S.F. 914 (Betzold) **H.F. 1100** (Thissen)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	MERF, PERA-General
Relevant Provisions of Law:	Minnesota Statutes, Chapters 353 and 422A
General Nature of Proposal:	Consolidates MERF into PERA-General on July 1, 2010
Date of Summary:	March 10, 2009

Specific Proposed Change(s)

Provides for the consolidation of MERF into PERA-General on July 1, 2010.

Policy Issues Raised by the Proposed Legislation

1. Actuarial condition of MERF and PERA-General.
2. Potential for MERF benefit default.
3. Urgency for consolidation legislation.
4. Precedent for consolidation.
5. Actuarial impact of a MERF consolidation on PERA-General.
6. Benefit impact on MERF members.
7. Unclear contribution by MERF members.
8. Financial impact of MERF/PERA-General consolidation on MERF-covered employing units.
9. Financial impact of MERF/PERA-General consolidation on the State of Minnesota.
10. Need for local approval for local legislation or general legislation.
11. Transitional provision; handling MERF employees in subsequent employment.

Potential Amendments

Technical Amendment

S0914-2A corrects an incorrect word.

Substantive Amendments

S0914-3A reduces the MERF accrued liability by totally eliminating the special adjustment for differences between the MERF post-retirement adjustment mechanism and the PERA-General post-retirement adjustment mechanism, referred to as "Uniformity Swap."

S0914-4A reduces the MERF accrued liability by partially eliminating the "Uniformity Swap."

S0914-5A extends the MERF state aid beyond 2020 to a to-be-determined future date.

S0914-6A adds a local approval effective date, to be implemented by the City of Minneapolis

S0914-7A revises the provision relating to the future employment of the current MERF employees.

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 LAM

RE: S.F. 914 (Betzold); H.F. 1100 (Thissen): PERA-General; MERF Consolidation

DATE: March 9, 2009

General Summary of S.F. 914 (Betzold); H.F. 1100 (Thissen)

S.F. 914 (Betzold); H.F. 1100 (Thissen) amends portions of Minnesota Statutes, Chapters 6, 13D, 43A, 69, 126C, 256D, 352, 353, 354A, 356, 422A, 473, and 480, and provides for the consolidation of the Minneapolis Employees Retirement Fund (MERF) into the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) on July 1, 2010.

Specifically, the proposed legislation provides for the following:

A. Consolidation Initiation. The MERF/PERA-General consolidation would be initiated by legislation, without any formal initiation action required of MERF, the City of Minneapolis, the MERF Association, or PERA. (Section 35)

B. Consolidation Approval Procedures. The consolidation would be implemented on July 1, 2010. (Section 35, Subdivision 7)

C. Funding Upon and Following the Consolidation. Legal title to all current assets of MERF would transfer to PERA/State Board of Investment on the effective date of the consolidation, with the beneficial title to the assets remaining in the MERF members. The City of Minneapolis would continue annually to make its contributions for MERF members to PERA set at the Fiscal Year 2008 dollar amount level until 2020. Additionally, the City of Minneapolis and other MERF-covered employing units would make an additional one-time contribution sufficient to bring the MERF funding ratio, determined at the market value of assets, up to the June 30, 2009, PERA-General funding ratio, determined at the market value of assets and payable either in a lump sum or in annual installments, with interest at 8.5 percent, for ten years. State aids currently payable to MERF would become payable to PERA-General until 2020, the PERA-General amortization target date. If PERA-General becomes fully funded before June 30, 2031, the state aids related to the former MERF and the Minneapolis ongoing annual regular contribution end as of the January 1 next following the full funded date. (Sections 21; 35, Subdivisions 4 and 5; and 57)

D. Disposition of MERF Tangible Assets and Personnel. The MERF office lease should be converted to a month-to-month lease in anticipation of the consolidation and would end on or shortly after the effective date of the consolidation. Any MERF office equipment should be transferred to PERA-General or surplused in the ordinary manner either through the State of Minnesota, the City of Minneapolis, or the Minneapolis Public School District. MERF employees hired before June 30, 2008, would be transferred to subsequent employment by either the City of Minneapolis or Special School District No 1 without loss of salary or benefits for a yet-to-be specified period, then would be given a civil service employment preference comparable to a veteran's preference for municipal or school district employment in a position determined appropriate based on the employee's education and experience by the normal Human Resources process of the governmental entity. (Sections 35, Subdivision 3; and 63)

