

Minneapolis Employees Retirement Fund (MERF)

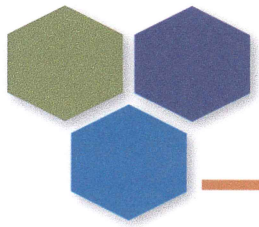
ANALYSIS OF FUNDING DEFICIENCY
January 13, 2010

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GRS

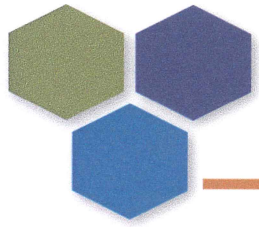
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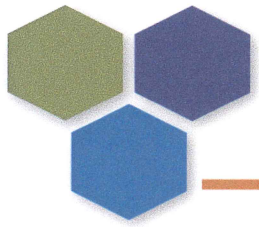
Analysis of Funding Deficiency

- ◆ Background/History of MERF
- ◆ Funding Sources/Contributions
- ◆ Actuarial Financial Conditions
- ◆ Statutory Impact on Valuation Assets
- ◆ MERF Severely Underfunded
- ◆ Actuarial Projections
- ◆ Reasons for Deficiency
- ◆ Solutions/Options



Background/History of MERF

- ◆ MERF was closed to new members by the Minnesota Legislature in 1978
- ◆ Coordinated Members transferred to PERA in 1979
 - ▶ All remaining members are Basic and not coordinated with Social Security
- ◆ Legislative history –
 - ▶ Prior to 2007: numerous changes/responsibilities of obligations and contributions defined, including caps
 - ▶ 2007 : all capped with unclear funding responsibility



Background/History of MERF

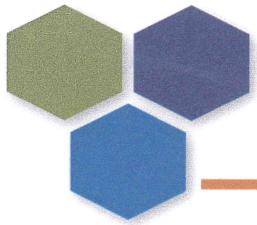
◆ Employers

- ▶ City of Minneapolis
- ▶ Metropolitan Airports Commission
- ▶ Municipal Building Commission
- ▶ Special School District No. 1 (SSD1)
- ▶ Hennepin County
- ▶ Minnesota State Colleges and Universities (MnSCU)

◆ State

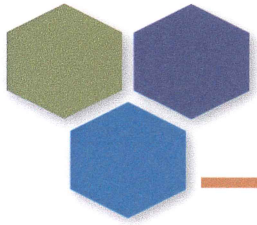
◆ Active Employees

- ▶ Member profile (active member decline)



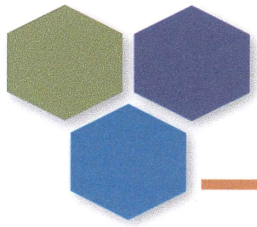
Funding Sources/Contributions Allocation of AAL

EMPLOYER	Allocation of AAL July 1, 2009
City of Minneapolis (Dept. 102, 103, 106 - 177, 400)	54.28%
Park Board (Dept. 104)	10.48%
Met Council (Dept. 200)	1.74%
Metropolitan Airports Commission (Dept. 300)	5.83%
Municipal Building Commission (Dept. 500)	1.09%
SSD1 (Dept. 600)	22.82%
Hennepin County (Dept. 701-707)	3.66%
MnSCU (Dept. 900)	0.10%



Funding Sources/Contributions

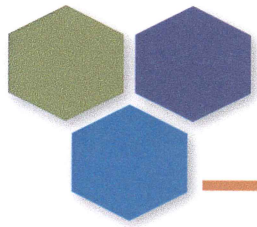
- ◆ Employers make annual contributions
 - ▶ Based on Statutory requirements in 422A
 - ▶ Subd. 1, clause (3): RBF assets equal RBF liability
- ◆ Active Basic members make annual contributions
 - ▶ Fixed at 9.75% of payroll, per Statutes
 - ▶ Not entitled to Social Security benefits
 - ▶ Membership has declined
- ◆ State level annual contributions to MERF
 - ▶ Capped at \$9 million



Actuarial Financial Conditions

Historical Financial Status of MERF (\$ in Millions)

