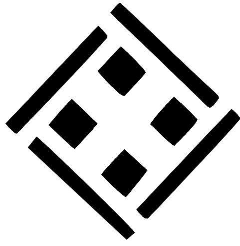

February 15, 2002

Restructuring of the Minnesota Teacher Retirement Plans

Submitted in accordance with the 2001 Omnibus Bill,
Laws of 2001, First Special Session, Chapter 10, Section 20,
Implementation Plan; Aggregation of Teacher Retirement Plans

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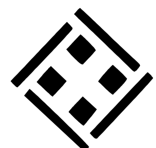

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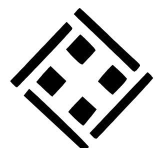


Executive Summary

The 2001 Legislature enacted a provision of law requiring the directors of the four public school teacher retirement funds that exist in the State of Minnesota to prepare and submit to the Legislature a report on the possible restructuring of the Minnesota teacher retirement plans. According to the provision, the four directors must:

1. Prepare a report detailing the steps necessary to create a single, restructured teachers retirement plan;
2. Establish and consult with a Task Force of representatives of both the affected employing units and pension plan members;
3. Include in the report proposed legislation, a detailed schedule and a timetable for completion;
4. File the report by February 15, 2002, to the Legislature.

The report is divided into four sections.

Section I provides background information including the study charge, the advisory Task Force, the process followed, historical information of the funds, and a list and summary of the reference materials used in preparing the report.

Key to the process was the understanding that the resulting proposal would be for a new restructured teachers retirement plan, and not simply an administrative consolidation of the four plans into one of the existing plans. Inherent in the proposal is the fact that the teacher members and the employers of the four existing plans must see tangible benefits resulting from the adoption of a new structure, governance and benefit package.

Section II focuses on tenets of the restructured plan that have been agreed upon by the four directors and the members of the Task Force. Of primary importance is the agreement that the structure of the restructured plan would be a nonprofit corporation with assets held in trust for the exclusive benefit of its members. The new plan will be designed according to the model outlined in the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) promulgated by the Uniform Law Commissioners in 1997, which gives full and exclusive authority and responsibility to its Board of Trustees. While agreement could not be reached on exact Permanent Board of Trustee composition, it was agreed that there would be a need for a Transition Board prior to the election and/or appointment of the Permanent Board.

Using the UMPERSA structure, the trustees of the restructured plan would have full, exclusive authority to establish an administrative budget, obtain services, and procure goods and property. The state would retain its authority to establish benefit levels and make other amendments to the plan. Membership in the restructured plan would follow the same criteria as currently exists, with the exception that Basic Plan members (non-Social Security) of the Minneapolis and St. Paul TRFAs would remain with their respective funds as closed funds.

Financing considerations will be a major issue in restructuring. Some recommendations are presented.

Analysis of current benefit provisions demonstrates that the benefits provided at the time of retirement are among the poorest in the nation, while the post-retirement adjustments are extremely generous. Proposed are significant improvements to the initial benefits provisions that would be partially funded by adopting a more traditional COLA provision.

Current retirees would not be impacted by the new benefit provisions. TRA retirees, as well as the coordinated retirees of the first class city funds, would receive their benefits from the Minnesota Post Retirement Investment Fund (Post Fund) according to existing provisions. St. Paul and Minneapolis TRFA Basic Plan retirees would elect to either remain with their existing fund or begin receiving benefits from the Post Fund. In addition, special consideration is made to preserve the existing Old Plan benefit provisions for a limited number of active Duluth TRFA members.

Full accountability, oversight and disclosure mechanisms as recommended by the UMPERSA model will be incorporated into the new plan.

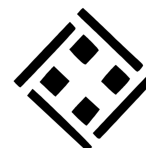
A tax-sheltered 403(b) retirement savings plan and supplemental medical programs will be administered internally by the new plan.

Section III includes issues that have been discussed, but not resolved, and issues remaining to be addressed. Included are the topics of investment authority, board structures, and timelines.

Section IV discusses the process for dissolution or merger of the first class city funds as nonprofit corporations and proposed legislation.

Section I: Background

1. Study Charge
2. Introduction
3. Organization of Report
4. Study Process
5. Historical Background
6. Review of Literature



Section I: Background

Chapter 1: Study Charge

The 2001 Legislature enacted a provision of law requiring the directors of the four teacher retirement funds in the State of Minnesota to prepare and submit to the Legislature a report on the possible restructuring of the Minnesota teachers retirement plans. This report is to be submitted to the Legislature by February 15, 2002.

The language contained in the 2001 Omnibus Bill, Laws of 2001, First Special Session, Chapter 10, Section 20 is as follows:

Sec. 20. [IMPLEMENTATION PLAN; AGGREGATION OF TEACHER RETIREMENT PLANS.]

(a) The executive director of the teachers retirement association, the secretary of the Duluth teachers retirement fund association, the executive director of the Minneapolis teachers retirement fund association, and the secretary of the St. Paul teachers retirement fund association jointly shall prepare a report detailing the steps that would be necessary to create a restructured teacher retirement plan if the legislature subsequently determines that this restructuring would be in the best interests of the state, its taxpayers, and the public education community.

(b) In preparing the report, the pension plan administrators must establish and consult with a task force. The task force must consist of representatives of the affected employing units and representatives of the collective bargaining organizations representing members of the affected pension plans.

(c) The report must include the draft proposed legislation that would be required to create a restructured teacher retirement plan as well as a detailed schedule and timetable of the completion steps for the creation of a restructured teacher retirement plan.

(d) The report must be filed by February 15, 2002, with the chair of the legislative commission on pensions and retirement, the chair of the senate committee on state and local government operations, and the chair of the house committee on government operations and veterans affairs policy.

Chapter 2: Introduction

The four teacher pension fund directors who are members of the Study Committee preparing this report are:

J. Michael Stoffel, Executive Secretary
Duluth Teachers' Retirement Fund Association (DTRFA)

Karen Kilberg, Executive Director
Minneapolis Teachers' Retirement Fund Association (MTRFA)

Gary Austin, Executive Director
Minnesota Teachers Retirement Association (TRA)

Eugene R. Waschbusch, Secretary/Treasurer
St. Paul Teachers' Retirement Fund Association (SPTRFA)

The directors worked with a consulting Task Force consisting of individuals who either a) represented the various bargaining groups representing the active teacher members of the four teacher retirement funds, or b) represented the interests of the employers of the four teacher retirement funds. The members of the Task Force are listed below:

Restructuring Advisory Task Force

Carol Ackerson	TRA Member Representative
Greg Burns	Education Minnesota
Mary Glass-LeBlanc	Duluth School Board
Ian Keith	St. Paul Federation of Teachers
Bob Lowe	Minnesota School Boards Association
Louise Sundin	Minneapolis Federation of Teachers
Ross Taylor	Minneapolis School Board
Mary Thornton-Phillips	St. Paul School Board
Pam Wheelock	Minnesota Department of Finance
Mike Zwak	Duluth Federation of Teachers

The fund directors wish to thank the members of the Task Force for their willingness to serve and for their assistance in sharing their ideas and concerns on behalf of the groups they represent.

Chapter 3:

Organization of Report

This report is divided into four sections. Section I is titled *Background*, and is included to familiarize the reader with historical information about the four existing teacher retirement fund associations, and with information on modern pension administration and previous studies, which became the rationale used in developing the proposals in this report.

Section II is titled *Agreed Upon Tenets for a Restructured Minnesota Teachers Retirement System*. This section details the structure, benefits and oversight that have been agreed to by the four directors and the members of the Task Force. It is intended by the writers that the information contained in this section will be complete, compelling and justify the inclusion of the topic in the proposal.

Section III is titled *Issues Remaining to be Resolved/Addressed*. The topics listed in this section have been researched, analyzed and discussed by the authors and the Task Force. Research and discussion will continue, with the expectation of a solution and agreement. In addition, there are important issues that have not been addressed.

Section IV is titled *Steps to Restructuring*. This section is a description of the implementation steps that are necessary to accomplish the restructuring of the Minnesota Teacher Retirement Plans. Included is proposed legislation to continue the study process.

Chapter 4:

Study Process

Early in the year 2000, the directors of the four Minnesota Teacher Retirement Plans held a series of meetings with representatives of Education Minnesota to see if there was any benefit to the public school teachers in the State of Minnesota in aggregating the four existing teacher retirement plans into one. The primary thought that was requisite to engaging in these discussions was that the resulting proposal would be a new "restructured" plan, not simply an administrative consolidation of the four plans into one of the existing plans. The chief concern of an administrative consolidation is that this could create actual or de-facto subgroups, an idea that is opposed by the directors and the Task Force as discussed later.

Inherent in the proposal contained in this report is the fact that the teacher members and the employers of the four existing plans must see reasons for and tangible benefits resulting from the adoption of a new structure, governance and benefit package.

Another key item in the discussions and agreements was that this proposal should be considered as a package. The various tenets are not to be thought of as separate issues, some of which could be selected and others rejected and discarded. The package of agreed upon items is the result of such discussion and negotiation and represents a consensus of the affected groups.

There is much information that must be understood by the readers of this report and the policymakers that will be acting on it. Understanding this essential information will aid the reader in gaining the desired perspective of the four directors and the boards they represent. One fundamental piece of information is an understanding of the current and historical benefit and financing structure of the four teacher retirement plans. Please see Chapter 5 and *Appendix A* for a comparison of the structure of the four teacher retirement plans and historical funding information.

In the initial stages of this study, the four directors and the Task Force brought forth a multitude of topics and issues. As these issues were discussed and research was completed, the concept of creating a system that employed the *Best Practices of Pension Management* became of paramount importance.

A partial listing of topics and issues that have been proposed and will be addressed in depth later in this report because they meet the best practices test is as follows:

- Legal Form of Restructured Plan
- Board/Governance
- Authority/Fiduciary Duties
- Membership
- Benefits
- Modification of Post-Retirement Adjustments
- Contributions
- Liabilities
- Oversight
- Benefit Guarantee
- Basic Plan Members (members not covered by Social Security)
- Ancillary Benefits (creation of a supplemental tax-sheltered 403(b) plan, post-retirement medical savings plan, and/or Medicare supplemental plan)

During the process of developing this report, the directors of the teacher retirement funds met 13 times throughout the year. Meetings were held at each of the retirement fund offices. These meetings were held to develop the restructuring plan, prepare for presentations to the Task Force, and to assemble this report.

The Task Force met three different times. In the first meeting, the directors described the direction of the restructuring plan that they had envisioned. The second meeting of the Task Force was held one month following that first meeting. The second meeting was designed to allow Task Force members to react to the information they heard at the first meeting, and to provide feedback to the directors that they may have obtained from their constituent groups. During the second meeting, the directors also presented more details about parts of the restructuring plan that had been developed since the first meeting. The third meeting of the Task Force was to allow members the opportunity to provide the directors with comments about a draft of this report that had been provided to them in advance.

Chapter 5:

Historical Background

The directors of the four teacher retirement plans are including a chapter on the history of funding and benefits in each of the respective plans. It is hoped that this information will help provide an understanding of the current status of each of the plans.

The Duluth Teachers' Retirement Fund Association Story

The Duluth Teachers' Retirement Fund Association (DTRFA) began in 1910 as a nonprofit organization for the public school teachers in the City of Duluth. Initially, and up to 1975, the employer contributions were financed by local property taxes, levied by the City of Duluth. The Trustees of the fund had authority to set member contribution rates, based upon actuarial recommendations. The Trustees also had authority to set employer contribution rates, subject to local budgetary controls and approvals passed by the Duluth City Council.

The fund was put on an actuarial reserve basis in 1919. By 1965, the fund attained a 100 percent funding level, and since then has remained relatively strong.

Duluth became coordinated with the Social Security system in 1957 following a member referendum. Since that date there have been no Basic members in the Duluth plan. At the time of the conversion to a coordinated system, the employee contribution rate was set at 4.5 percent.

In 1975, legislation took away the authority for the City of Duluth to levy the employer contributions. These contributions became the obligation of the State of Minnesota. At that time the employer contribution rate was 5.5 percent.

An important difference in employer contribution rates among the three first class city teacher retirement funds occurred in 1979. The Duluth employer contribution rate for all its coordinated members was set at 5.79 percent. In the St. Paul and Minneapolis teacher funds the employer contribution rate for coordinated members was 4.5 percent, and was not increased until some time later. The employer contribution rate for Duluth remains at 5.79 percent today.

