



TO: Members of the Legislative Commission on Pensions and Retirement  
FROM: Ed Burek, Deputy Director *EB*  
RE: Summary of Proposals for Actuarial Services to the Commission  
DATE: June 3, 2009

### Introduction

The 2008 Legislature (Laws 2008, Chapter 349, Article 10, Sections 7-9, and 17-18) revised the provision of actuarial services to the major public pensions plan administrations and to the Legislative Commission on Pensions and Retirement. The requirement that the pension funds jointly retain an actuary was revised by removing the joint actuary requirement. Instead, each plan system retains its own actuary. The Pension Commission was authorized to retain an actuary to audit or review the actuarial valuations, experience studies, and other reports and services provided by the actuaries retained the various pension plan governing boards.

In late January 2009, the Pension Commission requested proposals from qualified actuarial consulting firms to provide a range of actuarial audit/review services to the Commission as specified in the Request for Proposal (RFP). Seven actuarial service firms responded to the RFP: Cheiron (pronounced ki'ron), Deloitte, Gabriel Roeder Smith and Company (GRS), Hay Group, Kenney Consulting, Milliman, and PricewaterhouseCoopers. Summaries of the proposals received are attached. The remainder of the cover memo briefly indicates the scope of the proposed tasks outlined in the RFP and makes a few observations on the received proposals.

### Proposal Requirements

The Commission's RFP requested actuarial audit/review services to be provided to the Commission. The RFP asked the firms to submit fixed fee compensation for the following purposes:

1. to review the quadrennial experience studies of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and the Teachers Retirement Association (TRA); and
2. to review or replicate the annual actuarial valuations of the 13 defined benefit plans in MSRS, PERA, TRA, the first class city teacher plans, and the Minneapolis Employees Retirement Fund (MERF).

It is considered good practice to fully replicate the annual actuarial valuations once every four or five years, and to do a thorough review in years where full replication does not occur.

The RFP also requested hourly rates to review or replicate actuarial cost estimates for proposed benefit, contribution, actuarial assumption, or other changes; to review or audit optional annuity form tables; to review or audit prior service credit purchase payment amount determinations; to review or audit privatization gain or loss estimates; to attend Pension Commission meetings; to provide advice and counsel on pension benefit design and funding; and to provide other special studies.

The RFP specified minimum firm and team qualification standards, which include:

1. that the provider be regularly engaged in the business of providing actuarial services and be a Fellow in the Society of Actuaries (FSA);
2. that the firm have sufficient size to meet the Commission's needs and that of its other clients;
3. that the firm and the individuals assigned to the Commission's account have prior public plan experience and prior reviewing/auditing actuary experience;
4. that the team working on the Commission's account be able to meet Commission timeframes and be readily accessible on short notice; and
5. that, to the extent possible, there are no contractual liability limits.

In addition, the RFP requested information on the firm's structure, how the assigned team will be organized and will function, who will replace team members if there was staff turnover or a key member was otherwise not available, and whether the firm's computerized valuation system is sufficiently flexible to handle the Commission's needs and has sufficient capability to handle the large membership in

Minnesota public plans. The RFP also asked for client additions and subtractions in recent years, for references, and whether the firm had current or potential conflicts of interest due to current services it provides to Minnesota pension plans or other interested parties.

### Comments on the Attached Summaries

The firms vary in size from international firms with hundreds of employees to a small firm with only four employees. All of the firms have prior public plan experience, although for the smallest firm, Kenney Consulting, that experience seems limited to a few small plans. The proposed teams also have team members with public plan experience. That team experience may be thin when one looks beyond the team leader. The team leader serves as the Commission's contact and the individual who will meet with the Commission when needed, but in general, most of the work will be done by other team members. A few teams have team leaders or other team members with considerable experience working on Minnesota pension plans.