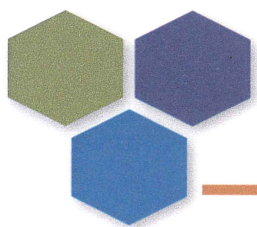
(\$ in Millions)	July 1, 2007		July 1, 2008		July 1, 2009	
	(Old Asset Method)	(New Asset Method)	(Old Asset Method)	(New Asset Method)	(Old Asset Method)	(New Asset Method)
Unfunded Actuarial Accrued Liability (UAAL) - shortfall	\$116.8	\$227.1	\$116.1	\$374.7	\$121.4	\$694.9
Statutory Contributions (422A)	\$17.2 108.69% of payroll	\$17.2 108.69% of payroll	\$16.7 131.34% of payroll	\$16.7 131.34% of payroll	\$17.7 163.16% of payroll	\$17.7 163.16% of payroll
Required Contributions (356)	\$17.2 108.69% of payroll	\$29.7 187.33% of payroll	\$16.7 131.34% of payroll	\$47.5 374.32% of payroll	\$17.7 163.16% of payroll	\$90.4 833.55% of payroll
Contribution Deficiency	\$0.0 0.00% of payroll	(\$12.5) (78.64%) of payroll	\$0.0 0.00% of payroll	(\$30.8) (242.98%) of payroll	\$0.0 0.00% of payroll	(\$72.7) (670.39%) of payroll



Actuarial Financial Conditions

Supplemental Contribution Deficiency (\$ in Millions)

Fiscal Year Beginning	Based on Statute Contributions defined under Chapter 422A (RBF Assets equal RBF liability) (1)	Based on Actuarial Required Contributions defined under Chapter 356 (All assets valued at Market Value) (2)	Annual Contribution Deficiency (2) – (1)
July 1, 2007	\$13.2	\$25.7	\$12.5
July 1, 2008	\$13.9	\$44.7	\$30.8
July 1, 2009	\$15.4	\$88.1	\$72.7



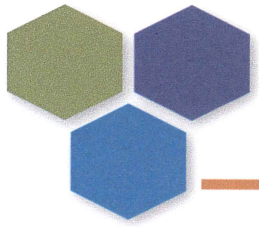
Statutory Impact on Valuation Assets

Actuarial Valuation Date	Actuarial Accrued Liability (AAL)	Liquidity Trigger Adjustment (LTA)	Actuarial Value of Assets (AVA)	AVA Funded Ratio AVA/(AAL+LTA)	Market Value of Assets (MVA)***	MVA Funded Ratio MVA/(AAL+LTA)
7/1/2003	\$1,645,921,000 *	N/A	\$1,519,421,000*	92.31%	\$1,184,427,000	71.96%
7/1/2004	\$1,643,139,996 *	N/A	\$1,513,388,863*	92.10%	\$1,273,933,000	77.53%
7/1/2005	\$1,624,354,645	N/A	\$1,489,713,085	91.71%	\$1,297,552,000	79.88%
7/1/2006	\$1,617,653,312	N/A	\$1,490,280,063	92.13%	\$1,310,369,000	81.00%
7/1/2007 **	\$1,610,881,229	N/A	\$1,383,741,762	85.90%	\$1,398,395,188	86.81%
7/1/2008 **	\$1,576,854,841	\$12,135,486	\$1,214,305,152	76.42%	\$1,214,522,650	76.43%
7/1/2009 **	\$1,551,099,019	\$23,912,506	\$880,133,155	55.88%	\$859,895,146	54.60%

* Includes amortization obligations not yet paid.

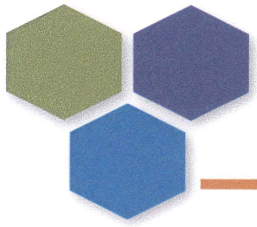
**New Asset Method calculation for Actuarial Value of Assets

***Actual (true) Market Value of Assets, includes RBF Transfer of Reserves



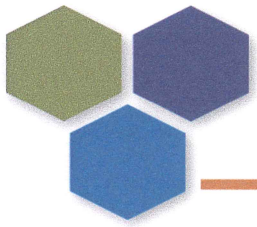
MERF Severely Underfunded

- ◆ Liabilities as of July 1, 2009 total \$1.55 billion dollars (93.4% of total liabilities are pay status/inactive)
- ◆ Market value of assets as of June 30, 2009 total \$860 million
 - ▶ Funded ratio on market value basis is 54.60%
- ◆ Actuarial value of assets as of June 30, 2009 total \$880 million
 - ▶ Funded ratio on actuarial value basis is 55.88%



