Retirement Systems of Minnesota

Minnesota State Retirement System • Public Employees Retirement Association • Teachers Retirement Association

The Post Fund Proposal

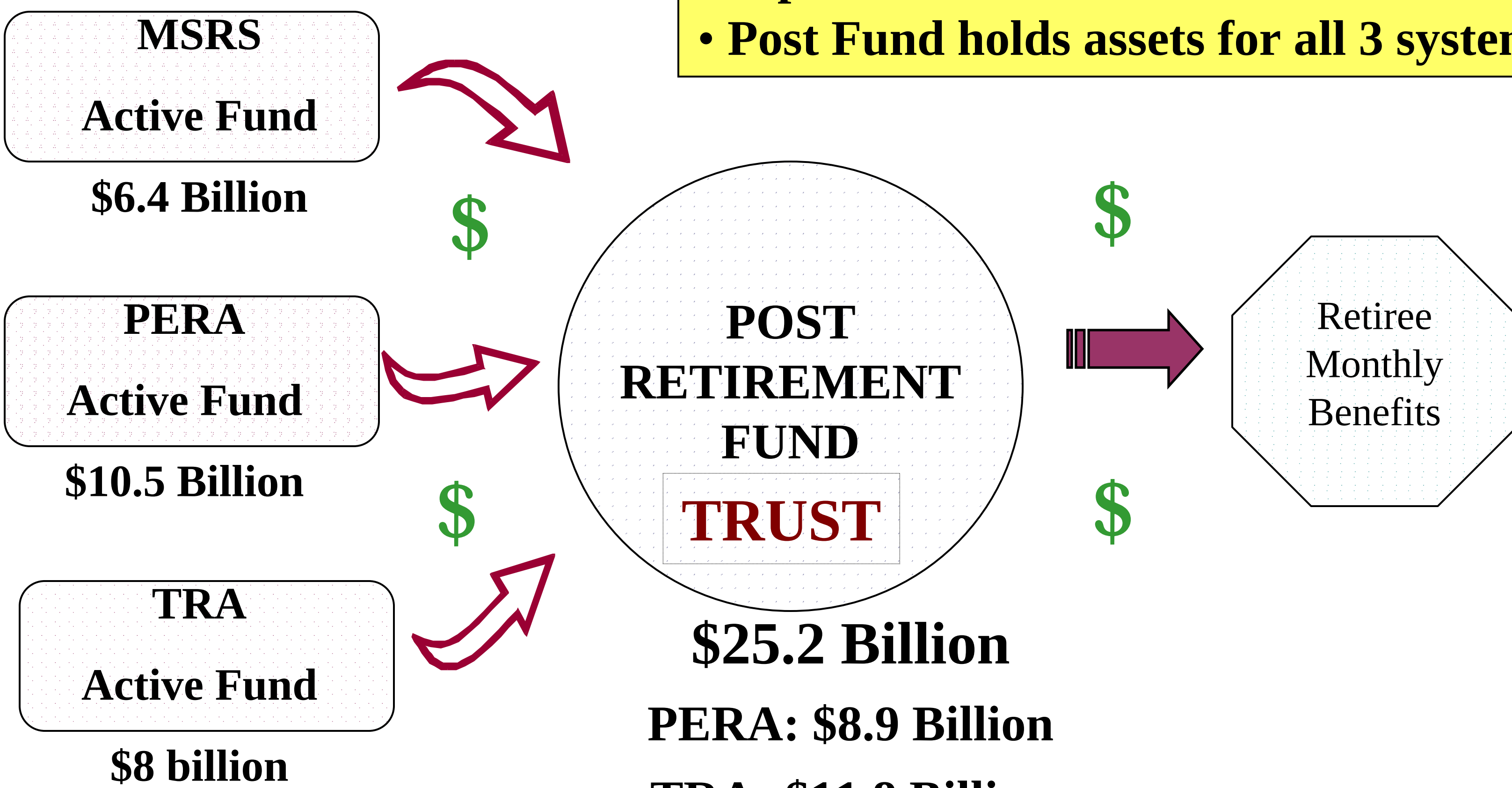
Legislative Commission on Pensions & Retirement

December 6, 2007

Current Fund Structure – Unique in Country

3 Statewide Systems

- **Separate active & retiree funds**
- **Post Fund holds assets for all 3 systems**



