



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Susan Lenczewski, Executive Director
SUBJECT: Experience Studies
DATE: November 2, 2015

The Commission's agenda for the November 3rd meeting includes a presentation by the Commission's actuary regarding the experience studies conducted on the State's three largest pension plans, MSRS-General, PERA-General and TRA. In addition, the Commission is being asked by the plans to approve actuarial assumption changes that have already been approved by the respective governing board for each plan, but which cannot take effect immediately without Commission approval. The assumption changes are the result of each plan actuary's conclusions and recommendations upon completing the experience study.

In addition to considering the results of the experience studies conducted on their largest plans, the governing boards of MSRS and PERA have approved having experience studies conducted on several smaller pension plans for which they are responsible. The issue that has arisen is whether the plans must obtain the approval of the Commission to conduct these experience studies.

This memo provides background information regarding experience studies, the experience studies recently completed and to be completed and whether Commission approval is required for studies on smaller plans.

I. MSRS-General, PERA-General, TRA

Minnesota Statutes § 356.214, Subd. 1(d) requires the completion of a quadrennial "experience study" on the retirement plans for the following three associations or systems:

- Teachers Retirement Association ("TRA");
- Minnesota State Retirement System ("MSRS");
- Public Employees Retirement Association ("PERA").

As noted, experience studies are to be conducted every quadrennial, but in 2012, the legislature approved a special amendment to extend the period for the current quadrennial to a sexennial, resulting in experience studies being conducted on the three plans for the period July 1, 2008 through June 30, 2014.

The experience study is to be conducted by the actuary retained by each plan and in accordance with the “Standards for Actuarial Work” (“Standards”) adopted by the Commission. The statute further provides that the experience study must evaluate the following:

1. Individual salary progression;
2. Rate of return on investments based on the current asset value;
3. Payroll growth;
4. Mortality;
5. Retirement age;
6. Withdrawal; and
7. Disablement.

An experience study is defined as “a report providing experience data and an actuarial analysis of the adequacy of the actuarial assumptions on which actuarial valuations are based.”¹ In other words, an experience study is a look back at the past to determine how closely predictions and best guesses made at the time were borne out by subsequent real life experience. For instance, it had been predicted that there would be 4,021 “Rule of 90” retirements in the MSRS-General plan during the 2008 through 2014 period, when, in fact, there were only 2,841 Rule of 90 retirements. (“Rule of 90” permits eligible members to retire with an unreduced pension at an earlier age than normal retirement so is more costly to the plan than not having a Rule of 90 provision.) The prediction, which turned out to be in error by predicting significantly more Rule of 90 retirements than actually occurred, would have meant that the overall expected cost of the plan was anticipated to be higher than it turned out to be.

Two copies of each experience study must be filed with the executive director of the Commission,² the commissioner of management and budget and with the Legislative Reference Library, not later than the last day of the 12th month occurring after the end of the last fiscal year of the four-year period which is covered by the experience study (*i.e.*, June 30, 2015, for an experience study that covers the period ending June 30, 2014). The Commission may have its actuary audit or review any experience study.

As mentioned, in addition to the statutory requirements, the experience study must comply with the Standards. The Standards set forth requirements for the experience studies, which presumably apply in addition to the statutory requirements. The Standards split the analysis to be conducted in an experience study into two parts:

- economic experience, which analyzes (i) investment return, (ii) compensation increases and (iii) payroll growth; and
- demographic experience, which analyzes age and years of service at death, disablement and quit, and calculates a ratio of actual to expected for each event.

The Standards require that enough statistics be included so reviewers can assess the viability of the actuary’s conclusions and the A/E ratio (ratio of actual to expected events) for each assumption is to be presented graphically and for each year and for the sexennial. The Standards were last updated August 11, 2010.

¹ Minn. Stat. § 356.215 Subd. 1(e).

² Minn. Stat. § 356.214 Subd. 3.

The Commission timely received the following experience studies from the following actuarial firms:

- “Minnesota State Employees Retirement Fund 6-Year Experience Study July 1, 2008 through June 30, 2014” by Gabriel Roeder Smith & Company, Minneapolis, Minnesota.
- “General Employees Retirement Plan of Minnesota 6-Year Experience Study July 1, 2008 through June 30, 2014” by Gabriel Roeder Smith & Company, Minneapolis, Minnesota.
- “Teachers Retirement Association of Minnesota Experience Study July 1, 2008 through June 30, 2014” by Cavanaugh Macdonald Consulting, LLC, Bellevue, Nebraska.

