changes approved by the Legislature in 2005 for the Minneapolis Police Relief Association is set forth in Attachment D.

Background Information on Authorized Public Pension Plan Investments and Investment Performance

Background information on the investment securities authorized for major Minnesota public pension plans, investment performance reporting, and actual Minnesota public pension plan investment performance 1990-2004 is set forth in Attachment E.

Discussion and Analysis

S.F. xxx; H.F. 2577 (Mullery) increases the authority of the trust fund board of trustees when the Minneapolis Police Relief Association becomes a city-administered trust fund upon dropping to a membership of 225, substantially increases the salary payable to the Minneapolis Police Relief Association board president, increases salaries for other Minneapolis Police Relief Association board members, increases retroactively to January 1, 2005, the service pensions of Minneapolis Police Relief Association retirees and active members with less than 20 years of service credit, and permits the Minneapolis Police Relief Association to invest up to five percent of assets in junk bonds.

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

1. Appropriateness of Proposed Trust Fund Management and Administration Changes. The policy issue is the appropriateness of the changes in the authority and selection of the governing board for an eventual Minneapolis police retirement trust fund when the plan membership drops to 225. In 1980, when the remaining local police and paid fire relief associations were placed on a phase-out basis by State legislation, the question of the future governance of the residual relief association affairs as it wound down was addressed, with a shift to a city-administered trust fund and a benefit recipient-selected board provided under Minnesota Statutes, Section 423A.01, Subdivision 2, Clause (2). The proposed legislation appears to attempt to retain a trust fund board of greater than five members, to eliminate city selection of additional trustees when there are less than five competent benefit recipients remaining, to eliminate city ratification of elected trustees, and to continue the compensation of trust fund board members. The Minneapolis Police Relief Association had 939 members as of December 2004, and does not convert to a city-administered trust fund until that membership number drops to 225 under 2005 legislation (see First Special Session Laws 2005, Chapter 8, Article 11, Section 9). Arguments over the proper manner for operating the Minneapolis Police Relief Association in its winding-down years at a time when that changeover is at least a decade or two away is premature. There has been apparent distrust and animosity to the point of current litigation between the Minneapolis Police Relief Association and the City of Minneapolis, which is likely reflected in this proposed change, which should be resolved before the Legislature becomes involved in the dispute.
2. Appropriateness of the Proposed Increase in the Minneapolis Police Relief Association Board President Salary. The policy issue is the appropriateness of a 133.33 percent increase in the salary of the Minneapolis Police Relief Association board president. The proposed legislation increases the board president's salary from three units (\$258.06 per month) to seven units (\$602.14 per month). When the Minneapolis Police Relief Association special laws were recodified as Minnesota Statutes, Chapter 423B, in 1990, the salary of the board president was set at ten percent of the salary of a first-grade patrol officer. The salary was reset to three units in 1999 (see Laws 1999, Chapter 222, Article 6, Section 1). The salary is now proposed for a substantial increase, although it is unclear what change in the board president's duties or responsibilities have occurred since 1999 to justify a salary increase of this magnitude.
3. Appropriateness of the Proposed Increase in Minneapolis Police Relief Association Board Member Salaries. The policy issue is the appropriateness of a 66.67 percent increase in the salaries payable to Minneapolis Police Relief Association board members other than the Minneapolis Police Relief Association board president. The increase would be from \$258.06 per month to \$430.10 per month. It is unclear what increase in duties or responsibilities the Minneapolis Police Relief Association board has experienced to justify the compensation increase. Given that Minneapolis Police Relief Association board position elections always seem to be contested, with two or more candidates, it is unlikely that the compensation is needed to recruit potential board members, which is an argument sometimes forwarded for board compensation or compensation increases.
4. Appropriate Portion of Minneapolis Police Relief Association Administration Expenses Attributable to Board Salaries. The policy issue is the appropriate portion of the administrative expenses of the Minneapolis Police Relief Association that should be consumed by board of trustee salaries. The Minneapolis Police Relief Association annual financial report provides no allocation of the component

parts of fund administration expenses, potentially to avoid scrutiny over various portions of the administrative expense total, so it is impossible to determine whether or not the current level of Minneapolis Police Relief Association board salaries are appropriate currently or to compare the portion of total administrative expenses attributable to board salaries between the Minneapolis Police Relief Association and the Minneapolis Firefighters Relief Association or other Minnesota public pension plans. If the Minneapolis Police Relief Association board did an outstanding job investing fund assets (see issue #11), it would be easier to justify increased board salaries on a value-added basis or, perhaps, to base board salaries in whole or in part on investment performance in excess of the State Board of Investment.

5. Appropriateness of the Current Practice of Funding Minneapolis Police Relief Association Administrative Expenses as Additional Unfunded Actuarial Accrued Liability. The policy issue is the appropriateness of continuing the Minneapolis Police Relief Association practice of not including the fund administrative expenses in the annual financial requirements of the relief association under Minnesota Statutes, Section 69.77, but effectively adding these expenses to the unfunded actuarial accrued liability of the relief association. Administrative expenses were made part of the relief association annual funding requirement in 1987 (see Laws 1987, Chapter 259, Section 6), but these expenses were removed from the Minneapolis Police Relief Association and Minneapolis Firefighters Relief Association annual funding requirements in 1989 (see Laws 1989, Chapter 319, Article 19, Section 3) as part of the “thirteenth check” post-retirement adjustment legislation. Administrative expenses are really recurring costs of having a pension plan and should be funded in the year in which they are incurred rather than simply added to the accrued liability of the plan.
6. Appropriateness of a Continued Separate Plan Administration for the Minneapolis Police Relief Association. The policy issue is the appropriateness of retaining a separate plan administration for the Minneapolis Police Relief Association. Three of the four Minneapolis public pension plans have been closed to new entrants for more than 25 years, having steadily declining numbers of active members. At some point, arguably, a pension plan becomes too small in size, has shifted sufficient functions to outside contractors, and is too expensive in administrative costs to justify a continuation as a separate plan administration. If the Minneapolis Police Relief Association has reached that point in the opinion of the Commission, there are at least three options that could be considered for reorganizing the Minneapolis Police Relief Association administration. These options are:
 - a. Administration by PERA. The Minneapolis Police Relief Association board either could be authorized to contract with PERA for the provision of plan administrative services for the Minneapolis Police Relief Association or PERA could be mandated to administer the Minneapolis Police Relief Association.
 - b. Combine Minneapolis Pension Plan Administrations. The plan administrations of some or all of Minneapolis’ pension plans could be combined into a single plan administration.
 - c. Immediately Convert the Minneapolis Police Relief Association to a Trust Fund Administered by the City. The Minneapolis Police Relief Association could be converted to a trust fund to be administered by the City of Minneapolis, akin to the situation of the former Eveleth Police Relief Association, the former Eveleth Fire Department Relief Association, and the former Thief River Falls Police Relief Association.
7. Appropriateness of Providing a Benefit Increase for Short-Service Retirees and Active Members. The policy issue is the appropriateness of providing the 2005 benefit increase to members who have less than 20 years of service. The 2005 benefit increase (see First Special Session Laws 2005, Chapter 8, Article 11, Section 10) clearly applied only to members with 20 years of service credit, which is the minimum threshold of a normal working career for a Minneapolis police officer. Former Minneapolis police officers with less than 20 years of service credit have another employer, and presumably, other pension coverage, for some portion of their total working career, and the obligation of the pension plan to provide an adequate benefit to these partial career employees is less onerous than for “full” career employees. It is unclear that the current “partial” career Minneapolis Police Relief Association member benefits are inadequate and need improvement at this time.
8. Actuarial Condition of the Minneapolis Police Relief Association; Cost of Benefit Increase. The policy issue is the actuarial condition of the Minneapolis Police Relief Association and the actuarial cost of the proposed benefit increase. The current (12/31/2004) actuarial condition of the Minneapolis Police Relief Association is as follows:

**Minneapolis Police Relief Association
2004**

<u>Membership</u>		
Active Members		18
Service Retirees		678
Disabilitants		0
Survivors		243
Deferred Retirees		0
Nonvested Former Members		<u>0</u>
Total Membership		939
<u>Funded Status</u>		
Accrued Liability		\$455,753,045
Current Assets		<u>\$322,278,156</u>
Unfunded Accrued Liability		\$133,474,889
Funding Ratio	70.71%	
<u>Financing Requirements</u>		
Covered Payroll		\$1,429,255
Benefits Payable		\$33,527,589
Normal Cost	18.50%	\$264,361
Administrative Expenses	<u>0.00%</u>	<u>--</u>
Normal Cost & Expense	18.50%	\$264,361
Normal Cost & Expense	18.50%	\$264,361
Amortization	<u>2091.50%</u>	<u>\$29,892,885</u>
Total Requirements	2110.00%	\$30,157,246
Employee Contributions	0.00%	\$0
Employer Contributions	1951.33%	\$27,889,552
Employer Add'l Cont.	--	--
Direct State Funding	--	--
Other Govt. Funding	--	--
Administrative Assessment	<u>--</u>	<u>--</u>
Total Contributions	1951.33%	\$27,889,552
Total Requirements	2110.00%	\$30,157,246
Total Contributions	<u>1951.33%</u>	<u>\$27,889,552</u>
Deficiency (Surplus)	158.67%	\$2,267,694
Amortization Target Date	2010	
Actuary	Van Iwaarden	

The Minneapolis Police Relief Association has not provided the Commission staff with an actuarial cost estimate of the proposed benefit increase.