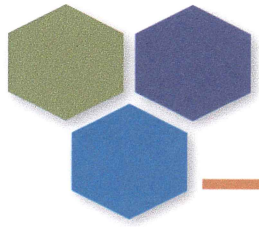
MERF Severely Underfunded

- ◆ The plan is experiencing negative cash flow
- ◆ Employer contributions totaled \$6.6 million last year
 - ▶ All contributions on behalf of current actives
 - ▶ No supplemental contribution currently being made to address post fund
- ◆ Employee contributions of remaining actives totaled \$1 million
- ◆ State contributions are limited to a total of \$9 million



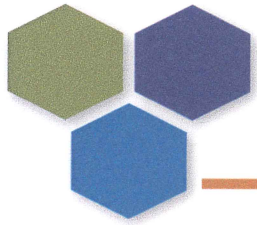
MERF Severely Underfunded

- ◆ Benefit payments totaled \$149 million in 2009
- ◆ Net Cash flow out of the fund was \$142 million
 - ▶ In the absence of significant earnings, that only gives the trust (\$860 million) about 10 more years of existence
 - Assumes the trust earns 6.00% per year and includes a 1.00% Cost-of-Living Adjustment (COLA)
- ◆ Liquidity Trigger Adjustment as of June 30, 2009 was \$24 million
 - ▶ Statutory issue by allowing employers to delay making required payments timely



Actuarial Projections

- ◆ Default is certain if nothing is done
- ◆ Reasonable economic and actuarial expectation that default will occur within 5 – 10 years
 - ▶ Sooner if another significant market decline occurs
 - ▶ Ennis Knupp 2008 analysis
 - ▶ GRS actuarial projections (next slide)

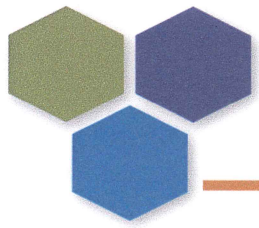


Actuarial Projections

Reconciliation of Market Value of Assets (\$ in Millions):

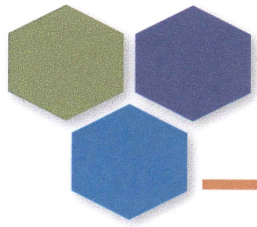
- Actuarial Projections as of July 1, 2008 show fund will exhaust within 10 years
- Assumes the following schedule of:
 - estimated income, contributions (determined under Minnesota Statutes Chapter 422A),
 - expenses, and a 6.00% assumed rate of return for fiscal years beginning July 1, 2009.

Fiscal Year Beginning	MVA – Beginning of Year	Income	Contributions (Statute)	Benefit Payments and Expenses	MVA – End of Year
July 1, 2008	\$1,214.5	(\$239.1)	\$16.7	\$149.3	\$842.7
July 1, 2009	\$842.7	\$46.8	\$16.2	\$145.0	\$760.7
July 1, 2010	\$760.7	\$42.0	\$16.0	\$140.5	\$678.2
July 1, 2011	\$678.2	\$37.1	\$15.8	\$136.0	\$595.1
July 1, 2012	\$595.1	\$32.3	\$15.5	\$131.6	\$511.3
July 1, 2013	\$511.3	\$27.4	\$15.3	\$127.0	\$426.9
July 1, 2014	\$426.9	\$22.4	\$15.0	\$122.4	\$342.0
July 1, 2015	\$342.0	\$17.5	\$14.8	\$117.6	\$256.7
July 1, 2016	\$256.7	\$12.5	\$14.6	\$113.3	\$170.5
July 1, 2017	\$170.5	\$7.4	\$14.4	\$108.4	\$83.9
July 1, 2018	\$83.9	\$2.4	\$14.3	\$103.5	\$0



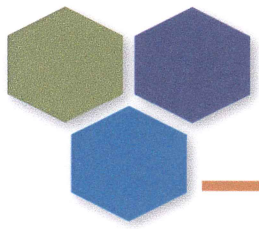
Reasons for Deficiency – Market Downturn

- ◆ Severe downturn of markets
 - ◆ Lower investment returns mean more is needed in contributions to fund the same benefit
- ◆ MERF funded before downturn
- ◆ In a closed plan we recommend viewing the funded ratio and contribution requirements based on the market value of assets- since the market value is all that is available to pay benefits.



