



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Susan Lenczewski, Executive Director

RE: HF1908 (Atkins); SF1774 (Hayden); Benefit Increase for Certain Former Local Police and Paid Fire Relief Association Recipients Covered by PERA-P&F

DATE: February 23, 2016

Summary of HF1908 (Atkins); SF1774 (Hayden) and Delete-All Amendments H1908-2A and H1908-3A

HF1908 (Atkins); SF1774 (Hayden) was introduced on March 16, 2015, but was not considered by the Legislative Commission on Pensions and Retirement during the 2015 legislative session. The bill amends Minnesota Statutes § 353.65, by adding a new subdivision to this section, which deals with contributions to the public employees police and fire fund to fund Public Employees Police and Fire Retirement Plan (PERA-P&F) benefits.

Both amendments are “delete-all” amendments that replace all of the substantive provisions of the bill. The amendments add a new subdivision to Minnesota Statutes § 353.651, which deals with retirement annuities upon leaving public service. Since the new subdivision increases the retirement annuity currently being paid to retirees and their surviving spouses, it is more appropriately added to this section rather than the section amended by the bill.

As noted, the amendments add a new subdivision 6 to section 353.651. Subdivision 6, as set forth in Amendment H1908-2A, provides for the following:

1. A pension increase for any person who (a) was a former member of a local salaried police or firefighters relief association that consolidated with PERA P&F, (b) elected to have his or her pension calculated under the former local plan, and (c) had at least 20 years of service or was receiving a disability pension.
2. The retiree’s annual pension benefit is to be increased, effective July 1, 2016, to \$38,000 or by 20%, whichever results in the lower annual amount.
3. In the case of the surviving spouse of a person described in paragraph 1, above, the spouse’s annual benefit is to be increased, effective July 1, 2016, to \$30,000 or by 20%, whichever results in the lower annual amount.
4. Post-retirement adjustments are to be paid on the pension equal to the rate applicable to PERA-P&F under Minn. Stat. § 356.415, subdivision 1, paragraph (c), which is currently 1%.
5. To pay for the benefit increases, the portion of the annual supplemental state aid of \$15.5 million under Minn. Stat. § 423A.022 that is paid to the PERA-P&F Plan and the State Patrol Plan administered by the Minnesota State Retirement System (MSRS) is to be extended beyond the termination date that would otherwise apply to the state aid. The state aid to the PERA-P&F Plan

and the State Patrol Plan will terminate when the funding ratio of market value assets to actuarial accrued liabilities of both plans reaches 90%. Since the Plans' portion of the state aid is approximately \$10 million, and the cost of the increased benefits was calculated by PERA to be approximately \$8.5 million (\$2.4 million for retirees and \$6.1 million for surviving spouses), as of January 16, 2015, one additional year of state aid should cover the cost of the benefit increases. The cost estimate by PERA, however, is now out of date and we would expect the cost of the increased benefits to be higher, due to mortality and other changes.

Amendment 1908-3A is identical to Amendment 1908-2A, except that it does not include the benefit increases for surviving spouses (item 3, on page 1 of this memo).

Background

Please see the attached is a summary of a report prepared by PERA's executive director dated January 16, 2015, for background on the local salaried police or firefighters relief associations, consolidations into PERA-P&F and choices given to members in connection with the consolidations. More detail is provided in the PERA report, which is also attached.

Considerations

The following considerations summarize and update points raised in memos prepared by former Commission staff members in response to similar legislation proposed in 2014 and HF1908/SF1774.

1. Payments into the Fund Will Substantially Lag Payments Out of the Fund and May Never Occur. As noted, to pay for the benefit increases, the portion of the annual supplemental state aid of \$15.5 million under Minn. Stat. § 423A.022 that is paid to the PERA-P&F Plan and the State Patrol Plan is to be extended beyond the termination date that would otherwise apply. The state aid to the PERA-P&F Plan and the State Patrol Plan will terminate when the funding ratio of market value assets to actuarial accrued liabilities of both plans reaches 90%. PERA-P&F is projected to reach 90% funding in 2033 and the State Patrol Plan is projected to reach 90% funding in 2049, so the later of the two is 2049. These projections do not include potential changes from the pending experience studies underway for both plans. We can expect that these experience studies will impact these projections. By way of comparison, the impact of the recently completed experience study on the PERA General Employee Retirement Plan (PERA-General) moved its 90% funding date from 2033 to 2039.

The increased pension benefits for these members will begin to be paid shortly after enactment. However, the funding of the liability will not occur until at least 2049, when the State Patrol Plan is projected to reach the 90% funding target. The Commission may wish to consider whether it is appropriate and good precedent to pay out increased benefits many years before the funding of the related liability will occur. We can also expect that if the liability will not begin to be addressed for many years, the cost of advancing benefit payments without corresponding funding will increase the overall cost of these benefit increases.

2. Projected Funding Impact Information is Out of Date. The information on which PERA's cost estimates is based dates back to July 1, 2014, and does not reflect the impact of the updated actuarial assumptions, including increased mortality. Also, Commission staff understands that there have been changes in the retirees and survivors impacted by the legislation, such as deaths and

changes in marital status. The passage of time and these developments can be expected to have an impact on the cost of providing increased benefits. Since one of the Commission's duties, under Minnesota Statutes § 3.85 is to analyze proposed pension legislation "with particular reference to analysis of their cost," the Commission may wish to consider deferring action until the funding impact can be updated. PERA may reasonably want to rely on the advice of its actuary to ensure the accuracy of any update, which will result in additional expense. This too is a topic for the PERA board and the Commission may want to understand the cost and timing of an actuarial update as well as the PERA board's position on incurring the additional expense.

