



H.F. 3764 (Thissen); S.F. 3506 (Larson)

H.F. 3385 (Thissen); S.F. 2982 (Larson)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): Minneapolis Firefighters Relief Association

Relevant Provisions of Law: Minnesota Statutes, Chapter 423C

General Nature of Proposal: H.F. 3764 (Thissen); S.F. 3506 (Larson): Minneapolis Firefighters Relief Association (MFRA); Increasing Service Pension, Joint-and-Survivor and Surviving Spouse Pensions by One Unit and Doubling Amount of Future Thirteenth Checks

H.F. 3385 (Thissen); S.F. 2982 (Larson): Minneapolis Firefighters Relief Association (MFRA); Increasing Service Pension, Joint-and-Survivor and Surviving Spouse Pensions by One Unit

Date of Summary: April 3, 2008

Specific Proposed Changes

H.F. 3764 (Thissen); S.F. 3506 (Larson):

- (1) increases all service pension, joint-and-survivor, and surviving spouse pensions by approximately one unit when the plan's funding ratio exceeds 110 percent;
- (2) specifies that the increase in item (1) above takes precedent over the additional lump sum payment triggered in Minneapolis firefighter law when the funding ratio exceeds 110 percent, and specifies that the benefit increase is payable not just to active members when they retire, but to the "retired membership";
- (3) whenever the pension fund is less than 102 percent funded, increases the annual "thirteenth check" post-retirement adjustment from one-half of one percent of relief association special fund assets to one percent of relief association special fund assets, and specifies that any amount of excess investment income not used to pay the thirteenth check will be used to reduce the city of Minneapolis property tax levy to the association in the following year; and
- (4) repeals the revised thirteenth check provision which passed the Legislature last year.

H.F. 3385 (Thissen); S.F. 2982 (Larson) is identical to the above bill except it lacks items (3) and (4) above.

Policy Issues Raised by the Proposed Legislation

1. Whether there is any need to consider this bill during this legislative session.
2. The cost of the benefit revisions intended under this legislation. The Commission rarely considers a benefit improvement without cost information.
3. Lack of any contribution by active members or benefit recipients to cover the cost of this proposal.
4. Unclear need for any increase in the unit value for the active membership.
5. Conflict with Commission's Principles of Pension Policy of providing benefit increase to those already retired.
6. Vague, contradictory, and confusing drafting:
 - application to deferred retirees and disabilitants;
 - trigger for payment of benefits;
 - permanent or intermittent benefit change.
7. Unclear need for increased 13th check adjustment.
8. Lack of public purpose for various plan post-retirement adjustment mechanisms.
9. Treatment of unmarried service pensioners.
10. Appropriate amount of 13th check adjustments.
11. Inappropriateness of "13th check" last participant's club aspect.
12. Disability issue.
13. Actuarial condition of the Minneapolis Firefighters Relief Association and affordability.
14. Lack of local approval clause effective date.
15. Minneapolis Police Relief Association, comparable benefits.
16. Question of the extent of municipal support.

Potential Amendments

- H3764-1A** removes Section 3 from the bill, if the Commission concludes that the increased thirteenth check distribution proposed in the bill should be removed.
- H3764-2A** removes Sections 1 and 2 from the bill, if the Commission concludes that the proposed increase in units used to compute a pension should be removed.
- H3764-3A** can be used if Sections 1 and 2 remain in the bill, and adds a local approval clause for those sections.
- H3764-4A** is an alternative to Amendment H3764-1A and provides a one unit increase for disabilitants.
- H3764-5A** can be used if Section 1 remains in the bill, and increases the benefit to unmarried service providers a full percent, rather than .9 percent.
- H3764-6A** is an alternative to earlier amendments except Amendment H3764-3A, and can be used if the Commission concludes that the benefit increase under Section 1 is a permanent increase rather than an intermittent increase, and if the Commission wants to restrict the increase to active members only.
- H3764-7A** is an alternative to Amendment H3764-6A, and is comparable to that amendment except that H3764-7A includes a one percent increase for disabilitants.
- H3764-8A** an alternative to Amendments H3764-6A and H3764-7A, is like H3764-6A except that, consistent with the bill language but in conflict with Commission policy against applying benefit improvements to anyone who is not an active member, the improvement would apply to all active members, all deferred members, and all service pensioners and survivors.
- H3764-9A** is like Amendment H3764-8A, except that it also applies a one unit increase to disabilitants. The amendment is an alternative to Amendments H3764-6A, H3764-7A, and H3764-8A.
- H3764-10A** could be used in lieu of Amendments H3764-6A, H3764-7A, H3764-8A, and H3764-9A if the Commission wishes to leave the bill essentially unchanged except for specifying that the benefit increase is "up to one unit" rather than "one unit," and the trigger will be when funding exceeds 110 percent rather than equals or exceeds that funding level.
- H3764-11A** creates an employee contribution, in an amount to be set by the Commission, to help to pay for the benefit improvements of this bill.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Edward Burek, Deputy Director EB

