H.F. 3421
(Murphy, M., by request)

S.F. 2969
(Betzold)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	Various Statewide Retirement Plans
Relevant Provisions of Law:	Minnesota Statutes, Chapter 11A
General Nature of Proposal:	Revision or dissolution of the Minnesota Post Retirement Investment Fund
Date of Summary:	March 27, 2008

Specific Proposed Changes

- If the Minnesota Post Retirement Investment Fund remains sufficiently funded on a market value basis, the bill continues the Consumer Price Index adjustment component, unnames and modifies the investment performance adjustment component, adds a lost purchasing power adjustment component, and provides for additional benefit and funding recommendations in the event of significant future excess funding.
- If the Minnesota Post Retirement Investment Fund becomes insufficiently funded, the current post-retirement adjustment mechanism and fund arrangement is dissolved, retiree assets would be re-deposited in each retirement fund, and a flat 2.5 percent annual benefit increase would replace the current mechanism.

Policy Issues Raised by the Proposed Legislation

1. Unclear conformity with Commission's Principles of Pension Policy.
2. Appropriateness given unclear policy goal for MPRIF modifications.
3. Appropriateness given the proponents' bias in favor of dissolving the MPRIF.
4. Appropriateness of instituting a dissolution trigger and the selection of the particular trigger.
5. Appropriateness of the complexity of the proposed changes in a retained MPRIF.
6. Unlikely prospect for any meaningful increases from proposed "lost purchasing power" component.
7. Appropriateness of the proposed benefit reductions.
8. Unclear application of MPRIF changes to Minnesota Statutes, Section 356.41.
9. Federal tax code compliance issues arising from the proposal.

Potential Amendments

H3421-1A moves MERF-related provisions from the MPRIF law to the MERF law (technical amendment).

H3421-2A makes language and style revisions under current drafting conventions (technical amendment).

H3421-3A eliminates MPRIF dissolution article, requiring legislative determination before any MPRIF dissolution.

H3421-4A, upon MPRIF funding decline, requires fund administrator report rather than MPRIF dissolution.

H3421-5A resets MPRIF dissolution trigger to a lower funding ratio.

H3421-6A adds actuarial gain pool to the "lost purchasing power" adjustment determination procedure.

H3421-7A makes conforming changes to Minnesota Statutes, Section 356.41, the MPRIF adjustment indexation provision.

State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: H.F. 3421 (Murphy, M., by request); S.F. 2969 (Betzold): Minnesota Post Retirement Investment Fund; Revisions and Dissolution Procedure

DATE: March 27, 2008

Summary of H.F. 3421 (Murphy, M., by request); S.F. 2969 (Betzold)

H.F. 3421 (Murphy, M., by request); S.F. 2969 (Betzold) amends Minnesota Statutes, Section 11A.18, and adds new Minnesota Statutes, Section 11A.181, relating to the Minnesota Post Retirement Investment Fund (MPRIF), the post-retirement adjustment mechanism for the various statewide retirement plans, by making the following changes:

a. Retention (Article 1). If the MPRIF funding ratio is above 80 percent in all future years and is above 85 percent in all future consecutive two-year periods, the following provisions apply:

   (1) Continuation of CPI Component. The current adjustment based on the annual increase in the Consumer Price Index (CPI), not to exceed 2.5 annually, continues without change;

   (2) Unnaming and Modification of Investment Performance Adjustment Component. The current investment performance adjustment component is modified by the elimination of the investment performance reference and by the addition of a specific cap that either is the remaining amount by which the CPI adjustment is less than 2.5 percent or is the amount by which the CPI exceeds 2.5 percent, continuing to be payable only if the MPRIF has no deficit and if its investment performance has a net positive margin above 8.5 percent, and, when added to the CPI component after 2010, does not exceed 5.0 percent in total;

   (3) Addition of Lost Purchasing Power Adjustment. If the MPRIF is at least 90 percent funded, if the MPRIF investment performance for the most recent fiscal year is greater than 8.5 percent, and if the CPI adjustment component is less than 2.5 percent, an increase equal to the amount by which each MPRIF annuitant's past benefit adjustments have failed to match the CPI increase since the June 30 of the year before the first MPRIF adjustment was paid, but not to exceed the difference between the combined amount of the two other prior MPRIF components and 2.5 percent for each person. The adjustment is subject to an additional reduction by the amount needed to maintain the MPRIF at a 90 percent funded ratio; and