In 1995, the employee contribution rate was increased from 4.5 percent to 5.5 percent to provide additional funding for the benefit improvements passed into law that year.

Following legislation passed in 1997, the DTRFA began to receive an additional $486,000 in annual state aid payments as part of a package of benefit improvements and funding. Contingent upon a clarification of state statute, it appears that state aid payments will be permanently discontinued in 2002.

The Minneapolis Teachers' Retirement Fund Association Story

The Minneapolis Teachers' Retirement Fund Association (MMTRFA) was established in 1909 with permissive language in Minnesota Statutes. From the time of its establishment until 1975, the City of Minneapolis was the employer of record for the MTRFA. During that time the MTRFA would certify annually to the city the amount of the required employer contributions. Because of levy limits, the city did not always provide the MTRFA with the amount certified and an unfunded liability began to accrue.

By 1974, the city was contributing enough to put the MTRFA on a fully funded track for the statutory amortization date of 1997 and the funding ratio was 57 percent. In 1975, the state passed new laws that changed the employer from the city to the State of Minnesota. The accrued unfunded liability of over $76 million owed by the City of Minneapolis was never addressed. There was an increase in benefits at the same time and even though the employer contribution stayed the same and the employer supplemental contribution decreased, the employee contribution increased from 6.5 percent to 8.5 percent. Later adjustments were made in the employer contributions but they still were not sufficient to eliminate the funding deficiency.

In 1978, the Coordinated Plan was established, which meant that any new teacher hired became a member of that plan instead of the old basic plan. It also meant that, unlike TRA or Duluth, when a teacher retired the fund lost the employer supplemental contribution it had been receiving to help pay off the unfunded liability. It took until 1993 to restore the employer supplemental contribution, but instead of being based on the funding needs of the MTRFA, it was based on the amount that TRA employers were paying. At the time TRA was over 82 percent funded with a 0.41 percent deficiency and the MTRFA was about 54 percent funded with a 11.57 percent deficiency.

When the employer of record was changed in 1986 to the school district, the unfunded accrued liability had ballooned to over $267 million. Again, the accrued unfunded liability was never addressed. The funding ratio was 50.81 percent but mainly because the amortization date had been moved in 1979 to 2009 and the earnings assumption was changed in 1983 from 5 percent to 8 percent. (This change alone brought the funding level from 38.2 percent in 1983 to 45.3 percent in 1984.)

During the decade of the 90s, the City of Minneapolis, the Minneapolis school district, the state and the members of the fund all participated in providing additional support for the funding of the MTRFA. The schedule below shows the impact of this legislation:

1993 Funding				**1996 Funding***			**1997 Funding**	
Calendar Year	**City**	**School District**	**State**	**Calendar Year**	**City**	**School District**	**Ended June 30**	**State**
1994 and thereafter	$1,250,000	$1,250,000	$2,500,000	1998	$ 250,000	$ 250,000	1998	$17,954,000
				1999	400,000	400,000	1999 and thereafter	12,954,000
				2000	550,000	550,000		
				2001	700,000	700,000		
				2002	850,000	850,000		
				2003 and thereafter	1,000,000	1,000,000		

**The 1996 funding legislation also provided for reallocation of amortization state aid to the MTRFA. The amount of this funding for the MTRFA started at $1,084,189 in MTRFA fiscal year 1996 and has increased to $1,740,029 in MTRFA fiscal year 2001.*

Besides these additional contributions the members of the fund are now assessed administrative expenses if the cost of operating the MTRFA exceeds that of the TRA. Furthermore, retirees have their post-retirement adjustments decreased by the contribution deficiency.

In 1997 when a formula increase was granted to coordinated members along with all other public employees, the cost of this increase was paid for solely by the members. MTRFA members pay 5.5 percent for normal costs while the employer pays 4.5 percent. (It should be noted that TRA coordinated members pay 5.0 percent for slightly better benefits.)

The MTRFA is certainly grateful for the additional support that has been granted during the 1990s, but unfortunately these contributions still fall short of what is needed to put the MTRFA

on a fully funded track. According to the LCPR actuary, the funding deficiency has increased to -2.73 percent in 2001 from a sufficiency of 0.38 percent in 1997 and the funded ratio has decreased from 67.38 percent in 1999 to 65.95 percent in 2001. In the 2001 valuation the LCPR actuary lists the following as reasons why the MTRFA is in a dangerous funding position:

1. The current statutory rates are less that those that should be required.
2. Current amortization is a fixed date and that means there are higher requirements to pay the bill on time.
3. The supplemental contributions of 1993, 1996, 1997 are fixed amounts and subsequently would be a smaller percentage of payroll in years ahead.
4. The MTRFA post-retirement COLA has a built-in bias for loss to the plan.

Not listed but also a contributing factor is higher than expected number of retirements, which have increased the liabilities.

For a more detailed look at the funded ratios and contribution rates, please see *Appendix A*.

The St. Paul Teachers' Retirement Fund Association Story

The St. Paul Teachers' Retirement Fund Association (SPTRFA) began in 1909 as a nonprofit public employee retirement plan for the public school teachers located in the corporate limits of the City of St. Paul. The plan operated on a "pay as you go" basis from inception to 1955. "Pay as you go" means that employees were required to contribute a percentage of pay to the fund and the fund used the employee contributions to pay current retiree benefits with little or no chance to build a reserve. SPTRFA did not receive any employer contributions from the City of St. Paul or from the State of Minnesota until 1955. At that time the SPTRFA fund reserves were under $300,000, which was about six months annuitant payroll.

The funding ratio of SPTRFA in 1955 was about zero. The Legislature began to require contributions from the employer at that time. This requirement began the progress toward fiscal solvency. Steady progress was made so that by 1974 SPTRFA had assets of over $40,000,000 and had a funding ratio of

36.1 percent. In 1974, the total contributions to SPTRFA from all sources was 21.5 percent of payroll. This amount was needed to correct the past underfunding by the employer (city and state).

Starting in 1975 there was a series of changes in the contribution rates and responsibilities. In 1975, the State of Minnesota assumed the responsibility for the employer contributions to the teacher plans. The problem that occurred was that the state reduced the employer contribution by over 2 percent of payroll, causing a funding deficiency.

In 1978, the funding problems got worse because the Legislature required all new members of SPTRFA become members of a newly created coordinated plan. A significant problem that accompanied the creation of this new coordinated plan was that the Legislature discontinued the employer additional contribution on behalf of the coordinated plan members that SPTRFA had been receiving on behalf of its Basic Plan members to make up for past omitted contributions. St. Paul and Minneapolis coordinated plans were the only plans that were not given an additional employer contribution for coordinated plan members to reduce the unfunded liability.

The total contributions to SPTRFA continued to decline until 1991 when the total contributions were 15.44 percent. During this period, SPTRFA was not provided with the necessary assets that could have been used to help solve its funding problems. In 1992, the first step was made to solve the SPTRFA funding problem when the Legislature began requiring the employer to make an employer additional contribution for the coordinated plan. The inception of this employer additional contribution and legislation in 1996 and 1997 put SPTRFA on track to meet the full funding target date of 2020.

The Teachers Retirement Association of Minnesota Story

The precursor to the current Teachers Retirement Association of Minnesota (TRA) fund was established in 1915. The 1915 Fund, also referred to as the Pioneer Teachers Retirement Fund, was liquidated during the Great Depression.

The current statewide TRA was established in 1931. Initially, teachers could elect exemption from membership until they were age 25. Members made contributions as a percentage of their salary

into a sort of savings account with no state matching until the members retired and purchased a retirement annuity in this defined contribution (DC) plan.

In 1957, membership in TRA became mandatory and the state began partially matching member contributions on a current basis.

In 1959, election of Social Security coverage became available to all members and new hires were automatically members of the coordinated system with Social Security coverage. In addition to matching employee contributions, the state began making supplemental employer contributions of 1 percent in recognition of past service liabilities.

In 1969, in response to woefully inadequate defined contribution benefits, members were given the option to elect a defined benefit plan (Career-Average Formula), a variable annuity defined contribution plan, or remain in their improved money purchase defined contribution plan. Employee and employer contribution rates were increased and the state increased its supplemental contributions to 2 percent.

In 1973, the benefit formula was changed from a Career Average to a High-5 formula plan, a major benefit improvement. At that time, the funding ratio of assets to liabilities was only 50 percent, so employer supplemental contributions were increased once again to 2.5 percent. In 1979, the supplemental contributions were increased to 3.05 percent.

In 1984, as the funding ratio continued to flounder at less than 60 percent, the employer supplemental contributions were increased for the last time to 4.48 percent. The increased contributions and favorable investment returns allowed the TRA funding progress to steadily improve and permitted the reduction of the employer supplemental rate to 3.64 percent in 1991.

With adequate employee and employer contributions and strong investment returns, TRA became financially healthy during the 1990s. In 1997, as part of the Pension Benefit Uniformity package, TRA employer contributions were reduced by 1.5 percent from 8.14 percent to 6.64 percent (5 percent matching and 1.64 percent supplemental). This reduction resulted in a savings of approximately $37.5 million annually. From this savings, $22 million was redirected to PERA to respond to their funding deficiency, $12.9 million went in direct state aid to Minneapolis

Teachers' Retirement Fund, $2.8 million to the St. Paul Teachers' Retirement Fund, and $500,000 to the Duluth Teachers' Retirement Fund to solve their respective funding problems.

In 1998, as a result of achieving 100 percent funding status, the remaining TRA employer supplemental contribution of 1.64 percent was eliminated, reducing the total contribution rates to the current level of 10 percent overall – 5 percent employee and 5 percent employer. The 5 percent employer contribution is its lowest rate since 1969 and the 10 percent total contribution rate is the lowest since 1973.

Currently, the July 1, 2001, actuarial valuation indicates that TRA has a funding ratio of 105.8 percent and a contribution sufficiency of 2.15 percent.

Chapter 6:

Review of Literature

The recommendations of the fund directors and the “steps that would be necessary” to accomplish the creation of a new restructured teachers retirement plan are the result of extensive research and review of the following:

(1) Previous studies of consolidation of the Minnesota Teacher Plans, the most thorough of which was the 1993 study conducted by the Minnesota Department of Finance and reported to the Legislature (April 1994).

(2) Work that has been done in the area of public employee pension structure and administration. The most notable recent study is the report prepared by The National Conference of Commissioners on Uniform State Law entitled *Uniform Management of Public Employee Retirement Systems Act (UMPERSA)*.

(3) Features of the leading public employee retirement systems in the nation as presented in the National Education Association (NEA) report *Characteristics of 100 Large Public Pension Plans* (September 2000).

(4) Information included in the report *Is Your Pension Protected?* (2000) published by the National Retired Teachers Association (NRTA).

(5) A report prepared by the NRTA entitled *FIGHTING INFLATION: How Does Your COLA Compare?* (2000). This document allowed the authors and Task Force to compare and contrast the post-retirement adjustments used by other teacher retirement plans.

(6) *Public Pension Plans, The State Regulatory Framework (3rd Edition, 1998),* published by the National Council on Teacher Retirement (NCTR), which gave information on the “best practices” of pension plans.

(7) The study titled *Preservation of Defined Benefit Plans* (Cynthia L. Moore, NCTR, 1996) researched the idea of creating a defined benefit plan vs a defined contribution plan.

(8) The Government Finance Officers Association (GFOA) publication, *Recommended Practices for State and Local Governments* (May 2001), provided additional “best practices” information to the study group.

(9) The document prepared by Minnesota Legislative Commission on Pensions and Retirement (LCPR), entitled *Principles of Pension Policy,* was reviewed.

(10) The *2000 Survey of State and Local Government Employee Retirement Systems,* prepared by the GFOA Research Center for members of The Public Pension Coordinating Council. This document presents the results of a survey of 246 public employee retirement systems representing 371 retirement plans. These plans covered 85 percent of the 12.8 million active plan members reported by the U.S. Bureau of the Census.

As the authors have stated before, the guideline that was used by the study group throughout this study on restructuring of the Minnesota Teacher Retirement Plans was that the plan created by the Study Group, in consultation with the Task Force, incorporate the best practices of pension plan structure and administration as described in the above-referenced documents.