9. Appropriateness of the Proposed Benefit Increase Retroactivity. The policy issue is the appropriateness of making the proposed short-service pension increase retroactive to January 1, 2005. If the benefit increase is needed because the prior benefit was inadequate and if the failure to enact it in 2005 was on oversight, then retroactivity is arguably justified. If the retroactivity is simply intended to placate a group of retirees who are demanding inclusion in a past benefit increase, the retroactivity is less justifiable.
10. Appropriateness of Authoring Junk Bond Investments. The policy issue is whether or not the authorization and use of below-investment grade debt securities, otherwise known as "junk bonds," is appropriate for the Minneapolis Police Relief Association. When the State Board of Investment requested junk bond authority in the early 1990s, the issue was controversial, especially in the House of Representatives, and the authorization was intended to be limited to the State Board of Investment and not extended to all other Minnesota public pension plans, prompting the substantial number of provisions added to Minnesota Statutes, Section 356A.06, Subdivision 7. While junk bonds arguably may have a place in an overall portfolio assembled by a sophisticated investor, the Minneapolis Police Relief Association has demonstrated in the past that it is not a sophisticated investor and, consequently, that it should not be given the authority. If the Minneapolis Police Relief Association could match the returns of the State Board of Investment based on its own endeavors, the addition of a

small amount of junk bonds could marginally improve returns, but with a comparable increase in the risk of a potential bankruptcy/payment default by the applicable debtor.

11. Appropriateness of the Past Poor Investment Returns by the Minneapolis Police Relief Association. The policy issue is the appropriateness of the Minneapolis Police Relief Association in asking for additional investment authority when the plan cannot equal or exceed the returns of the State Board of Investment and elects not to utilize its existing authority to commit assets to the State Board of Investment. Attachment E covers the investment performance of the Minneapolis Police Relief Association for the period 1990 to 2004, which indicates results for the Minneapolis Police Relief Association that were not particularly favorable. The overall economics of the period had both a bull market and a bear market, so the plan cannot argue that the results are limited to a broader economic downturn solely. If the past Minneapolis Police Relief Association investment performance results trouble the Commission, the Commission may wish to pursue legislation that mandates Minneapolis Police Relief Association to invest with the State Board of Investment.
12. Unclear Municipal Support. The policy issue is the appropriateness of the Commission considering this proposed legislation without a clear indication of formal support for the proposed legislation by the City of Minneapolis. Since the proposed legislation requires local approval to become effective, the proposed changes will only be made if the City supports the legislation. Without a resolution from the Minneapolis City Council supporting the legislation, the time of the Commission that is spent on this bill could be a waste of valuable Commission effort and resources.

Attachment A

Background Information on the Minneapolis Police Relief Association

- a. Relief Association Establishment and Operation. The Minneapolis Firefighters Relief Association was established as an organization in 1868, initially to provide relief to disabled firefighters and to their families, when the Minneapolis Firefighters was a volunteer fire department, and was incorporated under Minnesota law in 1886, after the Minneapolis Fire Department became a paid fire department, in 1879. The Minneapolis Firefighters Relief Association began paying service pensions to retiring firefighters in 1897. Membership in the Minneapolis Firefighters Relief Association was closed to new firefighters as of June 15, 1980, when pension coverage for newly hired Minneapolis firefighters shifted to the statewide Public Employees Police and Fire Plan (PERA-P&F).

The Minneapolis Police Relief Association is managed by a governing board of nine members, of which seven are elected by the relief association membership and two are representatives of the City of Minneapolis. In addition to maintaining records and determining benefit amounts, the Minneapolis Police Relief Association governing board is the investment authority for the assets of the special (pension) funds of the relief association.

In calendar year 2004, the Minneapolis Police Relief Association received total contributions of \$27.9 million (74.6 percent from the city and 25.4 percent from the State), received net investment income of \$30.8 million, paid total retirement benefits of \$32.8 million, and paid administrative expenses of \$770,000 (for which the relief association provided no itemization in its annual financial report).

- b. Nature of the Benefit Plan; Benefit Coverage. The Minneapolis Police Relief Association provides from its special fund a salary-related service pension to police officers retiring at age 50 or older with at least five years of service, a disability benefit to temporarily or permanently disabled police officers, a survivor benefit to the surviving family of a deceased active, retired, or disabled police officer, and a return of contributions to the estate of deceased active, retired, or disabled police officers on whose behalf no survivor benefit is payable. Pensions and benefits are based on the salary of a top grade police officer, irrespective of the actual rank of the police officer, and these pensions and benefits increase after retirement as the salary of a top grade police officer increases (the “escalator” post-retirement adjustment mechanism) and also increase based on the investment performance of the special fund (the “thirteenth check” post retirement adjustment). Under Laws 1997, Chapter 233, Article 4, a joint-and-survivor optional annuity form can be elected in lieu of the automatic survivorship coverage otherwise provided by the fund.

Since 1992 (Laws 1992, Chapter 471, Article 1, Section 14), the contributions by any member (eight percent of the pay of a top-grade police officer) who has 25 or more years of service are not deposited in the special fund; but rather, the contribution is deposited in a health insurance account set up for the member. After retirement, in addition to the pension benefit paid from the association’s special fund, the retiree receives distributions from the health insurance account, which the retiree can use toward health care costs or other expenses of the retiree.

When a Minneapolis police officer retires and begins drawing a service pension from the association’s special fund, those benefits are eligible for increases annually through three different post-retirement increase mechanisms. Individually and as a package, these adjustment provisions are poorly designed and can produce increases which bear no relationship to inflation, and can produce erratic changes in the benefits over time. The mechanisms are:

1. Active Salary-Related Escalator. The first post-retirement adjustment is a standard escalator tied to increases in the salary of a top-grade police officer. This escalator increases retirement benefits by the same percentage increase as the percentage increase in top-grade police officer pay negotiated between the City and the Minneapolis Police Federation.
2. 13th Check Adjustment. A second increase provision is based on the investment performance of the special fund of the relief association, and is referred to as the 13th check post-retirement adjustment. The 13th check post-retirement adjustment was enacted in 1989.
3. Additional Post-Retirement Adjustment. A third post-retirement increase mechanism was added to law in 2000 (Laws 2000, Chapter 461, Article 17). If the funding ratio (percentage of plan pension liabilities covered by plan assets) of the relief association exceeds 110 percent, the

association is authorized to distribute a portion of the funding in excess of 110 percent of its liabilities to its benefit recipients.

- c. Actuarial and Financial Reporting. The Minneapolis Police Relief Association is required to prepare actuarial reporting under Minnesota Statutes, Sections 69.77, 356.215, 356.216, and 423B.15. The relief association is required to make financial reports under Minnesota Statutes, Sections 69.051 and 356.20.

Minnesota Statutes, Section 69.77, initially enacted in 1969 (Laws 1969, Chapter 223), and amended periodically thereafter, requires municipalities to fund their local relief associations on an actuarial basis. The basic provisions of the 1969 Local Police and Salaried Firefighters Relief Associations Financial Guidelines Act are as follows:

1. Each member of a local association is required to contribute at least eight percent of the salary used for calculating retirement benefits, with the contribution to be made by salary deduction.
2. The financial requirements of the associations must be calculated annually based on the most recent actuarial valuation. The financial requirements are to include normal cost and amortization of the unfunded accrued liability by the year 2010. The minimum obligation of the municipality to be raised by taxes each year is the financial requirements of the association, less member contribution amounts received under the police or fire state aid program, and amounts received under the local police and salaried firefighter relief associations' amortization aid programs for that year.
3. The levy required to meet the municipality's minimum obligation is outside statutory or charter levy limitations.
4. If a municipality fails to include an amount sufficient to meet the minimum obligation to the association, the relief association has the authority to certify the amount required to the county auditor for inclusion in the municipality's tax levy.
5. Investments of local associations must be in securities which are authorized investments under Minnesota Statutes, Chapter 356A.
6. Local associations are authorized to contract with outside investment advisors and are authorized to certify funds for investment by the State Board of Investment in the Minnesota Supplemental Investment Fund.
7. Actuarial valuations must be filed by the association with the State Auditor, the Legislative Commission on Pensions and Retirement, the Legislative Reference Library, and the municipality.
8. All articles of incorporation or bylaw amendments affecting benefits for a local relief association must be ratified by the municipality prior to becoming effective.
9. The penalty for a violation of the act is to make the transfer of funds received under the various state aid programs or the levying of taxes by the municipality unlawful.