RE: H.F. 3764 (Thissen); S.F. 3506 (Larson): Minneapolis Firefighters Relief Association (MFRA); Increasing Service Pension, Joint-and-Survivor and Surviving Spouse Pensions by One Unit and Doubling Amount of Future Thirteenth Checks

H.F. 3385 (Thissen); S.F. 2982 (Larson): Minneapolis Firefighters Relief Association (MFRA); Increasing Service Pension, Joint-and-Survivor and Surviving Spouse Pensions by One Unit

DATE: April 2, 2008

Summary of H.F. 2453 (Thissen); S.F. 2258 (Larson)

H.F. 3764 (Thissen); S.F. 3506 (Larson) does the following:

- (1) increases all service pension, joint-and-survivor, and surviving spouse pensions by approximately one unit when the plan's funding ratio exceeds 110 percent;
- (2) specifies that the increase in item (1) above takes precedent over the additional lump sum payment triggered in Minneapolis firefighter law when the funding ratio exceeds 110 percent, and specifies that the benefit increase is payable not just to active members when they retire, but to the "retired membership";
- (3) whenever the pension fund is less than 102 percent funded, increases the annual "thirteenth check" post-retirement adjustment from one-half of one percent of relief association special fund assets to one percent of relief association special fund assets, and specifies that any amount of excess investment income not used to pay the thirteenth check will be used to reduce the city of Minneapolis property tax levy to the association in the following year; and
- (4) repeals the revised thirteenth check provision which passed the Legislature last year.

H.F. 3385 (Thissen); S.F. 2982 (Larson) is identical to the above bill except it lacks items (3) and (4) above.

Comments

During the 2007 session, the Legislature passed a bill for the Minneapolis Firefighters Relief Association (MFRA), H.F. 2453 (Thissen); S.F. 2258 (Larson), which doubled the thirteenth check amount in situations where the fund is less than 102 percent funded. The bill was not approved by the City of Minneapolis. One of the bills introduced this session, H.F. 3385 (Thissen); S.F. 2982 (Larson), introduced near the end of February, may have been drafted before the city's rejection of that 2007 proposal. A later bill, H.F. 3764 (Thissen); S.F. 3506 (Larson), includes the thirteenth check provision which the city rejected, but revises it to specify that if the thirteenth check provision does not exhaust the excess assets, the remainder can be used to reduce Minneapolis property tax levy for the following year, and repeals the provision which was not approved by the Minneapolis City Council.

Background Information

Background information on relevant topics is set forth in the following attachments:

- **Attachment A** contains background information on the Minneapolis Firefighters Relief Association (MFRA).
- **Attachment B** contains background information on the MFRA post-retirement adjustment mechanisms.
- **Attachment C** contains background information on MFRA funding problems.

Discussion and Analysis

H.F. 3764 (Thissen); S.F. 3506 (Larson) doubles the Minneapolis Firefighters Relief Association (MFRA) "thirteenth check" post-retirement adjustment when the pension fund's funding ratio is less than 102 percent, and when the plan's funding ratio exceeds 110 percent, permanently increases all retirement, survivor, and joint-and-survivor pensions by approximately one unit, including those who are already retired.