It was sometimes difficult to determine from the proposals the extent to which a firm or team has served as reviewing/auditing actuaries, rather than as production actuaries. This may or may not be an issue for the Commission. The teams have public plan experience, and any actuarial firm retained to provide actuarial valuations will begin by performing a detailed review or replication of a prior actuary's work, to ensure as seamless a transition as possible and to spot possible errors. Thus, even if an actuary has not officially been an actuarial auditor, they are likely to have performed that function informally as a first step on prior projects.

Accessibility may be an issue with some of the companies. Only one company would service the contract locally (from Minneapolis). The others are located in other states, as far away as Washington DC and California. In a few cases the individual who is to provide backup if the key contact person is not available may be an independent contractor rather than a company employee.

The Commission presumably is interested in contracting with a company willing to back up its work with high or unlimited liability limits. Only one company, Cheiron, is clearly willing to enter into a contract that does not set liability limits, but the proposed cost of full replication from that company was more than twice that of the lowest bids.

A few firms have conflict of interest problems. The Deloitte team has for several years provided actuarial advice to Minneapolis regarding its dealings with MERF and the two Minneapolis relief associations. If the Pension Commission were to need advice regarding any proposed merger of MERF or these relief associations into PERA, the same firm would be advising both the city and the state. If this were to occur, the Deloitte proposal indicates that an individual from Deloitte's Chicago office, rather than the Minneapolis team, would advise the state. The Commission may need to decide if that is a reasonable solution. Another company, GRS, currently is the retained actuary for MERF and the St. Paul Teachers Retirement Fund Association (SPTRFA). If GRS is retained by the Commission, GRS would be responsible for auditing their own work. The solution GRS proposes is to simply not perform audits of the MERF and SPTRFA actuarial valuations, auditing only 11 plans rather than the 13 plans requested in the RFP. Auditing some but not all plans is not consistent with the RFP and the Commission may conclude that the GRS proposal is not consistent with the Commission's needs. Milliman does not currently have a conflict, but one could develop. Milliman has responded to a Duluth Teachers Retirement Fund Association (DTRFA) RFP to be the production actuary for that fund. Milliman has proposed a reasonable solution. If it is retained by DTRFA before the Commission decides on a firm to retain, it will withdraw from Commission consideration. If the Commission chooses to retain Milliman before DTRFA makes a decision, Milliman will withdraw from DTRFA consideration.

The compensation requirements stated in the proposals vary considerably between firms. Some firms provided several different sets of compensation requirements, depending on specific mixes of services the Commission might request in a given year. That information is included in the summary of each proposal. Because that presentation makes it difficult to compare fees across firms, Commission staff has also included a one page compensation summary which may make comparison easier. For purposes of that compensation summary, Commission staff selected the compensation requirements specified in the proposals assuming that the first major work assigned to the team occurs in fiscal 2009 and is a review of the 2008 actuarial valuations, followed by work in fiscal 2010 to review the three experience studies and to have a full replication of the 2009 actuarial valuations. This is followed in 2011 and 2012 by a review of the actuarial valuations. The charge for services varies considerably between the companies. No company is consistently lower for all services. A given company may have submitted a high bid for full

replication of actuarial valuations, but have a rather low charge for an actuarial review. For this specific set of services, Kenney Consulting had the lowest overall cost.

A problem for the Commission is that one firm may define actuarial review, actuarial audit, and full replication differently than another firm, making it difficult to determine whether the firms provided compensation requirements for comparable services. Some of the proposals imply that an actuarial review is a very limited check for reasonableness and consistency with statutes and actuarial standards, while an audit is more thorough than a review but less than a full replication of the actuarial valuation results. Other proposals suggest that an audit requires full replication. The Commission may need to explore this more to ensure it can make valid comparisons across firms.

Only one firm, Kenney Consulting, provided the requested fixed hourly rates to audit service credit purchase procedures, review of cost estimates, and similar work. Other firms indicated that the price could not be known in advance; it would depend on the specific request and the mix of team members needed on any given task.

