



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director *EB*

RE: H.F. 1313 (Thissen); S.F. 1141 (Betzold): MERF; Permitting Investing with the State Board of Investment and Transfer Liquidity Flexibility

DATE: February 28, 2007

Summary of H.F. 1313 (Thissen); S.F. 1141 (Betzold)

H.F. 1313 (Thissen); S.F. 1141 (Betzold) amends sections in Minnesota Statutes, Chapter 422A, the Minneapolis Employees Retirement Fund (MERF) chapter, by making the following changes:

1. MERF Authority to Invest with the State Board of Investment. The MERF Board would be permitted to invest some or all of the fund's assets with the State Board of Investment (SBI) through either the Minnesota Supplemental Investment Fund, a mutual fund-like family of investment accounts, or the Minnesota Combined Investment Funds, an investment pool made up of the active member assets of the various statewide retirement plans (Section 1).
2. MERF Internal Transfer Liquidity Flexibility. The transfer of assets between the MERF active member investment account (the MERF Deposit Accumulation Fund) and the MERF retired member investment account (the MERF Retirement Benefit Fund), if the Deposit Accumulation Fund has insufficient assets to make the transfer upon the retirement of an active member, can be made with an internal interest-bearing promissory obligation. The obligation would bear interest at the rate of five percent, plus the percentage increase in the Consumer Price Index over the period, and the interest and the principal of the obligation would be payable first from any balance in the Deposit Accumulation Fund (Sections 2 to 6).
3. Repealer. Minnesota Statutes, Section 422A.101, Subdivision 4, a provision requiring the City of Minneapolis to provide sufficient assets to make required transfers to MERF's retired fund at the time of retirement, is repealed (because it is replaced by the mechanism in 2, above).

These provisions are effective June 30, 2006.

Background Information

1. MERF, In General. Background information on the creation, plan design, benefits, and administration of the Minneapolis Employees Retirement Fund (MERF) is attached as Attachment A.
2. Minnesota Retirement Plan Investment Authority. Background information on the investment authority of MERF as compared to SBI and other major local retirement plans is presented in Attachment B.
3. MERF Post-Retirement Adjustment Mechanism. Background information comparing the operation of MERF's retirement Benefit Fund with the Minnesota Post Retirement Investment Fund operated by SBI is contained in Attachment C.
4. Background Information on State Aid to MERF. Background information on the state aid payable to MERF is set forth in Attachment D.

Discussion and Analysis

H.F. 1313 (Thissen); S.F. 1141 (Betzold) authorizes the MERF Board to invest some or all of MERF's assets with the State Board of Investment through either the Minnesota Supplemental Investment Fund or the Minnesota Combined Investment Funds; and it would authorize use of internal interest-bearing promissory obligations for use in covering transfer requirements between MERF's active and retired member fund when the active fund has insufficient assets to make the transfer upon the retirement of an active member. The interest on the obligation would be five percent plus the percentage increase in the Consumer Price Index over the period, and the interest and the principal of the obligation would be payable first from any balance in the active fund.

The current bill is based on a bill introduced in the House in 2005 by Representative Margaret Anderson Kelliher, H.F. 853. The Commission heard 2005 H.F. 853 (Kelliher) and recommended it to pass, but it

was not enacted in 2005. On February 15, 2006, the Commission again recommended various provisions of that bill to pass, but portions of it were removed by the House and again not enacted. The two items that were removed by the House, revised MERF investment authority to allow investing with SBI and permission to use an internal liquidity transfer, are the substance of the current bill. The drafting incorporates technical revisions suggested by Commission staff in 2006.

H.F. 1313 (Thissen); S.F. 1141 (Betzold) raises several pension and related policy issues for Commission consideration and discussion, as follows:

1. Appropriateness of a Continued Separate Plan Administration for MERF and other Minneapolis Pension Funds. The policy issue is the appropriateness of retaining a separate plan administration for MERF. The MERF benefit plan has been closed to new members since 1979 (1977 in actuality, since the MERF Coordinated Program created for all new entrants in 1977 was consolidated into the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) in 1979). According to the July 1, 2006, MERF actuarial valuation, MERF had only 335 active members (down from 462 a year earlier), and a considerable portion of these remaining active members meet or exceed minimum age and service requirements for retirement. MERF uses outside investment managers to handle its portfolios, and MERF is considering placing some or all MERF assets with the State Board of Investment.

MERF also has a considerably larger administrative expense per plan member (including all active, disabled, deferred, retired, and survivors) than PERA-General (\$147.12 per member for MERF compared to \$26.07 per member for PERA-General in fiscal 2006). Another way of viewing this is that, on a per member basis, for every \$1 PERA spends on administrative expenses, MERF spends \$5.65. The two other Minneapolis pension funds, the Minneapolis Fire Relief Association (MFRA), and the Minneapolis Police Relief Association (MPRA) are even less efficient. In the State Auditor's Large Public Pension Plan Investment Report for the Year Ended December 31, 2005, and in a presentation before the Commission last year, State Auditor Patricia Anderson indicated that in 2005, MPRA's administrative expenses were \$640 per member and MFRA's administrative costs were \$1,047 per member. On a per member basis, for every \$1 in administrative expenses spent by PERA to run PERA-General, the MPRA spent about \$24.60, while the MFRA spent \$40.26.

At some point pension plans become too small in size, have shifted sufficient functions to outside contractors, and are too expensive in administrative cost to justify continuing separate plan administration. If MERF or other Minneapolis pension funds have reached that point in the opinion of the Commission, there are at least three options that could be considered for reorganizing the MERF and other Minneapolis plan administrations. These options are:

- a. MERF Administration by PERA. The MERF Board either could be authorized to contract with PERA for the provision of plan administrative services for MERF or PERA could be mandated to administer MERF. **Amendment H1313-1A** authorizes the MERF Board to contract with the PERA Board for plan administrative services. **Amendment H1313-2A** mandates that PERA administer MERF.
- b. PERA Administration of the Minneapolis Firefighters and the Minneapolis Police Relief Associations. **Amendment H1313-3A** mandates that PERA administer the Minneapolis Firefighters Relief Association and the Minneapolis Police Relief Association.
- c. Combine Minneapolis Pension Plan Administrations. The plan administrations of two or more of the Minneapolis pension plans could be combined into a single plan administration. **Amendment H1313-4A** would require that the MERF plan administration provide administrative services for the Minneapolis Firefighters Relief Association and the Minneapolis Police Relief Association.
- d. Convert MERF to a Trust Fund Administered by the City. MERF 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. **Amendment H1313-5A** converts MERF to a trust fund of the City of Minneapolis to be administered by the city finance director.

A consideration for any proposal that would have MERF administer one or both of the Minneapolis relief associations is that it would be a second-best solution, and a temporary one. All these organizations are rapidly losing their remaining active membership to retirement and soon will consist entirely of retirees and survivors. It may be more efficient to consider merging all administrative functions into PERA and all investment-related functions into SBI.