The following are brief summaries of some of the above-referenced materials. More comprehensive information is included in Appendix B and C of this report.

Minnesota Department of Finance Consolidation Study

The 1993 Minnesota Department of Finance Consolidation study proposed and analyzed 14 different ways of consolidating two or more of the four teacher plans and in some cases the Minneapolis Employees Retirement Fund (MERF). The scenarios studied ranged from a simple consolidation of the administrative functions of MTRFA and MERF to a complete consolidation of all the teacher plans into the existing TRA plan.

After extensive study and after obtaining the actuarial cost impacts of each of the scenarios evaluated, the Minnesota Department of Finance study came to a number of conclusions indicating that the cost of consolidation was very high, the process and issues complex, and savings of administrative costs minimal. Some of the conclusions in the report are:

"Consolidation or phase-out of first class city pension funds appears to be very costly under each scenario evaluated. These options are also more controversial, long-term and complex to implement than others considered."

"Administrative costs are not significant in terms of overall funding requirements. Under virtually every option we studied, administrative savings were assumed liberally, but were never sufficient to offset much larger adverse actuarial impacts of consolidation options..."

"Where plans are consolidated or phased-out, issues to be resolved are many and complex, particularly as regards to elections of benefits, asset transfer ratios, along with establishing base pensions, and financing post-retirement increases."

The Executive Summary of this report is included as *Appendix B*.

National Conference of Commissioners on Uniform State Laws (NCCUSL), Uniform Management of Public Employee Retirement Systems Act (UMPERSA)

UMPERSA is the result of much study on the "best practices" of pension plan design, superior plan administration and statutory authority by the National Conference of Commissioners on Uniform State Laws. A summary of the key elements of UMPERSA follows.

Organization of the NCCUSL

The National Conference of Commissioners on Uniform State Laws (NCCUSL) was organized in 1892. Its mission is to work for the uniformity of state laws. It is a nonprofit unincorporated association, comprised of commissioners on uniform laws from each state, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands. All of the more than 300 uniform law commissioners are required to be members of the bar. While some commissioners serve as state legislators, most are practitioners, judges and law professors. They serve for specific terms, and receive no salaries or fees for their work with the Conference.

The state uniform law commissioners come together as the National Conference for one purpose – to study and review the law of the states to determine which areas of law should be uniform. The commissioners promote the principle of uniformity by drafting and proposing specific statutes in areas of the law where uniformity between the states is desirable. It must be emphasized that the Conference can only propose – no uniform law is effective until a state Legislature adopts it.

Among the projects by the NCCUSL are the Uniform Commercial Code, Interstate Family Support Act, Limited Liability Company Act, Limited Partnership Act, and the Probate Code.

Uniform Management of Public Employee Retirement Systems Act

In 1997, the Uniform Law Commissioners promulgated the Uniform Management of Public Employee Retirement Systems Act (see *Appendix C*). The Act is the first uniform law that applies to the more than one trillion dollars in assets held in state and local retirement systems. UMPERSA was developed to remedy a deficiency identified by the Uniform Law Commissioners: A mixture of state law governs these systems, unlike private retirement systems which are governed primarily by a common federal law, the Employee Retirement Income Security Act (ERISA). State laws vary considerably, and in some cases have not kept up with modern investment practices. Hence the Commissioners saw the need for an act that would modernize, clarify, and make uniform the rules governing the management of public retirement systems.

The Act is designed to replace laws that inhibit or, in a number of States, even prevent use of modern investment practices. In the long run, these outmoded laws result in billions of dollars of lost opportunities for investment income. The lost income could be used to increase pension benefits, lower contribution rates, or some combination thereof. The immediate beneficiaries would be the system's participants and beneficiaries, but the ultimate beneficiary would be the State's taxpayers. Taxpayers could offer employees either a better pension for the same cost or the same pension for a lower cost.

In broad terms, UMPERSA protects participants and beneficiaries of public retirement systems in two ways. First, the Act articulates the fiduciary obligations of trustees and others with discretionary authority over various aspects of a retirement system and ensures that trustees have sufficient authority to fulfill their obligations (Sections 4 through 10). Second, the Act facilitates effective monitoring of retirement systems by requiring regular and significant disclosure of the financial and actuarial status of the system, both to participants and beneficiaries directly and to the public (Sections 12 through 18).

Considered in more detail, the Act's regulation of the management of public employee retirement systems can be divided into six categories:

1. The Act requires that all retirement system assets be held in trust (Section 4);
2. The Act ensures that the trustee has exclusive authority over those assets (Section 4), and sufficient control over the organization to manage the assets efficiently and effectively (Sections 5 and 6);
3. The Act articulates the duties of trustees and others with discretionary authority over the operation and administration of a retirement system or the management of its assets (Sections 6 through 10);
4. To facilitate effective monitoring of retirement systems, the Act imposes significant disclosure requirements. The Act clarifies the application of state open record and open meetings laws to retirement systems (Section 12) and requires systems to publish various types of reports (Sections 13 through 18). The reports must be distributed widely and be made available to the public (Sections 13 through 15);
5. The Act has provisions to permit effective enforcement (Sections 11, 19, and 20);
6. Finally, the Act prohibits the assignment or alienation of benefits, unless the Legislature expressly decides that assignment or alienation is appropriate and consistent with the underlying policy of protecting retirement benefits (Section 21).

The enactment of UMPERSA establishes the independence of a retirement system from its sponsoring employer. Independence places a legal wall between the governor and Legislature and the retirement system by putting system assets in trust and making trustees loyal exclusively to the interests of participants and beneficiaries. These actions help curtail politically motivated reversions. The Act provides the retirement system trustees with the necessary independence and institutional resources necessary to manage retirement system assets in accordance with modern investment practices. It minimizes political influence over systems and facilitates effective monitoring of trustees by

requiring significant openness in the operation of retirement systems. UMPERSA therefore meets standards of loyalty to participants and beneficiaries, openness and accountability.

The UMPERSA model provides for improved investment returns for public employee retirement systems. It guarantees important information to public employers, trustees and participants about the administration of these systems. It provides clear liability and enforcement rules. State and local governments, trustees and fiduciaries, participants and the taxpayer, who must pay for financial deficiencies in such systems, all stand to gain from the adoption of the model public employee retirement system outlined in UMPERSA. Throughout this report, we will reference sections of UMPERSA as a guide to what is proposed in the restructured teachers retirement plan for the educators of the State of Minnesota.

Characteristics of 100 Large Pension Plans

(September 2000)

This document is the product of the National Education Association Survey of the 100 largest state and local public teacher retirement plans in the nation. It compares and ranks the various governance, benefit and funding mechanisms existing in the majority of public employee pension plans that have teachers as members. This study covers approximately 11.3 million active members and 4.5 million retired members of the 100 plans. Some of the major topics of this study are:

1. Retirement Eligibility
2. Cost of Living Adjustments (COLAs) and Taxes
3. Employer/Employee Contributions
4. Investment Allocations and Rates of Return
5. Actuarial Methods and Funding
6. Board of Trustee Membership

Based on the information in this report, the Study Group worked to incorporate benefits and governance structures that would place the teachers in the State of Minnesota in the top half of the teacher plans studied. The State of Minnesota would benefit by having a superior pension plan through the ability to attract and retain the best teachers and educational administrators in the nation.

Is Your Pension Protected? A Compilation of Constitutional Pension Protections for Public Educators *(2000)*

This is a publication produced by the National Retired Teachers Association (NRTA), a division of AARP, and the NRTA Round Table. The NRTA consists of members from 50 states and 2,700 city and local retired educators' associations.

The publication is a compilation of constitutional pension protections in 50 states, concentrating on educators' retirement funds. It provides a summary of the constitutional pension protections found in various states which include such things as: funding requirements, assets for retirement purposes only, no diversion of assets, board of trustees governance, guaranteed right to a benefit, investment authority, and separate trust funds. It makes additional recommendations about other protections that could be enacted.

Many of the constitutional guarantees found in other states are considered to be essential protections for all pension funds. The study group realizes that it is extremely difficult to change a state's constitution but many changes could be made through statute changes. Some of the protections found in this publication have been incorporated into the recommendations in this report, not only because they are currently missing in our constitutional protections, but because they are also a part of the best practices recommended by UMPERSA.

Fighting Inflation: How Does Your COLA Compare?

(2nd edition: copyright 2000 by AARP)

This publication was prepared by the National Retired Teachers Association (NRTA), a division of the American Association of Retired Persons (AARP). The publication is a compilation of cost of living adjustment (COLAs) laws and policies in the 50 states and the District of Columbia, specifically focusing on the state retirement plans that provide benefits to retired educators.

Inflation can severely reduce the purchasing power of retiree pensions. The document provides an overview by state of how and when COLAs are paid. It also reviews approaches that state governments use to fund COLAs.

The views expressed in this document are for information, debate and discussion and do not necessarily represent formal policies of the NRTA.

Preservation of Defined Benefit Plans

(NCTR, Third Edition, 1998)

This publication was prepared by Cynthia L. Moore, who is General Counsel to the National Council on Teacher Retirement (NCTR). The publication provides a comparative analysis of the qualities and deficiencies of defined benefit and defined contribution retirement plans.

The four fund directors felt that a brief discussion of the advantages of defined benefit over defined contribution retirement plans for public employees is a necessary part of this report so that the reader will know that this important topic was addressed.

Defined benefit plans are commonly used by large corporate employers and by the majority of public employers in the United States. These plans provide a more complete retirement program than defined contribution plans as illustrated in the following points.

Normal Retirement. In a defined benefit plan the employee earns a fixed benefit based on a formula. The benefit is easily determined if the employee's final average salary and years of service are known. In a defined contribution plan no guarantee of a specific retirement benefit is given. The benefit is based on the account value at the time of retirement. Thus after experiencing market fluctuations, employees in defined contribution plans may well have a tendency to "bail out" of the workforce just when there is a shortage of employees. The shortage of employees often occurs when the economy is good, markets are high and the defined contribution portfolios are at relative peaks. It is at this time that defined contribution portfolios of members who leave employment are rich.

Disability Retirement. Defined benefit plans are designed to share risk, so disability coverage could easily be built into the total retirement program. In a defined contribution plan risk cannot be shared.

Death Benefits. A defined benefit plan can provide a fixed formula death benefit. The death benefit can pay to a survivor some minimum amount even if the deceased member's earned benefit was small. In a defined contribution plan, the death benefit depends solely on the account balance. No minimum benefit can be established.

COLAs. Defined benefit plans can provide for post-retirement increases or COLAs. These increases are frequently tied to the Consumer Price Index (CPI), which measures the cost of living. A COLA provides retirees with a means of protecting their retirement benefits against the adverse effects of inflation. Most defined contribution plans do not provide COLAs because it is difficult to incorporate the funding necessary to pay for them.

Benefit Increases. A well funded, mature defined benefit plan can pay for benefit increases through favorable actuarial or investment experience. The only way to increase benefits under a defined contribution plan is to increase account balances. Account balances can only be increased by raising employee/ employer contributions or by increasing investment performance.

Portability. Defined benefit plans provide for portability by allowing vested members to purchase service in the current plan for service in another plan for which they do not have a future pension benefit. In addition, most defined benefit plans allow a former member to withdraw the employee contributions (and in some cases a part of the employer) plus interest. In defined contribution plans the member can take their account balance with them when they leave service.

It is for these reasons that the proposed restructured plan is a defined benefit plan.

2000 Survey of State and Local Government Employee Retirement Systems

(Published by the Public Pension Coordinating Council: April 2000)

The Public Pension Coordinating Council (PPCC) consists of representatives from four national organizations. The four organizations are:

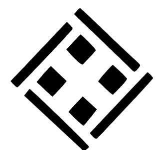
- Government Finance Officers Association (GFOA)
- National Association of State Retirement Administrators (NASRA)
- National Conference on Public Employee Retirement Systems (NCPERS)
- National Council on Teachers Retirement (NCTR)

This report presents a summary statistical analysis of state and local government employee retirement systems surveyed by the PPCC during the summer of 1999. It provides in-depth information about the current practices of public employee retirement systems regarding administration, membership, benefits, contributions, funding, investments and reporting.

This survey has been conducted for a number of years and is likely to be updated again during 2002.