## Actuarial Services Proposal Summary

Firm: Cheiron (*pronounced ki'ron*)

### A. Minimum Qualification Standards and Important Qualification Factors

1. Prior Public Pension Experience by Actuarial Firm. Before Cheiron was formed in 2002, consultants now at Cheiron provided actuarial services for more than 25 years to statewide defined benefit retirement systems in Maryland, Florida, and Maine. Since Cheiron was founded, the company has provided actuarial services to the state retirement system of Delaware, the Pennsylvania Municipal Retirement System, the Oregon PERS, CalSTRS, the State of New Jersey, numerous cities (including Baltimore, Philadelphia, Annapolis, San Francisco, Norfolk and Chattanooga) and several counties, and the Maryland State Legislature.
2. Prior Public Pension Experience by Assigned Firm Personnel. The peer reviewers have extensive public plan experience, but they will play a limited role. One of the two "actuarial consultants" (Linda Bournival) has considerable public plan experience but is not an employee of Cheiron. She is identified as the Executive Vice President of Ricci Consultants. The other actuarial consultant has 18 years of experience with defined benefit plans and headed actuarial audits for a state Blue Cross/Blue Shield system. The project managers have lesser amounts of public plan experience.
3. Prior Reviewing/Auditing Actuary Experience. The firm has provided auditing and evaluation of the work of other actuaries for the California State Teachers' Retirement System, the Oregon Public Employees Retirement System, the Wichita Employees Retirement System, the Wichita Police and Fire Retirement System, and the Michigan Laborers Pension Fund. Proposal does not specifically mention involvement of the proposed Pension Commission's team in these activities.
4. Accessibility. Proposal claims work products will be timely, with highly qualified individuals available to meet tight deadlines and attend required legislative or other meetings. Three individuals are responsible for presenting reports and results to Pension Commission. The primary contact is Scott Greeno, an ASA with 18 years of experience. Backups are Linda Bournival, an FSA with 25 years of experience, and Fiona Liston, an FSA with 25 years of experience.
5. Absence of Contractual Liability Limits and Contractual Third-Party Reliance Disclaimers. No liability limitations. Proposal states that the key Cheiron consultants worked together for many years in the Washington DC office of a major international actuarial firm. Cheiron was formed after its founders took exception to the efforts of their prior employer and the actuarial industry in general to unilaterally impose liability limitations on clients.

### B. Firm Information

1. Firm Size, Structure, Operational Method, and Communications Capability.
  - a. Firm size, structure:
    - Employee-owned corporation.
    - Full staff component is 46 full-time staff (including 26 credentialed actuaries) and two part-time staff.
    - Offices in Washington DC, Chicago, New York City, Philadelphia, and San Diego.
    - Firm also has an alliance with Ricci Consultants enabling both companies to act as a single entity. (Ricci Consultants may eventually be acquired by Cheiron.)
    - Company also has an affiliate, Arene Health Partners, LLC, providing healthcare consulting.
  - b. Operational method:
    - Employs internal quality controls to minimize frequency and impact of any mistakes.
    - Each actuary is adept at computer programming and does not rely solely on "back rooms" to provide all calculations.
    - Each lead consultant knows in detail the process that produces all of the actuarial numbers.
  - c. Communications capability:
    - Stresses open lines of communication with clients.
2. Five Major References
  - a. Mr. David Craik, Pension Administrator, Delaware Retirement System
  - b. Ms. Gail Drake-Wright, Executive Director, Maine State Retirement System
  - c. Mr. David Wescoe, Executive Director, San Diego City Employees' Retirement Systems
  - d. Mr. Robert L. Mears, Executive Director, Fairfax County Retirement Systems
  - e. Ms. Kimla T. Milburn, Director of Human Resources, City of Annapolis
  - f. Mr. James Allen, Secretary, Pennsylvania Municipal Retirement Systems
3. Client Additions and Subtractions. The proposal lists approximately 135 clients added since 2004, and claims to have lost only one account. Some of these are health/welfare plans.
4. Firm's Valuation System. Actuarial valuation software, called ProVal, is leased from Winklevoss Technologies. The software can handle large amounts of data, use select and ultimate interest rates, multiple funding methods, multiple decrements, actuarial gain and loss by source, and open and closed

group forecasts. Computations and reports are produced on PCs. Client projects and files distributed among many multiple employees. Proposal claims this is not as susceptible to catastrophic failures as in a central computer approach. Work is backed up to centralized network storage device with redundant power supplies. All computers use encryption to ensure data security. Can do projection valuations, extensive graphic capability, and sensitivity analysis.

