



S.F. 669
(Betzold)

H.F. 741
(Kahn)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA, MFRA, MPRA
Relevant Provisions of Law: Minnesota Statutes, 353.01, Subdivisions 2, 2a, and 6
General Nature of Proposal: Provides PERA-General Pension Coverage for Staff of Minneapolis Firefighters Relief Association and Minneapolis Police Relief Association
Date of Summary: February 23, 2009

Specific Proposed Changes

- Places staff of MFRA and MPRA in PERA-General, if not covered by local relief association plan.

Policy Issues Raised by the Proposed Legislation

1. Need for change.
2. Potential additional requests to shift pension coverage.
3. Mandatory coverage or election.
4. Cost implications for PERA.
5. Purchases of service credit issue.
6. Local approval.

Potential Amendments

The following amendments are drawn to delete-everything amendment S0669-1A:

S0669-2A adds a local approval clause.

S0669-3A is an alternative to S0669-2A and can be used if the Commission does not support a local approval clause but does want to revise the effective date section to specify an effective date other than the first day of the first full pay period after final enactment. The Commission would need to put a date in the blank

S0669-4A allows an election of PERA-General coverage rather than having that coverage be mandatory.

S0669-5A permits full actuarial value purchases of service credit in PERA-General for all or part of prior relief association employment.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director *EB*
RE: S.F. 669 (Betzold); H.F. 741 (Kahn), in the Form of Delete-Everything Amendment S0669-1A: PERA-General; Providing PERA-General Pension Coverage for Staff of Minneapolis Firefighters Relief Association and Minneapolis Police Relief Association
DATE: February 19, 2009

Summary of Delete-Everything Amendment S0669-1A to S.F. 669 (Betzold); H.F. 741 (Kahn)

The delete-everything amendment S0669-1A to S.F. 669 (Betzold); H.F. 741 (Kahn) gives staff of the Minneapolis Firefighters Retirement Association (MFRA) and the Minneapolis Police Retirement Association (MPRA) coverage by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) on a prospective basis and terminates continued coverage in any prior primary pension plan.

Discussion

Original bills S.F. 669 (Betzold); H.F. 741 (Kahn) created pension coverage in PERA-General for staff of the MFRA and MPRA by adding the two Minneapolis relief associations to PERA's definition of "government subdivision." Under PERA law, employees of a government subdivision are covered by PERA unless specific law requires coverage by another plan.

The delete-everything amendment provides greater clarification by doing the following, in addition to adding the relief associations to PERA's government subdivision definition:

- adds employees of the Minneapolis relief associations, who are not covered by the relief association plans, to PERA's included employee definition;
- clarifies that any employee of these relief associations who is covered by the relief association pension plan is not eligible for the PERA coverage;
- to avoid potential double coverage, specifies that contributions to the plan or plans that previously provided primary pension coverage must end when PERA coverage commences; and
- makes the provisions effective with the first full payroll period beginning after final enactment.

This delete-everything amendment also moves existing law language which provides PERA-General coverage for full-time Dakota County Agricultural Society employees from PERA's "public employee" definition to a more logical place in PERA's "included employee" definition.

Background Materials Attached

- Background information on the Minneapolis Firefighters Relief Association and Minneapolis Police Relief Association appears in **Attachments A and B**.
- Background on the differences between defined benefit plans and defined contribution plans appears in **Attachment C**.

Minneapolis Relief Association Staff

According to the Annual Financial Report for the year ended December 31, 2007, for the Minneapolis Police Relief Association (MPRA), that association had two staff members, Executive Director Renee Tessier and a second staff member, Sharyn North, not identified by title. Presumably, these two individuals are not members of relief association. Commission staff is not aware of the specific pension coverage currently provided to these two individuals.

The corresponding Minneapolis Firefighters Retirement Association (MFRA) report lists one staff member, Kathy Morkrid, who is employed as an administrative assistant. Commission staff is not aware of the specific pension coverage currently provided to this person. MFRA Executive Secretary Walter Schirmer is a member of the association covered by the relief association plan, and is also paid a considerable salary, although he is not specifically listed as staff in the report. Under MFRA law (Minnesota Statutes, Section 423C.03), if the executive director is an active plan member firefighter, he or she receives a salary as executive secretary not to exceed 50 percent of the salary of top grade firefighter. If the executive secretary is not an active plan member the salary cannot exceed the salary paid to the

executive directors of the Minnesota State Retirement System (MSRS), the Public Employees Retirement Association (PERA), or the Teachers Retirement Association (TRA).