Minnesota Statutes, Sections 356.215 and 356.215, require the preparation of actuarial valuations under the entry age normal cost actuarial method, using specified interest and salary rate actuarial assumptions, and calculating the actuarial requirements based on a specified amortization target date. Minnesota Statutes, Section 423C.15, provides for an adjustment to the city normal cost contribution, suspends city normal cost contributions in certain instances, provides 15-year amortization periods for actuarial losses after 2001, and limits the amortization target date revisions to the end of the average life expectancy of the relief association membership.

Minnesota Statutes, Section 69.051, a portion of the police state aid program, requires the preparation of a financial report and audit for qualification for police state aid, with the report filed with the State Auditor and with the Legislative Commission on Pensions and Retirement. Minnesota Statutes, Section 356.20, requires annual financial reporting by various Minnesota public pension plans, but grandparents financial reporting under Minnesota Statutes, Section 69.051, by local fire and police relief associations.

- d. Minneapolis Police Relief Association Funding Problems. Although not as poorly funded as the Minneapolis Firefighters Relief Association in the 1960s, the Minneapolis Police Relief Association

was a poorly funded retirement plan historically, with a funding ratio (assets divided by accrued liability) of two percent in 1967, of almost 11 percent in 1972, and of just under 29 percent in 1982. Akin to the Minneapolis Firefighters Relief Association, the Minneapolis Police Relief Association was funded on a current disbursements/pay-as-you-go basis for almost a century, which greatly contributed to its general poor funding situation in the 1960s. As occurred with the Minneapolis Firefighters Relief Association, actuarial funding was phased in for the Minneapolis Police Relief Association in 1969 under the Local Police and Paid Fire Relief Associations Guidelines Act and the 1969 legislation caused the improved funding ratios in the 1970s. In 1980, the Minneapolis Police Relief Association was closed to new active members, a requirement to amortize the unfunded actuarial accrued liability by 2010 was added, and an amortization state aid program was created, with the Minneapolis Police Relief Association receiving about one-sixth of the \$6.5 million annual aid amount.

The 1969 and 1980 actuarial funding requirements, the addition of direct state aid programs in 1980, 1984, and 1996, combined with the periodically strong investment markets since 1980, have produced consistently improving funded ratios during the period 1982 to 1999, with the Minneapolis Police Relief Association becoming 50 percent funded in 1986, 75 percent funded in 1990, and 95 percent funded in 1999. The improved funding condition of the Minneapolis Police Relief Association over the period 1982-1999 caused the employer requirement to drop from a high of \$15 million in 1985 to a low of \$3.5 million in 1999. Various circumstances caused an erosion in the Minneapolis Police Relief Association funded ratio since 1999, with a 2003 funded ratio of 65 percent. The circumstances causing the funded ratio to erode were the cumulative effect of various benefit increases, general investment underperformance, a significant loss in the relief association's large venture capital investment in Technomar, a board-driven redefinition of the salary level on which benefits are based, and the recent investment market decline. The funded ratio erosion has caused the employer contribution requirement to increase to \$32 million annually. The actuary for the Minneapolis Police Relief Association is currently recommending a strengthening of the post-retirement mortality assumption which, if approved by the Legislative Commission on Pensions and Retirement, will increase the actuarial accrued liability and unfunded actuarial accrued liability of the plan, will further reduce the plan's funded ratio, and will increase the employer contribution requirement.

Between 1982 and 2004, the Minneapolis Police Relief Association has received \$43 million in special direct pension-related aids, or 26.42 percent of the unfunded actuarial accrued liability of the plan in 1982. Combined with \$57.1 million in police state aid since 1982, payable in whole or in part to the Minneapolis Police Relief Association, the State has funded 61.5 percent of the 1982 Minneapolis Police Relief Association unfunded actuarial accrued liability.

Since 1969, when the Minneapolis Police Relief Association was first required to begin being funded on an actuarial basis, the Minneapolis Police Relief Association has sought and received numerous benefit increases, including a service pension and disability benefit change in 1969 (Laws 1969, Chapter 560), a medical insurance authorization in 1975 (Laws 1975, Chapter 428), the addition of a health and welfare benefit in 1980 (Laws 1980, Chapter 607, Article XV), a service pension vesting change in 1987 (Laws 1987, Chapter 372, Article 2), the addition of a second post-retirement adjustment in 1989 (Laws 1989, Chapter 319, Article 19), a survivor benefit change and the addition of a health insurance benefit in 1990 (Laws 1990, Chapter 589, Article 1), a survivor benefit change in 1993 (Laws 1993, Chapter 124), a survivor benefit change in 1994 (Laws 1994, Chapter 590), the addition of optional survivor benefit forms and a post-retirement adjustment change in 1997 (Laws 1997, Chapter 233, Article 4), and the addition of a third post-retirement adjustment in 2000 (Laws 2000, Chapter 461, Article 17). The Minneapolis City Council approved all of these benefit increases and the benefit increases increased the Minneapolis Police Relief Association actuarial accrued liability. Additionally, in 1994, without legislative action and without city approval, the Minneapolis Police Relief Association board of trustees unilaterally redefined the salary of a top grade patrol officer, on which benefit amounts are based, to include additional compensation items (i.e. overtime pay, shift differentials, dog handler compensation, etc.). The 1994 salary redefinition produced an increase in the Minneapolis Police Relief Association actuarial accrued liability and unfunded actuarial accrued liability.

During the period 1987-2004, the Minneapolis Police Relief Association also declined to consolidate with the Public Employees Police and Fire Plan (PERA-P&F) under Minnesota Statutes, Chapter 353A, as 44 other local police and paid firefighter relief associations did. The general thrust of the post-1987 benefit changes appears to have been to dissuade the Minneapolis Police Relief Association membership from pursuing a potential consolidation with PERA-P&F.

Attachment B

Development of the Statutes Governing Local Police and Paid Firefighter Relief Associations

a. Development of the Statutes Governing Local Police and Paid Firefighter Relief Associations. In Minnesota, the first statewide retirement plan for local government public safety employees, the Public Employees Police and Fire Retirement Plan (PERA-P&F), was not established until 1959 (Laws 1959, Chapter 650). For police officers and paid firefighters employed before the creation of PERA-P&F in 1959 either had retirement coverage by a local police or paid firefighter relief association, typically in larger cities, or had retirement coverage by the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General).

In total, 59 local police and paid firefighter relief associations were established in 35 municipalities. Of the 59, one provided supplemental retirement coverage and the balance provided primary retirement coverage. Of the total, 27 relief associations were established before World War II, while 32 relief associations were created during or after World War II. The following compares the establishment decades of the 23 paid firefighters relief associations and the 36 police relief associations:

Decade	Paid Firefighter Relief Associations		Police Relief Associations		Total Relief Associations	
pre-1880s	1	(4.35%)	0	(0.00)	1	(1.69)
1880s	3	(13.04)	0	(0.00)	3	(5.08)
1890s	5	(21.73)	1	(2.78)	6	(10.16)
1900s	4	(17.39)	2	(5.56)	6	(10.16)
1910s	1	(4.35)	1	(2.78)	2	(3.39)
1920s	1	(4.35)	0	(0.00)	1	(1.69)
1930s	2	(8.70)	6	(16.67)	8	(13.56)
1940s	6	(26.10)	13	(36.11)	19	(32.20)
1950s	2	(8.70)	4	(11.11)	6	(10.16)
1960s	0	(0.00)	6	(16.67)	6	(10.16)

Appendix A sets forth the specific establishment dates for the 59 local police and paid firefighter relief associations.