5. Firm's Potential Conflicts of Interest. No conflicts. Firm has no other Minnesota clients.
6. Most Recent Audited Annual Financial Report. Firm is not publicly held. Would be willing to share detailed financial statements if selected as a finalist.

### C. Approach and Work Plan

1. Ability to Meet Service Timeframes. States that all time requirements will be met.
2. Organization of Assigned Staff. The organization and function of assigned personnel in the proposal is very confusing. The structure appears to be, starting from the bottom:
  - a. actuarial analysts to do most of the number crunching;
  - b. project managers to ensure that tasks are on schedule;
  - c. actuarial consultants who will deliver the work products to the Commission, provide any needed presentations, and attend Pension Commission meetings; and
  - d. peer reviewers who will provide peer review of all work products.

What is confusing is that three individuals are identified as "the proposed project manager" without any explanation of why there are three project managers or who has final project management responsibility, and two individuals are identified as "the proposed actuarial consultant." Perhaps this is due to poor editing of the proposal, or perhaps it is an intended structure to ensure that, if necessary, a request can be promptly filled, but an explanation is needed. As presented, one wonders whether anyone is truly in charge.

3. Plan for Coordinating Services with Commission Staff. Firm intends to meet with Pension Commission staff to determine appropriate lines of communication with Commission staff, discuss expectations, intermediate goals, and deadlines.
4. Primary Contact Person and Replacement Personnel. Primary contact is Scott Greeno, ASA, located in Chicago. Multiple individuals are assigned to each function (peer review actuaries, consulting actuary, project manager, etc.), so if someone leaves or is unavailable, other individuals totally familiar with the account can step in.

### D. Actuarial Services Compensation

1. Proposal includes compensation requirements for three levels of service, referred to as Plans A, B, and C.
  - a. Plan A is a review of 2008 valuations for all 13 plans. For 2009, firm would do full replication of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and the Teachers Retirement Association (TRA), and review the remaining ten plans. In 2010 would perform full replication of four additional plans and review remaining nine. In 2011 full replication of final six plans, review of others.
  - b. Plan B is annual review of 13 plans with no full replication.
  - c. Plan C is full replication of all 13 plans.

Proposed Costs for Plan A:

Fixed Fees, Plan A	Year 1	Year 2	Year 3	Year 4
Review/replication of annual actuarial valuation reports for 13 plans	\$68,000	\$130,000	\$131,000	\$133,000
Review/replication of quadrennial experience studies for MSRS-General, PERA-General, and TRA	\$20,000			
Hourly Fees, Plan A	Year 1	Year 2	Year 3	Year 4
Review/replication of actuarial cost estimates for proposed benefit, contribution, actuarial assumption, or other changes	Rate per hour			
Review/audit of optional annuity form table or annuity reserve factor changes	Rate per hour			
Review/audit of prior service credit purchase payment amount determination	Rate per hour			
Review/audit of privatization gains or losses	Rate per hour			
Attendance at Commission meetings	Rate per hour			
Provision of advice and counsel on pension benefit design and funding	Rate per hour			
Preparation of special studies for the Commission	Rate per hour			

Proposed Costs for Plan B:

Fixed Fees, Plan B	Year 1	Year 2	Year 3	Year 4
Review/replication of annual actuarial valuation reports for 13 plans	\$68,000	\$71,000	\$73,000	\$75,000
Review/replication of quadrennial experience studies for MSRS-General, PERA-General, and TRA	\$20,000			
Hourly Fees, Plan B	Year 1	Year 2	Year 3	Year 4
Review/replication of actuarial cost estimates for proposed benefit, contribution, actuarial assumption, or other changes	Rate per hour			
Review/audit of optional annuity form table or annuity reserve factor changes	Rate per hour			
Review/audit of prior service credit purchase payment amount determination	Rate per hour			
Review/audit of privatization gains or losses	Rate per hour			
Attendance at Commission meetings	Rate per hour			
Provision of advice and counsel on pension benefit design and funding	Rate per hour			
Preparation of special studies for the Commission	Rate per hour			