The proposed legislation raises several pension and related public policy issues that may merit Commission consideration and discussion, as follows:

1. Need for Consideration. The issue is whether there is any need to consider this bill during this legislative session. Recent investment markets have been turbulent. Last year's stock market provided approximately a five percent return, only half the long-term average. As of this writing, the stock market in the current year is down nearly ten percent. These markets will harm all pension funds. This may be an inopportune time to consider a proposal to distribute more pension assets to retirees through a thirteenth check (Sections 3 and 4 of the bill), or to enhance benefits through increases in the unit value used to compute monthly benefits when the pension fund hits 110 percent funding (Sections 1 and 2 of the bill). As of the most recent actuarial valuation for this plan (December 31, 2006), the plan was 87 percent funded. The chance of it becoming 110 percent funded in the near term is remote at best.
2. Cost. The issue is the cost of the benefit revisions intended under this legislation. The Commission rarely considers a benefit improvement without cost information.
3. Employee/Retiree Avoidance of Cost Burden. The issue is the lack of any contribution by active members or benefit recipients to cover the cost of this proposal. There is no provision in the bill to have active members cover any of the cost. At the current time, few active members—and perhaps none—are contributing at all to the plan. Under Minnesota Statutes, Section 423C.04, Subdivision 4, once an individual has 25 years of service, employee contributions are deposited, not into the plan's special fund, but into a health care account set up for the individual, which is then used to cover health care expenses in retirement. The plan was closed to new entrants in 1980. At the current time, the last entrants to the plan will have, if there are no breaks in service, nearly 28 years of service. Thus, it is likely that currently no employees are contributing to the pension fund.

There may be no practical way to charge retired member groups for this benefit improvement, at least not all of it. Trying to collect the cost of the improvement from retired groups would largely amount to withholding an amount from the monthly payments equal to the additional amount they would otherwise receive due to the improvement. The city, and the state through state aid, will bear the cost and financial risk for the benefit improvement.

4. Unclear Need for Unit Increase for Active Membership. The issue is the unclear need for any increase in the unit value under Sections 1 and 2 of the bill for the active membership. According to the most recent actuarial study, this plan has 31 active members, 374 service retirees, and 167 survivors. (The plan also has 51 individuals listed as disabled.) The plan was closed to new members in 1980. At this point, the last active members to enter this plan have nearly 28 years of service. The plan permits full unreduced retirement at age 50, and according to the plan's actuarial report the average age of the remaining active members is nearly 55. A benefit improvement for these individuals may not serve any clear public purpose. It may be difficult to demonstrate that they face any true financial hardship when they retire. It may also be difficult to make a case based on equity. If members of this plan contend their plan benefits are below those they would have if they were covered by the Public Employees Police and Fire Plan (PERA-P&F), that harm is self-inflicted by the full relief association membership. Consolidating into PERA-P&F was authorized by the 1987 Legislature and remains in law. Dozens of local relief associations chose to consolidate into PERA-P&F. The Minneapolis relief associations are among the four relief associations which chose not to consolidate. The Minneapolis relief associations, instead, chose to revise their plans to make consolidation more difficult. Given that the members and leadership of this relief association chose this path, the Commission might choose to conclude that the Minneapolis and state taxpayers should not be required to eliminate any self-inflicted harm.
5. Conflict with Commission's Principles of Pension Policy of Providing Benefit Increase to Those Already Retired. The issue is whether the proposed unit increase to those already retired can be justified. In part, Section 1 of the bill revises the formula or procedure used to compute the annuity, and applies that revision to those who are already retired. Applying this form of benefit increase to retirees is most unusual, and adds considerably to the cost of the proposal. In this plan, retirees and survivors outnumber

active members by 17 to 1. The Commission's Principles of Pension Policy states, on page 2, that retroactive benefit increases for retirees and other benefit recipients should not be permitted. The underlying concern reflected in that policy statement is cost. Depending upon the plan, the cost of providing benefit increases to retirees can be high, making it prohibitively expensive to make changes deemed appropriate for policy reasons. Revising benefits to existing annuitants (other than to adjust for the impact of inflation) is a gratuity. A benefit improvement is not part of any written or implied contract which induces these individuals to provide further service, because these individuals are no longer providing service.