The MFRA law specifying salary for the executive secretary also indicates that the plan provides salary, in lesser amounts, to the board president and all other elected board members. The president and elected board members are all either active or retired relief association members.

Discussion and Analysis

The delete-everything amendment to S.F. 669 (Betzold); H.F. 741 (Kahn) creates PERA-General pension coverage for staff of the Minneapolis fire and police relief associations who are not covered by the respective relief association pension plans, and terminates continued coverage for those placed in PERA-General from any prior primary pension plan, if any.

The proposed legislation raises a number of pension and related public policy issues that merit consideration and potential discussion by the Commission, as follows:

1. Need for Change. The issue is why this change is being proposed. MFRA has existed since 1868 and MPRA since 1890. Whatever pension coverage that was provided to the staff of these organizations was deemed acceptable and appropriate since these organizations were founded. What recent event or events create a sufficient need to revise or create PERA-General pension coverage for these relief association staff?

The Commission may wish to inquire about the current pension coverage provided to the individuals who would be covered by these bills. If they were covered by Minnesota public plans, logical plans would be PERA or the Minneapolis Employees Retirement Fund (MERF), but they are not currently covered by PERA and are unlikely to have MERF coverage because that plan closed to new members in 1979. If they had had MERF coverage, there is no justification for moving just a few MERF members to PERA.

2. Potential Additional Requests to Shift Pension Coverage. If the current coverage is of a defined contribution nature, the request to change pension coverage may stem in whole or part from the serious impact recent market declines have had on the value of defined contribution plans. Providing defined benefit pension coverage, through PERA-General, creates some certainty for these individuals, but it creates liability in PERA and shifts all investment risk to the plan and its employing units.

If these bills reflect a desire to shift from defined contribution to defined benefit plan coverage, the Commission may choose to be concerned that passage of these bills may lead to many more requests to revise coverage. There are Individual Retirement Account Plans (IRAP), covering various employees of the State Arts Board, Minnesota Humanities Commission, and Minnesota Historical Society under Minnesota Statutes, Chapter 354D, and many employees of the Minnesota State Colleges and Universities System (MnSCU), under Minnesota Statutes, Chapter 354B. These are defined contribution plans. The individuals covered by those plans have suffered large losses in recent markets. If these individuals were permitted to transfer to the TRA or MSRS defined benefit plans for prospective coverage, this may have a considerable adverse impact on the plan's cost structure because of the age of the entrants (normal cost tends to increase with age), and it shifts all investment risk to the plan contributing units.

3. Mandatory Coverage or Election. The issue is whether the PERA-General coverage should be mandatory as in these bills, or whether the bills should be revised to allow the individuals to elect this coverage. The individuals may wish to hear testimony from individuals who would be covered by these bills, and also from the employing units. A related issue is whether they have received sufficient information and counseling regarding this coverage, to reduce the chance of a later claim that the coverage harmed the individuals. If the likely years of continued employment are few, it is possible that the PERA coverage would have little value.
4. Cost Implications for PERA. The issue is the cost implications for PERA-General. PERA-General's actuarial condition as specified in the July 1, 2008, actuarial report appears below. The individuals who will be commencing PERA-General coverage under these bills are older than typical new hires first entering PERA-General coverage, having already provided a decade or two of service, according to information provided in the MPRA and MFRA financial reports. Older individuals entering a plan tend to increase a plan's normal cost compared to younger entrants. In the case presented by these bill, however, the impact on the fund will be immaterial because so few individuals are involved. The Commission may choose to be concerned, however, if this bill leads to additional requests to revise or transfer pension coverage.