Proposed Costs for Plan C:

Fixed Fees, Plan C	Year 1	Year 2	Year 3	Year 4
Review/replication of annual actuarial valuation reports for 13 plans	\$68,000	\$240,000	\$250,000	\$260,000
Review/replication of quadrennial experience studies for MSRS-General, PERA-General, and TRA	\$20,000			
Hourly Fees, Plan C	Year 1	Year 2	Year 3	Year 4
Review/replication of actuarial cost estimates for proposed benefit, contribution, actuarial assumption, or other changes	Rate per hour			
Review/audit of optional annuity form table or annuity reserve factor changes	Rate per hour			
Review/audit of prior service credit purchase payment amount determination	Rate per hour			
Review/audit of privatization gains or losses	Rate per hour			
Attendance at Commission meetings	Rate per hour			
Provision of advice and counsel on pension benefit design and funding	Rate per hour			
Preparation of special studies for the Commission	Rate per hour			

2. Additional Fee-Related Items:

- Current (2009) hourly rates for other clients for firm personnel assigned to account:
  - Senior lead consultant, \$285–\$450
  - Other consultants, \$235–\$285
  - Actuaries, \$190–\$235
  - Actuarial students/interns, \$109–\$190
  - Administrative staff, \$76–\$125

Bill rates anticipated to increase approximately 3% to 5% per year.

3. Charging of out-of-pocket expenses:

- Out-of-pocket expenses, such as travel expenses, will be billed at cost.

4. Charging computer expenses:

- No additional charge.

5. Charging development costs:

- i. Any necessary changes to the firm's current computer systems:
  - No additional charge.
- ii. Any necessary changes for data entry:
  - No additional charge.
- iii. Gaining familiarization with the Minnesota pension plans and systems:
  - No additional charge.

- iv. Obtaining other data and information necessary to perform actuarial services tasks:
  - No additional charge.

6. Billing practices, timing, and procedures:

- Basic retainer and non-retainer services will be billed monthly.

**E. Human Rights Affirmative Action Certificate**

Not applicable. Firm has no Minnesota employees.

**F. Workers Compensation Coverage Compliance**

Not applicable. Firm has no Minnesota employees.

**G. Additional Proposal Content Requirements**

1. Copies of examples of best work product for a prior or current client: actuarial valuation, experience study, and benefit cost estimate results.

Provided examples of actuarial valuation, experience study, and benefit cost estimates to unnamed or hypothetical client.

2. Other Minnesota relationships:

N/A

**H. Comments**

Strengths:

- a. Large firm so should be able to draw resources when needed.
- b. Considerable public plan experience both in the firm and on the team.
- c. Has lost only one account in recent years.
- d. No contractual limit on liabilities.

Concerns:

- a. High proposed cost.
- b. Key team member is employee of a firm which has an alliance with Cheiron rather than being an employee of Cheiron, which could cause turnover trouble on our account if relationship between companies changes.
- c. Confusing staff arrangement. Our account would have multiple peer review actuaries, multiple consulting actuaries, and multiple team leaders. Proposal contends this assures prompt response to our needs and highly accurate work products. However, may simply indicate that our account would be serviced from a large pool of staffers, whoever has available time, without anyone giving the account high priority or becoming expert in the particulars of Minnesota pension funding law and our actuarial standards.
- d. Out-of-pocket expenses may be high. Proposal states that a peer review actuary will be present at any Pension Commission meeting where results are being presented, in addition to the actuarial consultant. Depending on the topic involved, a project manager may also be in attendance. Commission is likely to be billed for travel expenses for all of these individuals, and possibly the hourly rate for all these individuals.
- e. Concern about excessive growth. The firm has added over 135 clients in recent years. May be more concerned about revenue growth than quality of work.
- f. Very wide ranges of hourly rates, creating considerable uncertainty about any work billed based on hourly fees.