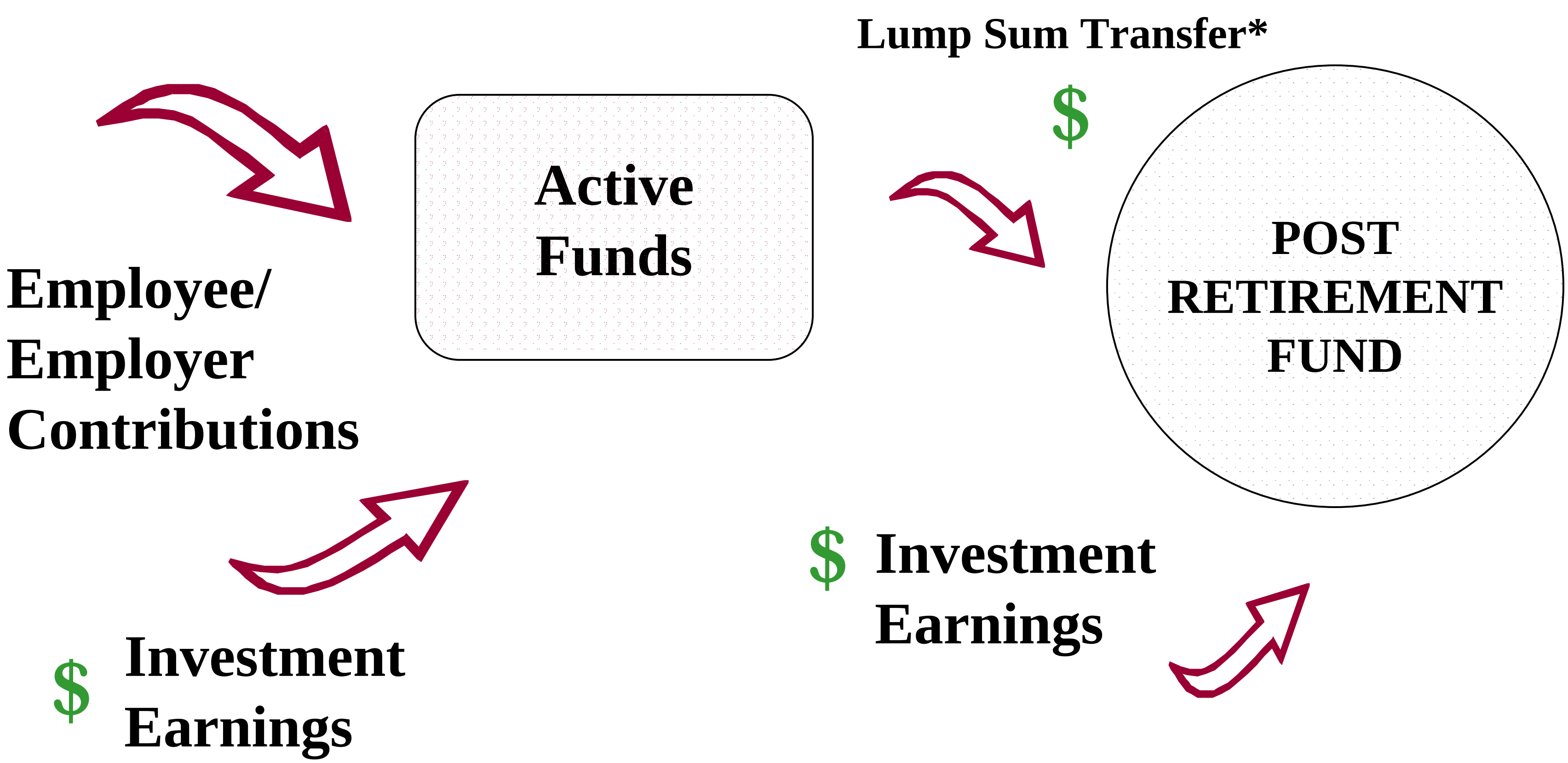
$25.2 Billion

PERA: $8.9 Billion

TRA: $11.8 Billion

MSRS: $4.5 Billion

Post Fund Revenue Sources Limited



***Lump Sum Transfer**
Assume annual investment earnings:
6% for fund + 2.5% for inflation = 8.5%

Post Fund History

Changes made over time

- Created in 1969 to give retirees sense of security
- 1969-1980 – MN Adjustable Fixed Benefit Fund (low increases)
- 1980-1993 – MN Post Retirement Investment Fund (bond oriented moderate increases)
- 1993-present – Inflation +Investment component (stock-oriented, large increases)