3. Precedent. The legislation creates precedent and may lead to more requests from retirees in this and other plans for increases in benefits whenever they become aware that similarly situated pension recipients are receiving greater benefits. As drafted, the legislation amounts to acquiescence to a request to swap plans, a less generous plan for a more generous plan. A group of retirees is not satisfied with the benefits currently provided to them and they are requesting to instead be provided with benefits levels more comparable to that which they would have at the current time if they were instead covered by the PERA-P&F Plan in its entirety. This could lead to requests from other groups of retirees under the other public pension plans that they also receive benefits comparable to those that would be provided by plans with richer benefit formulas, such as the Teachers Retirement Association, and higher post-retirement adjustment rates, rather than the benefits under their own plans. This would create additional liabilities, be difficult for the plans to administer, and make predicting liabilities and funding requirements nearly impossible.
4. Reversing Irrevocable and Informed Elections. Commission staff understands that the record indicates that these retirees' elections were intended to be irrevocable, that the retirees were given notice of that fact, and that these retirees' elections were freely made. Where pension benefits are the result of choices freely made by a plan's members, the Commission may reasonably choose to decide that PERA-P&F and the taxpayers are under no obligation to relieve these individuals from the consequences of their actions.

Under the applicable consolidation laws (Minn. Stat. Ch. 353A), active members of the local relief association at the time of consolidation were given a choice between the local benefit plan in its entirety (local plan retirement/disability/survivor provisions plus local plan post-retirement adjustments), or the PERA-P&F Plan in its entirety (PERA-P&F retirement/disability/survivor provisions plus PERA-P&F post-retirement adjustments). Individuals who, at the time of consolidation had already terminated from the employment for which they were covered by the local relief association were limited to benefits under local relief association laws, except that they could choose post-retirement adjustments under the local plan provisions or those of PERA-P&F. Thus, regardless of whether the retirement, disability, or survivor benefit was computed under local law or PERA-P&F provisions, the individual had a choice between local plan and PERA-P&F post-retirement adjustments. Local plan post-retirement adjustment adjustments typically are tied to changes in active duty salary. While procedures differed between local plans, generally the retirees were to receive the same percentage increase in benefits as the percentage increase in the local salaries being paid to top grade patrol officers or firefighters. The PERA-P&F adjustments, for much of this period, was a percent increase matching inflation, plus additional amounts related to investment results in excess of the plan's investment return assumption. Through portions of the 1980s, post-retirement adjustments may have been higher when computed under the local plan laws. During the 1990s, the adjustments under the PERA-P&F provisions were very generous, because of exceptional returns to the stock

market, providing increases likely to have exceeded those provided by local plan provisions. More recently, particularly since 2010, PERA-P&F adjustments have been very low, and we are again in a period where adjustments are very likely to be higher under local plan provisions. For the indefinite future, the PERA-P&F plan is expected to provide only a 1% annual post-retirement adjustment.

5. Concern that Members May Not Have Received Adequate Counseling When Electing Benefits. While Commission staff has no information to suggest that this is a concern, it is possible that PERA staff may not have provided adequate counseling and information prior to member elections. If that occurred, the question is whether the legislation is a reasonable approach to address such a concern, since benefit increases are provided on a global basis to a large group of benefit recipients. The Commission may wish to consider that addressing a problem of deficient counseling may be more appropriate for individual legislation when the facts of each case have been investigated and determined and the Commission is able to give attention to the specific arguments and equity issues in each case.
6. Windfall Concern. The Commission may wish to consider that within the group covered by the legislation are individuals who were active members at the time of consolidation and who specifically chose local plan benefits because they provided the individual with a specific advantage, *e.g.*, the local plan provided the individual with a higher benefit. The local plans typically permitted individuals to retire with full benefits as early as age 50, which would not be permitted under PERA-P&F, and local plans often would provide benefits to a surviving spouse at no direct cost to the retiree. In contrast, under PERA-P&F the individual would have had to take a monthly benefit reduction to provide survivor coverage. If an individual specifically chose local plan benefits for reasons such as this, and is now to receive a further increase in benefits under this legislation, that adjustment may be considered as a windfall.
7. Post-Retirement Adjustment Issues. If the legislation is intended to address a perceived problem due to differences over time in local plan post-retirement adjustments compared to PERA-P&F post-retirement adjustments, Commission members may wish to consider that many local plans provided adjustments matching the percentage increase in active duty police officer or firefighter salaries. Over the long term, those increases are likely to have at least kept pace with, and probably exceeded, inflation, which should have provided excellent protection for retirees. For retirees with that protection, there is little basis for a claim of harm. In any event, anyone receiving post-retirement adjustments based on local plan provisions is receiving those adjustments because the active member, retiree, or disabled individual freely elected those adjustments rather than those of PERA-P&F.
8. Future Post-Retirement Adjustments Are Only 1%. After increasing the pension amount, the legislation provides that the pension is to be adjusted over time using the PERA-P&F post-retirement adjustment procedure. Doing so overturns the supposedly irrevocable election of local plan post-retirement adjustments which each retiree covered by the legislation freely made. In addition to reversing that election, the legislation saddles that individual or his or her survivor with post-retirement adjustments, going forward, which are likely to be inferior to those provided under the local law provisions. PERA-P&F post-retirement adjustments are currently only 1% per year. If the legislation is enacted, the group is likely to request additional legislation in the future, claiming that this legislation harmed them going forward.
9. PERA Board Position is Unknown. Commission staff understands that the PERA board has not adopted a formal position regarding these benefit increases. Since the PERA board may be in the

best position to understand the impact of these benefit increases on the fund generally and are charged as fiduciaries with protecting the fund, among other duties, the Commission may wish to consider deferring action until the PERA board's position is known.