Reasons for Deficiency – Closed Plan

- ◆ Closed plan faces certain additional risks
 - ▶ Declining active workforce means solutions for funding deficiency are limited (6,000 in 1978 to 164 today)
 - ▶ No new members so decline in employer and member contributions
 - ▶ Limited ability to reduce basic benefits as they cannot be legally reduced
 - ▶ Shorter time horizon
 - ▶ Closed plans often become abandoned by employers



Reasons for Deficiency – Post Fund

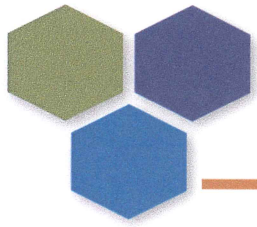
◆ MERF's Post Fund structural deficiencies

▶ Two funds remain in MERF

- Active
- Retiree Benefit Fund (RBF)

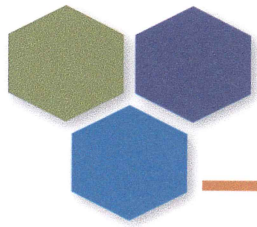
▶ RBF not valued at market until 2007

- Before 2007 the statute “hid” the funded status of the plan, by mandating that the RBF assets be artificially set equal to the RBF liabilities.
- Much greater proportion of liabilities are in RBF (87.48% for 2009)
- Funded ratios for RBF are set equal to 100% prior to 2007



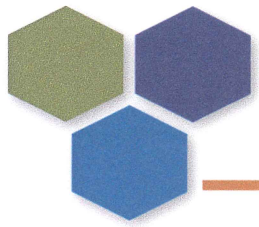
Reasons for Deficiency – Post Fund

- ◆ Questioned Practice
 - ▶ Legislative Auditor's Report (2007) on valuing Post Fund
 - ▶ LCPR Standards of Actuarial Work
 - ▶ In 2007 PERA, TRA and MSRS combined their post and active funds
 - ▶ MERF is the only fund in Minnesota to still have a separate "post fund" and active fund



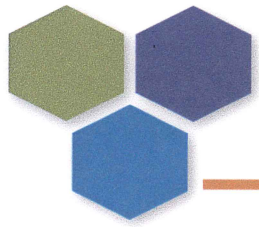
Reasons for Deficiency – Statutory

- ◆ Minnesota Statutes, Section 422A.101 is deficient
 - ▶ Statute fixed in 2007 to value assets at true market value for both active and RBF
 - ▶ Caps have been put in place that limit the contributions, but there is no cap on the liabilities
 - ▶ Subd.1, Clause (3) does not clearly allocate responsibility of deficiency
 - States RBF assets equal RBF liabilities for funding
 - ▶ Inconsistent with actuarial standards
 - ▶ Contribution deficiency is now more transparent



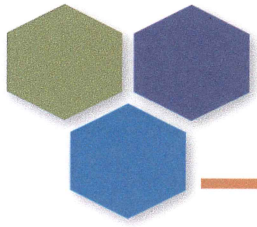
Solutions/Options

- ◆ Recognize need to fund a closed plan in line with other closed Minnesota pension funds
- ◆ Fix Minnesota Statutes, Section 422A.101 to accurately reflect MERF's financial condition and funding requirements
- ◆ Increase contributions from various sources (State, Employer) to fix MERF funding deficiency



Solutions/Options

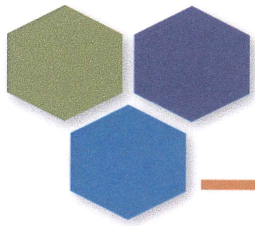
- ◆ MERF does not have a proper mechanism for adequately assigning the financial requirements of the RBF
- ◆ Other closed funds in Minnesota have a mechanism for assuring any deficiencies are paid
 - ▶ Minneapolis Police and Firefighters (No Post Fund)
 - ▶ PERA Police and Firefighters consolidated accounts



Solutions/Options

◆ Solutions that are infeasible

- ▶ Amending benefits (new hires)
 - Not available to MERF- closed plan
- ▶ Increase contribution rates on members
 - Not available to MERF- very few active members remain
- ▶ Alter asset allocation to achieve higher returns
 - MERF has high liquidity constraint
- ▶ Increase funding from other sources
- ▶ Do nothing and let the trust be depleted



Solutions/Options

- ◆ Statutory fix of MERF funding mechanism
 - ▶ Full consolidation with another statewide plan
 - ▶ Consolidation account with statewide plan
 - ▶ MERF stand alone plan but contract administrative services with statewide plan
- ◆ Pay-As-You-Go plan
- ◆ Do nothing: MERF defaults resulting in alternative non-legislative solutions