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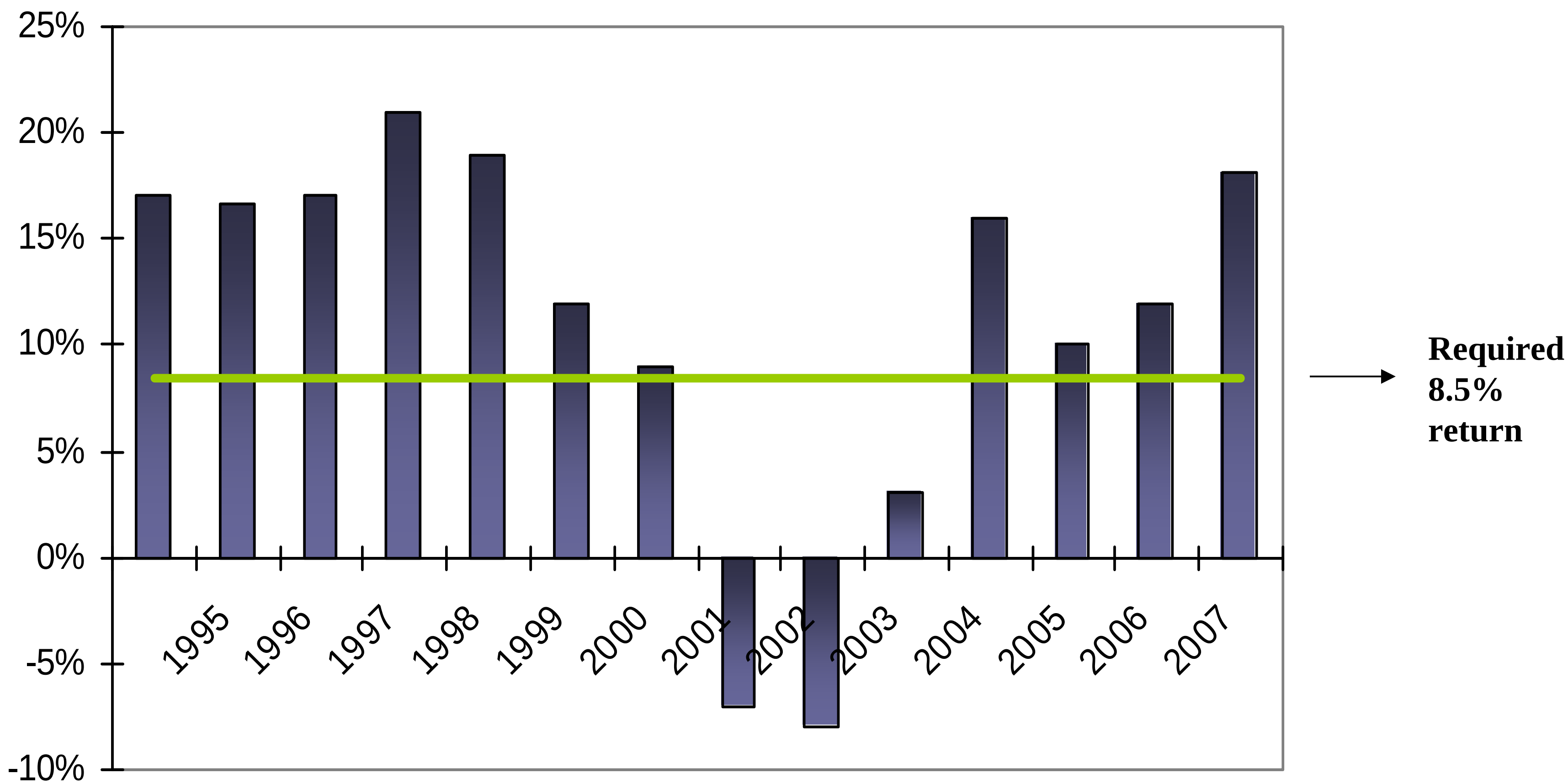
Post Fund Investment Returns*