6. Vague Drafting: Application to Deferred Retirees and Disabilitants. The issue is who is considered to be part of the "retired membership" or, in other words, who is eligible for inclusion in this benefit increase. Page 1, lines 18 and 20, state "Active members retiring after the effective date of this subdivision will be entitled to the additional unit upon retirement from the fire department, once the requirements of this legislation have been satisfied and the benefit has been provided to the *retired membership*." "Retired" or "retired membership" are not defined terms in this chapter. Other language in the paragraph clarifies that service retirees and survivors are included, but whether deferred members or disabilitants are included is left unstated. Deferred members have terminated from employment with the fire department but they are not yet receiving an annuity, so they are not "retired." The status of disabilitants under the plan is unclear. They are receiving a benefit, but they are not "retired."
7. Contradictory Drafting: Trigger for Payment of Benefits. The drafting of Section 1 contains inconsistent statements regarding what funding level is needed to trigger the benefit change. Page 1, lines 11 and 12, indicate that revised benefits are triggered when the funding ratio *is greater* than 110 percent, while page 1, lines 21 and 22, state that those events are triggered when the funding ratio *equals or exceeds* 110 percent.
8. Confusing Drafting: Permanent or Intermittent Benefit Change. The drafting is unclear regarding whether the benefit change is to be intermittent, depending upon the funding ratio as stated in the latest actuarial valuation, or a permanent increase first becoming payable when the an actuarial valuation indicates that a funding ratio of 110 percent has been met or exceeded. Page 1, lines 11 to 13, suggest that the additional unit is to be paid only if the most recent actuarial valuation indicates a funding ratio greater than 110 percent. That suggests that if the funding ratio exceeds 110 percent and the benefit increase begins to be paid, and whenever the latest actuarial valuation indicates that the funding ratio has fallen below 110 percent, the benefits being paid must be reduced. If that language is intended as the trigger for when a fixed, permanent increase first becomes effective, that language should be revised.
9. Unclear Need for Increased Thirteenth Check Adjustment. The policy issue is the appropriateness of again seeking to modify the thirteenth check mechanism, under Sections 3 and 4, given the other post-retirement adjustments provided under this plan, and given the recent rejection of that proposal by the City of Minneapolis. That provision in this bill (Section 3) differs from the rejected provision by adding a statement (page 3, lines 13 to 15) that "Any amount of the excess investment income not used to pay a postretirement benefit to eligible members shall be applied to reduce the city of Minneapolis' property tax levy to the association for the following calendar year." That may have minimal beneficial impact for the city. Under this proposal, if the required investment criteria is satisfied, one percent of relief association assets, rather than one-half percent, is declared to be "excess investment income" and will be distributed to the retired membership in a lump sum payment as a "thirteenth check." Under relief association law (the statement is found on page 3, lines 10 to 12), if the computed thirteenth check amount for a recipient exceeds the monthly benefit check normally paid to the individual, the thirteenth check payment must be capped at the normal monthly benefit amount. Thus, the excess investment income not used to pay a post-retirement benefit consists solely of the residual excess amounts, if any, above the capped payment. Whether any excess amount exists to offset property tax levies is a function of monthly benefit levels and the total amount of relief association assets, since excess assets are defined as one percent of that total. The higher the monthly benefit level, the less likely it is that there will be any residual excess income. The lower the asset level, the less likely it is that there will be any residual excess income. But the higher the monthly benefit level, the greater the need for financial support. Similarly, low asset levels may occur at times when it is necessary to rebuild a depleted pension fund. If this provision provides any relief to the city, it seems to be when that relief is least needed.
10. Lack of Public Purpose for Various Plan Post-Retirement Adjustment Mechanisms. The issue is the lack of need for the various post-retirement adjustment mechanisms in this plan. The primary rationale for post-retirement adjustments set forth in the Commission's Principles of Pension Policy is to replace all or a portion of the purchasing power of a retirement benefit that is lost to inflation. Minneapolis Firefighters Relief Association (MFRA) retirees and survivors cannot contend that their benefits have