   (4) Addition of Excess Assets Trigger for the Formulation of Additional Benefits and Funding Recommendations. If the MPRIF becomes at least 115 percent funded in a future year, the governing bodies of the retirement plans participating in the MPRIF must jointly prepare recommendations on overall benefits and funding for active members and benefit recipients.

b. Dissolution (Article 2). If the MPRIF funding ratio is below 80 percent as of June 30 in any one year or is below 85 percent as of June 30 for two consecutive years, the MPRIF dissolves, with no future required reserve transfers as of the December 31 following the triggering event, with no actuarial mortality loss transfers after the triggering event, and with the transfer back of each retirement plan's participation in the MPRIF as of the June 30 of the next year following the triggering event. Upon MPRIF dissolution, an automatic 2.5 percent annual post-retirement adjustment applies to all benefit recipients.

Background Materials

Background material relevant to the proposed legislation is attached, as follows:

A. Attachment A presents background information on the current statutory provisions of the Minnesota Post Retirement Investment Fund (MPRIF).

B. Attachment B presents background information on the development of the MPRIF.

C. Attachment C presents background information on the requirements for the transfer of retirement fund assets to and from the MPRIF.

D. Attachment D presents a comparison of the percentage rates of post-retirement adjustments provided by the various Minnesota statewide and major local retirement plans over time, including the MPRIF.

E. Attachment E presents a comparison of federal Consumer Price Index increases with post-retirement adjustments from the MPRIF.

F. Attachment F presents information on the past funded ratio of the MPRIF and its predecessor for the period 1979-2007.

Technical Amendments

1. **Technical Amendment H3421-1A** simplifies the revised Minnesota Post Retirement Investment Fund governing statute by moving the provisions in Minnesota Statutes 2006, Section 11A.18, applicable to the Minneapolis Employees Retirement Fund (MERF) to the applicable MERF statutory provision.
2. **Technical Amendment H3421-2A** makes various language style and usage revisions to gain greater conformity to the current drafting conventions.

Document H3421-E3 is a draft engrossed version of the bill with both technical amendments, for ease in ascertaining the impact of those amendments.

Analysis and Discussion

H.F. 3421 (Murphy, M., by request); S.F. 2969 (Betzold) establishes a trigger for the dissolution of the Minnesota Post Retirement Investment Fund (MPRIF), the current statewide retirement plans' post-retirement adjustment mechanism, replaces the MPRIF with an automatic annual 2.5 percent adjustment upon a future MPRIF dissolution when the poor funding trigger occurs, and adds two potential additional adjustment components to the MPRIF if the dissolution trigger event is not met, a lost purchasing power component payable if the MPRIF is less than fully funded, but at least 90 percent funded, and if the Consumer Price Index (CPI) component adjustment is less than 2.5 percent, to be funded from that difference, and an excess asset benefit modification report and joint retirement plan recommendation if the MPRIF is at least 115 percent funded.

The proposed legislation raises several pension and related public policy issues for Commission consideration and potential Commission discussion, as follows:

1. Unclear Conformity with Commission's Principles of Pension Policy. The policy issue is the extent to which the proposed revision or dissolution of the Minnesota Post Retirement Investment Fund (MPRIF) conforms with the Principles of Pension Policy formulated by the Commission over the years. Principle II.C.8., relating to post-retirement adjustments, indicates that:

   II.C.8. Postretirement Benefit Adequacy

   a. The retirement benefit should be adequate during the period of retirement.
   b. Postretirement benefit adequacy should function to replace the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement.
   c. The system of periodic post retirement increases should be funded on an actuarial basis.
   d. In order to replace inflation, the post retirement adjustment system should follow a valid recognized economic indicator.

   Based on comparisons of the annuity and benefit amounts for the various retiree cohorts in Attachment E, annuitants and benefit recipients have kept pace with inflation in their current benefit amounts, but as a review of the annual patterns of each cohort or of the chart accompanying Table 2, the match between the MPRIF adjustments and the cost of living as measured by the federal Consumer Price Index (CPI) has generally not been very close. The proposed additions to the MPRIF, pending its dissolution, would increase post-retirement adequacy based on valid recognized economic indicator, the CPI, but only during periods of very low inflation, which would not remedy the current flaw in the MPRIF of a poor correlation between adjustments and inflation during all periods but those with exceptionally low inflation. Upon a dissolution of the MPRIF, the proposal would replace the current mechanism with a flat 2.5 percent annual increase completely untied to the CPI.