E. Consolidation Transfers. MERF assets have already been shifted to the Minnesota Supplemental Investment Fund, operated by the State Board of Investment. As of June 30, 2009, the MERF Board would no longer have any investment authority over the MERF assets with the State Board of Investment and the State Board of Investment would then either continue the investment of former MERF assets in the Minnesota Supplemental Investment Fund or would transfer the former MERF assets to PERA's participation in the Minnesota Combined Investment Funds. MERF's membership and business records would be transferred to PERA as of July 1, 2010. After consolidation, retirement benefit payments to benefit recipients of the former MERF would become the responsibility of PERA. A successor-in-interest provision substitutes PERA for MERF in all legal obligations or for potential causes of action other than instances where MERF fiduciaries were not acting in good faith. (Section 35, Subdivision 4)

F. Benefit Plan Conversion. Current MERF active members would be covered by the current benefit provisions of Minnesota Statutes 2008, Chapter 422A, administered by PERA, except for post-retirement adjustments, which would be an automatic 2.5 percent increase annually, and upon retirement, the initial annuity would be adjusted to that amount which, with a 2.5 percent post-retirement adjustment, would have the same actuarial present value as the pre-adjustment MERF annuity with the MERF Retirement Benefit Fund adjustment (i.e., Consumer Price Index-based increases up to 3.5 percent annually). Service credited by MERF for current actives before consolidation would be credited by PERA-General as reported by MERF. The current benefit and related provisions of Minnesota Statutes, Chapter 422A, would be repealed effective upon the consolidation. MERF retirees initially would receive their current benefit amounts adjusted for an additional annuity amount that has the same actuarial present value as the difference between an automatic 2.5 percent annual post-retirement adjustment and an automatic post-retirement adjustment based on CPI increases up to 3.5 percent and then would receive annual automatic 2.5 percent post-retirement adjustments. (Sections 22 to 34; and 35, Subdivision 5)

G. Conforming Changes. Crossreferences to MERF and statutory citations to MERF or MERF-related provisions are eliminated and most current MERF provisions are repealed. (Sections 1 to 20; 36 to 56; 58 to 62; and 64 to 66)

Section-By-Section Summary

A section-by-section summary of S.F. 914 (Betzold); H.F. 1100 (Thissen) is attached.

Relevant Background Information

Background information relating to the Minneapolis Employees Retirement Fund (MERF) is set forth in several attachments, as follows:

- Attachment A, background information on MERF, generally.
- Attachment B, funding problems of MERF.
- Attachment C, actuarial valuation data for MERF, 1943-2008.
- Attachment D, state aid to MERF.
- Attachment E, MERF post-retirement adjustments.

Technical Amendment

Amendment S0914-2A is a technical amendment, substituting "employer" for "employee" in a PERA-General law provision relating to employer contributions.

Analysis and Discussion

S.F. 914 (Betzold); H.F. 1100 (Thissen) provides for the consolidation of the Minneapolis Employees Retirement Fund (MERF) into the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), fully effective July 1, 2010.

S.F. 914 (Betzold); H.F. 1100 (Thissen) raises a number of pension and related public policy issues for Commission consideration and potential discussion, as follows:

1. Actuarial Condition of MERF and PERA-General. The policy issue is the actuarial condition of the two retirement plans involved in the proposed pension plan consolidation. As of July 1, 2008, the actuarial valuation results of the two retirement plans as calculated by their respective actuaries, Gabriel Roeder Smith & Company for MERF and Mercer for PERA-General, were as follows:

	MERF 2008		PERA-General 2008	
Membership				
Active Members		211		145,238
Service Retirees		3,577		54,855
Disabilitants		154		2,046
Survivors		915		6,979
Deferred Retirees		134		42,308
Nonvested Former Members		0		116,805
Total Membership		4,991		368,231
Funded Status				
Accrued Liability		$1,576,854,841		$17,729,847,000
Current Assets		$1,214,305,152		$13,048,970,000
Unfunded Accrued Liability		$362,549,689		$4,680,877,000
Funding Ratio	77.01%		73.60%	
Financing Requirements				
Covered Payroll		$12,697,639		$4,952,751,000
Benefits Payable		$148,221,483		$824,372,000
Normal Cost	12.18%	$1,546,554	7.74%	$383,111,000
Administrative Expenses	5.66%	$718,074	0.19%	$9,410,000
Normal Cost & Expense	17.84%	$2,264,628	7.93%	$392,521,000
Normal Cost & Expense	17.84%	$2,264,628	7.93%	$392,521,000
Amortization	356.47%	$45,263,846	6.29%	$311,528,000
Total Requirements	374.32%	$47,528,474	14.22%	$704,049,000

Employee Contributions	9.75%	$1,238,020	6.00%	$297,220,000
Employer Contributions	47.99%	$6,093,597	6.63%	$328,211,000
Employer Add'l Cont.	2.72%	$345,011	0.00%	$0
Direct State Funding	70.88%	$9,000,000	0.00%	$0
Other Govt. Funding	0.00%	$0	0.00%	$0
Administrative Assessment	0.00%	$0	0.00%	$0
Total Contributions	131.34%	$16,676,628	12.63%	$625,431,000
Total Requirements	374.32%	$47,528,474	14.22%	$704,049,000
Total Contributions	131.34%	$16,676,628	12.63%	$625,431,000
Deficiency (Surplus)	242.98%	$30,851,846	1.59%	$78,618,000
Amortization Target Date	2020		2031	

Actuarial Assumptions

	MERF	PERA-General
Mortality Rates:	Pre-Retirement Average of male and female rates of 1986 Projected Experience Table with a 1-year age setback.	Pre-Retirement • 1983 Group Annuity Mortality for males set back eight years. • 1983 Group Annuity Mortality for females set back seven years.
	Post-Retirement Average of male and female rates of 1986 Projected Experience Table with a 1-year age setback.	Post-Retirement • 1983 Group Annuity Mortality for males set back one year. • 1983 Group Annuity Mortality for females set back one year.
	Disabled Average of male and female rates of 1986 Projected Experience Table with a 1-year age setback.	Disabled 1965 RRB rates through age 54. For ages 55 to 64, graded rates between 1965 RRB rates and the Healthy Post-Retirement Mortality. For ages 65 and later, the Healthy Post-Retirement Mortality.
Interest:	Pre-Retirement 6.0% per annum.	Pre-Retirement 8.5% compounded annually.
	Post-Retirement 5.0% per annum.	Post-Retirement 6.0% compounded annually.
Salary Increases:	Total reported pay for prior calendar year increased 1.98% (half year of 4.00%, compounded) to prior fiscal year and 4.00% annually for each future year.	Reported salary for prior fiscal year, with new hires annualized, increased to current fiscal year and annually for each future year according to the ultimate rates in the rate table. During a 5-year select period, 0.60% x (5-T) where T is completed years of service is added to the ultimate rate.
Retirement Rates:	100% at age 61.	Graded rates beginning at age 55 as shown in rate table. Members who have attained the highest assumed retirement age are assumed to retire in one year.