not kept up with inflation. First, all annuities are escalated annually to match the percentage increase in the salary of a top grade Minneapolis firefighter. Those increases alone should be more than sufficient to adjust for inflation. Second, these relief associations pay benefits which are a portion of the current top grade firefighter or police officer salary. Over time, the Minneapolis relief associations have revised what they deem is includable as salary of a top grade firefighter or police officer, as applicable, which may lead to further increases in benefits. Third, these relief associations have not one, but three, provisions for adding to annuitant payments. In addition to the automatic escalator tied to the salary of a top grade firefighter or police officer, the plans provide an additional distribution of assets in the form of a thirteenth check whenever the investment rate of return for a five-year period exceeds by two percent the percentage increase in the applicable top grade salary for that same period. A few years ago a third increase mechanism was added to the plans, permitting an additional, and larger, distribution of assets to members whenever the funding ratio exceeds 110 percent, payable in addition to the escalator and thirteenth check.

If inflation is the reason for the requested benefit increases, Minneapolis Firefighters Relief Association (MFRA) officials should be requested to provide additional testimony about its view of recent inflation, the extent that the current escalator post-retirement adjustment and thirteenth check provisions have addressed those recent inflationary increases, and its retirees' needs for additional retirement income. If the requested post-retirement increase is based on factors other than inflationary pressures, MFRA officials should be requested to testify on why those factors are valid public policy reasons for the enactment of the benefit increase.

11. Treatment of Unmarried Service Pensioners. The issue is whether the new benefit level for unmarried service pensioners is correctly stated in the bill. Page 1, lines 11 to 15, claim that every service pensioner, joint-and-survivor annuitant, and surviving spouse member is entitled to a one unit increase. However, language on page 1, lines 22 to 24, claims the increase is to be "up to one unit," rather than "one unit." The new pension amounts specified on lines 23 and 24 indicate a one unit increase for service pensioners and surviving spouse members, but the new higher benefit for unmarried service pensioners reflects an increase of .9 units rather than one unit. (Under existing law unmarried service pensioners receive a pension of 42.3 units (Minnesota Statutes, Section 423C.05, Subdivision 9). A one unit increase would create a 43.3 unit pension, rather than 43.2 units as stated in the bill. If this benefit level is not an error, an explanation from a representative of the pension fund, and perhaps clarifying language, is needed.
12. Appropriate Amount of Thirteenth Check Adjustments. The policy issue is the appropriateness of the doubling of the future thirteenth check adjustments in Section 3 in light of the amount of the current thirteenth check adjustment and the proposed unit adjustment in Section 1. Under the December 2005 actuarial valuation of the Minneapolis Firefighters Relief Association (MFRA), there were 385 retirees, 50 disabilitants, and 166 surviving spouses. Under the proposed legislation, the total distribution and potential individual payment amounts would double:

	Current potential distribution under the "13 th check" provision (one-half of one percent of MFRA assets):	Proposed total distribution and potential individual payment amounts would double to:
Available for payments:	\$1,212,981	\$2,425,963
Lump sum payment to each retiree or disabilitant:	\$2,434	\$4,868
Survivors receive:	\$1,217	\$2,434

The proposed total distribution and potential individual payment amounts would be in addition to any amounts paid due to other lump sum distribution provisions of the plan, and in addition to any increase due to an increase in the salary of a top grade firefighter.

13. Inappropriateness of "Thirteenth Check" Last Participant's Club Aspect. The policy issue is the appropriateness of further modifying a post-retirement adjustment mechanism that already functions as a last participant's club and that may reflect jealousies among a declining group of "last" participants. That same concern may have been the motivation in whole or in part of the 110 percent funded post-retirement adjustment. With the closure of the Minneapolis Firefighters Relief Association (MFRA) to new active members in 1980, the retirement plan became a totally closed group and setting the size of post-retirement adjustments based on the size of retirement plan assets inevitably made the plan's operation a "last participant's club," where larger potential adjustments become possible with the twin developments of greater mandated funding and a smaller covered population. Older retirees may discern