Section II: Agreed Upon Tenets for a Restructured Minnesota Teachers Retirement System

7. Structure of Plan
8. Governing Board
9. Authority and Fiduciary Responsibilities of the Trustees
10. Accountability, Oversight and Disclosure
11. Plan Membership
12. Plan Benefits
13. Current Benefit Recipients
14. Duluth Old Plan
15. Minneapolis and St. Paul Basic Plan
16. Contributions and Liabilities
17. Financing
18. Ancillary Benefits



Chapter 7:

Structure of Plan

The Study Committee and the Task Force reviewed two alternative structure options that are commonly employed in the design of a public employee retirement plan. Those two choices are: a) a state agency, or b) a nonprofit corporation.

Each of these two options is currently being used by various public employee pension plans throughout the USA. The structure of the new fund is crucial because it would provide the mechanism with which all other issues would be implemented.

Proposal and Rationale

Structure: Nonprofit corporation with assets held in trust for the exclusive benefit of its members.

Background

Since their inception, after permissive language in 1909 allowed their creation, the three first class city teacher funds have existed as nonprofit corporations. Their boards of trustees under prudent investor standards invest the assets of the corporations. Their members are covered under the protections granted to them under MN Statutes, Chapter 317A (MN Nonprofit Corporation Act) including the right to vote on any changes to the corporation (see Chapter 24, Implementation Phase: Merger, Consolidation, Dissolution Laws Affecting Nonprofit Corporations).

The state teachers' fund, created in 1931, is a governmental agency. MN Statute 354.10 states that the assets of the TRA belong to the State of Minnesota until they are paid to the pension plan member and Chapter 11A states the assets of the agency are invested by the State Board of Investment under the guidance of the constitutional officers of the State of Minnesota. These laws do not recognize the difference of the retirement systems from other state agencies. The pension system has a more singular responsibility than do other state entities since its duties and responsibilities require acting in the best interests of plan members. "Specifically, the obligation of the trustees is to act

solely on behalf of the retirees who are currently receiving benefits and the active members who will receive benefits in the future." *Day v. New Hampshire Retirement System*, 635 A.2d 493, 496-97 (NH, 1997). State officials have a much broader mandate. Their duty is to all citizens.

Additionally, MN Statutes 356A.04 states that Minnesota public pension plan trustees' fiduciary duties are to their members, the State of Minnesota, and its taxpayers. This creates a real conflict of interest for the fiduciaries of the pension funds and would not be acceptable under ERISA and is not acceptable under the federal *exclusive benefit* rule found in the Internal Revenue Code 401(a). This rule applies to retirement system trustees and requires a duty of loyalty to the members only. If a retirement system fails to comply with this rule, serious tax consequences could follow.

Unlike Minnesota, many states currently have constitutional protections for their pension benefits and assets. These constitutional protections include such things as funding requirements, assets used for retirement purposes only, no diversion of assets, board of trustees' governance, guaranteed right to a benefit, investment authority, and separate trust funds. The following statewide teacher pension funds are independent organizations: Colorado, Georgia, Illinois, Louisiana, Missouri, New York, Ohio, and Utah. (See *Is Your Pension Protected?* in Chapter 6.)

Since Minnesota pension funds are without any constitutional protections and because current state law seems to be contrary to federal exclusive benefit rules, adopting the "best practices" provisions of UMPERSA would address these issues.

Rationale

Restructuring the new pension plan in the form of a nonprofit corporation would be in keeping with the recommendation of UMPERSA, Section 4, that states: "except as otherwise provided in subsection (b), all assets of a retirement system are held in trust. The trustee has the exclusive authority, subject to this (ACT), to invest and manage those assets."

It would also implement Section 7 of UMPERSA regarding General Fiduciary Duties thus satisfying the exclusive benefit rule. This section states: "A trustee or other fiduciary shall discharge duties with respect to a retirement system: 1) solely in the interest of the participants and beneficiaries... ."

In order to carry out the duties specified in UMPERSA Sections 4 and 7, Section 5 of UMPERSA relating to the powers of the trustees would also be incorporated into the restructured teachers retirement plan. This section is crucial since it allows trustees to carry out their fiduciary duties.

The restructured plan would treat all members the same. Currently, there are differences in benefits not only between members of the same fund but also members of the TRA and first class city funds. Furthermore, some members are paying more than others for the same benefits and some members are paying for benefits they do not have. The restructured plan would treat all members equally in terms of benefits and contribution rates. All assets and liabilities would be pooled into one fund and the funding level would be the same for all members.

This structure as an independent entity does not mean that the state has given up its authority to establish benefit levels and make other amendments to the plan. The Legislature would retain this authority subject to any contractual rights previously promised to plan participants. In addition, taxpayers would have a continuing interest in the management of the retirement system. Citizens would benefit from a well-run and soundly invested retirement system because it would be less expensive to operate and would help in attracting and retaining teachers of excellence.

Chapter 8: Governing Board

An important component of the restructured teachers retirement plan is the composition and authority of the fiduciaries of the plan, the Board of Trustees. The next chapter of this report will expand on the authority and fiduciary responsibilities of the trustees and the rationale for such authority.

This chapter will examine the rationale for inclusion of the various classifications of members of the Board of Trustees. It is important for the reader to note that we will be discussing two distinct boards of trustees, as the authors concluded that the transition from four separate teacher plans to one statewide restructured teachers retirement plan would need a Transition Board for a period prior to the election and/or appointment of the Permanent Board.

A report prepared by the GFOA Research Center for the members of The Public Pension Coordinating Council, entitled *2000 Survey of State and Local Government Employee Retirement Systems,* stated that for most retirement systems, overall management is the responsibility of the system's retirement board or Board of Trustees, which is made up of individuals who are either appointed to their positions, elected by system members, or otherwise designated to serve. This survey, which contained the responses of 246 public employee retirement systems representing 371 retirement plans, goes on to state that the number of retirement board members ranged from four to twenty-six members. The average board size was 8.1 members, however, systems covering teachers tended to have somewhat larger boards, averaging 9.7 members per system.

A typical Permanent Board composition would be a nine-member board composed of a majority of active teachers who are elected by the members of the system, retiree representation, appointed members usually from the state administration, and from a school board association.

In Minnesota, the size and composition of the respective teacher fund boards is as follows:

Duluth TRFA	St. Paul TRFA	Minneapolis TRFA	Minnesota TRA
9 trustees	**10 trustees**	**7 trustees**	**8 trustees**
7 elected members	9 elected members	6 elected members	5 elected members
1 school board member	1 school board member	1 school board member	3 ex-officio:
1 superintendent or designee			Comm. of Finance
			Comm. of CFL
			MN School Board Assn.

The composition of the Permanent Board structure is further discussed in Chapter 19.

The composition of a Transition Board would be different and usually comprised of a larger number of members. The Transition Board would usually be appointed from various groups such as active teacher trustee(s) from each of the four boards involved in the restructuring and employer trustees from the various existing teacher retirement boards. The period of existence of the Transition Board would be until the full board could assume the operation of the restructured teachers retirement plan. The composition of the Transition Board is further discussed in Chapter 19.

Chapter 9:

Authority and Fiduciary Responsibilities of the Trustees

The trustees of the restructured teachers retirement plan would have full, exclusive authority for the following areas:

1) **To establish an administrative budget** sufficient to perform the trustee's duties and, as appropriate and reasonable, draw upon assets of the retirement system to fund the budget;

2) **To obtain by employment or to contract the services necessary** to exercise the trustee's powers and perform the trustee's duties, including actuarial, auditing, custodial, investment, and legal services; and

3) **To procure and dispose of goods and property necessar**y to exercise the trustee's powers and perform the trustee's duties.

In exercising authority, the trustees must carry out their fiduciary duties, but would not be subject to civil service, personnel, procurement, or similar general laws relating to other state agencies and other state employees.

According to Section 7 of UMPERSA, the authority conferred upon the trustees is intended to ensure that retirement system trustees have a level of independence sufficient to permit them to perform their duties and to do so effectively and efficiently. Trustees are different from other agents of the state, or other state employees, because trustees are subject to an extensive and stringent set of fiduciary obligations to retirement system participants and beneficiaries. These obligations both require and justify some level of trustee independence.

Independence is required because it permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations. In the absence of independence, trustees may be forced to decide between fulfilling their fiduciary obligations to participants and beneficiaries or complying with the directions of others who are responding to a more wide-ranging, possibly conflicting set of interests. In this sense, the independence given to the trustees is an important corollary of the fiduciary obligations that they have.

The fiduciary obligations of trustees also justify the level of independence. Trustees are not independent without constraint; instead, they must comply with their fiduciary obligations when exercising judgment. The trustees are endowed with more independence than other agents of the state or other state

employees, but in exercising that independence the trustees are subject to a more extensive and stringent set of fiduciary obligations than those other individuals.

Trustee independence aligns well with the interests and prerogatives of the Legislature. First, the Legislature has a strong interest in effective and efficient management of public retirement systems. Mismanagement presents obvious political hazards and, in the long run, may result in lower benefits, higher contribution levels, or both. The trustee is already under a fiduciary duty to act effectively and efficiently; this section removes constraints that may interfere with the fulfillment of that duty. Second, the Legislature is interested in protecting its legitimate prerogatives. For example, it creates retirement programs, establishes benefit levels, and determines funding methods. Trustee independence does not infringe on those prerogatives. The trustee's independence is confined to the trustee's legitimate role of managing the operation, administration, and assets of a retirement system.

Item #1, authority to establish a budget, indicates that the trustees must have authority, within the confines of fiduciary duties, to draw on retirement system assets to fund the administrative budget and to accomplish the purposes of the trust.

Item #2, authority to employ or contract for services, is intended to provide the trustees of the restructured teachers retirement plan with broad authority over personnel matters. The intent is to free the trustee from restrictive civil service requirements, to shield the trustee against interference by others who do not share the trustee's fiduciary obligations, and to protect the trustee against representation by those with potentially conflicting interests.

Additionally, Item #2 authorizes the trustee to obtain actuarial and other services. The actuary retained by the trustees would be responsible to perform the official annual actuarial valuations, conduct periodic experience studies, and would make recommendations as to the appropriate funding level, and the use of appropriate actuarial assumptions of the retirement plan. Trustees would have full, exclusive authority to set the actuarial assumptions. The actuary obtained by the trustees might not be the only actuarial firm in place. State law could allow the Legislature or another oversight body to retain an actuary for additional oversight, and to review the work of the actuary

retained by the trustees. According to the *2000 Survey of State and Local Government Employer Retirement Systems,* published by the GFOA Research Center, of the 246 state and local retirement systems across the country that responded to the survey, 218 systems, almost 90 percent, indicated that the retirement system trustees have authority to set the actuarial assumptions.

Item #3, authority to procure and dispose of goods and property is intended to provide the trustees with broad authority over procurement matters. Under this arrangement, trustee decisions on procurement matters must comply with his/her fiduciary responsibilities, rather than with the requirements of state procurement laws.

Finally, the authors believe there is a need for some mechanism whereby recommendations from the plan actuary to change contribution rates could be addressed and adjudicated on a timely basis. This is particularly critical when the recommendations are made as a result of analysis by the actuary of current and future demographics of the plan membership, or as a result of conclusions reached after conducting an experience study, projection valuation, or other actuarial analysis.

The intent of this chapter is to assert that trustees must have independence. Trustees must be subject to certain fiduciary duties, but should not be subject to obligations imposed by general civil service, personnel, or procurement laws of a state or political subdivision. Nevertheless, other general laws such as conflict of interest, code of ethics rules, and other requirements in nonprofit law would continue to apply to the trustees.

Chapter 10:

Accountability, Oversight and Disclosure

Accountability

A trustee or other fiduciary will be held personally liable to the members and beneficiaries of the plan for any breach of fiduciary duty. This liability applies to any fiduciary breach whether "knowing and willful" or non-knowing or non-willful that results in a non-recoverable loss to the system. This liability cannot be limited by any agreement. This accountability is recommended by UMPERSA.

Oversight

Oversight is a critical component of the restructured educators pension plan. We believe that many of the current oversight mechanisms currently in place are necessary under the restructured teachers retirement plan. The oversight mechanisms currently in place would continue:

1. Annual financial and compliance audit by the Office of the State Auditor;
2. Investment performance monitoring by the Office of the State Auditor;
3. Reporting to, and oversight, by the Legislature.