2. Appropriateness Given Unclear Policy Goal for MPRIF Modifications. The policy issue is the appropriateness of the proposed modifications in the Minnesota Post Retirement Investment Fund (MPRIF) when there is no clear explicit or implicit policy goal underlying the changes. The proposal represents the result of a joint committee drawn from the boards of the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA) and the Teachers Retirement

Association (TRA). The joint committee had 11 meetings, considered ten alternatives, and arrived at this proposal. The announced guiding principles for the joint board committee in developing the proposed legislation were:

Guiding Principles

Primary Principles

1. The post-retirement increase mechanism will provide some form of inflation protection for retirees and will have long-term financial sustainability.
2. The post-retirement increase mechanism will result in less funding volatility and less volatility in annual increases than the current method.
3. The committee's focus will be on finding solutions for the Post fund.

Post Fund Mechanism

1. Post retirement increases should have some tie to the rate of inflation.
2. Any component that is paid in addition to some inflation protection should avoid increasing benefits that later could result in significant unfunded liabilities.
3. The new adjustment mechanism should function in alternative economic scenarios.
4. The underlying inflation protection would be the same for all plans, but any incremental increases in addition to inflation, may differ for various plans.

Funding

1. The post-retirement changes will minimize additional cost to the plan.
2. Any funding solutions will be based on reasonable actuarial assumptions.

Those guiding principles are contradictory in practice and do not resolve themselves into a clear policy goal. The retirement plan sponsors of the proposal should be provided an opportunity to clarify what policy goal or goals they believe are forwarded by the proposed legislation.

3. Appropriateness of the Proposal's Bias In Favor of Dissolving the MPRIF. The policy issue is the appropriateness of the proposed legislation when the proposal has a clear bias in favor of a future dissolution of the Minnesota Post Retirement Investment Fund (MPRIF). From the materials provided to the Commission from the joint boards committee on the MPRIF, there was strong interest from the outset of the project to either permit some retirement plans to withdraw from the MPRIF or to dissolve the MPRIF entirely. The final proposal, although described in materials as reserving the dissolution option to a future scenario where the funding level of the MPRIF falls to an unacceptable level or facts to make funding progress over an appropriate period, sets the unacceptable level for one year at 80 percent funded and sets the funding progress failure over an appropriate period at 85 percent funded over two years. The setting of those levels was apparently the last issue settled by or on behalf of the joint committed, reportedly based on a number of actuarial studies, but that body of information has not been provided to the Commission. Other than to recite unsubstantiated figures about the improbability of the MPRIF becoming fully funded in any one year, the proponents of the proposed legislation have not indicated what policy or practical disaster will follow if the funded ratio of the MPRIF should fall below 80 percent during the course of some future recession, panic, or depression and why that disaster would not occur with the proposed mixing of the retiree asset value decline with the asset value decline that would also be felt on the active member assets. Without some clear indication of the harm that would occur from a funded ratio setback in the MPRIF, providing for a dissolution of the MPRIF at an arbitrarily funded ratio figure seems premature.

4. Appropriateness of a Dissolution Trigger; Trigger Selection. The policy issue is whether or not it is appropriate to have an automatic dissolution of the Minnesota Post Retirement Investment Fund (MPRIF) if a triggering event happens rather than leaving the MPRIF dissolution to the Legislature based on a careful consideration of the circumstances at hand and the implications involved and, if an automatic trigger is appropriate, is the proposed trigger appropriate. The primary reasons usually given for an automatic trigger is that a timely response is needed for an emergency event that cannot be delayed to the next legislative session or that there is such clarity on what constitutes an emergency and on what the response should be that the program can be put on automatic pilot. It is not clear that a simple economic or market decline constitutes a sufficiently clear emergency for which a sole response is indicated, especially when the decline will also impact on the balance of the retirement plan assets in a comparable fashion. The past history of the MPRIF and its predecessor has indicated that relatively wide swings in the funded condition of the investment fund have occurred and logic suggests that those savings could be expected again. While the MPRIF had its most sustained period of underfunding in its history during the period since 2000, the investment fund has had underfunded years in the 1980s and has numerous instances where the fund has had changes in its funding ratio from year to year greater than five percent.