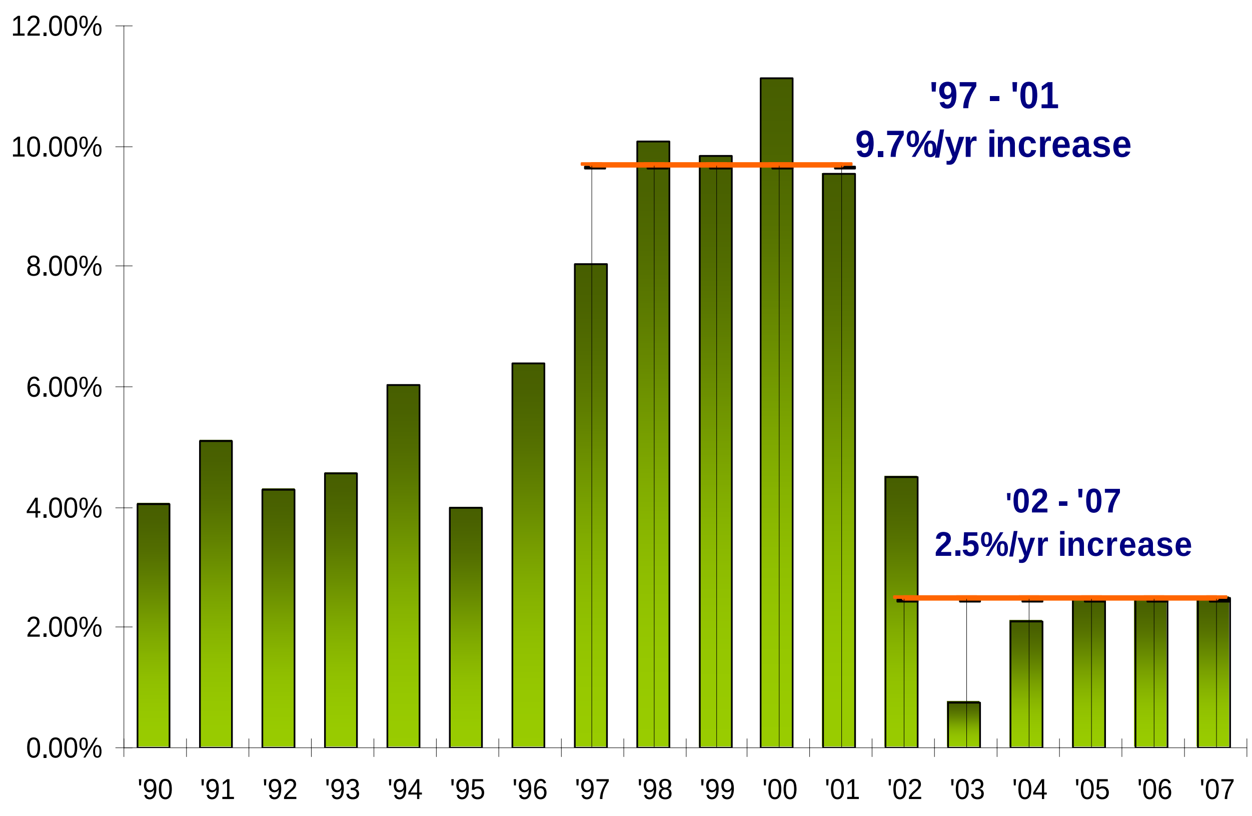


*** Investment gains & losses smoothed over 5 years**

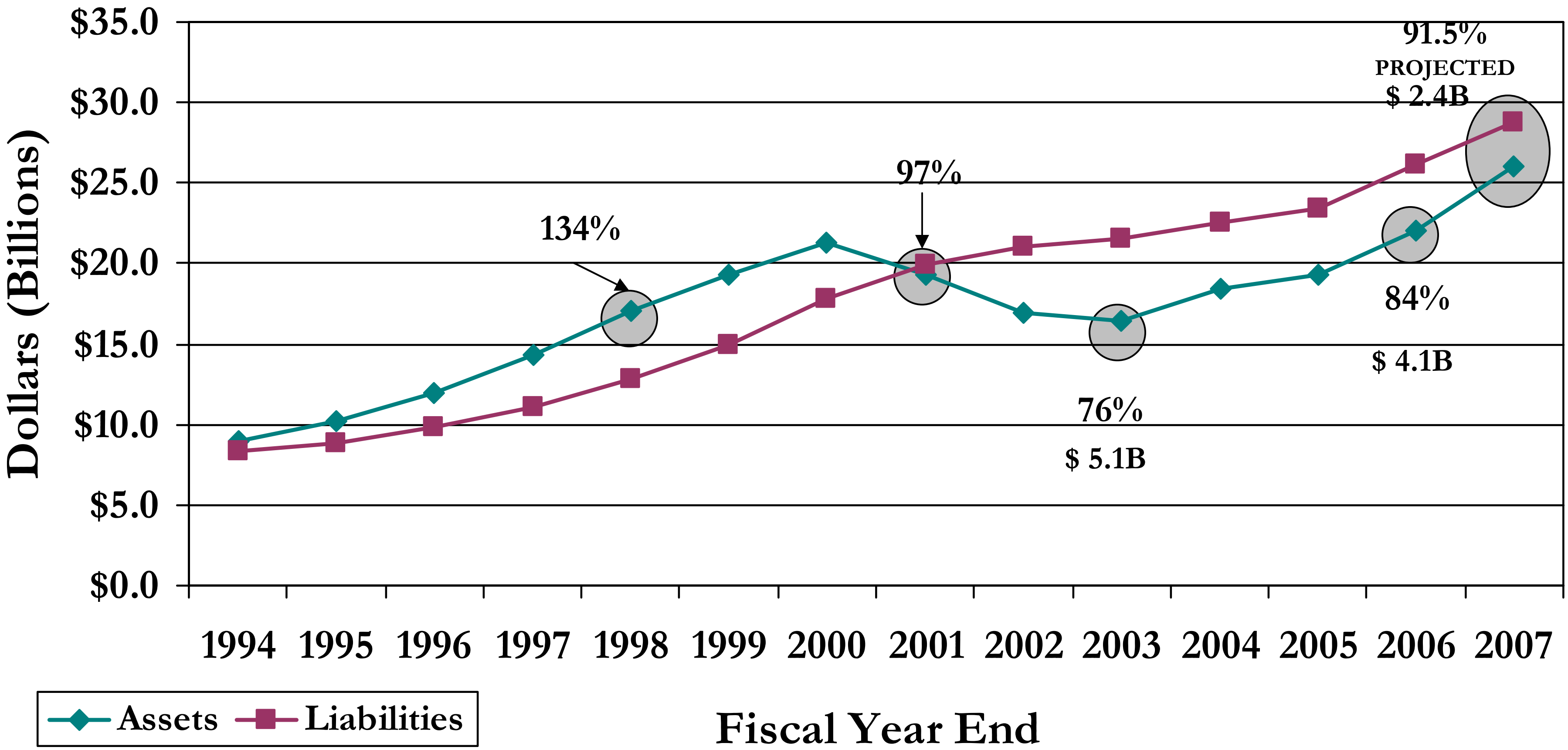
Post Fund History of Increases

Past history

- Market gains in 1990s produced large Post Fund increases
- 1997-2001 – 9.7% annual average
- 2001-present 2.5%