Disclosure

Disclosure is also an important feature of the restructured teachers retirement plan. The following items would be important disclosure features of the plan:

1. **Open public meetings and records**. Currently, each of the separate teacher retirement fund Boards are required to follow the open meeting law requirements contained in MN Statutes, Chapter 13D. This would continue under a restructured educators' plan. However, it is suggested in UMPERSA that the Board of Trustees, having authority to invest or manage assets of a retirement system, may deliberate about, or make tentative or final decisions on, investments or other financial matters in executive session if disclosure of the deliberations or decisions jeopardizes the ability to implement a decision or to achieve investment objectives. Additionally, a record of a retirement system that discloses deliberations about, or a tentative or final decision on, investments or other financial

matters is not a public record under the State Open Records Law to the extent and so long as its disclosure jeopardizes the ability to implement an investment decision or program or to achieve investment objectives.

2. **Disclosure to the Public**

   a. The administrator of the restructured educators' retirement plan would prepare the following for distribution to the employer units and to the public:

      i. Summary plan description of each retirement plan it administers. Basically, this is a description of the retirement program and its benefits. It must be written in a manner understood by the average participant and be accurate and sufficiently comprehensive to reasonably inform the participants and beneficiaries of their rights and obligations under the retirement program. It must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

      ii. A summary description of any material changes or modifications to the terms of the retirement program, or to the summary plan description.

      iii. An annual disclosure of financial and actuarial status. This is a compilation of a great deal of information about the retirement system and program, its financial position, and, for defined benefit plans, its actuarial position. It does not need to be distributed to each participant and beneficiary. Instead, it has a very limited required distribution intended to make the report widely available to interested parties at modest cost to the retirement system.

      iv. A summary annual financial report. This is a summary of the annual disclosure of financial and actuarial status. It must contain certain key financial information and, for defined benefit plans, key actuarial information. The summary annual report must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

b. The administrator shall make available for public examination in the principle office of the administrator and at each of the employer units in order to make information reasonably available to the members:

   i. the governing law of the retirement program and system;

   ii. the most recent summary plan description;

   iii. summary descriptions of any material changes or modifications to the terms of the retirement program, or to the summary plan description;

   iv. the most recent annual disclosure of financial and actuarial status;

   v. the most recent comprehensive annual financial report.

3. **Disclosure to Participants and Beneficiaries**

   a. The administrator shall furnish to each participant and beneficiary who is receiving benefits the following:

      i. A copy of the most recent summary plan description, and any summary description of changes or modifications to the plan within three months after a person becomes a contributing member, or within three months after a person first receives benefits;

      ii. A summary description of any changes or modifications to the plan within seven months after the fiscal year end in which a modification or change has been made;

      iii. A copy of an updated summary plan description that integrates all modifications to the plan at intervals not to exceed five years;

      iv. A summary annual report within seven months after the end of each fiscal year.

   b. The administrator shall provide to each participant a statement containing information that estimates projected benefits reasonably, to the extent the information is regularly maintained by the retirement system.

4. **Reports to the Legislature**

The following reports would be provided to the Legislature as they are prepared by the trustees of the restructured teachers retirement plan:

a. Annual actuarial valuation. This is a measure of the actuarial condition of the retirement plan. It would be prepared by a qualified actuarial firm retained by the trustees of the plan.

b. Comprehensive annual financial report. This is a compilation of a great deal of information about the retirement system and program, its financial position, and its actuarial position. It does not need to be distributed to each participant and beneficiary. Instead, it has a very limited required distribution intended to make the report widely available to interested parties at modest cost to the retirement system. A summary of the annual report must be distributed to participants and beneficiaries receiving benefits, and be made available to the public. The report must contain the financial statements and notes in conformity with generally accepted accounting principles. The principal current articulation of those principles is Governmental Accounting Standards Board Statement No. 25, which requires two financial statements (a statement of plan net assets and a statement of changes in net plan assets) and accompanying notes. Governmental Accounting Standards Board Statement No. 25 also addresses a multitude of other issues that must be addressed in preparing the financial statements and notes.

c. Periodic Experience Study Reports. These reports analyze the actual experience of the plan compared to the actuarial assumptions currently in place.

d. Other actuarial reports and analysis such as projection valuations, etc.

Chapter 11:

Plan Membership

Except for the Basic Plan members of Minneapolis and St. Paul teacher retirement fund associations (see Chapter 15), membership in the restructured plan would retain the same criteria as is currently provided in statute for the existing teacher funds. For each fund, "teacher" is defined in statute. Any service performed by any person within this definition would be considered covered service. Licensure granted by the Minnesota Board of Teaching or by the Minnesota Department of Children, Families and Learning is required to qualify as a "teacher" within the definition. Teaching service performed for "for-profit" employers would not be covered by the restructured plan.

Chapter 12:

Plan Benefits

A very significant aspect of developing a restructured plan is improving the structure of the benefit provisions included in the plan. In this Chapter, analysis is first presented of the existing benefit provisions, which is followed by the proposed improvements to the benefit structure for those who are not retired at the time the new restructured plan begins.

Determining a Retirement Benefit

The four teacher retirement plans are defined benefit plans. Defined benefit plans provide a guaranteed and predictable pension benefit that generally would be a percentage of the teaching salary at the time of retirement. The amount of retirement benefit would be determined by three primary variables: 1) the final average salary (FAS); 2) years of credited service; 3) age at retirement. By inserting these variables into the benefit formula, precise amount of benefits could be calculated quite easily.

Again, the benefit formula is comprised of three basic components:

1) **Final Average Salary** (FAS) – the number of years of salaries that are averaged to determine the base salary for benefit calculation.

2) **Formula Multiplier** – the percentage of the FAS that is awarded for each year of credited service

3) **Normal Retirement Age** – the age, service, or combination of age and service at which a member could receive an unreduced pension benefit.

By using these components to determine a benefit, the formula multiplier is applied to each year of service to determine what percentage of the FAS would be included in the benefit. If the retiree has reached the minimum normal retirement age, this percentage of the FAS would be the annual base benefit. If the retiree has not yet reached normal retirement age, early retirement reduction factors would be applied to discount the benefit.

Evaluating Minnesota’s Current Benefit Provisions

The value or determination of the three components of a benefit formula vary greatly among public pension plans throughout the nation and consequently, the amount of pension benefits varies greatly for retirees that have similar experience with respect to salary, service, and age at retirement. In comparing the three

formula components used by the Minnesota Teachers Retirement Association (TRA) in determining initial benefits for its retirees to the formula components used by the similar statewide teacher retirement systems throughout the nation, TRA comes up very low in all three comparisons. Not surprisingly, a comparison of contribution rates indicates that Minnesota's contributions, in particular its employer contributions, are considerably lower than the national average.

This comparison is based on information provided in the publication *Characteristics of 100 Large Public Pension Plans* published by the National Education Association in September 2000, which is summarized in *Attachment A* on page 46. Comparison in this report is made to the 33 statewide teacher retirement systems that have benefit structures similar to Minnesota TRA. States not included in the comparison are non-Social Security states for pension purposes and, consequently, have significantly greater public pension benefits.

Formula Multiplier Comparison – The formula multiplier is the percentage factor that is applied to each year of creditable service to determine what overall percentage of the FAS would be included in the initial pension benefit. Of the three formula components, the value of the formula multiplier generally has the greatest impact in determining a retiree pension benefit. In comparing the factors used in the 34 states, the multipliers range from a low of 1.5 percent per year to a high of 2.35 percent per year. The table in *Attachment A* ranks the states according to the value of their respective formula multiplier. Half (17) of the states have multipliers that are 2.0 percent or higher and the average of all states was slightly over 1.88 percent. In Minnesota, members hired before 1989 have a two-tier benefit calculation provision in which the retiree can use whichever method generates the greatest benefits. Members retiring after age 62 generally get a larger benefit under Tier II which has a formula multiplier of 1.7 percent for each year of service. Most TRA retirees, however, utilize the Tier I calculation method because it is associated with the Rule of 90 early retirement provision. Under Tier I, the formula multiplier is a very low 1.2 percent for the first 10 years and 1.7 percent for each year thereafter. For a 30-year teacher, the formula multiplier for a Tier I retiree averages only 1.53 percent per year – only Michigan has a lower factor of 1.5 percent per year.

Final Average Salary (FAS) Comparison – There is considerable variance in the 34 systems in how many years of salary are to be averaged in determining the FAS for benefit calculation. Minnesota is one of six states that averages the highest five years of salary to determine FAS. Three years of salary is by far the most common and is used in 24 states. The other four states use either two, three and one-half, or four years in their FAS. No systems use more than five years. Logically, averaging three years would generate a larger FAS than averaging five years, and a larger FAS would generate a larger, initial benefit if we assume the other two components are equal.

Normal Retirement Age/Service Comparison – Normal retirement age/service is the established minimum age and/or service criteria a member must obtain to be able to retire and not be subject to early retirement penalties. Normal retirement age is the earliest age a member having the minimum amount of service required for vesting can qualify for an unreduced retirement benefit. In addition, nearly all funds have a service related "early retirement" provision that permits a member to retire before the normal retirement age if they obtain a certain number of years of service or reach an age and service combination. For example, several systems allow unreduced pension benefits after 30 years of service regardless of age, whereas other systems have a combination of age plus service (e.g., Rule of 90) to determine their early retirement provision. These provisions are listed in the fifth column of *Attachment A*.

In Minnesota, teachers hired before 1989, can retire with an unreduced retirement benefit at age 65 or when their age plus service totals 90, whichever is earlier. For teachers hired after 1989, the normal retirement age is 66 with no early retirement provision. No other state in the nation requires its members to go beyond age 65 to receive an unreduced pension benefit. In fact, only 13 of the 34 states have age 65 as normal retirement age. In other states, 6 have age 62, 13 have age 60, one has age 58, and one has age 55. In addition, most states have a service-related early retirement provision that is considerably more liberal than the TRA Rule of 90. In 16 states, 30 years of service would allow retirement at any age with no reduction. Another eight have age and service combinations that are less than Rule of 90 (e.g., Rule of 80, 85, 88, etc.). Only Idaho with its age 65 normal and

Rule of 90 appears to be as conservative as Minnesota's pre-1989 provision with this component. Certainly, no other funds have anything as stringent as the age 66 normal retirement with no early retirement provisions that is currently available for our members hired after July 1, 1989.

Contribution Rate Comparison

As indicated on the two right columns of *Attachment A*, employee and employer contributions vary greatly among similar statewide teacher retirement systems. Minnesota's TRA contribution rates are currently 5 percent each for employee and employer. While the 5 percent employee contribution is only slightly less than the average of 5.29 percent, the 5 percent employer contribution is considerably less than the average employer contribution rate of 7.96 percent. While Minnesota's contribution rates are already very low, it is particularly disturbing to hear there is consideration to reduce them further, rather than improve the initial benefit provisions.

Evaluation Summary

In summary, based on the comparison of the three component parts of pension benefits, Minnesota has the poorest overall initial benefit provisions of any similar statewide teacher retirement system. Only Michigan has a slightly lower formula multiplier (1.5 percent), but they use a High-3 final average salary and have a normal retirement age of 60 with ten years of service or any age with 30 years of service.

Evaluating Minnesota's Current Post-Retirement Adjustment Provision

In contrast to having the poorest initial retirement benefit provisions in the nation, Minnesota has one of the most generous cost-of-living adjustment provisions for member benefits after retirement.

Minnesota is quite unique in that it has pension assets divided between two funds – one for its active members and a second for its retired members. Only the Wisconsin Retirement System has a similar arrangement. The active member fund is comprised of employee and employer contributions plus investment earnings that have accumulated during the years prior to retirement.

When a member retires, the assets necessary to fully fund the member's retirement benefits throughout a normal lifetime are transferred from the active member fund to the retiree fund, which is called the Minnesota Post Retirement Investment Fund (Post Fund). Assets are transferred with the assumption that the Post Fund will earn 6 percent annually on these assets.

Minnesota COLA provisions have two components: an inflation guarantee up to 2.5 percent maximum and an investment component based on earnings in excess of the combined assumed rate of 6 percent and the inflation component (2.5 percent maximum). There is no maximum to the Minnesota COLA. Essentially, all Post Fund investment earnings in excess of the 6 percent assumed earnings are distributed to retirees in the form of annual post-retirement adjustments or COLAs.

