State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: S.F. 686 (Pappas); H.F. xxxx: SPTRFA: Revising Post-Retirement Adjustment Procedure; Additional Information for Further Consideration

DATE: March 19, 2009

Introduction

This memo contains additional information for the Commission's consideration of S.F. 686 (Pappas).

Discussion

The procedure in statute for the St. Paul Teachers Retirement Fund Association (SPTRFA) to determine post retirement increases is found in Minnesota Statutes, Section 354A.29. The provision authorizes the SPTRFA to provide an automatic two percent annual increase. An additional investment performance increase can also be paid if the five-year annualized time-weighted return of the fund is in excess of 8.5 percent. The percentage amount of the additional adjustment is equal to the return above 8.5 percent, after making a slight adjustment for the contribution deficiency of the fund. Ignoring that minor adjustment, if the fund had a 10.5 percent return, that return is two percent above the 8.5percent trigger, and the fund could pay an additional percentage-based adjustment of two percent, in addition to the automatic two percent increase, for a total of four percent. Due to an uncoded provision enacted in 2006 (Laws 2006, Chapter 277, Article 1, Section 2), the total increase provided by this fund is capped at five percent.

For the past two years, SPTRFA has not used the statutory provision to provide increases due to an uncoded provision passed in 2007 (Laws 2007, Chapter 134, Article 7, Sections 1 and 2), suspending the use of the statutory provision for two years (2008 and 2009), replaced by a move in the direction of a capped inflation match. Under the 2007 law, the plan matched inflation up to 2.5 percent, notwithstanding investment returns or funding levels. An inflation match up to five percent is permitted if both the one-year and five-year time-weighted rates of return are at least 8.5 percent.

Given the bill as drafted, the proposed staff amendments and other plausible alternatives, the Commission has numerous options. Among those identified to date are:

1. Take no action on the bill. If no action is taken on the bill, the procedure in statute as described above, with a five percent cap due to the 2006 uncoded provision, will again become operative. SPTRFA retirees and other benefit recipients will receive an automatic two percent annual increase, plus additional increases equal to the five-year annualized fund return in excess of 8.5 percent (with minor adjustment for the contribution deficiency), with the total capped at five percent annually.

2. Take action on the bill, using one of the following options:
    a. With technical revisions only; post-retirement adjustments will match inflation up to five percent, regardless of investment returns, contribution deficiencies, or funding level. (Amendment S0686-1A)
    b. Index adjustments to those provided by the Social Security Administration, with a five percent cap. (Amendment S0686-3A)
    c. Provide a 2.5 percent annual increase, the same as is provided to retirees of the Teachers Retirement Association (TRA), the Minnesota State Retirement System (MSRS), and the Public Employees Retirement Association (PERA). (Amendment S0686-4A)
    d. Provide an increase matching inflation, capped at 2.5 percent. (Amendment S0686-5A)
    e. Extend the 2007 provisions for an additional year, through 2010. Under the 2007 laws, the plan would match inflation up to 2.5 percent, notwithstanding investment returns or funding levels. An inflation match up to five percent is permitted if both the one-year and five-year time-weighted rates of return are at least 8.5 percent. (Amendment S0686-11A)
    f. Extend the 2007 provisions for two additional years, through 2011. (Amendment S0686-12A)

Investment Performance Information

Recent investment performance information on the SPTRFA may be of use in the Commission's consideration, since various options provide increases are based on investment performance, or permit inflation matches in excess of 2.5 percent if returns in excess of 8.5 percent are achieved.

The total portfolio returns, taken from the annual reports of the association, are quite high. Some claimed returns for individuals asset classes require some explanation, and some justifying of their credibility. (For example, the returns from the 2007 SPTRFA annual report claim the fund earned a 15.3 percent return on its cash investments, and a 49.4 percent return on a "cash equitization (overlay account).")

The total portfolio returns claimed in the reports in recent years are as follows:

Fiscal Year 2004:	20.09%
Fiscal Year 2005:	12.09%
Fiscal Year 2006:	12.96%
Fiscal Year 2007:	20.10%
Fiscal Year 2008:	- 6.60%

Despite the negative return in 2008, the five-year annualized return for these years is 11.27 percent, which is considerably above 8.5 percent

Using the 2005 through 2008 returns, it is possible to solve for 2009 return needed to provide a five-year annualized return of 8.5 percent, which would be 5.9 percent. If the fund were to achieve a 2009 return of 5.9 percent, it would be able to pay some additional increase under any system that required at least an 8.5 percent five-year annualized return to provide an inflation match if a five-year annualized return of 8.5 percent is achieved, or in a system permitting an additional adjustment, regardless of inflation levels, if a five-year return of at least 8.5 is achieved. If the system put in place required both the most recent year's return and the five-year return to meet or exceed 8.5 percent, then the fund would need an 8.5 percent return in 2009 if it is to meet both requirements.

As a general observation, what the review of these returns shows is that this association could very quickly be in a position to begin paying investment performance based adjustments when the current economic situation improves. The Commission may wish to consider a balance between payouts to retirees and retaining assets in the fund to reduce the need for state funding for SPTRFA. In making its determination, the Commission may also wish to consider equity issues that may arise if SPTRFA postretirement adjustments are higher than those provided to TRA retirees, and state and local retirees covered by MSRS and PERA.

