State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Susan Lenczewski, Executive Director

RE: S.F. xxxx; H.F. xxxx (LCPR17-009): SPTRFA; Funding Bill Proposal

DATE: February 6, 2017

Summary of S.F. xxxx; H.F. xxxx (LCPR17-009)

S.F. xxxx; H.F. xxxx (LCPR17-009) is the bill that sets forth the employer contribution and post-retirement adjustment modifications, among other changes, proposed by the St. Paul Teachers Retirement Fund Association ("SPTRFA"). The proposal is intended to respond to:

- The anticipated increase in plan liabilities due to changes in actuarial assumptions, including mortality;
- The anticipated increase in liabilities when the plan's investment rate of return assumption is reduced from the current 8%; and
- Lower actual investment rates of return, in the last couple years, as compared to the assumed rate of return.

The following is a summary of the bill and policy considerations.

Current Status

As reported in SPTRFA's actuarial valuation report as of July 1, 2016, issued by the actuarial firm, Gabriel Roeder Smith & Company:

	July 1, 2016 Valuation Results	July 1, 2015 Valuation Results
Total Required Contribution Rate	22.4%	22.3%
Statutory Contribution Rate	21.5%	20.7%
Sufficiency/(Deficiency)	(0.9%)	(1.6%)
Unfunded Actuarial Accrued Liability ($Billions)	$0.6	$0.6
Funded Ratio (Actuarial Assets)	63.3%	62.6%

<u>Section 1</u>: *Pension Adjustment Revenue*

The allocation of general education revenue is set forth in Minnesota Statute § 126C.10. General education revenue is allocated among a number of categories, including, to name just a few, basic revenue, gifted and talented revenue, declining enrollment revenue, small schools revenue, and pension adjustment revenue. The proposed change is to the method for determining the amount of the pension adjustment revenue for each school district. The change adds to the amount of pension adjustment revenue described in current law for each school district an amount representing the proposed increases

in employer contributions to the Teachers Retirement Association ("TRA") and SPTRFA so that the amount each district receives will keep pace with the proposed increases.

We understand this shifts the financial burden of the proposed employer contribution increases from the school districts to the state.

Section 2: ***Conforming Change Regarding Use of "Investment Return Assumption"***

This provision was modified to replace "preretirement or postretirement interest rate assumption" with "investment return assumption" to be consistent with language changes made to Minnesota Statute § 356.215, subdivision 8, in Section 12, described below.

Sections 3-5, 8, 10, 11, 14, 15: ***Interest Rate on Payments, Refunds, Service Credit Purchases, Shortages, Overpayments and Late Payments***

SPTRFA and the other plans pay interest or are paid interest on many different types of payments. For SPTRFA, such payments include purchases of service credit for leaves of absence, payments made by rehired members when they repay a previous refund, payments by the school district when they fail to deduct enough from an employee's paycheck (a "shortage"), overpayments of benefits, payments to beneficiaries, and late payment of employer contributions by a school district.

The rate of interest is tied to the investment rate of return assumption. With the lowering of that assumption, all statutory references to interest rates had to be revised. Rather than make that change in numerous places throughout the statutes, a reference to a new section, Minnesota Statute § 356.59, had been inserted to replace specific references to rates of interest. The new statute is added by Section 14 of the bill, and is a compilation of all the interest rates over different time periods for each of the plans.

Section 6: ***Employer Contribution Rate Increases***

For coordinated members:

	Current	FY18	FY19	FY20	FY21	Total
Increase		1.0%	0.75%	0.5%	0.75%	3.0%
Rate	6.25%**	7.5%	8.25%	8.75%	9.5%	9.5%

*** A scheduled increase to 6.5% on 7/1/17 is already in statute; the 1% increase is in addition to that 0.25%; new proposal includes a 3% increase phased in over 4 years.*

Cost of Contribution Increases Assuming 0% Payroll Growth					
	FY18	FY19	FY20	FY21	Total
Increase	1.0%	0.75%	0.5%	0.75%	3.0%
Cost	$2.6M	$4.5M	$5.8M	$7.8M	$20.7M

Cost of Contribution Increases Assuming 2.5% Payroll Growth					
	FY18	FY19	FY20	FY21	Total
Increase	1.0%	0.75%	0.5%	0.75%	3.0%
Cost	$2.7M	$4.8M	$6.3M	$8.6M	$22.3M