When the current COLA formula was established in 1992, it was anticipated that favorable investment experience would generate annual adjustments that would be approximately equal to the CPI rate of inflation so that retirement benefits could retain purchasing power – increases generally in the 2 to 4 percent range each year. It was never anticipated that there would be year after year of the very high investment earnings that were experienced in the 90s. With these much higher than expected investment earnings, the TRA annual adjustment COLAs averaged 9.3 percent for 1997-2001 – four times the average CPI inflation rate of 2.42 percent. Longer term, since 1981 TRA COLAs have averaged 7.0 percent – nearly double the CPI average of 3.52 percent (see *Attachment C*, page 48).

While this evaluation compares the COLA of TRA to other statewide teacher retirement systems, it is important to note that the COLAs provided by the Minneapolis, St. Paul, and Duluth Teacher Retirement Fund Associations have been extremely generous in recent years as demonstrated by the graph in *Attachment D* on page 49.

Only Wisconsin among the other statewide teacher retirement systems in the nation provides automatic COLA increases that are even close to the generous level provided by Minnesota TRA. According to the publication *Fighting Inflation: How Does Your COLA Compare?* printed by AARP in 2000 (see *Attachment B* on

page 47), 37 statewide teacher retirement systems provide an automatic COLA for their retirees each year. Other states provide increases to retirees on an ad hoc basis.

Of these 37 states providing automatic increases, the COLAs in:

- 9 states provide fixed percentage increases each year ranging from 1.5 to 3.1 percent
- 16 states equal CPI with maximums ranging from 2 to 5 percent per year
- 3 states equal the CPI only if there are excess earnings. Maximums range from 3 to 6 percent
- 4 states are a percentage of CPI with maximums averaging from 4 to 5 percent
- 1 state provides CPI plus excess earnings with an overall maximum of 5 percent

Wisconsin provides increases or decreases based solely on excess earnings above its earnings rate of 5 percent and has no maximum. Like Minnesota, Wisconsin awarded very generous increases throughout the 90s, but Wisconsin retirees received substantial decreases in their benefits for the year 2000. Minnesota's benefits are never reduced.

There are two fundamental problems with providing these unlimited and very generous post-retirement increases.

First, these generous increases do not come without a cost and part of that cost is lower initial benefits. Funding retirement benefits using low post-retirement earnings assumptions (6 percent in MN, and 5 percent in Wisconsin) provides a nice built-in cushion for providing post-retirement increases because investment earnings are generally expected to be higher than that – in the 10 percent range long-term. However, funding benefits using lower earnings assumptions is much more expensive than if higher earnings assumptions are used. If funding the benefits is more expensive, the way to keep the overall cost at a reasonable level is by providing lower benefits at the time of retirement. This is one of the reasons Minnesota has the lowest initial retirement benefits in the nation and Wisconsin ranks only slightly better – 32 out of 34 similar statewide teacher plans.

A second problem, distributing all excess earnings with no maximum cap, creates extreme volatility in the increases from year to year. A defined benefit plan generates a guaranteed and predictable initial pension benefit and its post-retirement COLAs should also be somewhat consistent and predictable for retirement planning purposes. Retirees should not have to be concerned with the investment performance of pension fund assets during their retirement years.

While nobody could have predicted the unbelievable rise in the investment market during the 1990s, the huge increases generated by the much higher than anticipated investment earnings resulted in a huge windfall for members who retired before or during this time period. Members retiring in 1996 received cumulative increases in their benefits of over 59 percent during the five years following their retirement. By contrast, a member retiring today, after the dramatic downturn of the markets, likely would receive much smaller increases compounding to less than 20 percent during the five years following retirement. This extreme disparity due to the investment market was not anticipated in Minnesota's post-retirement increases and should not exist in any defined benefit pension plan.

Proposed Improvements to Initial Benefit Provisions

In restructuring our current pension provisions, it is desirable to bring both the initial benefits and the COLA provisions from the current respective extremes when compared to peer pension plans to a more traditional middle-of-the-road defined benefit plan. We propose making significant improvements to the initial benefit provisions that would be funded particularly by adopting a less expensive but more typical COLA provision.

While there are numerous ways that pension plans could be altered to provide various desired outcomes, we are proposing three substantive changes that would bring our plan benefits more closely into the mainstream of benefits that other pension plans are providing today. These three improvements are:

- Increasing the formula multiplier to 2 percent per year for all years of service,
- Using the highest three years instead of the highest five years in determining the final average salary,
- Making a normal retirement age of 65 and the Rule of 90 early retirement provision available to all members.

Two Percent Formula Multiplier

Increasing the formula multiplier to 2 percent for all years of service brings our plan into the mainstream for this very important component of the benefit formula. As previously indicated, half (17 out of 34) of the similar statewide teacher retirement systems have formula multipliers that are 2 percent or greater.

High-3 Years for Final Average Salary

Using three years instead of five years for determining the final average salary upon which the retirement benefit would be based would provide a modest benefit improvement for most new retirees. Over 70 percent (24 out of 34) of the similar statewide funds use three years while only five other states use five years in their final average salary determination. No fund uses more than five years.

Age-65 Normal Retirement Age and Rule of 90 applicable to all members

This improvement is primarily a fairness and equity provision that would not have a significant impact on retirements for nearly 20 years. This provision extends to teachers hired after July 1, 1989, the same benefit provision that their teacher counterparts who were first hired before that date currently enjoy. All teachers make the same contributions and should be entitled to the same level of benefits.

Young teachers first hired after 1989, would not meet the service requirements for Rule of 90 for several years but it is important that they have a target date that they can strive for as an incentive in their long range planning. Currently, post-1989 hires have no early retirement target incentive and must wait until age 66 to retire with an unreduced benefit. No other state in the nation has such a stringent requirement for its teachers.

Extending these retirement provisions to members regardless of when they were hired is an equity issue. It does not alter the fact that Minnesota's age 65 normal retirement age and Rule of 90 provisions remain about the most conservative with respect to this component of the benefit formula when compared to other similar statewide plans. In light of the current teacher shortage, we are not proposing liberalized age/service requirements for anyone retiring in the immediate future.

Improvement Summary

Despite retaining the conservative age/service requirements for unreduced benefits, the increase in the formula multiplier to 2 percent per year and to a high three years in determining final average salary are two very significant improvements that would move Minnesota much closer to the middle of comparable pension funds in its benefit provisions instead of being last.

Proposed Changes to the Post-Retirement COLA for Current Active Members

By providing a more traditional automatic COLA mechanism for new retirees instead of the current generous but expensive provisions, significant cost savings could be incurred that would partially fund the improvements proposed for initial benefits. Current retirees will retain the current post-retirement adjustment mechanism.

The most significant cost savings would be generated by increasing the post-retirement earnings assumption from its current 6 percent to 7 ½ percent. Assuming 7 ½ percent future investment earnings on retiree assets means that fewer dollars need to be reserved at the time of retirement to pay benefits over a retiree's lifetime.

Increasing the post-retirement earnings assumption by 1 ½ percent means that the current inflation component guarantee would be reduced from the current 2 ½ percent maximum to a flat 1 percent guarantee regardless of inflation. With the 7 ½ percent assumption plus 1 percent guarantee, the assets would have to earn 8 ½ percent to cover this cost. With the current asset mix utilized by the investment policy of the State Board of Investment, earnings are generally expected to average closer to 10 percent over time. This anticipates excess earnings to provide post-retirement adjustments beyond the 1 percent guarantee.

All investment earnings in excess of the required 8 ½ percent would be used to increase the total COLA amount up to CPI with the COLA capped at 4 percent per year. Earnings in excess of that necessary to pay for the COLA would be carried forward and accumulated in an "excess earnings account" which could be available for funding future COLAs. This account could incur a negative balance in the event there were not enough earnings to cover the 1 percent guarantee.

In similar fashion to accumulating excess earnings for future COLAs, excess CPI would accumulate during years when the funds were not available to pay COLAs equal to the CPI or in years when the CPI exceeds the 4 percent maximum.

With this COLA structure, new retirees would automatically receive annual increases ranging from 1 percent to 4 percent with anticipation of averaging about 2 ½ percent. Although this percentage is considerably less than recent retirees have enjoyed, it is higher than increases provided by most private sector pension funds, and similar to the provisions of most statewide teacher retirement systems.

Comparing Minnesota TRA with All Similar Statewide Teachers Retirement Systems

(Non-Social Security States Excluded)

Rank	State	Formula Multiplier	Final Avg Salary	Normal Retirement Age/Service	Contributions Employee	Contributions Employer
1	New Mexico	2.35	High-5	65/5, A25, R75	7.60	8.65
2	Texas	2.20	3	65/5, R80	6.40	6.00
3	Rhode Island	2.20	3	60/10, A28	9.50	12.01
4	Arkansas	2.12	3	60/5, A28	6.00	12.00
6	Arizona	2.10	3	65/A, 62/10, R80	2.66	2.66
6	Alabama	2.01	3	60/10, A25	5.00	5.96
7	Georgia	2.00	2	60/10, A30	5.00	11.29
8	New York	2.00	3	62/10, 55/30	3.00	1.42
9	Oklahoma	2.00	3	62/10, R90	7.00	9.80
10	Pennsylvania	2.00	3	62/1, 60/30, A35	6.25	1.94
11	Utah	2.00	3	65/4, A30	0.00	13.69
12	Wyoming	2.00	3	60/4, R85	5.57	5.68
13	Iowa	2.00	3	65/A, 62/20, R88	3.70	5.75
14	Hawaii	2.00	3	55/5	7.80	9.69
15	Idaho	2.00	3.5	65/5, R90	5.85	9.77
16	Washington	2.00	5	60/5, 55/25, A30	3.01	7.10
17	West Virginia	2.00	5	60/5, 55/30, A35	6.00	17.95
18	Nebraska	1.90	3	65/5, R85	7.25	7.32
19	North Dakota	1.88	3	65/3, R85	7.75	7.75
20	Mississippi	1.88	4	60/4, A25	7.25	9.75
21	South Carolina	1.82	3	65/A, A30	6.00	7.70
22	Maryland	1.80	3	60/A, A30	7.00	10.95
23	North Carolina	1.80	4	65/5, 60/25, A30	6.00	8.83
24	Delaware	1.80	5	62/5, 60/15, A30	3.00	9.52
25	Kansas	1.75	3	65/A, 62/10, R85	4.00	4.19
26	**Minnesota — Level**	**1.70**	**5**	**65/3**	**5.00**	**5.00**
27	Florida	1.68	5	62/10, A30	0.00	9.21
28	Vermont	1.67	3	62/5, A30	3.40	4.96
29	New Hampshire	1.67	3	60/A	5.00	4.11
30	Montana	1.67	3	60/5, A25	7.15	7.58
31	New Jersey	1.67	3	60/A	4.50	5.44
32	Oregon	1.67	3	58/A, A30	6.00	12.25
33	Wisconsin	1.60	3	65/A, 57/30	6.20	6.10
34	**Minnesota — Step (R90)***	**1.53**	**5**	**65/3, 62/30, R90**	**5.00**	**5.00**
35	Michigan	1.50	3	60/10, A30	4.30	11.66
	AVERAGE	**1.884**	**3.44**		**5.29**	**7.96**

***Step Formula** = 1.2% for first 10 years, 1.7% thereafter; for 30 years of service, multiplier averages 1.53% per year

A = Any Example: A30 = any age with 30 years of service; 65/A = 65 years of age with any service

R = Rule of Example: R 80 = Rule of 80

Sources: Characteristics of 100 Large Public Pension Plans, NEA (Sept 2000)

Statewide Teacher Retirement Systems COLA Comparison

States*	Type of COLA	Benefit**	Min %	Max %
AL	Ad Hoc			
AZ	Automatic	Lesser of CPI or excess earnings	0	3
AR	“	3% *simple*	3	3
CA	“	2% *simple*	2	2
CO	“	CPI	0	3.5
CT	“	CPI based on excess earnings account	0	6
DE	Ad Hoc	2%	2	2
DC	Automatic	CPI	0	3
FL	“	3%	3	3
GA	At board discretion	CPI every 6 months	0	1.5
HI	Automatic	2.5% *simple*	2.5	2.5
ID	“	Portion of CPI based 100% funding	1	6
IL	“	3%	3	3
IN	Ad Hoc			
KS	“			
KY	Automatic	1.5% plus 1.5% ad hoc	1.5	3
LA	“	CPI	0	2
ME	“	CPI	0	4
MD	“	CPI	0	3
MA	Legislative approval	CPI on first $12,000	0	3
MN	Automatic	CPI up to 2.5% plus excess earnings	0	No max
MS	“	Formula?		
MO	At board discretion	CPI 75% career maximum	0	5
MT	Automatic	1.5%	1.5	1.5
NE	“	CPI	0	2
NV	“	CPI	0	5
NH	Recommended by actuary	CPI plus excess earnings account	1	5
NJ	Automatic	60% of CPI *simple*	0	No max
NM	“	50% of CPI, 100% if CPI less than 2%	0	4
NY	Ad Hoc			
NC	“			
ND	“			
OH	Automatic	CPI Accumulates excess CPI	0	3
OK	Ad Hoc			
OR	Automatic	CPI Accumulates excess CPI	0	2
PA	Ad Hoc			
RI	Automatic	3%	3	3
SC	“	CPI	0	4
SD	“	3.1%	3.1	3.1
TN	“	CPI	0	3
TX	Ad Hoc			
UT	Automatic	CPI *simple* Accumulates excess CPI	0	4
VT	“	50% CPI beginning at age 62	0	5
VA	“	CPI up to 3%, plus 50% of CPI between 3% and 7%	0	4.5
WA	“	CPI	0	3
WV	Ad Hoc			
WI	Recommended by actuary	Based on excess earnings	0	No max
WY	Automatic	CPI Accumulates excess CPI	0	2.5

* Alaska, Iowa and Michigan are not included in this chart because they have more than one type of COLA.