The conclusions and recommendations set forth in each study indicate that changes should be made to most of the actuarial assumptions used in the preparation of the plans’ actuarial valuations. The recommended changes were presented to the board of directors or board of trustees for each of the plans, which adopted all recommended changes. These changes have been compiled and presented to the Commission for approval in the chart entitled “Proposed 2015 Actuarial Assumption Changes.”

II. Experience Studies for Plans Other than MSRS-General, PERA-General and TRA

Minnesota Statutes § 356.214, Subd. 1(f) states that if the “actuarial gain and loss analysis in the actuarial valuation calculations indicates a persistent pattern of sizable gains or losses, the governing or managing board or administrative official shall direct the actuary to prepare a special experience study” for the following plans:

- MSRS Correctional Employee Retirement Plan
- MSRS State Patrol Retirement Plan
- MSRS Judges Retirement Plan
- PERA Public Employees Police and Fire Plan
- St. Paul Teachers Retirement Plan
- MSRS Legislators Retirement Plan and
- PERA Local Government Correctional Service Retirement Plan

This “special experience study” is to be conducted “in the manner provided for in the standards for actuarial work adopted by the Commission.”

The relevant provision in the Standards, on page 20, Section IV.D.(5), states:

A comprehensive experience study report on the Legislators Plan, Elective State Officers Plan, the St. Paul Teachers Retirement Fund and the Duluth Teachers Retirement Fund may be inappropriate because of their smaller size. However, the assumptions used in the valuations should be reviewed after the experience studies are completed for the larger systems to determine if any of the findings in those reports indicates a need to make adjustments to the valuation assumptions used by the smaller plans. The Actuary for the Legislators Plan, Elective State Officers Plan, the St. Paul Teachers Retirement Fund and, the Duluth Teachers Retirement Fund shall report in writing that a review of all actuarial assumptions was performed and identify any changes in assumptions recommended and the reason for the recommended change. *An experience study can be*

recommended by the Actuary or by the respective Plan Administrator of any plan, but must be approved by the Commission before preparation.

(Italics added to highlight specific language to be considered below.)

With the completion of the experience studies on the three largest plans and the resulting recommendations that a number of assumptions be adjusted, the governing boards of MSRS and PERA determined that limited scope studies should be conducted on their smaller plans. Consequently, PERA's Board of Trustees has approved having limited scope experience studies performed on two of the smaller plans governed by PERA, the PERA Police and Fire Plan and the Local Government Correctional Service Retirement Plan, by the end of this fiscal year. Similarly, MSRS' Board of Directors has approved having limited scope experience studies performed on three of the smaller plans covered by MSRS, the State Patrol Retirement Plan, the Correctional Employees Retirement Plan and the Judges Retirement Plan.

Commission staff were asked whether there was need for Commission approval in view of the language in the Standards that appears to require Commission approval. Staff is of the opinion that the language, when read in context, requires Commission approval of experience studies on the four plans specifically listed: Legislators Plan, Elective State Officers Plan, St. Paul Teachers Retirement Fund and the Duluth Teachers Retirement Fund (no longer a separate plan). This reading is based on the following rationale:

- First, the requirement is at the end of a paragraph that specifically addresses only four plans, not all the smaller plans.
- Second, this paragraph, along with the rest of the Standards, has not been updated in over five years. The need for Commission approval of just these four plans should be revisited when the Standards are revised in 2016 and consideration given to eliminating the requirement.
- Third, as a policy matter, it is not clear why the Commission would need to approve experience studies, since the actuarial cost of the study would seem to dictate against the Plans contracting for unnecessary experience studies. Moreover, if the concern was that more studies would lead to more actuarial assumption changes (and some sort of abuse), the need to present to and obtain the approval of the Commission with regard to assumption changes would appear to mitigate (and eliminate) that concern.

We have researched this issue in the Commission's files and memos on related topics and have found nothing on point that explains the need for Commission approval and why the approval requirement appears to apply only to the four plans listed in the paragraph.

III. Conclusion

Experience studies are required every four years for MSRS-General, PERA-General and TRA and those have been completed on a timely basis. Experience studies may be done on the smaller plans and is required to be done where experience losses are significant. Commission approval of having experience studies done is not necessary except that, under a provision in the Standards that is not clear and may be revised or eliminated in connection with updating the Standards, Commission approval appears to be necessary in the case of the Legislators Plan, Elective State Officers Plan and St. Paul Teachers Retirement Fund.