Post Fund Funding Ratio History



Source: State Board of Investment Annual Letters to Executive Directors regarding Post Fund Benefit Increase

Joint Retirement Boards Work on Post Fund Problem

- 1999 & 2000 -- Proposed to move from 5-year to 10-year smoothing.
- 2005 -- Proposed 5% cap on Post Fund increases. Cap enacted in 2006 (effective 2010).
- 2006 -- formed **Joint Post Fund Committee** to develop comprehensive proposal for the 2008 session.
  - Post Fund Committee met 7 times
  - Established "Guiding Principles"
  - Informed and engaged members and stakeholder groups; reviewed hundreds of letters and heard testimony from many groups
  - Analyzed multiple reform options (10+)
  - Developed draft proposal
  - Incorporating feedback

Joint Post Fund Committee Principles

- Post-retirement increase mechanism should provide some form of **inflation protection** and reflect the cost of living better than the current formula.
- The increase mechanism should result in more **consistency** than the current method; **less volatility** of increases.
- The increase mechanism must be **affordable** to the plan and **financially sustainable**.
- The increase mechanism should **minimize cost** to the plan and active employees.

Communication Efforts

- **Post Fund Committee Meetings**
  - Stakeholder groups and individuals provided immediate feedback at formal meetings, including one dedicated to feedback in August
  - Input from other pension funds and the Legislative Auditor solicited
- **All Funds**
  - Presentations to active employee and retiree groups
  - Meetings with stakeholder group boards and at annual meetings
  - Common newsletter sent to all in April; continuing information through regular newsletters to participants
  - Website updates and e-mail solicitation for input and comments
  - Incorporated into system-sponsored seminars and other presentations
- **PERA**
  - Board Town Meetings in Duluth, Austin and Willmar

Joint Committee Proposal
2 approaches

•High Investment Returns

•Post Deficit Reduced/Eliminated

Post Fund Continues

- Inflation Component
- Revised Investment Component (Added Inflation Protection)
- Inflation Equalizer for more recent retirees
- 5% cap on increases
- Excess asset mechanism*

*If Post Fund becomes at least 115% funded, future retirement system boards could propose additional increase.

•Sluggish/Negative Returns

•Post Deficit Worsens

Post Fund Merged

•Safeguard Merger of Post and Active Funds

•Flat 2.5% Annual Increase

•Additional incremental increases proposed by each Board after comprehensive benefits analysis

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Joint Committee Proposal

Current Law	Post Fund Continues
Inflation Component: □ 100% of inflation up to 2.5%	**Inflation Component:** □ Same as current law
Investment Component: □ Once Post Fund is 100% funded □ Additional increase paid when investment returns are high & generating excess assets	**Added Inflation Protection:** □ Once Post Fund is 100% funded □ Pay added inflation increase if inflation greater than 2.5%
□ 5% Cap on annual increase	□ 5% Cap on annual increase
	Inflation Equalizer: □ If inflation is less than 2.5% □ Added inflation for retirees who lag behind inflation □ Paid even if not 100% funded

Post Fund Continues

Example of Added Inflation Protection

- Maintain current inflation adjustment up to 2.5 percent
- Additional inflation protection will **<u>replace</u>** investment increase and paid if Post Fund becomes fully funded again and assets are sufficient to pay added inflation protection.*
- Maintain 5 percent cap

Example assuming Post Fund is more than fully funded:

Inflation (CPI-W) =	**3.75%**	Initial Inflation Increase	=	2.50%
		Additional Inflation	=	1.25%
		Total Increase	**=**	**3.75%**

***Aligns with Legislative Auditor's Report and LCPR principle II.C. 8(b)calling for increases that provide protection against the economic impact of inflation on retiree benefits.**

Post Fund Continues -- Inflation Equalizer

- **Inflation Equalizer – New Feature**
  - If inflation is less than 2.5% and investments exceed 8.5%, an extra inflation increase would be paid to retirees whose benefits lag inflation.
  - Inflation equalizer paid only if Post Fund is at least 90% funded.
  - Total inflation component capped at 2.5% until fully funded.

Example: Inflation 2.0% & Investment Earnings 9.25%

All Retirees Increase	=	2.0%
Additional Inflation Equalizer	=	0.5%

Inflation equalizer paid as long as the Post Fund continues, but if the Post Fund is dissolved, the equalizer would sunset.