The 59 local police and paid firefighter relief associations differed in the manner in which their governing law or laws were enacted, with some relief associations governed almost entirely by general statute, some relief associations governed primarily by local or special laws, and some relief associations governed almost entirely by local or special laws. The following compares the extent of general statute on local law involvement in specifying the benefit plan of the relief association:

Relief Association Governed Minimally By Local Law	Relief Associations Governed Primarily By Local Law	Relief Associations Governed Almost Wholly By Local Law
Albert Lea Police	Austin Police	Albert Lea Fire
Anoka Police	Bloomington Fire	Austin Fire
Brainerd Police	Bloomington Police	Brooklyn Center Police
Crystal Police	Buhl Police	Chisholm Fire
Duluth Fire	Columbia Heights Police	Chisholm Police
Faribault Police	Crookston Police	Cloquet Fire
Fridley Fire	Eveleth Police	Columbia Heights Fire
Fridley Police	Fairmont Police	Crookston Fire
New Ulm Police	Mankato Police	Duluth Police
Red Wing Police	Minneapolis Fire	Eveleth Fire
St. Louis Park Fire	Moorhead Police	Faribault Fire
South St. Paul Police	Richfield Fire	Gilbert Police
West St. Paul Police	Richfield Police	Hibbing Fire
	Rochester Police	Hibbing Police
	St. Louis Park Police	Mankato Fire
	St. Paul Fire	Minneapolis Police
	Thief River Falls Police	Moorhead Fire
	Virginia Police	Nashwauk Police
	Winona Police	Red Wing Fire
		Rochester Fire
		St. Cloud Fire
		St. Cloud Police
		St. Paul Police
		South St. Paul Fire
		Virginia Fire
		West St. Paul Fire
		Winona Fire

b. Phase-Out of Local Police and Paid Fire Relief Associations. The role and function of local police and paid firefighter relief associations began to change in the late 1960s. In 1958, the Legislative Commission on Pensions and Retirement collected actuarial work from the various local police and paid firefighter relief associations, but did not again collect actuarial work from those plans until 1965. Those 1965 actuarial valuations showed continuing actuarial problems among those public safety pension plans, as follows:

	Police			Fire		
	1/1/1958	1/1/1965	Difference	1/1/1958	1/1/1965	Difference
Accrued Liability	\$40,733,876	\$64,506,665	+\$23,772,789	\$43,347,780	\$59,782,444	+\$16,434,664
Assets	<u>3,128,230</u>	<u>5,018,3000</u>	+ 1,890,070	<u>2,612,185</u>	<u>3,812,842</u>	+ 1,200,657
Unf. Accr. Liab.	\$37,605,646	\$59,486,355	+\$21,892,719	\$40,735,595	\$56,976,848	+\$16,241,253
Funding Ratio	7.68%	7.78%	+0.10%	6.03%	6.38%	+0.35%
Covered Pay	\$8,587,851	\$13,133,000	+\$4,545,149	\$8,113,050	\$11,196,624	+\$3,083,574
Normal Cost	17.5% \$1,502,874	16.1% \$2,114,414	+\$611,540	13.9% \$1,127,714	14.1% \$1,578,724	+\$451,010
Amortization	19.2% <u>1,648,867</u>	21.9% <u>2,876,128</u>	+1,197,261	21.6% <u>1,752,418</u>	24.5% <u>2,743,173</u>	+ 990,755
Total Fin. Req.	36.7% \$3,151,741	38.0% \$4,990,542	+1,808,801	35.5% \$2,880,132	38.6% \$4,321,897	+1,441,765
Total Fin. Req.	36.7% \$3,151,741	38.0% \$4,990,542	+1,808,801	35.5% \$2,880,132	38.6% \$4,321,897	+1,441,765
Total Support	18.3% <u>1,576,048</u>	18.4% <u>2,424,298</u>	+ 848,250	20.6% <u>1,678,360</u>	24.3% <u>2,717,560</u>	+1,039,200
Deficiency	18.4% \$1,575,693	19.6% \$2,566,244	+\$960,551	14.9% \$1,201,772	14.3% \$1,604,337	+402,565

The funding problems of the local police and paid firefighter relief associations revealed in the 1958 and 1965 actuarial valuations prompted the Commission to make the structure and funding of public safety employee pension coverage a major issue for the next decade and a half. In 1959, a statewide public safety employee retirement plan was created within PERA for police officers and paid firefighters employed by cities that did not have local relief associations. In 1969, after much debate, the Commission developed the Local Police and Paid Firefighters Relief Association Financing Guidelines Act, coded as Minnesota Statutes, Section 69.71, which imposed actuarial funding requirements on relief associations and the applicable municipalities to replace the prior current disbursements (or “pay-as-you-go”) funding arrangement. The Guidelines Act phased-in a funding requirement of normal cost and interest on the unfunded actuarial accrued liability (“frozen” unfunded accrued liability rather than amortized unfunded accrued liability) over a ten-year period (1970-1980, except for Minneapolis, which interpreted the phase-in period as 1971-1981).

The initial phase-out of a local police or paid firefighter relief association occurred in 1969, with the phase-out of the Nashwauk Police Relief Association, and in 1971, with the phase-out of the Mankato Police Relief Association and of the Mankato Fire Department Relief Association. A relief association phased out by closing its benefit plan to new active members (i.e. newly employed personnel) after a specified date. The following summarizes the various special law local relief association phase-outs:

Year	Relief Association
1969	Nashwauk Police Relief Association
1971	Mankato Fire Department Relief Association
	Mankato Police Relief Association
1973	Anoka Police Relief Association
	Chisholm Firefighters Relief Association
	Chisholm Police Relief Association
	Cloquet Fire Department Relief Association (Consolidation)
	Fridley Fire Department Relief Association
	Gilbert Police Supplemental Retirement Plan
	Red Wing Fire Department Relief Association
	Red Wing Police Relief Association
	St. Cloud Police Relief Association
1974	New Ulm Police Relief Association
	St. Cloud Fire Department Relief Association
	Virginia Fire Department Relief Association
1975	Columbia Heights Fire Department Relief Association
1976	Austin Fire Department Relief Association
	Austin Police Relief Association
	Buhl Police Relief Association
1977	Columbia Heights Police Relief Association
	Eveleth Fire Department Relief Association (Partial Consolidation)
	Eveleth Police Relief Association (Partial Consolidation)
	Fairmont Police Relief Association
	Fridley Police Relief Association

<u>Year</u>	<u>Relief Association</u>
1978	Brooklyn Center Police Relief Association (Consolidation) Thief River Falls Police Relief Association (Partial Consolidation)
1980	Crystal Police Relief Association
1985	Faribault Fire Department Relief Association Faribault Police Relief Association Moorhead Fire Department Relief Association (Consolidation) Moorhead Police Relief Association (Consolidation)

In 1975, a general prohibition on the creation of local pension plans, other than volunteer firefighter relief associations, was enacted (Minnesota Statutes, Section 356.25). In 1980, a general police and paid fire relief association phase-out was enacted, with an option for each city to elect to retain its local relief association or associations. Beyond the 26 relief associations that were phased out (or consolidated) by local law before 1981, 29 relief associations were phased out by the 1980 law, coded as Minnesota Statutes, Section 423A.01. Two municipalities elected to continue three relief associations, which were the Crookston Fire Department Relief Association, the Faribault Fire Department Relief Association, and the Faribault Police Relief Association. The Faribault relief associations eventually were phased out by subsequent local action that was ratified by 1985 special legislation.

The 1980 relief association phase-out legislation (Laws 1980, Chapter 607, Article 15, Section 4, Subdivision 2) governed the calculation of the minimum municipal obligation under the 1969 Guidelines Act, specified the minimum municipal contribution level to local relief associations, required relief associations to transition to a municipal-administered trust fund upon the retirement of the last active member, set a current disbursements obligation as an alternative minimum funding obligation of the municipality with respect to the relief association, required the calculation of service pensions upon the applicable salary level, even if no active relief association member receives that salary rate, and required the allocation of police or fire state aid with respect to relief association members and other public safety officers.

- c. 1987 Consolidation of Local Police and Paid Fire Relief Associations Legislation. Minnesota Statutes, Chapter 353A, enacted in 1987, authorized a local police or paid fire relief association to undertake an administrative consolidation of the relief association with the Public Employees Police and Fire Fund (PERA-P&F) and authorized the membership of a consolidated local relief association to elect between the benefit plan coverage of the local relief association and of PERA-P&F.

A local relief association consolidation with PERA-P&F was a voluntary action on the part of the relief association membership and the applicable municipality. The consolidation action was initiated by a petition signed by a minimum proportion of the relief association membership. If the petition was sufficient in the number of signatures and verified, the consolidation question was subject to a membership referendum requiring a majority vote. If the referendum prevailed, the governing body of the applicable city was required to act twice upon the proposed consolidation, with preliminary approval of the consolidation as a policy matter leading to the preparation of an actuarial assessment of the possible liability impact of the benefit plan coverage option and with final approval of the consolidation after receipt of that actuarial work and a review of relief association investments by the State Board of Investment.

