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J. Michael Stoffel, _Executive Director_

DATE: March 5, 2007

TO: Members of the Legislative Commission on Pensions and Retirement (LCPR)

FROM: J. Michael Stoffel
Executive Director, DTRFA

RE: Mandated Commission Study; Investment Based Post-Retirement Adjustment Mechanism Structure and Teacher Retirement Benefit Provisions Comparison: Second Consideration

Thank you for the opportunity to provide you with our thoughts as you review information from LCPR staff and others in regards to post-retirement increases and comparisons of teacher pensions in Minnesota to teacher pensions in other states.

I have attached a critique of the memo dated November 8, 2006 from Lawrence Martin to members of the LCPR. The critique identifies several mistakes in the November 8 memo as it pertains to the analysis of the DTRFA post-retirement increase. Also attached is an analysis of the DTRFA post-retirement increase using an actual example of a typical retirement account of a DTRFA member who retired in 1977 and is receiving benefits yet today. Based on this actual, correct information it appears that since 1977, <u>the average DTRFA post-retirement increase of 3.9% is closer to the average increase in CPI of 4.3% than the average increase from any other fund included in the memo.</u>

Nevertheless, our view of changing the post-retirement increase mechanism of the DTRFA at this time is based on the following:

1. Numerous times over the last year, Education Minnesota has testified and presented data to the LCPR showing that benefit provisions in Minnesota pensions plans are almost the lowest in the nation;

2. The November 8, 2006 memo referenced above from LCPR staff also shows that many provisions in MN teacher pension plans are lower than teacher pension benefits in most other states. The bottom half of the attached critique clarifies ranking information in the November 8 memo. The memo seems to presume that there is only one benefit plan for Minnesota teachers. Actually, there are two plans with different eligibility requirements. The charts in the November 8 memo could be revised to rank the benefit provisions of both Minnesota plans. That sort of display would result in the placement of more provisions of the Minnesota plans towards the bottom of the rankings, especially the benefit provisions for post-89 teachers;

3. A January 2007 report from the Office of the Legislative Auditor (OLA), titled ***Postemployment Benefits for Public Employees*** notes several instances were pension benefit provisions in Minnesota are “less generous than the national average,” and “lower than the national median.” The OLA notes that pension benefits in Minnesota are lower than the benefits in most other states due to the following: lower benefit multipliers, less generous method for measuring salary used to compute benefits (high-five average), higher early retirement reductions, and a higher rate of taxation on pensions.

There is ample evidence and abundant data showing that many provisions of Minnesota teacher pension plans are lagging the rest of the nation. Therefore, the DTRFA Trustees believe it is undesirable to analyze only one component of the pension plan and make conclusions that result in a reduction of that one component of the plan. To make additional reductions and restrictions will put Minnesota further behind. The DTRFA Trustees are interested in participating in discussions regarding the structural elements of Minnesota pension plans, but believe that any changes should be determined ***“holistically”*** and not in piecemeal fashion. The DTRFA trustees are quite interested in discussions concerning higher formula multipliers, different salary measurements, lower early retirement penalties, lower taxation of pensions, along with revised post-retirement adjustments.

We look forward to continued discussions with the LCPR, staff of the LCPR, and others who are interested in providing competitive benefits in order to attract and retain the best teachers possible for the education of the elementary and secondary students in Duluth, Minnesota.

Critique by J. Stoffel, DTRFA of Memo Dated 11/8/06, from L. Martin to LCPR

Page 2	Second to last paragraph – I emphasize the point here that the consumer price index (CPI) published by the US Dept. of Labor - Bureau of Labor Statistics is an incomplete or inadequate measure of inflation for retirees.
Page 3; Page A-ii	The charts on Page 3 and on Appendix page A-ii, Table 3 showing the cumulative effect of post-retirement increases for retirees of the DTRFA omit the 8.7% increase on August 1, 1981 approved by the 1981 Legislature.
Pages 3, 4	The information about the DTRFA compounded annual percentage increase is misleading. The memo indicates that the 28-year compounded annual increase for the DTRFA was 2.9%. My calculation for an actual Duluth retiree with 32 years of credited service at retirement in 1977 shows an increase in monthly benefits averaging **3.9%** over 28 years. My calculation takes into account actual monthly benefit payments, actual 13th check payments, and actual COLA's. The conclusions in the memo are based on inaccurate analysis of DTRFA historical information and those conclusions, therefore, are inaccurate. The 3.9% average of DTRFA COLA increases since 1978 are closer to CPI than any other fund studied in the memo. ***(See attached revised analysis.)***
Page 5	The chart at the top of the page incorrectly notes that DTRFA post-retirement adjustments since 1977 have exceeded CPI in 9 years and have lagged CPI in 19 years. My analysis shows the DTRFA has exceeded CPI 13 years and has lagged CPI 15 years.
Page 10	Mr. Martin incorrectly asserts that the DTRFA COLA mechanism lacks any way to recognize the impact of inflation on the purchasing power of benefits. From 1913 to 2005, CPI in the USA has averaged 3.4%. The DTRFA proposed legislation in 1995 for a guaranteed COLA of 2% thinking that over the long term, that would account for two roughly thirds of historical CPI. The intent was that the other component of the post-retirement adjustment derived from excess investment returns would make up the remaining one-third of historical CPI and therefore protect retiree purchasing power. Since this method was implemented in 1996, DTRFA increases have averaged 5.8%, and CPI-U has averaged 2.6%, a difference of 3.2%.
Pages 16 to 24	Mr. Martin's analysis and comparison of teacher benefits in MN versus benefit in other states creates a perception that is different from reality. There are significant differences in the two MN teacher benefit plans, including eligibility. The analysis in the memo takes the best features of both MN plans and gives the reader the impression that all teachers have access to all these provisions. Specifically: • Table 1, page 16 – it appears that MN teachers are tied at second to last with Idaho teachers for the earliest normal retirement age. True for teachers hired pre-89, but for all post-89 hires, they are dead last with ***NO*** early normal retirement age. • Table 2, page 16 – it appears that MN teachers have a relatively good opportunity to take advantage of early retirement provisions. This may be true for some pre-89 teachers, but for post-89 hires, they must be at least age 55 with three years of service putting them much closer to the bottom, tied with North and South Dakota. • Table 3, page 17 – it appears that MN teachers have relatively low early retirement reduction factors. This may be true for pre-89 teachers, but post-89 teachers in the DTRFA have reductions ranging from 4.3% to 6.5% per year, depending on how early they retire. This puts them farther towards the bottom, near the ranking for Montana. • Table 6, page 18 – the chart shows the 1.9% accrual rate created by the 2006 Legislature for members in the MN TRA plans (excludes Duluth and St. Paul teachers) and applied to service credit earned after June 30, 2006. As of the date of Mr. Martin's memo, since the law had just passed, there was essentially ***no one*** with any service credit in the ranks of the TRA with service credited at 1.9%. The chart should somehow reflect that most of MN teachers to date retire with an accrual rate of 1.2% for each of their first ten years and 1.7% for each year over ten. For a career 30-year teacher, that averages to 1.53% per year, putting a MN teacher third from bottom. • Table 12, page 21 – The table shows MN TRA with a funded ratio of 92.91%. The memo fails to acknowledge that this is only half of the picture for the TRA. That is the funded ratio of the fund for active employees. The MN Post Retirement fund is approximately 80% funded. This is significant when making this kind of comparison, and then making conclusions with this information. Tables 13 and 14 are also flawed for this same reason.