   If the Commission has doubts about the wisdom of an automatic MPRIF dissolution based on a triggering event or a set of triggering events, **Amendment H3421-3A** would eliminate the dissolution article, leaving the decision on the dissolution of the MPRIF to a future legislature.

If the Commission views the current MPRIF deficit with concern and wishes to foster an earlier future discussion on the MPRIF if there is a future erosion in market value, **Amendment H3421-4A** converts the proposed trigger consequence from an automatic dissolution of the MPRIF and automatic benefit change to a mandated report and recommendations from the affected retirement plan administrators upon that future market value decline.

If the Commission believes that the proposed trigger (funded ratio falling to 80 percent in any one year or two consecutive years of funded ratio results of 85 percent or less) are not sufficiently dramatic to warrant an MPRIF dissolution, **Amendment H3421-5A** would reset the conditions to require a greater market decline for a longer period of time (less than 75 percent rather than less than 85 percent for three consecutive years rather than two consecutive years or less than 70 percent for two consecutive years rather than less than 80 percent for one year).

5. Appropriateness of the Complex Proposed Changes in the Current MPRIF. The issue is the policy and administrative appropriateness of the proposed changes in the current Minnesota Post Retirement Investment Fund (MPRIF), with the "unnaming" of the former investment performance component and the addition of the complex lost purchasing power component. The current investment component would continue without much substantive change other than dropping a reference to investment component, apparently in an attempt to create a perception that it is no longer connected to investment performance. This "unnaming" attempt simply makes the adjustment component more difficult to reference in statute or common parlance. The "lost purchasing power increase" establishes an individualized annual determination of the extent that past post-retirement adjustments have lagged past inflation and a potential increase for those who had lost past purchasing power. Once all potential lost purchasing power adjustments have been calculated, the actual adjustments to be paid must be further modified if their payment would cause the overall MPRIF funded ratio to fall below 90 percent. The additional increase is obviously an attempt to address the vocal complaints of recent retirees who have fared less well from the MPRIF than longer term retirees have found. If the preconditions for the payment of the increase exist, the new adjustment component will require individualized calculations and determinations for the current 123,524 MPRIF-covered retirees annually. It is unclear that the retirement systems have the hardware, software, and personnel in place to implement the new adjustment or to communicate it to the various retirees. While addressing vocal complaints from recent retirees has an attraction, the new adjustment is unlikely to make any significant actual headway on recapturing lost purchasing power (see issue #6) while appearing to provide a more significant benefit than it actually will provide and creating more recent retiree dissatisfaction compared to longer duration retirees.

6. Unlikely Prospect for Any Meaningful Lost Purchasing Power MPRIF Increases. The policy issue is the appropriateness of creating another whole increase component within the Minnesota Post Retirement Investment Fund (MPRIF) when the preconditions for the increase are so stringent and the effective cap on the increase is so modest that either no lost purchasing power increase will be paid or any lost purchasing power increase will be so nominal in any year that it would hardly justify the administrative expense to provide it. The proposed lost purchasing power increase is only payable if the MPRIF is at least 90 percent funded, that the MPRIF had earned at least one dollar of investment return in excess of 8.5 percent for the fiscal year and the Consumer Price Index (CPI) adjustment component provides an adjustment of less than 2.5 percent in that year. The proposed lost purchasing power increase is limited to the difference between the CPI adjustment component and 2.5 percent for each recipient and is further subject to a downward adjustment if the increase is calculated to cause the MPRIF funded ratio to fall below 90 percent. The lost purchasing power increase does not redistribute any portion of the difference between the CPI adjustment component and 2.5 percent for those retirees who have not suffered any lost purchasing power, so any perceived or actual inequity in treatment between long-term retirees and more recent retirees will not quickly be reversed.

To demonstrate the difference in the individual versus pool basis for adjustments, for an average MPRIF retiree who has one percent cumulative lost purchasing power, if the CPI adjustment component in a future year was 2.25 percent, the lost purchasing power increase limited on an individual basis as proposed would be $3.38 per month, while the lost purchasing power increase for the same circumstance using a pool basis would be limited to $35.76 per month if 20 percent of all retirees had lost purchasing power and $71.52 per month if ten percent of all retirees had lost purchasing power.

If the Commission desires to improve the lost purchase power increase within the confines of the actuarial gain obtained when the CPI adjustment component does not reach 2.5 percent, **Amendment H3421-6A** creates a pool from that actuarial gain from all retirees rather than handling the gain solely

on an individual-by-individual basis and allocates it to retirees with lost purchasing power in proportion to their prior purchasing power loss.