Equalizer -- Post Fund Increases vs. Inflation

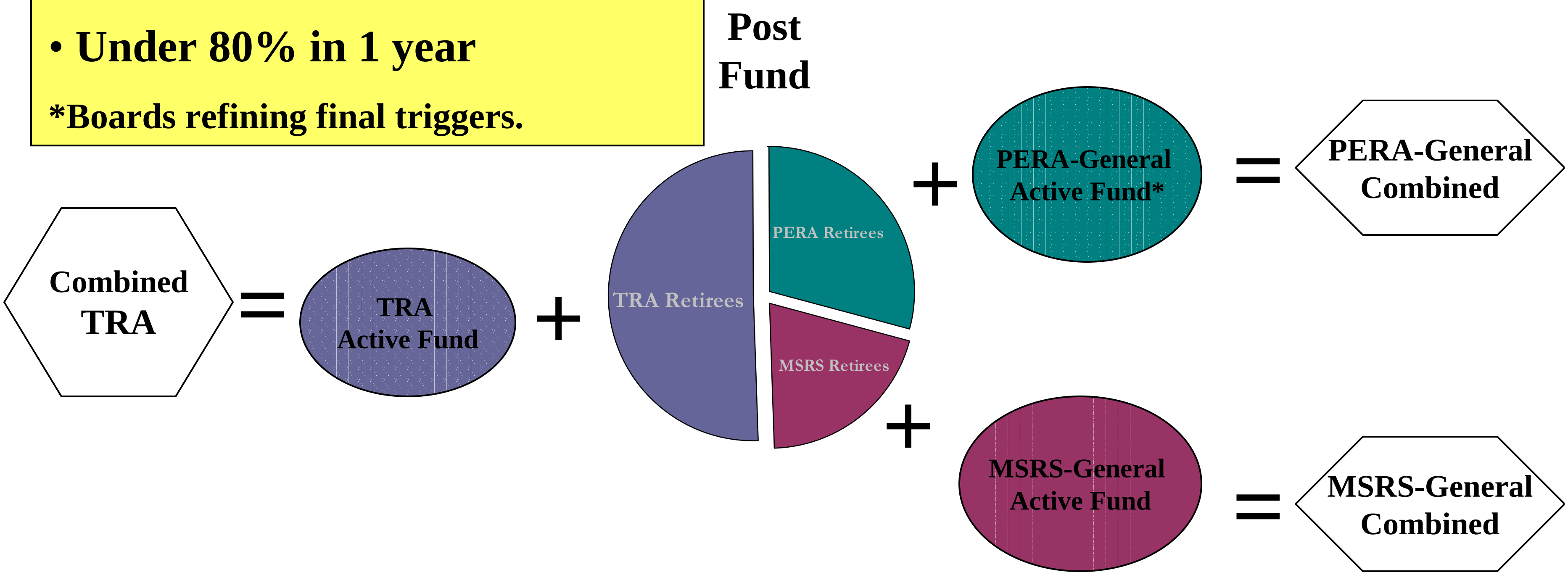
Year of Benefit Increase Paid	% Post Fund Increase	% Inflation	Difference	Cum. Difference Thru 1/2007
1994	6.0	2.8	+3.2	+43.4
1995	4.0	2.4	+1.6	+40.2
1996	6.4	3.1	+3.3	+38.6
1997	8.0	2.8	+5.2	+35.3
1998	10.1	2.1	+8.0	+30.1
1999	9.8	1.5	+8.3	+22.1
2000	11.1	1.9	+9.2	+13.8
2001	9.5	3.9	+5.6	+4.4
2002	4.5	2.7	+1.8	-1.17
2003	0.7	0.7	0	-3.07
2004	2.1	2.1	0	-3.07
2005	2.5	3.2	-0.7	-3.07
2006	2.5	2.6	-0.1	-2.27
2007	2.5	4.5	-2.0	-2.17
2008	2.5	2.67	-0.17	-0.17