Attachments

- Summary of PERA Report dated January 16, 2015
- PERA Report dated January 16, 2015 (without appendices)
- HF1908 (Atkins); SF1774 (Hayden)
- Proposed Amendment H1908-2A (Thissen)
- Alternative Proposed Amendment H1908-3A (Thissen)

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TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Rachel Barth, Deputy Director

RE: Summary of the 2015 PERA Report on a Proposal to Increase Benefits to Certain Individuals Receiving Benefits from the PERA Police and Fire Plan

DATE: February 17, 2016

Introduction

This memorandum is a summary of a report prepared by the Public Employees Retirement Association (PERA), dated January 16, 2015, at the request of the Pension Commission after consideration of proposed bill H.F. 1800/S.F. 1620, introduced in the 2013 session. The report provides background information on local police and fire relief association consolidations with the PERA Police and Fire Plan (P&F Plan) and the opportunities members had at various times to elect (i) the plan in which they wished to participate, (ii) the post-retirement adjustment (COLA) they wished to receive, and (iii) the benefits their surviving spouse would receive. The report provides statistical information and cost estimates for proposed benefit increases, which would be paid to certain retirees and survivors who had chosen to maintain their local police and fire plan benefits and.

The Report

Local Plan Consolidations

Local pension plans for paid police and fireman, called relief associations, were administered by the respective city and provided benefits based on each association's articles of incorporation and bylaws. Beginning in 1980, all newly hired paid police and fireman were required to be enrolled in the P&F plan. Due to administrative burdens and the improving P&F benefits, many relief associations wanted to consolidate with the P&F plan. Chapter 353A was enacted in 1987 that established a process for consolidation and the benefit options relief association members were able to choose from. Consolidation merely shifted the plan's administration to PERA, the city still had to provide funding to ensure all promised benefits were paid.

Benefit costs of a consolidation varied based on the benefit option choice each relief association participant made. So, to determine the consolidation costs to ensure that the city provided the appropriate funding, the actuary generated the cost as if each participant elected the benefit provisions that would provide the highest benefit payable, using the applicable PERA assumptions. Cities were required to make an initial annual contribution based on that cost estimate and future annual contributions thereafter, depending on various actuarial experiences.

If a consolidation occurred, active and former members of the relief association were authorized to make benefit choices. Active members had the option between the local plan's benefit and the P&F

coverage in its entirety. Former members, which included retirees, disability benefit recipients, surviving spouse benefit recipients, and deferred members, were required to retain the benefits paid to them on the date of consolidation, but they were able to choose how to receive their future annual post-retirement adjustments (COLA). The option was either to maintain the local plan increases, which were tied to wage increases negotiated for active members of a defined rank, or receive the P&F COLA, which was determined by the Minnesota Post Retirement Investment Fund (Post Fund) investment returns. Future surviving spouses of these benefit recipients were tied to the COLA choice made by the member spouse. The law also required that at the time the member passed away, PERA must use the applicable relief association bylaws to calculate the survivor benefit and apply the COLA choice the member made. So, if a member chose to receive the P&F COLA and received the COLA increases of the 1990s, which were significant, the eventual survivor benefit would be smaller than the member's benefit because the survivor benefit would not include those COLA increases.

Local plan benefits differed from P&F benefits. Local plan benefits were calculated as a percentage and allocated units of "base pay" upon which contributions had been paid with benefits commencing at age 50. Local plans provided for automatic survivor benefits that were paid from the plan so that the member did not have to take a lower benefit to provide a future benefit to the spouse. P&F benefits were calculated using the salary high-five with benefits being reduced if taken before the member reached age 55. The benefit was also reduced if the member chose a survivor benefit option.

Plans that had consolidated into PERA became increasingly more complex to administer due to the fewer numbers of members electing and paying into the local plan. The annual required calculation local plans with unfunded liabilities had to pay fluctuated every year, which put a strain on city budgets. P&F benefits were also improved three separate times. Each city had to approve the improvements before they could be extended to the members who had chosen P&F coverage because the improvements had to be funded by the city. Some cities were able to adopt the improvements while other cities were not, leading to benefit differences between what P&F members would receive. The desired result of consolidation was to achieve uniformity, which was no longer occurring among those who had or could elect P&F benefits.

Merger of Local Plans

The volatility of city contributions on behalf of the consolidated accounts and the differences in benefit levels among P&F members led to the eventual full merger of the consolidated relief associations. Cities that had unfunded liabilities were required to fully fund their benefit obligations and were given a specified amount and time frame to do so. The merger law provided a second election to benefit recipients who had chosen to retain the local plan COLA to instead choose the P&F COLA prospectively. Local plan participants who had elected to retain local plan benefits, were also given a second election to choose P&F COLAs, prospectively.

Participants who had been retired at the time of consolidation and had chosen P&F COLAs began to realize that their spouses' benefits would be lower due to the requirement that PERA calculate the spousal benefit using the local plan provisions, which did not recognize prior COLA increases. In 2000, legislation was enacted that allowed local plan retirees to elect either a 15% or 25% joint and survivor option. Selecting either option meant that the retiree's benefit would immediately be reduced by the respective percentage and provide for 15% or 25% of the current benefit to be paid to the spouse in addition to the local plan survivor benefit. This new option did not provide a "bounce back" feature like

the one in the P&F plan, which allows the member's benefit to "bounce back" to 100% if the member outlives the spouse. The cost of the "bounce back" feature is incorporated into the P&F retirement cost included in determining the contributions required to the fund plan. However, the local plan retirees had chosen the P&F COLAs after already retiring and therefore had not made any contributions to fund a "bounce back" feature. So, if a local plan retiree chose the new joint and survivor option but they outlived their spouse, their benefit would remain at the reduced rate.