	Retirement	
Age	Rule of 90 Eligible	Other
55	30%	7%
56	25%	7%
57	25%	7%
58	25%	7%
59	25%	9%
60	25%	9%
61	30%	15%
62	40%	22%
63	30%	20%
64	30%	20%
65	40%	40%
66	25%	25%
67	25%	25%
68	25%	25%
69	25%	25%
70	25%	25%
71	100%	100%

Withdrawal Rates:	Age	Rate (%)	Age	Rate (%) Male	Rate (%) Female
	20	21.00	20	8.40	8.40
	25	11.00	25	6.90	6.90
	30	5.00	30	5.40	5.40
	35	1.50	35	3.90	4.20
	40	1.00	40	3.00	3.50
	45	1.00	45	2.50	3.00
	50	1.00	50	2.00	2.50
	55	1.00	55	0.00	0.00
	60	1.00	60	0.00	0.00
	65	0	65	0.00	0.00
	70	0	70	0.00	0.00

Disability Rates:	Age	Rate (%)	Rate (%) Male	Rate (%) Female
	20	0.21	0.01	0.01
	25	0.21	0.01	0.01
	30	0.23	0.02	0.02
	35	0.30	0.05	0.04
	40	0.41	0.09	0.06
	45	0.61	0.14	0.09
	50	0.93	0.23	0.16
	55	1.60	0.49	0.26
	60	0	0.82	0. 46
	65	0	0.00	0.00
	70	0	0.00	0.00

Administrative Expenses:	Prior year administrative expenses (excluding investment expenses) increased by 4.00% expressed as a percentage of projected annual payroll.	Prior year administrative expenses expressed as a percentage of prior year payroll.
Allowance for Combined Service Annuity:	Liability for active members are increased by 0.2% and liabilities for former members (not in payment status) are increased by 30.0% to account for the effect of some participants having eligibility for a Combined Service Annuity.	Liabilities for active members are increased by 0.80% and liabilities for former members are increased by 60.00% to account for the effect of some participants having eligibility for a Combined Service Annuity.
Return of Contributions:	All members withdrawing after becoming eligible for a deferred benefit were assumed to take the larger of their contributions accumulated with interest or the value of their deferred benefit.	All employees withdrawing after becoming eligible for a deferred benefit are assumed to take the larger of their contributions accumulated with interest or the value of their deferred benefit.
Percent Married:	67% of active members are assumed to be married.	85% of male members and 65% of female members are assumed to be married.
Age of Spouse:	Females are assumed to be three years younger than males.	Females are assumed to be four years younger than males.

2. Potential for MERF Benefit Default. The policy issue is how imminent might a default in the payment of benefits to MERF retirees and other benefit recipients be. Although a consolidation of a retirement plan into another retirement plan can occur for a variety of reasons, avoidance of a default in the payment of retirement annuities and benefit is a very high priority potential rationale that could underlie a consolidation. If MERF is likely to default in the payment of retirement annuities and benefits, the likelihood of a default would be pertinent. As the Commission staff assesses the financial condition of MERF, following recent investment market declines, with an active membership that either is entitled to retire this year or next year in its entirety, and with a post-retirement adjustment mechanism that converts all investment gains into benefit increases when the retiree reserves are less than the present value of future benefits for retirees, the retirement plan will suffer a default within a decade, probably in seven or eight years. In an undated assessment prepared for MERF by a consultant, Ennis Knupp, probably made shortly after June 30, 2008, the probability that all MERF assets are depleted and the retirement plan suffers a default grows to more than 50 percent in 2017 and to 100 percent after 2022.

3. Urgency for Consolidation Legislation. The policy issue is why proposed legislation providing for a consolidation of MERF into PERA-General is urgent for enactment in 2009 when the actual

consolidation under the legislation will not occur in 2009. Section 66 of S.F. 914 (Betzold); H.F. 1100 (Thissen) makes the section setting forth the consolidation timeline (Section 35) effective July 1, 2009, and makes the balance of the proposed legislation effective July 1, 2010, the designated date for the consolidation. It would be appropriate to ask the proponents of the proposed legislation to address the issue of the urgency for proposed legislation that delays the actual consolidation for one year and explain why the proposed legislation could not be processed in 2010 instead.