If the consolidation was given final municipal approval, the local relief association ceased to exist as a pension fund and all administrative duties relating to the local plan shift to PERA-P&F. Following consolidation, individual members were given an opportunity to elect to retain their current benefit coverage or elect the PERA-P&F benefit plan. For retired members, the election was limited to the manner in which post-retirement adjustments are calculated. For active members, the election was a choice between all aspects of the respective plan. The benefit coverage election could have been exercised by retired members in the period following consolidation, and by active members within six months of consolidation, between ages 49 and 1/2 and 50, or upon employment termination.

As of March 1, 1999, when the Commission considered the 1999 merger legislation, 44 of the 48 local police or paid fire relief associations still in existence in 1987 had consolidated with PERA-P&F. The various relief associations which have completed consolidations with PERA-P&F, leaving the Fairmont Police Relief Association, the Minneapolis Firefighters Relief Association, the Minneapolis Police Relief Association, and the Virginia Fire Department Relief Association as the only remaining local police and paid fire relief associations. The consolidated local police and paid firefighter relief associations and the year of the consolidation are as follows:

Police

Albert Lea (1991)
 Anoka (1989)
 Austin (1993)
 Bloomington (1993)
 Brainerd (1996)
 Buhl (1987)
 Chisholm (1990)
 Columbia Heights (1994)
 Crookston (1998)
 Crystal (1992)
 Duluth (1987)
 Faribault (1996)
 Fridley (1993)
 Hibbing (1989)
 Mankato (1997)
 New Ulm (1994)
 Red Wing (1990)
 Richfield (1991)
 Rochester (1989)
 St. Cloud (1998)
 St. Louis Park (1990)
 St. Paul (1994)
 South St. Paul (1997)
 Virginia (1996)
 West St. Paul (1993)
 Winona (1990)

Fire

Albert Lea (1993)
 Austin (1998)
 Chisholm (1990)
 Columbia Heights (1994)
 Crookston (1990)
 Duluth (1992)
 Faribault (1991)
 Hibbing (1989)
 Mankato (1990)
 Red Wing (1989)
 Richfield (1997)
 Rochester (1990)
 St. Cloud (1989)
 St. Louis Park (1989)
 St. Paul (1992)
 South St. Paul (1994)
 West St. Paul (1988)
 Winona (1989)

Local police and paid fire relief association consolidations occurred on a relatively regular basis, as follows:

Year	Number	Percentage	
		Individual Year	Cumulative
1987	2	4.54%	4.54
1988	1	2.27	6.82
1989	8	18.18	25.00
1990	8	18.18	43.18
1991	3	6.82	50.00
1992	3	6.82	56.82
1993	5	11.36	68.18
1994	5	11.36	79.55
1995	0	0.00	79.55
1996	3	6.82	86.36
1997	3	6.82	93.18
1998	3	6.82	100.00

- d. 1999 Local Police and Paid Fire Consolidation Account Merger Legislation. Laws 1999, Chapter 222, Article 4, amending Minnesota Statutes, Chapter 353, provided for the merger of 44 local police and paid fire consolidation accounts into the Public Employees Police and Fire Retirement Plan and Fund (PERA-P&F). Additionally, that legislation provided for a distribution of a portion of surplus assets (assets in excess of liabilities) in the current consolidation accounts back to the municipalities and provided benefit enhancements to PERA-P&F and consolidation account members.

Unless the municipality declined to participate, all PERA-P&F consolidation accounts in existence as of March 1, 1999, were merged into the PERA-P&F fund on July 1, 1999. Municipalities chose to be excluded from the merger by filing a resolution before June 15, 1999, but no municipality did so. For the consolidation accounts merging into PERA-P&F, consolidation account liabilities transfer to PERA-P&F and consolidation accounts merging into PERA-P&F, consolidation account assets (except for amounts to be distributed back to the municipality) were transferred to PERA-P&F or the Post-Retirement Investment Fund, as applicable. For accounts where additional municipal contributions were necessary to cover existing liabilities (accounts where there is a positive amortizable base) the amortizable base amount was added to PERA-P&F assets as a receivable. Active members of consolidation accounts were allowed to elect PERA-P&F coverage in an election conducted before September 1, 1999. If no election was made, the individual retained the right to elect that coverage, in lieu of local plan benefit provisions, within 90 days of termination of service. Consolidation account service pensioners, disabilitants, and survivors who previously had chosen to

retain local plan post-retirement adjustments, were authorized to rescind that irrevocable election and to elect PERA-P&F post-retirement adjustments. Deferred consolidation account members were authorized to elect PERA-P&F post-retirement adjustments in an election conducted before September 1, 1999. The actuary retained by the Legislative Commission on Pensions and Retirement was required to compute the final funded status of each consolidation account that merged into the PERA-P&F fund. If an account was more than fully-funded, half of the assets reflecting amounts above full funding up to the June 30, 1999, PERA-P&F funding ratio and all assets reflecting amounts in excess of that PERA-P&F funding ratio were remitted to the municipality with interest. These amounts were required to be used by the municipality for fire or police related expenditures, as applicable. Before the municipality can receive any of these amounts, the municipality must have held a public hearing and adopted a plan for the expenditure of these assets. If a municipality had more than one consolidation account and one was over-funded while the other had an unfunded accrued liability, 75 percent of the amounts that would otherwise be refunded to the municipality must be credited to the consolidation account which has unfunded actuarial accrued liabilities. If the account had unfunded actuarial liability at the time of merger, the amount must be amortized on a level-dollar basis by December 31, 2009. Annual payments are due by each December 31 and late payment requires 8.5 percent interest. Unless a consolidation account member revised their benefit election, any prior election remained in effect. Upon transfer of liabilities and assets, the merging consolidation accounts were terminated.

The additional amortization aid provision was revised to specify that municipalities with a continuing amortization requirement due to their previous consolidation account will continue to be eligible for additional amortization aid, by revising plans that are eligible for that aid, and by specifying the post October 1, 2000, allocation among participants. Of the total, 64.5 percent will go to prior consolidation accounts with remaining liabilities, 34.2 percent is directed to Minneapolis relief associations, and 1.3 percent for Virginia Fire. If aid is released or unallocated because there is no unfunded liabilities in Minneapolis relief associations or Virginia Fire, any released aid is redirected to Minneapolis Teachers Retirement Fund Association (MTRFA) (49 percent) and St. Paul Teachers Retirement Fund Association (SPTRFA) (21 percent), and the remaining 30 percent of any released aid is allocated to the minimum fire state aid floor. To be eligible for this reallocation, the Minneapolis and St. Paul teacher funds must have five-year average investment returns, beginning on July 1, 2005, which equal or exceed the return on a 10 percent cash/60 percent bond/30 percent stock indexed portfolio.

Municipalities with prior consolidation accounts with unfunded accrued liability remain eligible for additional amortization aid for the duration of the required additional contributions (December 31, 2009). The total of amortization and supplemental amortization aid, and additional amortization aid to municipalities with ex-consolidation accounts with remaining accrued liability amounts to amortize is capped at an amount equal to their level dollar amortization requirement. Any excess is redirected back to remaining eligible consolidation accounts and if any excess continues to exist, that excess is redirected to other eligible pension funds. The amortization, supplemental amortization, and additional amortization state aid programs terminate when the MTRFA and SPTRFA become fully funded.

Attachment C

Background Information on Authorized Relief Association Administrative Expenses

Before 1978, the administrative expenses authorized for payment by local police, salaried firefighter or volunteer firefighter relief associations were specified, if at all, by the general or local legislation governing the relief association.

In 1977, after the Department of Commerce, which administered the fire state aid program at that time, disallowed the Austin Fire Department Relief Association from receipt of future fire state aid for the payment of expenses related to lobbying against proposed local police and salaried firefighter relief association phase-out legislation, the Legislative Commission on Pensions and Retirement determined that clearer regulation of local relief association administrative expenses was needed. The result was Minnesota Statutes, Section 69.80, enacted in 1978.

Aside from a clarification of the salaries authorized for the payment to relief association officers in 1987, prompted by the unauthorized practice of the St. Paul Firefighters Relief Association paying salaries to the relief association vice president, Minnesota Statutes, Section 69.80, has largely been unchanged since enactment.