PERA

2008*

<u>Membership</u>		
Active Members		145,238
Service Retirees		54,855
Disabilitants		2,046
Survivors		6,979
Deferred Retirees		42,308
Nonvested Former Members		<u>116,805</u>
Total Membership		368,231
<u>Funded Status</u>		
Accrued Liability		\$17,729,847,000
Current Assets		<u>\$13,048,970,000</u>
Unfunded Accrued Liability		\$4,680,877,000
Funding Ratio	73.60%	
<u>Financing Requirements</u>		
Covered Payroll		\$4,952,751,000
Benefits Payable		\$824,372,000
Normal Cost	7.74%	\$383,111,000
Administrative Expenses	<u>0.19%</u>	<u>\$9,410,000</u>
Normal Cost & Expense	7.93%	\$392,521,000
Normal Cost & Expense	7.93%	\$392,521,000
Amortization	<u>6.29%</u>	<u>\$311,528,000</u>
Total Requirements	14.22%	\$704,049,000
Employee Contributions	6.00%	\$297,220,000
Employer Contributions	6.63%	\$328,211,000
Employer Add'l Cont.	0.00%	\$0
Direct State Funding	0.00%	\$0
Other Govt. Funding	0.00%	\$0
Administrative Assessment	<u>0.00%</u>	<u>\$0</u>
Total Contributions	12.63%	\$625,431,000
Total Requirements	14.22%	\$704,049,000
Total Contributions	<u>12.63%</u>	<u>\$625,431,000</u>
Deficiency (Surplus)	1.59%	\$78,618,000

5. Purchases of Service Credit. The question is whether the bills should be revised to allow purchases of service credit at full actuarial value for prior periods of relief association employment. These individuals have provided many years of service to these relief associations, and are likely to want, either now or in the near future, to purchase service credit in PERA-General for some or all of the past service. There is risk to PERA if the Commission and Legislature authorize any service credit purchase, even if they are intended to be a full actuarial value purchase. A full actuarial value service credit purchase, which has become the Commission's standard approach when service credit purchases are permitted, does not provide a subsidy to the purchaser *if the pension fund earns a consistent 8.5 percent annual return* from the date the individual makes the purchase until the date of the individual's death. In the present investment market, there is considerable chance that the fund will be unable to achieve an 8.5 percent return. A sizable unintended subsidy may occur.
6. Local Approval. The issue is whether this act should have a local approval clause. Because the individuals covered by these bills are relief association employees, the employer contribution requirements to PERA-General will be a relief association expense. The City of Minneapolis is responsible for funding these relief associations, including their administrative expenses, although in these two relief associations administrative expenses are amortized rather than treated as an immediate expense.

Amendments for Consideration

The following amendments are drawn to delete-everything amendment S0669-1A.

- Amendment S0669-2A adds a local approval clause.
- Amendment S0669-3A is an alternative to Amendment S0669-2A and can be used if the Commission does not support a local approval clause but does want to revise the effective date section to specify an effective date other than the first day of the first full pay period after final enactment. The Commission would need to put a date in the blank.

- Amendment S0669-4A could be used to allow an election of PERA-General coverage rather than having that coverage be mandatory. Individuals would be given three months to make an irrevocable election. If an individual does not elect PERA-General or fails to make an election, present coverage continues.
- Amendment S0669-5A would permit full actuarial value purchases of service credit in PERA-General for all or part of prior relief association employment.

Attachment A

Background Information on the Minneapolis Firefighters Relief Association

- a. MFRA Establishment and Operation. The Minneapolis Firefighters Relief Association (MRFA) was established as an organization in 1868, initially to provide relief to disabled firefighters and to their families, when the Minneapolis Firefighters was a volunteer fire department, and was incorporated under Minnesota law in 1886, after the Minneapolis Fire Department became a paid fire department, in 1879. MFRA began paying service pensions to retiring firefighters in 1897. Membership in the MFRA was closed to new firefighters as of June 15, 1980, when pension coverage for newly hired Minneapolis firefighters shifted to the statewide Public Employees Police and Fire Plan (PERA-P&F). Prior to 2001, the relief association was named the Minneapolis Fire Department Relief Association and changed its name when its governing law was codified as Minnesota Statutes, Chapter 423C.

The MFRA is managed by a governing board of 12 members, of which two are active firefighters, eight are retired firefighters or surviving spouses, and two are appointed representatives of the City of Minneapolis. In addition to maintaining records and determining benefit amounts, the MFRA governing board is the investment authority for the assets of the special (pension) and general (non-pension) funds of the relief association.

In calendar year 2005, MFRA received total contributions of almost \$6.7 million (28.72 percent from the State of Minnesota, 71.10 percent from the City of Minneapolis, and 0.18 percent from the members), received net investment income of \$15.5 million, paid total retirement benefits of almost \$21.1 million, and paid administrative expenses of \$668,000 (28 percent for personnel, 48 percent for professional services, and 23 percent for conferences, communications, office rent, and other items).