7. Appropriateness of the Proposed Benefit Reductions. The policy issue is the appropriateness of the benefit reductions that are included in the proposed Minnesota Post Retirement Investment Fund (MPRIF) legislation, whether the MPRIF is retained or dissolved. If the MPRIF is retained, the former investment performance component adjustment, first made subject to a five percent annual maximum in conjunction with the Consumer Price Index (CPI) adjustment component in 2006 legislation, effective in 2010, would further be subject to the maximum of the difference between the CPI increase and 2.5 percent. If the MPRIF is dissolved, the sole post-retirement adjustment payable would be a flat annual 2.5 percent increase, irrespective of CPI increases or the investment performance of the retirement fund in excess of the interest rate actuarial assumption. The benefit reductions would be accompanied, if the MPRIF is retained, by the creation of a "lost purchasing power increase" and an unspecified potential adjustment alone or in combination with active member benefit modifications as part of joint retirement plan recommendations to be forwarded to the Commission if the MPRIF becomes at least 115 percent funded, and if the MPRIF is dissolved, by the potential for the payment of a full 2.5 percent adjustment when the CPI is less than 2.5 percent and there is no investment performance in excess of 8.5 percent. A benefit reduction is inconsistent with the Commission's Policy Principles unless combined with a benefit increase implementing sound pension goals, and may be found unconstitutional in subsequent litigation.

   Based on Christensen v Minneapolis Municipal Employees Retirement Board, 331 NW2d 740 (1983), the Minnesota Supreme Court treats public pensions as quasi-contracts under a promissory estoppel doctrine, thus barring most or all legislative diminutions as violative of the non-impairment of contract clause of the U.S. Constitution. Based on Sylvestre v State, 214 NW 2d 658 (1973), and Anderson v State, 214 NW2d 668 (1973), the Minnesota Supreme Court may permit the reduction of one pension benefit when accompanied by another beneficial legislative change, especially if the conjoining of a reduction and an increase are the result of formal or informal bargaining. In AFSCME Council 6 v Sundquist, 338 NW2d 560 (1983), the Minnesota Supreme Court suggested in dicta that it accepted the doctrine developed in other states that actuarial necessity could justify benefit modifications. It is unclear whether the benefit limitations or eliminations included in the proposed legislation are offset to a great enough degree by the benefit increase modifications to allow them to be upheld in future litigation.

   The Commission may wish to take testimony from the retirement plan administrators on the nature of the legal advice they received when assembling the proposed legislation and to seek guidance form the House Research Department and Senate Counsel lawyers with public pension subject matter responsibilities.

8. Unclear Application of Proposed Changes for Benefit Recipients Indexed to the MPRIF Increases. The policy issue is the manner in which the proposed changes in the Minnesota Post Retirement Investment Fund (MPRIF) will apply to those benefit recipients who have their adjustments indexed to the MPRIF increases. Minnesota Statutes, Section 356.41, currently provides the same increase annually to all benefit recipients of the Elective State Officers Retirement Plan, all survivors and annuitants since 2002 of the Legislators Retirement Plan, and disabilitants and survivors of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), the Public Employees Police and Fire Retirement Plan (PERA-P&F), the Local Government Correctional Employees Retirement Plan of the Public Employees Retirement Association (PERA-Correctional), and the Teachers Retirement Association (TRA). While the MPRIF adjustments remain a single annual percentage increase, Minnesota Statutes, Section 356.41, will operate as anticipated. With the proposed changes, especially the proposed "lost purchasing power increase," MPRIF adjustments will differ depending on the initial benefit payment date and that change is not contemplated by the current language of Minnesota Statutes, Section 356.41.

   Amendment H3421-7A attempts to make the necessary adaptation in Minnesota Statutes, Section 356.41.

9. Federal Tax Code Compliance Issues Connected with the Proposed Changes. The issue is whether or not the proposed modifications in the Minnesota Post Retirement Investment Fund (MPRIF) comply with the applicable federal Internal Revenue Code provisions. In 2006, when the Commission recommended the proposal forwarded by the joint retirement plan administrators to impose a five percent annual adjustment maximum on MPRIF increases, the maximum provision was given a delayed effective date until 2010 because the retirement plan administrators indicated that they needed