Proposed Legislation to Increase Benefits

In 2013 legislation was proposed to increase the benefits of all retired persons who retained benefits under the relief association laws to \$38,000 annually or 20%, whichever was less. It also directed that all survivors receiving benefits based on local plan bylaws were to receive an increase to \$30,000 annually or 20%, whichever was less. The bill did not have a provision to provide funding for those benefit increases.

PERA testified in opposition to the 2013 bill stating that it would violate PERA's fiduciary duty to use assets from the P&F plan to pay for increased benefits to a select group of members. PERA also raised concerns that other benefit recipients of the plan who were not formerly part of a relief association, but who were receiving similar benefit amounts to those identified in the bill, were not included. In 2014, PERA analyzed the accounts of those local plan benefit recipients who were former participants in the local plans that consolidated and ultimately merged into the P&F plan and released a report on January 16, 2015 to the LCPR.

PERA Report Results

PERA found that 970 retired members of the local plans were receiving benefits in 2014, 498 of whom were retired when their relief association consolidated or merged with P&F. Only 3 of those members chose to retain local plan COLA increases. PERA also found that of the 472 former local plan members who were deferred or still working when their relief association consolidated, 417 chose P&F benefits and 55 chose to retain their local plan benefits. Only 1 of those 55 members chose to retain local plan COLA increases when given the second election in 1999.

At the time PERA conducted the study, 83 individuals were receiving benefits that were below the proposed legislation's threshold of \$38,000. Of those 83, 58 were retired before consolidation and 25 retired after consolidation and retained local plan benefits. PERA found that the cost of increasing only the benefits was a present value of \$2,386,819 in 2014. PERA also found that 288 local plan survivors were below the proposed legislation's threshold of \$30,000. The cost of increasing the survivors' benefits was a present value of \$6,083,262 in 2014.

PERA also found that there were individuals who were receiving P&F benefits who also fell below the proposed legislation's thresholds. 7 individuals who retired after consolidation and chose P&F benefits fell below the \$38,000 threshold. PERA found that there were 418 survivors receiving P&F survivor benefits that below the \$30,000 threshold. If those 418 benefits were increased, the present value cost was \$9,697,738 in 2014.

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Local Police and Fire Benefit Plans

Introduction

A bill was introduced during the 2013 legislative session (House File 1800 and Senate File 1620) directing the Public Employees Retirement Association (PERA) to increase the retirement and survivor benefits of certain individuals receiving benefits from the PERA Police and Fire Plan (P&FP). The Legislative Commission on Pensions and Retirement (LCPR) held a hearing on the bill during the 2014 legislative session. Discussion focused on the surviving spouse benefits of former members of the local police and fire relief associations that had consolidated under PERA's administration and merged with the PERA P&PF effective June 30, 1999.

PERA staff testified in opposition to the bill as proposed because there was a cost associated with increasing the benefits for these individuals, but the bill did not provide for any means of covering that cost. Additional discussion followed, and the outcome was a request by the LCPR of PERA staff to prepare a report about Police and Fire benefit recipients who retained benefits under the local plan provisions.

A review of data associated with individuals receiving retirement and survivor benefits from the PERA Police and Fire Plan found that there are currently 970 former members of the local police and fire relief associations receiving retirement benefits, 498 of whom were retired before the individual consolidations occurred. Of those retirees, 83 are receiving annual benefits that are less than the threshold of \$38,000 or a 20 percent increase in current benefits, whichever is less, the threshold of benefits that was included in the 2013 proposed legislation.

The recommended benefit threshold proposed for surviving spouses was set at a 20 percent increase in current benefits or \$30,000, whichever is less. Data shows there are 288 surviving spouses of former relief association members who are receiving benefits under this threshold. We also included analysis of a lower threshold, a 20 percent increase in current benefits, or \$24,000, whichever is less, and found that there are 187 surviving spouse benefit recipients under that threshold.

We respectfully submit this report for informational purposes only. We have included background on the consolidation of local police and fire relief associations under PERA's administration and eventual full merger of those separate consolidation accounts into the PERA P&FP. We were not asked nor have we made any recommendations regarding these benefit payments.

Respectfully,
Mary Most Vanek
Executive Director

Local Police and Fire Benefit Plans

2014 Laws of Minnesota, Chapter 296, Article 9, section 7 directs PERA to report on the local relief association benefits under consolidation. Specifically, the law directs:

“The executive director of the Public Employees Retirement Association shall report to the Legislative Commission on Pensions and Retirement by February 1, 2015, regarding the situation of former members and surviving spouses of former members of local salaried police and fire relief associations governed by Minnesota Statutes, chapter 423A, that consolidated with the public employees police and fire retirement plan under Minnesota Statutes, chapter 353A, and Laws 1999, chapter 222, article 4.”

This study does not make any recommendations. It provides background on the consolidation of local plans under PERA’s administration and eventual merger with the PERA Police and Fire Plan. It includes information about the benefits currently paid to former members of the local salaried police and fire relief associations who did not choose the form of PERA benefits available to them through chapter 353A, and explains the second chance included in the 1999 merger legislation to select the former PERA Post Fund increases. It also provides background information about the survivor benefits payable to the surviving spouses of former members of the local plans based on the provisions governing the consolidation of local plans from 1987 through 1999. We specifically referenced the individuals currently receiving benefits under the thresholds defined in Minnesota 2013 session House File 1800 and Senate File 1630 which proposed increasing service and disability benefits by whichever is less, an increase of 20 percent or \$38,000 and survivor benefits by whichever is less, an increase of 20 percent or \$30,000.