- b. Nature of the Benefit Plan; Benefit Coverage. MFRA provides from its special fund a salary-related service pension to firefighters retiring at age 50 or older with at least five years of service, a disability benefit to temporarily or permanently disabled firefighters, a survivor benefit to the surviving family of a deceased active, retired, or disabled firefighter, and a return of contributions to the estate of deceased active, retired, or disabled firefighters on whose behalf no survivor benefit is payable. Pensions and benefits are based on the salary of a first grade firefighter, irrespective of the actual rank of the firefighter. Under Laws 1997, Chapter 233, Article 4, a joint-and-survivor optional annuity form can be elected in lieu of the automatic survivorship coverage otherwise provided by the fund.

Since 1990, the contributions by any member (eight percent of the pay of a first-grade firefighter) who has 25 or more years of service are not deposited in the special fund but into a health insurance account set up for the member. After retirement, in addition to the pension benefit paid from the association's special fund, the retiree also receives distributions from the health insurance account, which the retiree can use toward healthcare costs or other expenses of the retiree.

When a Minneapolis firefighter retires and begins drawing a service pension from the association's special fund, those benefits are eligible for increases annually through three different post-retirement increase mechanisms, which are:

1. Active Salary-Related Escalator. The first post-retirement adjustment is a standard escalator tied to increases in the salary of a first-grade firefighter. This escalator increases retirement benefits by the same percentage increase as the percentage increase in first-grade firefighter pay negotiated between the City of Minneapolis and the Minneapolis Firefighters Union.
2. 13th Check Adjustment. A second increase provision is based on the investment performance of the special fund of the relief association, and is referred to as the 13th check post-retirement adjustment. The 13th check post-retirement adjustment was enacted in 1989.
3. Additional Post-Retirement Adjustment. A third post-retirement increase mechanism was added to law in 2000. If the funding ratio (percentage of plan pension liabilities covered by plan assets) of the relief association exceeds 110 percent, the association is authorized to distribute a portion of the funding in excess of 110 percent of its liabilities to its benefit recipients.

Additionally, from its general fund, the MFRA provides a \$1,200 lump sum death benefit to the survivors or the estate of a deceased active or former firefighter and a \$102 per year of service lump sum retirement benefit to a retiring firefighter.

- c. Actuarial and Financial Reporting. The MFRA is required to prepare actuarial reporting under Minnesota Statutes, Sections 69.77, 356.215, 356.216, and 423C.15. The relief association is required to make financial reports under Minnesota Statutes, Sections 69.051 and 356.20.

Minnesota Statutes, Section 69.77, initially enacted in 1969 (Laws 1969, Chapter 223), and amended periodically thereafter, requires municipalities to fund their local relief associations on an actuarial basis. The basic provisions of the 1969 Local Police and Salaried Firefighters Relief Associations Financial Guidelines Act, adjusted for the MFRA, are as follows:

1. Each member of a local association is required to contribute at least eight percent of the salary used for calculating retirement benefits, with the contribution to be made by salary deduction.
2. The financial requirements of the associations must be calculated annually based on the most recent actuarial valuation. The financial requirements are to include normal cost and amortization of the unfunded accrued liability by the year 2010 or 15 years from the recognition date of a net new unfunded actuarial accrued liability, whichever is later, but not to exceed the average remaining life expectancy of its remaining members. The minimum obligation of the municipality to be raised by taxes each year is the financial requirements of the association, less member contribution amounts received under the fire state aid program, amounts received under the fire insurance premium surcharge, and amounts received under the relief association amortization aid programs for that year. If MFRA assets exceed 110 percent of the relief association actuarial accrued liability, the city is not obligated to make a normal cost contribution.
3. The levy required to meet the municipality's minimum obligation is outside statutory or charter levy limitations.
4. If a municipality fails to include an amount sufficient to meet the minimum obligation to the association, the relief association has the authority to certify the amount required to the county auditor for inclusion in the municipality's tax levy.
5. Investments of local associations must be in securities which are authorized investments under Minnesota Statutes, Chapter 356A.
6. Local associations are authorized to contract with outside investment advisors and are authorized to certify funds for investment by the State Board of Investment in the Minnesota Supplemental Investment Fund.
7. Actuarial valuations must be filed by the association with the State Auditor, the Legislative Commission on Pensions and Retirement, the Legislative Reference Library, and the municipality.
8. All articles of incorporation or bylaw amendments affecting benefits for a local relief association must be ratified by the municipality prior to becoming effective.
9. The penalty for a violation of the act is to make the transfer of funds received under the various state aid programs or the levying of taxes by the municipality unlawful.