Post Fund and Active Funds Combine

Post Fund Merger Triggers*

- **Under 85% for 2 years in a row**
- **Under 80% in 1 year**

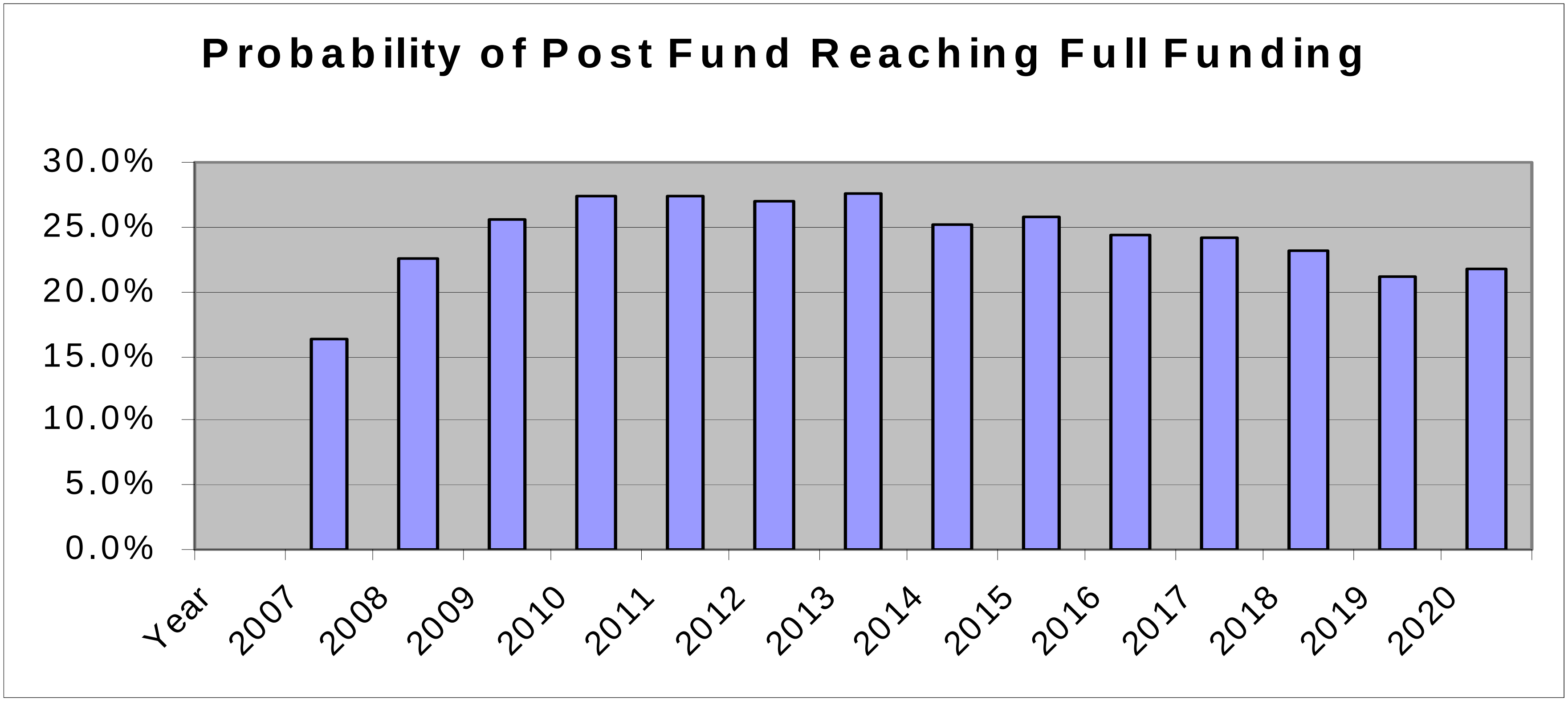
***Boards refining final triggers.**



*** This represents only the General Plans only for PERA and MSRS and is for illustrative purposes only. We would see a separate illustration for the combined assets of the smaller plans administered by PERA and MSRS also.**

Post Fund Probability Analysis

Probability of the Post Fund Reaching Full Funding is approximately 20% to 25% per Year



Analysis prepared by Mercer Consulting for October 19 Post Fund Committee Meeting

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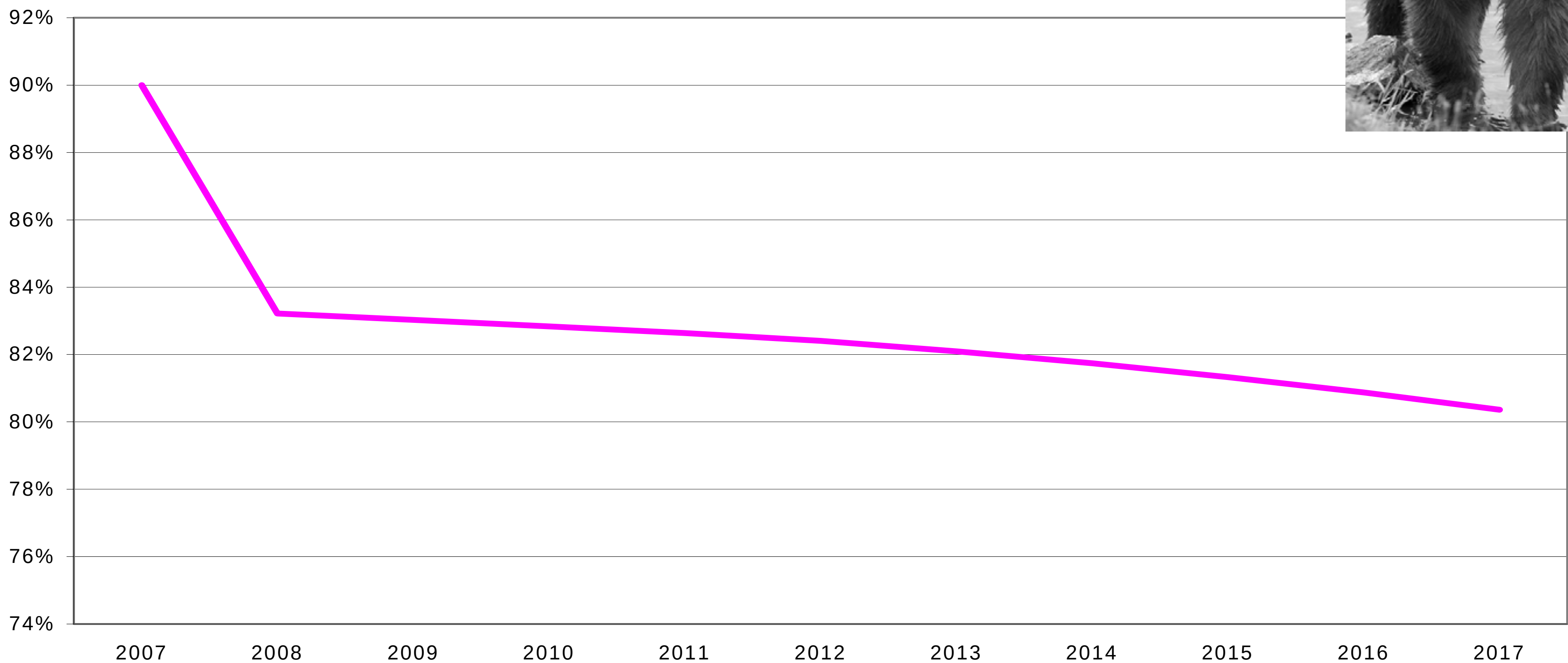
Funding Ratio of Post Fund