Background

Initiation of Consolidation of Local Plans with PERA Police and Fire

Major cities were authorized to establish their own locally administered pension and benefit plans for their police and fire departments. Those pension plans were called relief associations. Relief association pension plans that had been established for salaried police officers and firefighters were closed and newly hired public safety officers in these professions were required to be enrolled in the Public Employees Retirement Association (PERA) Police and Fire Plan (P&FP) effective June 16, 1980. As the P&FP began improving the benefits provided to its participants because of strong financing of the plan, some participants of the local plans began to question how they may be able to join the PERA plan. With benefit recipient numbers growing as active member numbers and contributions declined because these local plans were closed to new participants, an interest in getting out of the pension plan administration business also grew as an incentive to join the statewide (PERA) plan.

Local Police and Fire Benefit Plans

A task force created in 1985, that included members of the Legislative Commission on Pension and Retirement, was charged with developing a proposal to address the number of inquiries and questions that had been raised about allowing local plan members to participate in the PERA P&FP and other associated issues. Organizations representing the participants of these independent plans voiced concerns about what proposal may eventually be forwarded for consideration by the Legislature, voicing adamantly that mandatory consolidation of any of the independent plans not be part of the proposal. Enacted in 1987, the consolidation law, Chapter 353A, established a process for local plan participants' input on the question of whether to have PERA take over administration of their plan. It also set up the structure defining what benefit choices the participants would have if a majority of the relief association membership and the sponsoring city chose to "consolidate" under PERA's administration. The mechanism created in this law allowed Minnesota cities that were maintaining relief association pension plans to get out of the pension administration business, and extended to some participants of these plans an opportunity to elect PERA Police and Fire benefits.

While consolidation provided a means of shifting the administrative responsibilities to PERA, it did not affect the responsibility of the city to provide adequate funding to assure full payment of all benefits promised to the participants of the local public safety plan. Valuation procedures were established as part of Chapter 353A to direct the actuaries in how to determine the costs for the plan if consolidation were approved. Three cost scenarios were presented so that the plan participants and cities had a comprehensive picture of the costs they may expect to incur. The three scenarios included:

1. The cost of the benefits of the local plan assuming all participants would continue with the benefits provided by the plan and current law assumptions remained in place when valuing the plan.
2. The future cost of the plan assuming all participants elected to receive the PERA P&FP benefits offered to them under the provisions of the PERA plan, applying the assumptions in the law that were used to value the PERA plans.
3. The cost if each participant elected the benefit provisions, as allowed under the terms of Chapter 353A, that would provide the highest benefit payable to each individual, using the applicable PERA assumptions.

This third scenario generated the highest cost under the terms of consolidation. The law directed that if consolidation were approved, the city would be required to make an initial annual contribution based on the highest cost estimated. Future annual contributions would fluctuate depending on actual investment experience, mortality, and number of new retirements and were calculated annually as part of the fiscal year-end valuation of each consolidation account.

A significant difference between the local plans and PERA P&FP benefits was how post-retirement adjustments were determined. The annual post-retirement adjustment paid to most local plans'

Local Police and Fire Benefit Plans

benefit recipients was tied to some measure of what was negotiated with the city for active members holding a specific rank – typically top grade patrol officer for police funds and first class firefighter for fire funds. The actuary assumed for purposes of actuarial valuations that the increase would be 3.5 percent. The assets available for payment of the benefits to retirees, disability benefit recipients and survivors remained in the same pool of assets as the active members. Any investments earned on that pool added (or subtracted) from the funding position of the local plan.

PERA participated in the Minnesota Post Retirement Investment Fund (Post Fund). At retirement, or in the case of consolidating relief associations, upon election of PERA Post Fund benefits, assets equal to the present value of the future benefits payable to the benefit recipient, using 5 or 6 percent as the discount for future benefits, as applicable, were transferred to the Post Fund. This created two outcomes: a) the assets were no longer part of the active pool of the consolidated account's assets and thus any investments earned in excess of the post-retirement adjustment paid did not improve the funded position of the active pool of assets; and b) the active pool of assets was not used to pay any post-retirement adjustment, but rather the investments earned on the Post Fund generated the funds to pay those increases.

Individual Participant Choices under Consolidation

The consolidation law was very specific about from what benefit set consolidating plans' participants could elect coverage. Plan participants who were already being paid their benefits, including service pensions (retirees), disability benefit recipients and surviving spouse benefit recipients, retained the benefits paid to them on the date of consolidation. The only choice they had with respect to plan benefits thereafter was how to receive their future annual post-retirement adjustments, either retaining the local plan increases tied to active member wage negotiations, or electing the PERA Post Fund increases. Those individuals who were in deferred status, who had earned a right to a benefit, left employment, but who had not attained the age for receipt of payment, had the same choice as benefit recipients – they retained local plan benefits, but could choose between increases under the local plan and PERA Post Fund increases.

The law (section 353A.08) directed that the survivor benefit payable on behalf of any service pension (retiree), deferred member, or disability benefit recipient who elected the Post Fund benefit increase provision under PERA, "... must be calculated under the relief association benefit plan and is subject to future postretirement adjustments ..." Therefore, the survivor benefits, that were eventually payable to the surviving spouse of a retiree or disability benefit recipient of a local plan who benefited from the stock market-generated increases of the 1990s, did not bear any relationship to the benefits the couple were receiving while the retiree was living. Upon the death of the retired member of the local plan, the survivor benefit was calculated as a percentage or an established number of units of the current base salary for the working patrol officers or firefighters, as applicable.

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The degree to which the retiree benefit that increased under the Post Fund provisions came to bear no relationship to the eventual surviving spouse benefit can be seen in this example. At the time of his death, a retired police officer from a local plan who had received many of the Post Fund increases generated by the robust stock returns of the decade of the 1990s was just over \$5,000. Using the local plan survivor benefit calculation for the payment of the surviving spouse benefit resulted in a benefit to the widow of about \$1,800 per month after his death – a \$3,400 difference in monthly income.