Minnesota Statutes, Section 69.80, sets forth six categories of authorized administrative expenses that are payable from the special fund of the relief association. All other expenses are payable from the relief association general fund, which is not supported by local tax revenues or state aid. The authorized administrative expenses categories payable from the relief association special fund are as follows:

1. Office expense including but not limited to rent, utilities, equipment, supplies, postage, periodical subscriptions, furniture, fixtures, and salaries of administrative personnel;
2. Salaries of the president, secretary, and treasurer of the association, or their designees, and any other official of the relief association to whom a salary is payable under bylaws or articles of incorporation in effect on January 1, 1986, and their itemized expenses incurred as a result of fulfilling their responsibilities as administrators of the special fund;
3. Tuition, registration fees, organizational dues, and other authorized expenses of the officers or members of the board of trustees incurred in attending educational conferences, seminars, or classes relating to the administration of the relief association;
4. Audit, actuarial, medical, legal, and investment and performance evaluation expenses;
5. Reimbursement to the officers and members of the board of trustees, or their designees, for reasonable and necessary expenses actually paid and incurred in the performance of their duties as officers or members of the board; and
6. Premiums on fiduciary liability insurance and official bonds for the officers, members of the board of trustees, and employees of the relief association.

Since 1987, the allowable administrative expenses of a local relief association were made part of the financial requirements of the relief association and, ultimately, part of the required minimum municipal support of the relief association. By virtue of this inclusion of relief association administrative expenses in the required municipal obligation toward the relief association, the municipality becomes responsible for funding any litigation by the relief association against the municipality.

Attachment D

Background Information on the 2005 Minneapolis Police Relief Association Legislation

In 2005 (First Special Session Laws 2005, Chapter 8, Articles 1, 10, and 11), there were six changes that related to the Minneapolis Police Relief Association.

The six changes, two as part of general provision changes and five undertaken at the request of the Minneapolis Police Relief Association and subject to local approval, were:

1. Clarification of Salary Definition. The PERA definition of salary is revised by adding a cross-reference to applicable federal law limitations on salary for pension purposes, and by clarifying that salary for pension purposes (for individuals also covered by a laborer's national industrial pension fund, a plumber's or pipe fitter's national or local pension fund, or by an international union of operating engineers pension fund) includes any mandatory withholding of wages for the supplemental plan. (Laws 2005, First Special Session, Chapter 8, Article 1, Section 9. Source: S.F. 995 (Betzold); H.F. 2109 (Smith), and S.F. 1682 (Pogemiller).)
2. Definition of High-Five Average Salary Moved to Definition Section. Language defining "average salary" (high-five average salary) is moved from existing PERA provisions to the definition section, and cross-references in PERA-General and PERA-P&F annuity and disability benefit provisions are revised accordingly. (Laws 2005, First Special Session, Chapter 8, Article 1, Sections 10 to 14, and 32. Source: S.F. 436 (Betzold); H.F. 2115 (Smith).)
3. Full-Funding Date Extension to 2020. The full funding date is extended from December 31, 2010, to December 31, 2020. (Laws 2005, First Special Session, Chapter 8, Article 11, Sections 1 and 3. Source: S.F. 2038 (Michel); H.F. 2173 (Larson), and H.F. 2453 (Kahn).)
4. Board Continuation Provision Revised. The MPRA fund will become a city trust fund when there are 225 or fewer remaining members (active, retired, and or survivors), rather than fewer than 100. (Laws 2005, First Special Session, Chapter 8, Article 11, Section 9. Source: House Ways and Means Committee Amendment.)
5. Revised Service Pension Schedule, Benefit Enhancement. The service pension schedule applicable when the funding ratio is less than 90 percent is stricken; making the highest schedule applicable under all funding conditions, and the pension amounts applicable in that schedule for 20 or more years of service credit are increased by one unit, with the increase phased in over two years (the 25-year pension is increased from 42 units to 42.5 units retroactively to January 1, 2005, and is increased to 43 units on January 1, 2006). Those members who selected joint and survivor benefits must have their pensions increased by comparable amounts. (Laws 2005, First Special Session, Chapter 8, Article 11, Sections 10 and 11. Source: H.F. 2453 (Kahn), Commission Amendment.)
6. Revised Survivor Benefits, Benefit Enhancement. The survivor benefit for survivors of officers who took the automatic survivor benefit option is increased by one half unit through December 31, 2005 (from 22 units to 22.5 units), and by another half unit on January 1, 2006 (from 22.5 units to 23 units). (Laws 2005, First Special Session, Chapter 8, Article 11, Section 12. Source: H.F. 2453 (Kahn).)

Attachment E

Background Information on Authorized Public Pension Plan Investments and Investment Performance

- a. Development of Authorized Investments Regulation. In Minnesota, the assets of the local retirement plans (i.e., the first class city teacher retirement fund associations, the Minneapolis Employees Retirement Fund (MERF), and the local police, paid fire, and volunteer fire relief associations) are invested by the particular retirement plan board and the assets of the statewide retirement plans are invested by the State Board of Investment.

Prior to 1961, the responsibility to invest statewide public pension plan assets lay with the State Board of Investment (see Minnesota Statutes 1953, Sections 135.04, Subdivision 4; 352.06; and 353.06), but neither the retirement plan governing laws nor the State Board of Investment governing laws specifically regulated the types of investment securities in which those assets could be invested. In 1961 (Laws 1961, Chapter 380), the investment authority over state retirement funds was first delineated, with the legislation coded in the Minnesota State Retirement System (MSRS) governing law. The 1961 enactment set the prudent person rule as the general investment standard and included a “legal list” of authorized types of investment securities, which included the following:

1. U.S. Government bonds or notes;
2. Minnesota or other U.S. state bonds;
3. Dominion of Canada or Canadian province bonds;
4. Minnesota municipal bonds, notes, or obligations;
5. Other U.S. state municipal bonds;
6. Canadian municipal bonds;
7. International Bank for Reconstruction and Development obligations;
8. U.S. agency insured obligations;
9. Minnesota public housing obligations;
10. Other state, municipal, or public authority obligations with income for each of the prior five years at least equal to 120 percent of its average annual debt service;
11. U.S. or Canadian corporate bonds, if Canadian bond debt service is payable in U.S. dollars, and if the corporation has assets of at least \$10 million and has capital stock equal to at least 50 percent of its debt, has pretax earnings over each of the prior five years of 150 percent of annual interest charges, and has gross operating revenues of at least \$1 million, and the bond issue is rated at least “A” by a recognized commercial rating agency. Total corporate bond investments were limited to 40 percent of the total assets of the fund;
12. U.S. corporate stock of a corporation with at least \$10 million, with corporate earnings equal to the prior five-year average of interest and preferred dividend requirements for preferred stock, and with the payment of cash dividends for at least five years before the purchase. Investment in any one corporation was limited to one percent of the assets of the fund. The total corporate stock investments were limited to 25 percent of the assets of the fund, with a maximum increase in the stock investment in any year of five percent of the assets of the fund. The investment of all Minnesota public pension plans in any one corporation was limited to five percent of its voting stock;
13. Bank certificates of deposit and savings account if insured by a federal agency and if needed for liquidity; and
14. Commercial paper of less than 270-day maturity if the corporation has assets equal to 150 percent of current liabilities and long-term debt, and has average annual income over the past five years of at least \$1 million. Commercial paper in total cannot exceed five percent of the book value of the fund and in any one corporation cannot exceed two percent of the book value of the fund.

In 1961, the State Board of Investment created the predecessor the current Investment Advisory Council to advise the board on the entry of statewide Minnesota public pension plans into corporate stock investments.

In 1967 (Laws 1967, Chapter 404), the authorized retirement plan investment specification was moved out of the MSRS statutes and was added to the State Board of Investment statutes. During the 1970s and 1980s, the investment authority of the State Board of Investment was expanded and the requirements and maximums relaxed. In 1989, a separate public pension plan fiduciary responsibility law was enacted for the State’s statewide and local retirement plans, including a “prudent person” rule as a general fiduciary standard and legal lists of authorized investments. Initially, the fiduciary law legal list for larger or professionally managed local retirement plans replicated the legal list applicable to the State Board of Investment. In 1993-1994, in connection with the issue of authorizing non-

investment grade corporate bonds for the State Board of Investment, the fiduciary law legal list retained the pre-1994 authority of the State Board of Investment.