.... moves to amend S.F. No. 686; H.F. No. ....., as follows:

Delete everything after the enacting clause and insert:

"Section 1. Laws 2007, chapter 134, article 7, section 1, is amended to read:

Section 1. **ST. PAUL TEACHERS RETIREMENT FUND ASSOCIATION; PILOT POSTRETIREMENT ADJUSTMENT; LIMITATIONS.**

(a) Notwithstanding any provision of Minnesota Statutes, chapter 354A, to the contrary, for calendar years 2008, ~~and~~ 2009, and 2010, and for postretirement adjustments initially payable on January 1, 2008, ~~or~~ January 1, 2009, or January 1, 2010, as a pilot program this section supersedes Minnesota Statutes, section 354A.29, subdivisions 3 and 4, and the applicable bylaw provisions of the St. Paul Teachers Retirement Fund Association.

(b) The postretirement adjustment under the pilot program must be determined by the executive director and approved by the board annually using the procedures under this section.

(c) On January 1, each eligible person who has accrued or received an annuity or benefit under the articles of incorporation, the bylaws, or Minnesota Statutes, chapter 354A, for at least three full calendar months as of the end of the calendar year is eligible to receive a postretirement adjustment that is payable the following January 1.

(d) A percentage adjustment must be computed and paid under this paragraph to eligible persons under paragraph (c). This adjustment is determined by reference to the Consumer Price Index for urban wage earners and clerical workers all items index as reported by the Bureau of Labor Statistics within the United States Department of Labor each year as part of the determination of annual cost-of-living adjustments to recipients of federal old-age, survivors, and disability insurance. For calculations of the cost-of-living adjustment under paragraph (e), the term "average third quarter Consumer Price Index value" means the sum of the monthly index values as initially reported by the Bureau of Labor Statistics for the months of July, August, and September, divided by 3.

(e) Before January 1 of each year, the executive director must calculate the amount of the cost-of-living adjustment by dividing the most recent average third quarter index value by the same average third quarter index value from the previous year, subtract one from the resulting quotient, and express the result as a percentage amount, which must be rounded to the nearest one-tenth of one percent. The final amount may not be a negative number and may not exceed 2.5 percent if the rate of investment return of the retirement fund either for the most recent fiscal year or for the most recent five-year period, each calculated under the formula specified in Minnesota Statutes, section 11A.04, clause (11), is less than 8.5 percent and may not exceed 5.0 percent if the rate of investment return of the retirement fund both for the most recent fiscal year and for the most recent five-year period, each calculated under the formula specified in Minnesota Statutes, section 11A.04, clause (11), are equal to or greater than 8.5 percent.

(f) The amount calculated under paragraph (e) is the full cost-of-living adjustment to be applied as a permanent increase to the regular payment of each eligible member on January 1 of the next calendar year. For any eligible member whose effective date of benefit commencement occurred during the calendar year before the cost-of-living adjustment is applied, the full increase amount must be prorated on the basis of whole calendar quarters in benefit payment status in the calendar year prior to the January 1 on which the cost-of-living adjustment is applied, calculated to the third decimal place.

(g) This pilot postretirement adjustment program does not constitute a precedent for this or any other retirement plan.

EFFECTIVE DATE. This section is effective the day following final enactment."

Amend the title accordingly

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(c) On January 1, each eligible person who has accrued or received an annuity or benefit under the articles of incorporation, the bylaws, or Minnesota Statutes, chapter 354A, for at least three full calendar months as of the end of the calendar year is eligible to receive a postretirement adjustment that is payable the following January 1.

(d) A percentage adjustment must be computed and paid under this paragraph to eligible persons under paragraph (c). This adjustment is determined by reference to the Consumer Price Index for urban wage earners and clerical workers all items index as reported by the Bureau of Labor Statistics within the United States Department of Labor each year as part of the determination of annual cost-of-living adjustments to recipients of federal old-age, survivors, and disability insurance. For calculations of the cost-of-living adjustment under paragraph (e), the term "average third quarter Consumer Price Index value" means the sum of the monthly index values as initially reported by the Bureau of Labor Statistics for the months of July, August, and September, divided by 3.

(e) Before January 1 of each year, the executive director must calculate the amount of the cost-of-living adjustment by dividing the most recent average third quarter index value by the same average third quarter index value from the previous year, subtract one from the resulting quotient, and express the result as a percentage amount, which must be rounded to the nearest one-tenth of one percent. The final amount may not be a negative number and may not exceed 2.5 percent if the rate of investment return of the retirement fund either for the most recent fiscal year or for the most recent five-year period, each calculated under the formula specified in Minnesota Statutes, section 11A.04, clause (11), is less than 8.5 percent and may not exceed 5.0 percent if the rate of investment return of the retirement fund both for the most recent fiscal year and for the most recent five-year period, each calculated under the formula specified in Minnesota Statutes, section 11A.04, clause (11), are equal to or greater than 8.5 percent.

(f) The amount calculated under paragraph (e) is the full cost-of-living adjustment to be applied as a permanent increase to the regular payment of each eligible member on January 1 of the next calendar year. For any eligible member whose effective date of benefit commencement occurred during the calendar year before the cost-of-living adjustment is applied, the full increase amount must be prorated on the basis of whole calendar quarters in benefit payment status in the calendar year prior to the January 1 on which the cost-of-living adjustment is applied, calculated to the third decimal place.

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