Local plan participants who were still working had a choice between the local plan benefits and PERA P&FP benefits. The difference for active members was that they had to take all of the local plan benefit or the complete benefit set provided under PERA P&FP – there was no mixing of parts of the local plan benefit set with parts of the P&FP benefit set. The local plan provisions provided for the calculation of the payment generally as a percentage and allocated units of “base pay” upon which contributions had been paid with benefits commencing at age 50. Automatic survivor benefits were paid from the plan so that the member did not have to take a lower benefit by selecting an optional payment form to provide a future benefit to a spouse. The member also had to retain the local annual post-retirement increase provisions. The PERA P&FP benefit provisions included calculating benefits using an average of the highest five successive years’ salary on which contributions had been paid, reducing the benefit payable for retirement under age 55, selecting a joint and survivor annuity payment form to provide a benefit for a spouse – which lowered the payment to the member - and post-retirement increases paid from the Post Fund. Unlike the benefit recipients or deferred members, active members could not elect local plan benefits combined with Post Fund annual post-retirement adjustments.

Local Plans Consolidated Under PERA’s Administration are Merged with P&FP

By 1998, administration of the individual plans had become increasingly complex for a number of reasons. The number of active participants moving to retirement meant fewer active members were making contributions to the account, and the increasing number of retiring members who chose PERA P&FP benefits pulled assets from the local account and moved those funds into the Post Fund. With fluctuating markets affecting annual contribution requirements, some sponsoring cities experienced unpredictable annual amortization contributions. While PERA attempted to forecast for each account that was less than fully funded, the possible number of retirements and additional assets that may be required to fully fund transfers to the Post Fund, the fluctuating financial obligations became very concerning to some cities. If a number of the local plan’s working members decided to retire within a year when assets in the account did not cover the transfer to the Post Fund, the city was required to come up with the additional funds immediately to accommodate that transfer.

When benefit improvements were enacted in the P&FP in 1993, 1995 and 1997, the enactment required local approval to extend those improvements to participants of consolidated relief associations. The local plans consolidating under PERA’s administration before those dates were not

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automatically granted the new benefit formulas. These improvements added cost to the plan and each city would bear that cost in the calculation of annual contributions paid to amortize the unfunded liabilities, as applicable, of each consolidated relief association. Therefore, local approval was required before active, working participants in the plans who had or were eligible to elect PERA P&FP benefits would be entitled to the new benefit formula. Cities with local plan accounts that were over 100 percent funded were able to grant the extension of those benefit improvements. Administration of the local plan benefit provisions became increasingly complex as some cities were able to adopt one or two of the plan changes, but not necessarily all, and in some cases may not have the available assets to grant any of those changes. Issues arose due to the fact that there were now more differences between what working members would receive as a benefit from the PERA P&FP instead of the desired uniformity consolidation aimed to achieve for active participants.

Staff from the League of MN Cities and PERA personnel convened a group of city representatives from the consolidated plans and interested member stakeholders, and arranged to contract with the LCPR actuarial consultant to explore options for stabilizing the annual costs of consolidated accounts that were less than fully funded. The project also looked at leveling the benefits for all relief association active participants who had or may eventually elect PERA P&FP benefits, and providing an option for current benefit recipients who had not elected the Post Fund post-retirement adjustments to have another chance to do so.

The result of those discussions was the 1999 legislation that merged all 44 consolidated relief association accounts under PERA's administration into the PERA P&FP. The legislation followed the desired outcomes adopted by the working group, which included:

1. Cities preferred more stable, more predictable costs
2. Prospectively, full cost sharing was desirable. Exposure to gain/loss fluctuations based on individual account experiences was not desirable.
3. Cities with a current unfunded liability would be required to fully fund their benefit obligations.
4. Cities that had a true "excess" (i.e., funding beyond the P&FP level) wanted to realize some direct financial benefit from this "asset."

Accounts that were less than 100 percent funded had their annual amortization payment fixed through December 31, 2009, with excess police state aid initially providing a good share of the funding for that payment. Cities with accounts over 100 percent funded were able to apply for a refund of defined "excess assets" that were equal to 50 percent of the assets over 100 percent funding up to PERA P&FP's funded percentage at the time – about 127 percent, and all assets that represented a funded percentage in excess of PERA P&FP's funded percentage. Referred to as "residual assets," cities could apply for a refund of these assets with the State Auditor required to verify that the use of the assets

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complied with the merger law. The cities were required to use excess assets of fire consolidated accounts for fire department purposes and of police consolidated accounts for police department costs.

Merger Law Changes for Local Plan Benefit Recipients Who Retained Local Plan Benefits

The provisions of the 1999 Laws of Minnesota, Chapter 222, Article 7, extended to those local plan benefit recipients who had retained local plan post-retirement adjustments, the opportunity to elect Post Fund benefit increases through PERA P&FP, but prospectively only. Local plan participants, who as active members when the local plan consolidated elected to retain the benefits of their local plans, were also given the opportunity to elect Post Fund post-retirement adjustments. PERA's records show that all but a couple survivors elected Post Fund post-retirement adjustments following the enactment of Chapter 222.

2000 Legislation Provided Opportunity for Local Plan Retirees to Elect 15 or 25 Percent Options

Some retired members of the larger local plans had recognized that the escalated benefits paid to retirees who had elected the Post Fund adjustments were not going to provide for a higher benefit to their surviving spouses upon their deaths because of the way the consolidation law was structured. There had been at least one bill introduced a few years prior to 2000, seeking an increase in the survivor benefits payable to a couple of the larger relief accounts. PERA took the position that if the increased benefit provisions were enacted, the sponsoring city should be required to fund the cost of those improved survivor benefits. The legislation, as proposed, did not advance.