For the three remaining active basic members (members who will not also receive federal Social Security benefits):

	Current	FY18	FY19	FY20	FY21	Total
Increase		1.0%	0.75%	0.5%	0.75%	3.0%
Rate	9.75%	11%	11.75%	12.25%	13%	13%

** *A scheduled increase to 10% on 7/1/17 is already in statute; the 1% increase is in addition to that 0.25%; new proposal includes a 3% increase phased in over 4 years.*

SPTRFA is proposing to increase the employer contribution rates for coordinated and basic members, as described in the charts above, starting with the fiscal year beginning July 1, 2017.

According to SPTRFA's actuarial valuation report as of July 1, 2016, SPTRFA's assets are $585.2 million less than its liabilities and its funded ratio is 63.25%. As explained by Deloitte Consulting, the Pension Commission's actuary, at the Commission meeting last week, there are two options for addressing a funding shortfall:

- increase the dollars going into the fund, and/or
- decrease the dollars going out of the fund.

More dollars can come from any of three sources: more employer contributions (from school districts or direct state aid), more employee contributions or better investment returns. Of these three options, SPTRFA's proposal includes only increases in employer contributions.

As for decreasing the dollars being paid by the fund, there is an array of benefits that could be modified to achieve cost savings. In Sections 9 and 16, as described below, SPTRFA proposes only one benefit-related modification, which is to eliminate the triggers that automatically increase the post-retirement adjustment when certain funding thresholds are reached. A post-retirement adjustment, or COLA, is an annual adjustment that increases the pension being paid to retirees to roughly approximate increases in the cost of living.

Section 7: ***Direct State Aid***

SPTRFA is proposing an additional direct state aid of $5 million annually. This amount would increase the current annual amount of state aid from $9.827 million to a total of $14.827 million. This amount is in addition to the employer contribution increases.

Section 9: ***Clarifying Revisions to the Provision for Post-Retirement Adjustments ("COLAs")***

SPTRFA is not proposing a change to the COLA rate, which is 1%. The changes in this section revise subdivision 7 of Minnesota Statute § 354A.29 to remove references to the COLA triggers and clarify the language describing the COLA.

Section 12: ***Decrease in Assumption for Investment Rate of Return***

SPTRFA is proposing to reduce the assumption for investment rate of return from the current 8% to 7.5%, effective July 1, 2017.

Section 12 also makes changes to paragraph (b) of Minnesota Statute § 356.215, subdivision 8, to eliminate references to the COLA triggers for purposes of performing actuarial valuations. See Sections 9 and 16, which propose changes to eliminate the COLA triggers.

Section 13: *Resetting the Amortization Period*

SPTRFA proposes to reset the amortization period from 2042 to 2047, extending the period by 5 years. Resetting the amortization period lengthens the period over which the plan's current liability will be amortized or paid off. Current and future employees' contributions will be used for an additional 5 years to pay off liabilities accrued to date, that should be paid off by 2042 under current law. This runs counter to the principle of generational equity, if that is a principle the Commission wishes to support.

For some time, amounts going into the plan failed to keep pace with annual benefit accruals and pension payments to retirees, resulting in an ever-increasing funding shortfall. Lengthening the amortization period masks this problem. The analogy used to illustrate this situation is a mortgage refinancing. Refinancing does not reduce the remaining debt, but serves only to stretch out the repayment period and, thereby, reduce the annual installments. An option to extending the amortization period is to keep the current amortization date and look at ways to reduce plan liabilities.

Section 16: *Eliminating the COLA Triggers*

This section repeals two subdivisions in Minnesota Statutes § 354A.29 that provided for an automatic increase in the COLA when specified funding thresholds are reached. The COLA increases to 2% when the plan's funding ratio is at least 80% but less than 90% for two fiscal years and to 2.5% when the plan's funding ratio is at least 90% for two fiscal years.

The triggers result in a funding problem, because when the actuary determines the contributions needed to get the respective plan on track to reach full funding they take into account both the estimated date of reaching the trigger and the resulting increase in the COLA. As a result, the required contribution is larger in order to fund the higher COLA. Therefore, if the triggers are not removed, any additional money going into the plan would speed up the attainment of the trigger and fund the COLA increase rather than the plan's liabilities.