- b. Current Investment Authority Regulation. Minnesota Statutes, Chapter 356A, includes specific investment authority provisions covering the range of investments permitted in the portfolios. The primary investment authority provision for larger Minnesota public pension plans is Minnesota Statutes, Section 356A.06, Subdivision 7 (expanded list, permissible securities). Many volunteer fire plans are also subject to this provision. This is the primary investment authority provision for any volunteer fire relief association with assets in excess of \$1 million, or which uses the services of a registered investment advisor to invest at least 60 percent of its assets, or which uses the State Board of Investment to invest at least 60 percent of its assets, or which uses an investment advisor and the State Board of Investment in combination to invest at least 75 percent of its assets. The following describes the securities and other investment forms permitted under Minnesota Statutes, Section 356A.06, Subdivision 7:
1. Types of Permissible Investments. Permissible investments may be owned directly or through commingled trusts and are of the following types:
 - (a) *Government debt obligations, including debt obligations of the United States Government and its agencies, government sponsored organizations of which the United States is a member, state and local governments, and Canada and its provinces. All obligations must be backed by the full faith and credit of the issuing organization or be rated as an investment-grade security by a nationally recognized rating agency, and principal and interest must be payable in United States dollars. (An investment grade debt security is one rated in the top four quality categories.).*
 - (b) *Investment-grade corporate debt of companies organized under the laws of the United States and Canada, including bond notes, debentures, providing the securities are investment grade and are payable in United States dollars.*
 - (c) *Miscellaneous debt and cash equivalent securities, including bankers acceptances, certificates of deposit, commercial paper, mortgage participation securities and asset backed securities, guaranteed investment contracts, providing that securities of a cash equivalent nature are fully backed by insurance, and securities of a longer term debt nature are investment grade. The State Board of Investment may also purchase Minnesota Housing Finance agency mortgage pools providing none of the mortgages are in default.*
 - (d) *Stock or convertible securities of any United States or Canadian company, or of any company listed on domestic stock exchanges. The State Board of Investment may not own more than five percent of the outstanding shares of any given company.*
 - (e) *International securities.* While this is not further defined or specified in law, presumably this refers to foreign stocks and bonds.
 - (f) *Puts, calls, futures.* A covered pension fund may use puts, calls, and future contracts purchased and sold through regulated markets. Puts and calls are options giving the right to sell (put) or buy (call) a fixed amount of a security at a specified price. Puts can be used if one believes the market price of the security will go down by the contract settlement date; calls could be used if one believes the price may rise. A futures contract is an agreement to exchange securities or currencies at an agreed upon rate.
 - (g) *Various miscellaneous investments, including venture capital investments, regional funds, mutual funds, limited partnerships, real estate investment trusts, and resource investments.* For any of these investments, there must be at least four other owners in addition to the covered pension fund, and that pension fund may not own more than 20 percent of the investment, and may not be a general partner or engage in any activity that creates general liability.
 2. Asset Mix Restrictions. In addition to specifying legal investments, the section also puts some minimal limits on the proportion of equity investments that a covered pension fund must hold. *The total of all forms of equity investments [the domestic stock in (4) above, international securities in (5), and miscellaneous equity investments in (7)] cannot exceed 85 percent of the total portfolio's value. Furthermore, the miscellaneous equity investments in (7) above, considered separately, may not exceed 35 percent of the portfolio's value.*
- c. Investment Performance Reporting Requirements. In a pension plan that is funded on a full actuarial basis (annual contributions essentially equal the actuarial requirements,) investment income at the investment performance actuarial assumption rate will provide two-thirds to three-fourths of the total

revenue to be received by the pension plan. Investment income that exceeds the investment performance actuarial assumption rate will provide a further funding cushion, offsetting the need for some future amount of member contributions, employer contributions, or both.

Appropriate public pension fund investment management would include a clear understanding by the investment policy making board or entity of the applicable investment authority, the formulation by the investment policy making board or entity of an investment policy statement with sufficient specificity to be meaningful, a clear communication of that investment authority and that investment policy statement to any investment advisors, managers, brokers, operatives or agents, the acquisition and analysis of investment performance information calculated on a total time weighted rate of return basis, the maintenance of sufficient diversification of investment types, and the maintenance of sufficient liquidity.

Although Minnesota public pension plans have been investing their assets virtually from their inception as plans, investment performance reporting from the plans has only been required by State law since 1990 (see Laws 1990, Chapter 570, Article 2, Section 1). The 1990 law originated with the Legislative Commission on Pensions and Retirement. The 1990 law, coded as Minnesota Statutes 1990, Section 356.218, has been replaced by Minnesota Statutes, Section 356.219 (source: Laws 1994, Chapter 565, Article 2, Section 1). The 1990 investment reporting law was administered by the Commission staff, while the 1994 replacement investment reporting law is administered by the Office of the State Auditor. The 1990 and 1994 public pension plan investment reporting laws both require the reporting of time-weighted total rate of return investment performance numbers. A time-weighted rate of return measures the return earned on assets invested for the entire period. The time-weighted rate of return calculation method weights an account's cash flows by the amount of time each has been invested. A cash flow is an external capital addition or withdrawal of cash and/or securities that is investor-initiated, with dividend and interest income not considered cash flows. By filtering out the effects on return caused by a board's decisions to give additional assets to a manager during a period under study, or a board's decision to withdraw assets from a manager to cover benefit checks or other operating expenses, the time-weighted rate of return procedure removes the impact of events over which the investment manager has no control. A time-weighted rate of return is a different measure from a dollar-weighted rate of return. The dollar-weighted return, also known as internal rate of return, takes an investment's performance into consideration, but also uses the timing and size of an investment in its calculation. This method does not provide the ability to distinguish between a plan's performance and the effect of market timing on the rate of return. Return calculated under the dollar-weighted method might have more to do with when and how much was invested than where monies were invested. Since actuarial work does not focus on the relative value produced by investment managers in a competitive context, investment performance results for actuarial purposes and presented in actuarial valuations will be dollar-weighted rates of return. For comparisons among investment managers, among funds, or to compare fund or manager performance to returns offered by the market, time-weighted returns are the accepted industry standard. In investment manager presentations, the use of time-weighted rates of return rather than other forms of returns are required by Association of Investment Management and Research (AIMR) presentation standards and by the Securities and Exchange Commission (SEC).

- d. Investment Performance and Impact on Plan Funding. The following tables set forth information from calendar year 2003 on the portfolio mix, the time-weighted total rate of return numbers, and the comparative impact on funding for the State Board of Investment, the Minneapolis Employees Retirement Fund (MERF), the three first class city teacher retirement fund associations, the Minneapolis Firefighters Relief Association, the Minneapolis Police Relief Association, and the Bloomington Fire Department Relief Association:

	Portfolio Mix				
	Cash	Bonds	Stock		Other
			Domestic	Foreign	
SBI Combined	1.0%	22.9%	50.6%	16.6% ¹	8.9%
MERF Combined	1.5%	27.9%	39.7%	25.5%	5.4%
DTRFA	1.5%	27.4%	56.5%	12.6%	2.0%
MTRFA	2.0%	25.0%	57.0%	15.0%	1.0%
SPTRFA	0.0%	27.0%	52.2%	20.6%	0.2%
Minneapolis Fire	1.0%	30.0%	69.0%	0.0%	0.0%
Minneapolis Police	2.0%	30.0%	54.5%	13.2%	0.3%
Bloomington Fire	5.2%	30.6%	64.2%	0.0%	0.0%

¹ Identified by the State Board of Investment as International Stock.

Total Portfolio Returns

Calendar Year	SBI Combined Fund	MERF Combined Fund	DTRFA	MTRFA	SPTRFA	Minneapolis Fire	Minneapolis Police	Bloomington Fire	40% Bond/60% Stock
CY 1990	2.15%	-5.90%	-3.20%	-2.54%	4.57%	3.12%	2.06%	3.97%	n/a
CY 1991	22.93%	13.25%	22.00%	24.99%	19.79%	27.45%	16.77%	17.75%	n/a
CY 1992	7.06%	8.75%	6.50%	8.19%	7.20%	9.86%	6.82%	9.86%	n/a
CY 1993	11.90%	13.69%	12.80%	12.29%	11.32%	10.47%	10.49%	12.79%	n/a
CY 1994	-0.4%	1.2%	0.2%	0.1%	0.3%	-1.8%	-1.3%	-9.1%	-1.3%
CY 1995	25.5%	23.4%	25.5%	25.0%	26.2%	26.6%	20.6%	26.1%	29.3%
CY 1996	15.3%	12.9%	13.4%	13.6%	12.6%	14.0%	12.5%	12.5%	14.1%
CY 1997	21.5%	18.5%	15.5%	15.5%	19.6%	23.8%	12.7%	19.7%	22.7%
CY 1998	16.1%	15.7%	11.1%	14.2%	12.0%	21.9%	11.4%	13.8%	17.5%
CY 1999	16.5%	15.5%	29.4%	21.5%	13.6%	17.8%	11.1%	13.2%	13.9%
CY 2000	-2.8%	-1.3%	-1.6%	-6.0%	-0.2%	-2.7%	-2.0%	-3.9%	-1.9%
CY 2001	-6.0%	-6.2%	-4.7%	-7.7%	-1.4%	-3.3%	-4.1%	-7.8%	-3.2%
CY 2002	-11.6%	-11.3%	-12.8%	-16.2%	-9.6%	-10.5%	-10.1%	-14.3%	-8.4%
CY 2003	23.1%	25.2%	28.1%	22.8%	27.0%	19.6%	22.3%	19.9%	20.6%
CY 2004 ¹	3.9%	3.4%	--	1.8%	4.2%	1.7%	1.8%	--	--
3-Year to 12/31/03	0.76%	1.37%	2.11%	-1.70%	4.22%	1.16%	1.78%	-1.79%	2.26%
5-Year to 12/31/03	2.98%	3.50%	6.27%	1.64%	5.12%	3.48%	2.80%	0.61%	3.62%
10-Year to 12/31/03	8.94%	8.66%	9.51%	7.36%	9.39%	9.76%	6.79%	6.11%	9.63%

¹ The 2004 returns are partial year returns through September 30, 2004.