Minnesota Statutes, Sections 356.215 and 356.215, require the preparation of actuarial valuations under the entry age normal cost actuarial method, using specified interest and salary rate actuarial assumptions, and calculating the actuarial requirements based on a specified amortization target date. Minnesota Statutes, Section 423C.15, provides for an adjustment to the city normal cost contribution, suspends city normal cost contributions in certain instances, provides 15-year amortization periods for actuarial losses after 2001, and limits the amortization target date revisions to the end of the average life expectancy of the relief association membership.

Minnesota Statutes, Section 69.051, a portion of the fire and police state aid programs, requires the preparation of a financial report and audit for qualification for fire and police state aid, with the report filed with the State Auditor and with the Legislative Commission on Pensions and Retirement. Minnesota Statutes, Section 356.20, requires annual financial reporting by various Minnesota public pension plans, but grandparents financial reporting under Minnesota Statutes, Section 69.051, by local fire and police relief associations.

Attachment B

Background Information on the Minneapolis Police Relief Association

- a. MPRA Establishment and Operation. The Minneapolis Police Retirement Association (MPRA) was established as an organization in 1890, initially to provide relief to disabled police officers and to the families of deceased police officers. The relief association was incorporated under Minnesota law in 1905. Membership in MPRA was closed to newly employed police officers as of June 15, 1980, when pension coverage for new hires shifted to the statewide Public Employees Police and Fire Plan (PERA-P&F).

The MPRA is managed by a governing board of nine members, of which seven are elected by the relief association membership and two are representatives of the City of Minneapolis. In addition to maintaining records and determining benefit amounts, the MPRA governing board is the investment authority for the assets of the special (pension) funds of the relief association.

In calendar year 2005, MPRA received total contributions of \$31.6 million (79.2 percent from the city and 20.8 percent from the state), received net investment income of \$20.1 million, paid total retirement benefits of \$33.8 million, and paid administrative expenses of \$590,000 (for which the relief association provided no itemization in its annual financial report).

- b. Nature of the Benefit Plan; Benefit Coverage. The MPRA provides from its special fund a salary-related service pension to police officers retiring at age 50 or older with at least five years of service, a disability benefit to temporarily or permanently disabled police officers, a survivor benefit to the surviving family of a deceased active, retired, or disabled police officer, and a return of contributions to the estate of deceased active, retired, or disabled police officers on whose behalf no survivor benefit is payable. Pensions and benefits are based on the salary of a top-grade police officer, irrespective of the actual rank of the police officer, and these pensions and benefits increase after retirement as the salary of a top-grade police officer increases (the “escalator” post-retirement adjustment mechanism) and also increase based on the investment performance of the special fund (the “13th check” post-retirement adjustment). Under Laws 1997, Chapter 233, Article 4, a joint-and-survivor optional annuity form can be elected in lieu of the automatic survivorship coverage otherwise provided by the fund.

Since 1992 (Laws 1992, Chapter 471, Article 1, Section 14), the contributions by any member (eight percent of the pay of a top-grade police officer) who has 25 or more years of service are not deposited in the special fund; but rather, the contribution is deposited in a health insurance account set up for the member. After retirement, in addition to the pension benefit paid from the association’s special fund, the retiree receives distributions from the health insurance account, which the retiree can use toward health care costs or other expenses of the retiree.

When a Minneapolis police officer retires and begins drawing a service pension from the association’s special fund, those benefits are eligible for increases annually through three different post-retirement increase mechanisms. Individually and as a package, these adjustment provisions are poorly designed and can produce increases which bear no relationship to inflation, and can produce erratic changes in the benefits over time. The post-retirement increase mechanisms are:

1. Active Salary-Related Escalator. The first post-retirement adjustment is a standard escalator tied to increases in the salary of a top-grade police officer. This escalator increases retirement benefits by the same percentage increase as the percentage increase in top-grade police officer pay negotiated between the city and the Minneapolis Police Federation.
2. 13th Check Adjustment. A second increase provision is based on the investment performance of the special fund of the relief association, and is referred to as the 13th check post-retirement adjustment. The 13th check post-retirement adjustment was enacted in 1989.
3. Additional Post-Retirement Adjustment. A third post-retirement increase mechanism was added to law in 2000 (Laws 2000, Chapter 461, Article 17). If the funding ratio (percentage of plan pension liabilities covered by plan assets) of the relief association exceeds 110 percent, the association is authorized to distribute a portion of the funding in excess of 110 percent of its liabilities to its benefit recipients.