** All benefits compounded unless designated as simple.

Source: “Fighting Inflation: How Does Your COLA Compare?” AARP 2000.

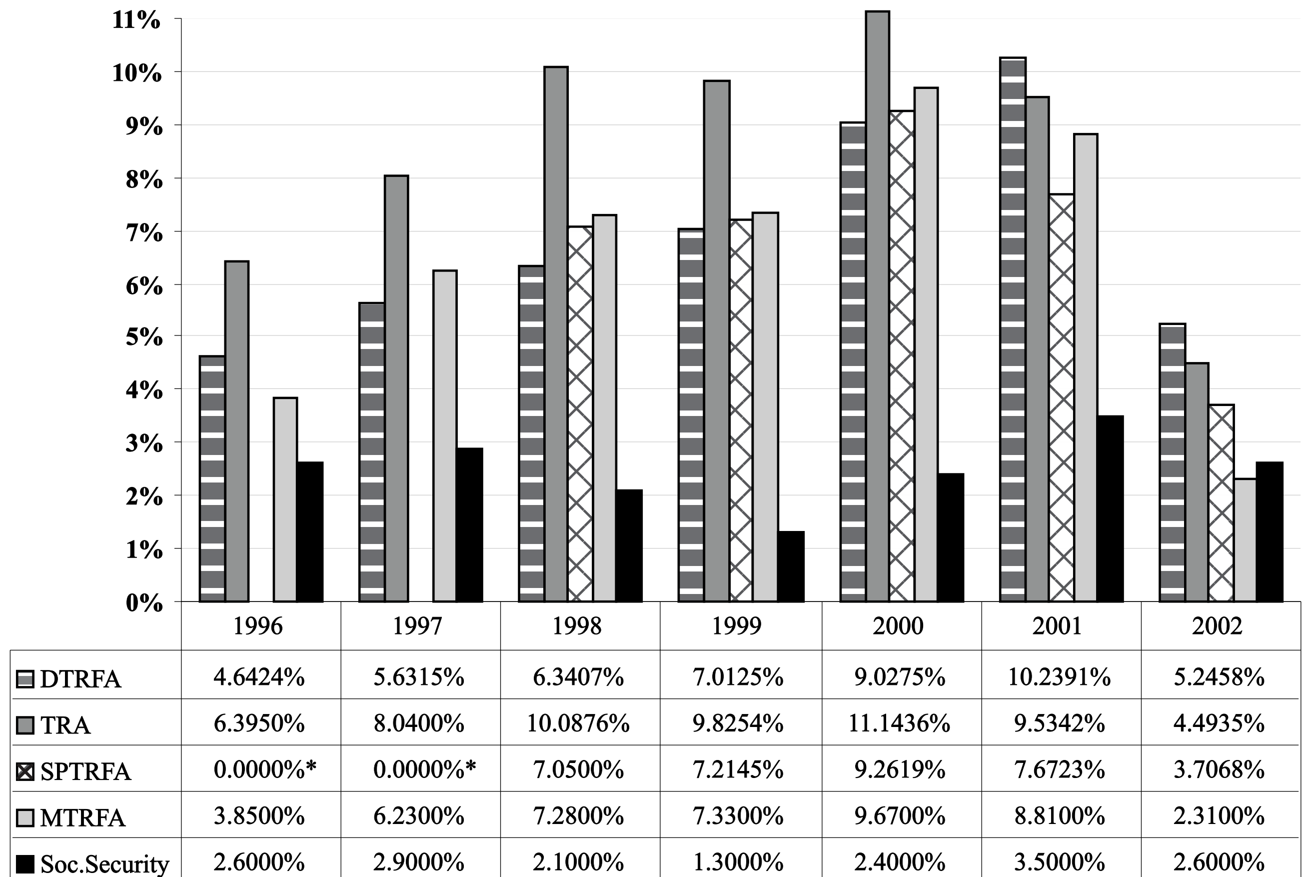
Note: Minneapolis, St. Paul and Duluth TRFA COLA: 2% plus excess earnings, 2% minimum, no maximum

Minnesota Post Retirement Investment Fund (MPRIF) Increases
vs
CPI Increases

Assuming 1980 monthly benefit of $1000

	MPRIF				CPI			
January 1	*Annual Increase*	*Benefit Amount*	*Cumulative Increase*	*Average Increase since 1980*	*Annual Increase*	*Benefit Amount*	*Cumulative Increase*	*Average Increase since 1980*
1981	3.2090%	$1,032.09	3.209%	3.209%	8.9%	$1,089.00	8.900%	8.90%
1982	7.4360%	$1,108.84	10.884%	5.323%	3.8%	$1,130.38	13.038%	6.35%
1983	6.8530%	$1,184.82	18.482%	5.833%	3.8%	$1,173.34	17.334%	5.50%
1984	7.4990%	$1,273.67	27.367%	6.249%	3.9%	$1,219.10	21.910%	5.10%
1985	6.9050%	$1,361.62	36.162%	6.380%	3.8%	$1,265.42	26.542%	4.84%
1986	7.8840%	$1,468.97	46.897%	6.631%	1.1%	$1,279.34	27.934%	4.22%
1987	9.7920%	$1,612.81	61.281%	7.083%	4.4%	$1,335.63	33.563%	4.24%
1988	8.0540%	$1,742.71	74.271%	7.204%	4.4%	$1,394.40	39.440%	4.26%
1989	6.9180%	$1,863.27	86.327%	7.172%	4.6%	$1,458.54	45.854%	4.30%
1990	4.0400%	$1,938.55	93.855%	6.859%	6.1%	$1,547.51	54.751%	4.48%
1991	5.1000%	$2,037.41	103.741%	6.699%	3.1%	$1,595.49	59.549%	4.35%
1992	4.2950%	$2,124.92	112.492%	6.499%	2.9%	$1,641.76	64.176%	4.23%
1993	4.5530%	$2,221.67	122.167%	6.349%	2.7%	$1,686.08	68.608%	4.12%
1994	6.0170%	$2,355.35	135.535%	6.325%	2.8%	$1,733.29	73.329%	4.02%
1995	3.9850%	$2,449.21	144.921%	6.169%	2.4%	$1,774.89	77.489%	3.91%
1996	6.3954%	$2,605.84	160.584%	6.183%	3.1%	$1,829.92	82.992%	3.86%
1997	8.0395%	$2,815.34	181.534%	6.293%	2.8%	$1,881.15	88.115%	3.80%
1998	10.0876%	$3,099.34	209.934%	6.503%	2.1%	$1,920.66	92.066%	3.71%
1999	9.8254%	$3,403.86	240.386%	6.678%	1.5%	$1,949.47	94.947%	3.59%
2000	11.1436%	$3,783.17	278.317%	6.902%	1.9%	$1,986.51	98.651%	3.51%
2001	9.5342%	$4,143.87	314.387%	7.027%	3.8%	$2,061.99	106.199%	3.52%
2002								
2003								

Annual Pension Increases of Minnesota's Teacher Retirement Plans



	1996	1997	1998	1999	2000	2001	2002
DTRFA	4.6424%	5.6315%	6.3407%	7.0125%	9.0275%	10.2391%	5.2458%
TRA	6.3950%	8.0400%	10.0876%	9.8254%	11.1436%	9.5342%	4.4935%
SPTRFA	0.0000%*	0.0000%*	7.0500%	7.2145%	9.2619%	7.6723%	3.7068%
MTRFA	3.8500%	6.2300%	7.2800%	7.3300%	9.6700%	8.8100%	2.3100%
Soc.Security	2.6000%	2.9000%	2.1000%	1.3000%	2.4000%	3.5000%	2.6000%

Adjustment Date = January 1

*St. Paul percentage COLA did not begin until 1998.

Chapter 13:

Current Benefit Recipients

The proposed pension benefit restructuring would apply only to future retirees and would not affect current benefit recipients. All current TRA benefit recipients would continue to be paid from the Minnesota Post Retirement Investment Fund (Post Fund) and have the same post-retirement adjustment formula that is currently in place.

Coordinated member benefit recipients from Duluth, Minneapolis and St. Paul would have their benefits paid from the Post Fund. For determining their post-retirement adjustments from the Post Fund those benefit recipients would make a one-time election to retain their 2 percent guarantee or receive the CPI adjustment up to a 2 ½ percent maximum that the other benefit recipients would receive.

Assets necessary to fully fund these benefit payments would be transferred to the Post Fund at a required amount determined by the actuary for the Legislative Commission on Pensions and Retirement (LCPR), to be sufficient to keep the Post Fund whole with no adverse impact on existing participants. Transfer of funds to the Post Fund from the first class city plan would be made at the funding ratio of the plan at the time of transfer. The difference between the required amount and the amount transferred from the first class city plan would be paid from other funding sources to be determined.

As outlined in Chapter 15, basic member benefit recipients from Minneapolis and St. Paul would make a one-time election to transfer to the Post Fund or remain with their existing plan.

Chapter 14:

Duluth Old Plan

Members of the Duluth Teachers' Retirement Fund Association hired prior to July 1, 1981, currently have rights and benefits in the DTRFA Old Plan. Contribution rates for Old Plan members are the same (5.5 percent) as "new law" members. However, the retirement benefits in the Old Plan are significantly different than the benefits for employees hired after June 30, 1981. The Old Plan has a normal retirement age of 60. It also has the Rule of 90, and a 3 percent per year reduction for members who retire prior to normal retirement age. The formula multiplier, currently 1.45 percent, is modest compared to the New Law plans. There are also some advantages in the leave of absence provisions in the DTRFA Old Plan. The members who utilize and benefit from the Old Plan are those who retire at an earlier age and retire with fewer years of service credit. On June 30, 2001, there were 309 active DTRFA members that were covered by the Old Plan, 31 survivors, and 474 retired members collecting benefits under the Old Plan.

Under the restructured teachers retirement plan, it is envisioned that the DTRFA members who are covered by the Old Plan would belong to the restructured plan, but would retain current rights and benefits. Active DTRFA members who were covered by the Old Plan would contribute to the restructured plan, would be voting members of the restructured plan, would have the same rights and benefits as all other members of the restructured plan, but would retain the rights and benefits of the DTRFA Old Plan. At time of retirement, DTRFA Old Plan members would have the same optional benefit choices and post-retirement adjustment options as all other members that come into the restructured plan from the various teacher retirement plans.

DTRFA members who have already retired with benefits from the Old Plan and survivors receiving Old Plan benefits would continue to receive those same benefits, but they would be paid and their accounts would be administered by the restructured teachers retirement plan.