FY 08 = 0% Return
8.5% Return Thereafter

Based on July 1, 2006 participant data, actuarial assumptions and plan provisions. Stable future population assumed.

Analysis: Mercer Consulting

Retiree Increases if Active/Post Funds Combine

⇨ Fixed 2.5% annual increase

- Every January 1 each retiree will receive a 2.5 percent adjustment, regardless of inflation and investment return.*
- Each board will study the plans' benefit structures and determine if anything more can be paid to retirees.

*Aligns with the LCPR principle II.C.8(c) that states that post retirement increases should be funded on an actuarial basis.

Historical Annual Inflation Rates

80 Years 1926 - 2005	30 Years 1976 - 2006	15 Years 1991 - 2005	Worst Decade 1973 - 1982	Best Decade 1926 - 1935
3.04%	4.31%	2.61%	8.7%	-2.6%

Note: fixed 2.5% is suggested to be a trade-off for retirees who would otherwise expect to get inflation up to 2.5%, with the potential for more, but also the potential for less in years when inflation is low.

Financial Impact of Post and Active Merger

Minnesota State Retirement System – General Plan

	July 1, 2007 Baseline	Assets at Actuarial Value with Assumption Changes	Assets at Market Value with Assumption Changes
Funding Ratio	92.5%	94.4%	100.8%*
Total Required Contributions	11.8%	10.4%	7.8%
Contribution Sufficiency or (Deficiency)	(1.8)%	(0.4)%	2.2%
Calculations assume scheduled contribution increases are fully implemented.			

Sources: Baseline results reflect Segal annual valuation results for July 1, 2007.
Other two columns reflect analysis by Mercer Consulting, independent actuary for all three retirement systems' boards, using Segal's baseline.

Financial Impact of Post and Active Merger

Public Employees Retirement Association – General Plan

	July 1, 2007 Baseline	Assets at Actuarial Value with Assumption Changes	Assets at Market Value with Assumption Changes
Funding Ratio	**73.3%**	**74.9%**	**79.1%**
Total Required Contributions	**13.3%**	**12.6%**	**11.6%**
Contribution Sufficiency or (Deficiency)	**(0.3)%**	**0.4%**	**1.4%**
Calculations assume scheduled contribution increases are fully implemented			

Sources: Baseline results reflect Segal annual valuation results for July 1, 2007.
Other two columns reflect analysis by Mercer Consulting, independent actuary for all three retirement systems' boards, using Segal's baseline.

Financial Impact of Post and Active Merger

Teachers Retirement Association

	July 1, 2007 Baseline	Assets at Actuarial Value with Assumption Changes	Assets at Market Value with Assumption Changes
Funding Ratio	87.5%	87.9%	93.3%
Total Required Contributions	13.4%	13.1%	11.4%
Contribution Sufficiency or (Deficiency)	(1.65)%	(1.35)%	0.4%

Sources: Baseline results reflect Segal annual valuation results for July 1, 2007.
Other two columns reflect analysis by Mercer Consulting, independent actuary for all three retirement systems' boards, using Segal's baseline.

Joint Committee Objectives

- Financially protect the Post Fund by planning for 2 contingencies:
    1. Post Fund recovers
    2. Post Fund deficit worsens

- Assure both retirees and actives of the future financial viability of the retirement systems

Action is important to ensure measures are in place in the event the Post Fund deficit worsens.

Public Pensions Important in Minnesota

- 1 in every 10 Minnesotans are served by 3 statewide pension systems (MSRS, PERA, TRA)
- 3 statewide systems pay out over $2.4 billion in benefits annually with an average monthly benefit of $1,600
- 84 cents of every benefit dollar financed by employees and investment earnings. Public employers/ taxpayers finance only 16 cents of every benefit dollar.
- Investment returns have averaged 11.9% annually over the past 25 years