Sources:

The 1994-1998 and 2001-2004 returns are as reported to the Commission staff by the pension fund administrators.
The 1998-2000 returns are as reported by the Office of the State Auditor.

**Investment Gain or Loss Compared to State Board of Investment Combined Fund
Calendar Years 1994-2003**

	10-Year Annualized Return 1994-2003	1994 Assets	Gain or Loss Relative to the SBI Combined Portfolio Given 1994 Assets	6/30/2004 Assets
	%	\$ millions	\$ millions	\$ millions
SBI Combined Fund	8.94%	\$18,852.0	--	\$40,500.0
MERF Combined Fund	8.66%	\$967.5	-\$57.9	\$1,485.3
DTRFA	9.51%	\$135.5	\$17.1	\$258.8
MTRFA	7.36%	\$541.1	-\$173.2	\$763.1
SPTRFA	9.39%	\$410.6	\$40.7	\$871.9
Minneapolis Fire	9.76%	\$177.5	\$32.5	\$237.0
Minneapolis Police	6.79%	\$288.9	-\$122.9	\$300.2
Bloomington Fire	6.11%	\$58.8	-\$32.0	\$92.2
Total:			-\$295.7	

May 18, 2005

**UNDERSTANDING OF AGREEMENT BETWEEN CITY OF MINNEAPOLIS
AND MINNEAPOLIS POLICE RELIEF ASSOCIATION**

1. Extend the funding date to 2020.
2. Guarantee language in HF 2508.
3. Retain current law on 13th check five year averaging.
4. Benefit increase of ½ unit upon local approval retroactive to January 1, 2005.
Additional ½ unit increase effective January 1, 2006.
5. Fund to trust status when fund reaches 350 remaining members.
6. No request for mortality study to LCPR until 2008.
7. Local approval.

____ City of Minneapolis *John McRae*

____ MPRA

Bill Rice for MPRA
Larry Wal

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State of Minnesota
HOUSE OF REPRESENTATIVES

**EIGHTY-FOURTH
SESSION**

HOUSE FILE No. 2577

January 19, 2006

Authored by Mullery

Unofficially referred to the Committee on Governmental Operations and Veterans Affairs

1.1 A bill for an act
1.2 relating to pensions; defining the terms of the successor trust fund for the
1.3 Minneapolis Police Relief Association; increasing salary limits of elected
1.4 members of the board of trustees; readjusting the compensation of officers of
1.5 the Minneapolis Police Relief Association; providing for additional investment
1.6 authority; amending Minnesota Statutes 2004, section 423B.07; Minnesota
1.7 Statutes 2005 Supplement, sections 423B.05, subdivision 3; 423B.09, subdivision
1.8 1; proposing coding for new law in Minnesota Statutes, chapter 423B.

1.9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

1.10 Section 1. Minnesota Statutes 2005 Supplement, section 423B.05, subdivision 3, is
1.11 amended to read:

1.12 Subd. 3. **Continuation of board.** Notwithstanding the provisions of section
1.13 423A.01, subdivision 2, or any other law, the board of trustees and its successors
1.14 established under subdivision 1 shall continue to govern the association until there are no
1.15 more than 225 members of the police pension fund. The fund thereafter must become a
1.16 trust fund in accordance with section 423A.01, subdivision 2, provided that the successor
1.17 trustees of the trust fund shall continue to exercise the same authority as provided for in
1.18 this chapter. To the extent there is any conflict between the provisions of section 423A.01,
1.19 subdivision 2, or applicable trust law provisions in the administration of the successor
1.20 trust fund, the provisions of this chapter shall prevail. The trustees of the trust shall be
1.21 elected by the members of the trust in a manner determined by the members.

1.22 Sec. 2. Minnesota Statutes 2004, section 423B.07, is amended to read:

1.23 **423B.07 AUTHORIZED FUND DISBURSEMENTS.**

1.24 The police pension fund may be used only for the payment of:

1.25 (1) service, disability, or dependency pensions;

(2) notwithstanding a contrary provision of section 69.80, the salaries of the elected members of the board of trustees in an amount not to exceed ~~three~~ seven units for the president and five units for other elected board members;

(3) expenses of officers and employees of the association in connection with the protection of the fund;

(4) expenses of operating and maintaining the association, including the administrative expenses related to the administration of the insurance plan authorized in section 423B.08; and

(5) other expenses authorized by section 69.80, or other applicable law.

Sec. 3. Minnesota Statutes 2005 Supplement, section 423B.09, subdivision 1, is amended to read:

Subdivision 1. **Minneapolis police; persons entitled to receive pensions.** The association shall grant pensions payable from the police pension fund in monthly installments to persons entitled to pensions in the manner and for the following purposes.

(a) An active member or a deferred pensioner who has performed duty as a member of the police department of the city for five years or more, upon written application after retiring from duty and reaching at least age 50, is entitled to be paid monthly for life a service pension. Active members, deferred members, and service pensioners are entitled to a service pension according to the following schedule:

		<u>A</u>	<u>B</u>
	5 years	8.0 <u>8.5</u> units	<u>9.0</u> units
	6 years	9.6 <u>10.1</u> units	<u>10.6</u> units
	7 years	11.2 <u>11.7</u> units	<u>12.2</u> units
	8 years	12.8 <u>13.3</u> units	<u>13.8</u> units
	9 years	14.4 <u>14.9</u> units	<u>15.4</u> units
	10 years	16.0 <u>16.5</u> units	<u>17.0</u> units
	11 years	17.6 <u>18.1</u> units	<u>18.6</u> units
	12 years	19.2 <u>19.7</u> units	<u>20.2</u> units
	13 years	20.8 <u>21.3</u> units	<u>21.8</u> units
	14 years	22.4 <u>22.9</u> units	<u>23.4</u> units
	15 years	24.0 <u>24.5</u> units	<u>25.0</u> units
	16 years	25.6 <u>26.1</u> units	<u>26.6</u> units

3.1	17 years	27.2 <u>27.7</u> units	<u>28.2</u> units
3.2	18 years	28.8 <u>29.3</u> units	<u>29.8</u> units
3.3	19 years	30.4 <u>30.9</u> units	<u>31.4</u> units
3.4		A	B
3.5	20 years	34.5 units	35.0 units
3.6	21 years	36.1 units	36.6 units
3.7	22 years	37.7 units	38.2 units
3.8	23 years	39.3 units	39.8 units
3.9	24 years	40.9 units	41.4 units
3.10	25 years	42.5 units	43.0 units

Column A is applicable until December 31, 2005, and applies retroactively to January 1, 2005, for a service pensioner who retired before January 1, 2005. Column B applies on and after January 1, 2006.

Fractional years of service may not be used in computing pensions.

(b) An active member who after five years' service but less than 20 years' service with the police department of the city, becomes superannuated so as to be permanently unable to perform the person's assigned duties, is entitled to be paid monthly for life a superannuation pension equal to four units for five years of service and an additional two units for each full year of service over five years and less than 20 years.

(c) An active member who is not eligible for a service pension and who, while a member of the police department of the city, becomes diseased or sustains an injury while in the service that permanently unfits the member for the performance of police duties is entitled to be paid monthly for life a pension equal to 34 units while so disabled.

Sec. 4. [423B.23] INVESTMENT AUTHORITY.

Notwithstanding the provisions of section 356A.06, subdivision 7, the association may invest up to five percent of the assets of the fund in below investment grade government or corporate bonds, debt, or other fixed investment instruments.

Sec. 5. EFFECTIVE DATE.

Sections 1 to 4 are effective the day after approval by the Minneapolis City Council under Minnesota Statutes, section 645.021.