Chapter 15:

Minneapolis and St. Paul Basic Plan

Prior to July 1, 1978, both Minneapolis Teachers' Retirement Fund Association (MTRFA) and St. Paul Teachers' Retirement Fund Association (SPTRFA) had plans that were not associated with Social Security. Duluth Teachers' Retirement Fund Association members are all coordinated with Social Security and TRA members currently are almost all coordinated with Social Security.

These plans, known as Basic Member Plans, are not only non-Social Security plans but also have different benefit structures than the Coordinated plans of the first class cities and the state TRA. (See *Appendix A*, *Funding History of the Teacher Pension Plans*.) Additionally, most of the retirees in the MTRFA and the SPTRFA are basic plan members.

Since these members do not have similar benefits to the coordinated members and since they exist under the Articles and Bylaws of their associations, these members would remain as closed funds in keeping with the Study Committee premise that there would be no sub-funds in the restructured teachers retirement plan. This has been done several times before in Minneapolis with the Minneapolis Employees' Retirement Fund Association and the Minneapolis Police Relief Association.

New benefit provisions for Minneapolis and St. Paul Basics: Active Members

1. 2.8 percent formula for all years of service up to a maximum of 100 percent. (The change in the COLA could provide funding for a higher formula.)
2. High three average salary.
3. Post-retirement adjustment would be changed to a guaranteed 1 percent plus additional adjustment, up to inflation.
4. Optional annuity provisions would be available to those who elect survivor benefits.

If active members choose to retain the old post-retirement adjustment, they could do so but they would then keep their current benefit provisions.

Retirees

There would be a one-time election by retirees to either keep their current post-retirement formula or move into the current TRA Post Fund. If the retiree elects to move into the TRA Post Fund, a transfer of funds would be made into the Post Fund at the funding ratio of the plan they transferred from. Additional funding would be needed to transfer current retirees into the state Post Fund. If there were actuarial losses, these would not come from the old basic plan.

Chapter 16:

Contributions and Liabilities

The split of the contributions between plan members and the employers in public employee retirement plans has been established in the guiding principles of the Legislative Commission on Pensions and Retirement (LCPR). That split has been determined to be an equal sharing of the "normal cost" by the employee and employer.

This concept of sharing the normal cost is present in public employee retirement plans. In most retirement plans in private industry, the employer pays the entire cost of providing a retirement plan to the employees. The prevailing thought in the private sector is that an employer-provided pension is a benefit like employer-provided insurance. Benefits are provided to attract and retain qualified employees.

It is common in most pension plans that the employer is responsible for any unfunded liabilities that exist. The primary reason for the employer or the state to bear the responsibility to pay for any existing unfunded liability is that past history has shown a pattern of inadequate or no funding at various times in the past. This is especially true in the case of the Minneapolis and St. Paul plans. (See Chapter 5 and *Appendix A, Funding History of the Teacher Pension Plans*.)

Generally accepted accounting principles in the public sector require that any unfunded actuarial liability be amortized over a period not to exceed 30 years (Statement No. 5 of the Governmental Accounting Standards Board, paragraph 36f, and 144).

Chapter 17: Financing

Financing the proposed Restructured Teacher Retirement System has demanded much discussion and caused the teacher fund directors to be as creative as possible while remaining within the bounds of sound pension principles.

Some of the major tenets agreed to by the authors are critical to keep in mind in thinking about the financing for the restructured teachers retirement plan. Those tenets include:

- In the restructured plan, there would be no subgroups or sub-accounts;
- At the time of restructuring, surplus assets in any plan would be reserved for the exclusive benefit of the members of that specific plan;
- After the restructuring is implemented, all members of the new plan would be treated the same, have the same benefits, pay the same contribution rates, and belong to one plan.

It is obvious that the only sources for financing the benefit package that is proposed in this paper are the same ones that have been present in the current retirement plans namely: 1) employee and employer contributions, 2) investment returns, and 3) additional contributions from the State of Minnesota or from some other source.

Employee and employer contributions could each be raised to meet the increased costs of an improved benefit package. Employers should contribute at least 50 percent of the normal cost of the plan. In addition when new benefits are adopted, a part of the increased liability that is greater than the normal cost increase could be amortized over a 30-year period.

Investment income could be used to help pay for the increased cost of an improved benefit package. It must be kept in mind that a key actuarial assumption of the plan is that the investments will be earning 8.5 percent return each and every year. In years when the return on investments exceeds this assumed earnings rate, the excess could be used to reduce the cost of the benefit package.

Additional, immediate contributions from some source would be needed to make up for the differences in the unfunded liabilities of the plans that are being aggregated, and for the increase in unfunded liabilities that would occur when plans with different funding ratios are aggregated into the new restructured plan.

Currently, the TRA and the DTRFA are over 100 percent funded, and the SPTRFA and the MTRFA are underfunded. By restructuring and aggregating the plans into one common pool, there must be a contribution on behalf of the underfunded plans to bring them up to a 100 percent funding ratio. If none of the funds are fully funded at the time of restructuring, then the additional contribution must be sufficient to bring each of the underfunded plans to the level of the plan with the highest funding ratio. Without this contribution, the members of the plans that were better funded at the time of restructuring would, in essence, be forced to contribute towards the unfunded liability of plans that were underfunded at the time of the restructuring.

There is also a need for an immediate infusion of funds when any of the current retirees from the first class city teacher retirement plans are transferred into the Minnesota Post Retirement Investment Fund (MPRIF). The MPRIF is required to be 100 percent funded. Since the interest earning assumption in the MPRIF is more conservative (6.0 percent) than in the first class city teacher retirement funds (6.5 percent), the amount of required reserves for current retirees that must be transferred to the MPRIF are higher than currently valued by the first class city teacher retirement funds. Compounding this problem again is the fact that each of the funds that would be aggregated has a different funding ratio. Retirees that would be transferred to the MPRIF from a plan that is less than 100 percent funded would not have a full reserve amount available for transfer. The amount of reserves required to be transferred to the MPRIF from an underfunded plan would be reduced by the funding ratio of the original plan. The deficiency of the required transfer amount would require an immediate infusion of funds from an alternate funding source in order to make the transfer and keep the MPRIF whole.

A final major cost consideration is the funding that is necessary to pay for the retirements of the Basic Plan members that would be remaining in the Minneapolis and St. Paul Teacher Retirement plans. Without an immediate infusion of money or a schedule to fully fund these plans by the target date of 2020, there would be a funding crisis that is estimated to reach over 100 million dollars per year in the not too distant future. In these two plans, the

actual division of assets between active and retired members, and between coordinated and basic members, continues to be a significant issue that needs resolution.

One option to provide the immediate infusion of money to address the problems outlined above is to imitate other state and local sponsors of public employee pension funds and issue bonds. Bonds would provide the needed immediate infusion of cash to the restructured teachers retirement plan and allow the State of Minnesota to pay off these bonds over a period of time. At times when interest rates on new bond issuances are relatively low, as they currently are, there may be attractive interest rate arbitrage opportunities that could make this a viable option.

There are additional changes that could be employed to mitigate the contribution requirements of the restructured plan. A notable change would be to reset the target date to achieve full funding to a date 30 years from the effective date of the restructuring. This would provide additional time to retire the unfunded liability of the plan, and would work well if bonds were issued. Also, at the time of the restructuring, if the market value of assets is greater than the actuarial value of assets, that higher value could be captured since each of the four existing plans would be legally closed and a new restructured plan would come into existence. Assets would transfer to the new restructured plan at full market value. Finally, changes already described to the post-retirement adjustment calculation in the restructured plan would act to reduce contribution requirements. All of these changes, depending on the timing of the restructuring, could lessen the cost of the restructuring by lowering the contribution requirements of the restructured plan.

In discussions about financing, the question arises as to the use of surplus assets that might exist in any of the teacher retirement plans at the time of restructuring, and if those assets could be used to help finance the obligations of the plans that are not as well funded. In all the literature that was reviewed, and in current federal law and state statute, it is clear that the assets of one system may not be used to solve the funding needs of another system even if the systems are consolidating. Based on current federal and state law the notion of the exclusive benefit applies to the assets that are held in trust by each of the systems.

Chapter 18: Ancillary Benefits

There are two ancillary benefits that are important to be administered internally for the active and retired members of the restructured plan:

1. Tax-sheltered 403(b) retirement savings plan; and
2. Supplemental medical programs.

Tax-Sheltered 403(b) Retirement Savings Plan

Most members currently indicate that they are not and do not care to become expert in matters concerning pensions, investments, taxes, economics, etc. Most also indicate they believe a defined benefit plan is most appropriate as their basic, fundamental retirement plan. They like the availability of a tax-sheltered defined contribution option to supplement their pension. For educators of public schools, this is available through vehicles such as 457 deferred compensation, tax sheltered 403(b) accounts, and various types of individual retirement accounts (IRA) and tax-sheltered annuities. All of these investment products are offered through private for-profit investment firms and insurance companies, except that deferred compensation, which is also available through the Minnesota State Retirement System. Most financial planners indicate that the most attractive options for public school educators to save for their retirement on a tax-deferred basis is through 1) tax-sheltered 403(b) accounts, 2) 457 deferred compensation, and 3) Roth IRAs.

Under the restructured teachers retirement plan, there would be a tax-sheltered 403(b) plan, administered by trustees of the plan. There are a number of advantages to having such a plan:

1. The infrastructure would be in place to efficiently implement such a plan. The basic retirement plan employs professional and high quality investment managers and a custodial bank. The investment of assets in the tax-sheltered 403(b) plan could flow to all or a combination of the existing investment firms already employed to manage the assets of the restructured teachers retirement plan. Separate custodial bank accounts could easily be opened at the existing bank for each of the investment managers participating in the tax-sheltered 403(b) program. Staff of the restructured plan would be

available to counsel members, and to prepare and distribute quarterly statements (unless it is determined that a third-party administrator would create even more efficiencies).

2. Members would receive professional, independent, and objective financial planning advice from staff concerning the advantages and operations of a tax sheltered 403(b) account. Other vendors are obviously very good at providing advice, but they are also motivated by profit. Staff at the restructured teachers retirement plan would have the interest of the members as their sole focus. Members looking for a trustworthy, independent source for objective financial planning information could rely on the staff to provide such a service.

3. Members would have one organization available to them to serve all their retirement planning needs. It is very effective to conduct retirement planning and to counsel members by first covering their basic pension benefit, and then expand to cover the tax-sheltered options as a way to supplement their pensions. Members would obviously have the ability to take advantage of the benefits and services offered through their own financial planners and advisors, or the Minnesota Deferred Compensation Program. However, those options involve taking an additional step, an additional contact to resolve issues, answer questions, etc.

4. An array of appropriate investment options could be offered to members. Investment options with varying degrees of risk and return potential would be made available to members to allow them to make their asset allocation determinations. There is a plethora of anecdotal information and regular stories in the press about investment advisors who have lead their clients into inappropriate investment vehicles, and advisors who developed inappropriate asset allocation plans for their clients. The likelihood of this occurring with a tax-sheltered 403(b) plan administered by the restructured teachers retirement plan is diminished due to the controls that would be in place over the basic pension plan operation. Selection of the investment firms would be conducted after

extensive due diligence and deliberation by the trustees of the restructured plan. A highly trained and professional staff would be in place. Oversight mechanisms would be present. Although the specific asset allocation determination would be left to the individual member, they would receive professional, objective information from the staff of the restructured plan to help them make those determinations.

5. Due to the significant economy of scale advantage, this service would be available to members at a greatly discounted fee compared to what is available at private investment firms in the open market.

Supplemental Medical Programs

Many school districts throughout the state either provide some monetary help to their retired employees or allow those employees to continue to belong to their group insurance plans until they reach the age for Medicare. However, many retirees find themselves paying extremely high costs for things like prescription drugs that Medicare does not cover or they take out individual supplemental policies at high costs.

The State of Minnesota has passed legislation that allows the establishment of post-retirement medical reimbursement. This is an excellent step toward helping retired employees cope with the cost of medical expenses. In conjunction with this, the restructured teachers retirement plan would sponsor Medicare supplemental insurance. The restructured plan has no costs associated with this nor does it have any liabilities. It simply provides the means by which retirees can purchase group supplemental health insurance.

If teachers have the means through a pre-retirement medical savings plan to set money aside before retirement for medical expenses and then have an opportunity to purchase affordable group medical insurance after retirement without costing the state any additional money, these public employees would certainly benefit.