Working with some of the stakeholders, PERA proposed legislation in 2000 to provide local plan retirees an opportunity to elect either a 15 or 25 percent joint and survivor option. Selecting one of these options meant the retiree's benefit would immediately be reduced, providing for 15 or 25 percent of the benefit to be paid to the person's surviving spouse at the time the retiree died, in addition to the automatic survivor benefit provided under the terms of the local plan provision.

PERA did not propose a "bounce back" feature with these optional annuity selections. PERA's plans subsidize the cost of the "bounce back" feature, and that cost is incorporated into the retirement benefit cost included in determining the contributions required to fund the plan. These individuals joined PERA after already retiring under the terms of the local plan and no contributions were collected to fund the "bounce back" feature. Recent analysis indicates that there are 69 retirees still living who chose the 15 percent optional annuity form and 91 who chose the 25 percent optional annuity form when offered in 2000. We also found that 4 individuals who had elected the 15 percent option and 2 who had elected the 25 percent option continue to receive the lower payment because their spouses who were intended to be the recipients of the optional annuity payment form died

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before the retiree. Since there was no “bounce back” feature included in the option selection, those 6 retirees continue to receive a reduced payment.

2013 House File 1800 and Senate File 1680

The bill, introduced late in the 2013 session, directed PERA to increase the benefits of all retired persons who retained benefits under the police or fire relief association laws to \$38,000 annually or 20 percent, whichever was less. It also directed that all surviving spouses who were receiving benefits based on the former police or fire relief association bylaws were to receive an increase to \$30,000 annually or 20 percent, whichever was less. There was no provision in the bill, as introduced, to fund those benefit increases.

PERA testified on the bill before the Legislative Commission on Pensions and Retirement during the 2014 legislative session stating concerns about the provisions of the bill. Particularly, the costs of increasing the benefits of the select groups of individuals defined in the bill were not addressed. How was the additional cost of these benefits to be funded? It would clearly violate PERA’s fiduciary duty to use assets from the P&FP to pay for increased benefits to the select group of members defined in the bill. PERA also raised concerns that other benefit recipients within the plan who were not formerly part of a local police or fire plan, but who were similarly situated in terms of annual benefit amounts received, were not included in the bill.

PERA concluded that much more study would be required to audit and verify the accounts that were intended to be covered under the bill as proposed. Additionally, the cost to engage the actuary to complete a comprehensive study and determine future costs of the benefit improvements would have been between \$4,000 and \$6,000. It has been the Board’s position that we do not use assets of the plan to fund special studies for only segments of the plan membership. PERA asked who would pay for the cost of the actuarial analysis.

2014 Directive to Present Report on Status of Local Plan Benefit Recipients

PERA staff analyzed the accounts of those PERA Police and Fire Plan benefit recipients who were former participants, or beneficiaries of former participants, in the local police and fire relief associations that consolidated under PERA’s administration and ultimately merged into the PERA P&FP. A list found in the appendix of this report will provide details of accounts, without names, of benefits being paid to former members of each of the plans merged with the Public Employees Retirement Association P&FP between 1987 and 2012 for which benefit recipients fall below the thresholds defined in the bill. We did not include the accounts of former Minneapolis Police and Minneapolis Fire relief associations because the agreement between those two relief associations and the city

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incrementally increased all payments beginning January 1, 2012 through benefits payable in 2015. The benefits paid to retirees, disability benefit recipients and surviving spouses of the two Minneapolis plans exceed the threshold recommended in the 2013 legislation that resulted in the LCPR requesting this report.

Overall, there continue to be 970 retired members of the local plans (not including the two Minneapolis plans) who are receiving benefits, 498 of whom were already retired when their individual relief association consolidated or merged with PERA P&F. Of these nearly 1,000 benefit recipients, only 3 chose to retain benefit increases paid under the provisions of the former relief association of which they or their spouse were members.

PERA's records show that of 472 former relief association members who were either deferred or still working when the local plan consolidated, 417 chose PERA P&FP benefits and 55 chose to remain with their local plan benefits. Only 1 of those 55 individual chose to retain local plan increases when given the opportunity in 1999 to elect a change in how future post-retirement adjustments would be determined.

Situation of Local Plan Retirees with Annual Benefit under \$38,000

PERA staff reviewed the records of all local plan retirees, those who had retired before consolidation and those who were active at the date of consolidation and who chose to retain local plan benefits. We found 90 individuals with benefits under the proposed legislation's threshold of \$38,000. Of those 90, 58 were retired before consolidation, 25 retired after consolidation and retained local plan benefits, and 7 retired after consolidation and chose PERA benefits, but the current annual benefit payment is under the threshold. We understand that these 7 were not intended to be included in the adjustment, if enacted, but we wanted to call attention to them in the report as we believe any adjustment for the others would likely generate some interest from these 7 individuals.

We have estimated that the cost of increasing the 83 local plan retirees by the lesser of a 20 percent increase in the current benefit or \$38,000 is a present value of \$2,386,819.

Specifically of these accounts under the threshold, we have charted details on the following page for each relief association with former members affected.