## Actuarial Services Proposal Summary

Firm: Deloitte

### A. Minimum Qualification Standards and Important Qualification Factors

1. Prior Public Pension Experience by Actuarial Firm. Considerable. Has provided services to statewide pension systems in 34 states and many cities and local plans, including Minneapolis.
2. Prior Public Pension Experience by Assigned Firm Personnel. The team has considerable public plan experience providing actuarial valuations, experience studies, actuarial auditing, and generally advising public plans. Details were provided on three cases in which team members play or played extensive roles: State of Illinois, City of Minneapolis, and Los Angeles City Employees' Retirement System. With the State of Illinois, found that required contributions were high and would grow extensively in future; is working with that state's Office of Management and Budget to develop cost-effective solutions and to educate interested parties regarding implications. Was hired in 2004 by Minneapolis to review escalating contribution requirements to Minneapolis plans, helped Minneapolis develop proposals to control costs. Reviewed Los Angeles pension programs and found liabilities seriously underestimated due to shortcuts used by other actuaries.
3. Prior Reviewing/Auditing Actuary Experience. The team leader, Michael de Leon, is the reviewing actuary to the City of Minneapolis, and the proposal includes an actuarial audit report by Mr. de Leon. He has performed both limited scope and comprehensive audits of large plans. Lance Weiss, another team member, is the reviewing actuary for the State of Illinois. Members of the team provide over 75 limited scope audits per year.
4. Accessibility. Highly accessible. The team leader, Michael de Leon, and most or all of the other team members work out of Deloitte's Minneapolis office and are available on short notice any time of year. One team member, Lance Weiss, who will be peer advisor and supporting actuary, works from firm's Chicago office.
5. Absence of Contractual Liability Limits and Contractual Third-Party Reliance Disclaimers. Will require some limitation on liabilities, but Deloitte is "prepared to negotiate in good faith with the Commission to achieve reasonable performance guarantees that address service concerns."

### B. Firm Information

1. Firm Size, Structure, Operational Method, and Communications Capability
  - a. Firm size, structure:
    - Deloitte, a limited liability partnership, is the second largest consulting firm in the world.
  - b. Operational method:
    - Not directly addressed.
  - c. Communications capability:
    - Claims to be committed to delivering pension fundamentals in non-technical manner.
2. Five Major References
  - a. Mr. Patrick Born, Finance Director, City of Minneapolis
  - b. Mr. John Filan, Director of Illinois Finance Authority, State of Illinois
  - c. Mr. Li Hsi, Administrative Services Manager, Los Angeles City Employees' Retirement System
  - d. Mr. Eric Samuels, Assistant Controller, Eastman Kodak Company
  - e. Ms. Ginger Hall, Human Resources, Metropolitan Government of Nashville and Davidson County, Tennessee
3. Client Additions and Subtractions. Claims it does not have a database that tracks clients gained or lost in the last five years for entire national practice. For the Minneapolis office, in the last five years lost 11 clients and gained 21 new clients. Does not disclose names due to company policy. Claims most common reason for client loss was due to merger or acquisition, and contends that none of losses was due to performance issues of actuarial team.
4. Firm's Valuation System. Has several systems referred to as Employee Benefit Tools (EBT), all developed in-house. These include the Census Management System which prepares the data for use in the valuation. Actuarial Computing Environment does the computing. Report and Actuarial Valuation Expediter is a pension worksheet and reporting system. Report Writer is used to write reports.
5. Firm's Potential Conflicts of Interest. Michael de Leon, the lead actuary on the proposed team, is the reviewing actuary for the City of Minneapolis. If mergers of MERF or the two relief associations into PERA are considered, the firm would be representing both the city and state. Proposal states that if this occurs, Lance Weiss from the Chicago office would advise the state on the merger. While at least the same individual would not be advising both parties, we would still have the same firm advising both parties.