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Relief Association	Number retired before consolidation	Number who retired and stayed local after consolidation	Number who retired after consolidation who elected PERA benefits
Albert Lea Police	2/1 elected 25 percent survivor option	3	
Austin Fire	18/5 elected either 15 or 25 percent option		
Brainerd Police	1/1 elected 25 percent survivor option		1 who chose PERA 50 percent joint and survivor option
Chisholm Police	1/1 elected 25 percent survivor option		
Crookston Fire			2/both of whom chose the PERA 100 percent joint and survivor option
Crookston Police	3	1	
Duluth Fire	1		
Duluth Police	1	1	3/1 each elected PERA 50, 75 or 100 percent joint and survivor option
Faribault Fire		2	
Faribault Police	1		
Fridley Police		1	
Hibbing fire	1		
Mankato Police	1		
New Ulm Police	2	1	
Red Wing Fire	2		
Red Wing Police	5	1	
Richfield Police	1	5	
Rochester Fire	3		
Rochester Police	1	3	
St. Paul Police	1	2	1 who elected the PERA 100 percent joint and survivor option
St. Cloud Fire	1	1	
St. Louis Park Fire	3/ 1 elected 15 percent survivor option	1	
St. Louis Park Police		2	
Virginia Fire*	7		
West St. Paul Fire	1/ 1 elected 25 percent survivor option		
Winona Fire		1	
Winona Police		1	

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*Virginia Fire Relief Association merged with the PERA Police and Fire Plan in 2012, all participants in benefit status at the time.

Situation of Local Plan Survivors with Benefits under \$24,000 and \$30,000

The legislation introduced in 2013 directed that the local plan survivor benefits should be increased by 20 percent or to \$30,000, whichever is less. There was some discussion about using a threshold of 20 percent or \$24,000, whichever is less. PERA staff prepared an analysis of how many current local plan survivors would fall under those benefit levels should the Legislature consider an adjustment.

The cost of increasing the local plan current survivors' benefits is estimated to be \$2,903,801 if the 187 survivor accounts would be increased by whichever is less, 20 percent or \$24,000. The number of accounts impacted by an increase in the current benefit of 20 percent or \$30,000, whichever is less, was found to be 288 for an estimated present value cost of \$6,083,262. All estimates are subject to verification by the actuary.

Specifically, the number of affected survivor accounts, by former local relief association plan includes:

Name of Plan	Number under \$24,000	Number under \$30,000
Albert Lea Fire	1	3/ 1 includes a 25 percent survivor option payment
Albert Lea Police	6	7
Anoka Police	1	1
Austin Fire	5	6
Austin Police	2/1 includes a 25 percent survivor option payment	5/ 2 include a 25 percent survivor option payment
Bloomington Police	1	5
Brainerd Police	4	5
Chisholm Police	1	1
Columbia Heights Fire		2
Crookston Fire		1
Crookston	2/1 includes a 15 percent survivor option payment	2/1 includes a 15 percent survivor option payment
Crystal Police	2/1 includes a 15 percent survivor option payment	3/2 include a 15 percent survivor option payment
Duluth Fire	8	17/1 with the 15 percent and 3 with the 25 percent survivor option payment
Duluth Police	10/1 with the 15 percent survivor option payment	17/1 with the 15 percent and 3 with the 25 percent survivor option payment

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Faribault Fire	1	1
Faribault Police	4/1 with the 25 percent survivor option payment	4/1 with the 25 percent survivor option payment
Fridley Police	2	3/1 with the 15 percent option payment
Hibbing Fire	5/1 with the 25 percent survivor option payment	5/1 with the 25 percent survivor option payment
Hibbing Police	2	3
Mankato Fire		6
Mankato Police	7/3 with the 25 percent survivor option payment	7/3 with the 25 percent survivor option payment
Red Wing Fire	6	6
Red Wing Police	2	2
Richfield Police	2	4
Rochester Fire	16/5 with the 15 percent survivor option payment	20/5 with the 15 percent and 1 with the 25 percent survivor option payment
Rochester Police	6/1 with the 15 percent survivor option payment	9/3 with the 15 percent survivor option payment
South St. Paul Fire		4/1 with the 15 percent survivor option payment
South St. Paul Police	10	12/2 with the 15 percent survivor option payment
St. Paul Fire	21	46/12 with the 15 percent survivor option payment
St. Paul Police	32	42/1 with the 15 percent survivor option payment
St. Cloud Fire	3	3
St. Cloud Police	4	10/2 with 15 percent and 1 with the 25 percent survivor option payment
St. Louis Park Fire		1
St. Louis Park Police	2	4
Virginia Fire	4	4
Virginia Police	2	2
West St. Paul Police	1	3
Winona Fire	9/1 with the 15 percent and 1 with the 25 percent survivor option payment	9/1 with the 15 percent and 1 with the 25 percent survivor option payment
Winona Police	3	3

We were interested in the number of PERA P&FP survivors who would fall under the benefit thresholds reviewed for this report. We found 309 accounts with annual payments under \$24,000 or 20 percent,

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whichever is less. The cost of increasing those 309 accounts was estimated to be \$5,442,012. For the higher threshold of \$30,000 or 20 percent whichever is less, we found 418 accounts with a present value cost of \$9,697,738 to increase the benefits. Many of these accounts are receiving the joint and survivor annuity optional payment form selected at the time of retirement.

Conclusion

It was not our intent to make any recommendations for modification of the benefits paid to retired members or survivors of the local police and fire relief associations that consolidated and merged with the PERA Police and Fire Fund. The session law directed us to report on the situation of these benefit recipients. We have provided information about the provisions of the local plan bylaws PERA relies on to administer the payment of surviving spouse benefits of local plan retirees upon their deaths. A chart of those benefit provisions is included in the appendix attached to this report.

We trust this information will provide sufficient background and detail for the Commission members' consideration. PERA staff who are knowledgeable about the administration of these benefits are available to respond to any questions Commission members may have.

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Appendix H	List of relief association survivors, by local plan, whose current benefits fall below the threshold of the lesser of a 20 percent increase or \$30,000
Appendix I	List of PERA Police and Fire survivors whose current benefits fall below the threshold of the lesser of a 20 percent increase or \$24,000
Appendix J	List of PERA Police and Fire survivors whose current benefits fall below the threshold of the lesser of a 20 percent increase or \$30,000