4. Precedent for Consolidation. The policy issue is whether or not there is a precedent for the consolidation of MERF into PERA-General and whether or not a MERF/PERA-General consolidation would become an inappropriate precedent for the future. The consolidation proposed in S.F. 914 (Betzold); H.F. 1100 (Thissen) would be a total retirement fund consolidation, involving the administration, investment functions, retirement fund, and most of the benefit plan, and resulting in the smaller retirement plan becoming part of the cost-sharing larger retirement plan. In this regard, the MERF/PERA-General consolidation has ten prior precedents, which were:

	Consolidating Plan(s)	Successor Plan	Year
1.	State Police Retirement Plan	State Patrol Retirement Plan	1969
2.	Various Judicial Retirement Plans	Uniform Judges Retirement Plan	1973/1978
3.	St. Paul Bureau of Health	PERA-General	1973
4.	Fridley Paid Firefighters Plan	Public Employees Police and Fire Plan (PERA-P&F)	1973
5.	Cloquet Firefighters Relief Association	PERA-P&F	1973
6.	Metro Council Transit Plan	General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General)	1978
7.	University of Minnesota Police Plan	PERA-P&F	1978
8.	Moorhead Police & Fire Relief Association	PERA-P&F	1985
9.	44 Local Police & Fire Consolidation Accounts in PERA	PERA-P&F	1999
10.	Minneapolis Teachers Retirement Fund Association (MTRFA)	Teachers Retirement Association (TRA)	2006

In consolidations that have occurred since 1978, other than the Minneapolis Teachers Retirement Fund Association consolidation, the consolidation has required additional contributions or assets be contributed by the affected employer or employers if the retirement plan was more underfunded than the recipient retirement plan. If the consolidation to be recommended by the Commission follows the usual post-1978 consolidation model, as the proposed legislation does, the MERF/PERA-General consolidation would not constitute an inappropriate precedent for future consolidation proposed legislation.

5. Actuarial Impact of a MERF Consolidation on PERA-General. The policy issue is the nature and magnitude of the actuarial impact of the consolidation of MERF into PERA-General. To ascertain the impact, the consulting actuary retained by MERF, Gabriel Roeder Smith & Company, has valued the MERF membership under the PERA-General assumptions, assuming eligibility for the current MERF post-retirement adjustment mechanism (3.5 percent maximum on the Consumer Price Index-related portion), assuming all current MERF active members retire immediately, and assuming the actuarial value of MERF assets of $850,000,000. Based on that estimate (Exhibit A: Scenario 3, in attached actuarial work), the effect of the MERF consolidation into PERA-General would be as follows:

	PERA-General 7/1/2008	MERF Liabilities and Assets 7/1/2008	PERA-General Resulting Condition 7/1/2008
Membership			
Active Members	145,238	211	145,449
Service Retirees	54,855	3,577	58,432
Disabilitants	2,046	154	2,200
Survivors	6,979	915	10,094
Deferred Retirees	42,308	134	42,442
Nonvested Former Members	116,805	0	116,805
Total Membership	368,231	4,991	373,222
Funded Status			
Accrued Liability	$17,729,847,000	$1,665,526,213	$19,395,373,213
Current Assets	$13,048,970,000	$850,000,000	$13,898,970,000
Unfunded Accrued Liability	$4,680,877,000	$815,526,213	$5,496,403,213
Funding Ratio	73.60%	51.03%	71.66%

Financing Requirements					
Covered Payroll		$4,952,751,000	$12,697,639		$4,965,448,639
Benefits Payable		$824,372,000	$148,221,483		$972,593,483
Normal Cost	7.74%	$383,111,000	$0	7.72%	$383,111,000
Administrative Expenses	0.19%	$9,410,000	$925,074	0.21%	$10,335,074
Normal Cost & Expense	7.93%	$392,521,000	$925,074	7.93%	$393,446,074
Normal Cost & Expense	7.93%	$392,521,000	$925,074	7.93%	$393,446,074
Amortization	6.29%	$311,528,000	$82,236,300	7.93%	$393,764,300
Total Requirements	14.22%	$704,049,000	$83,161,374	15.86%	$787,210,374
Employee Contributions	6.00%	$297,220,000	$1,218,973		
Employer Contributions	6.63%	$328,211,000	$1,218,973		
Employer Add'l Cont.	0.00%	$0	*		
Direct State Funding	0.00%	$0	$9,000,000		
Other Govt. Funding	0.00%	$0	*		
Administrative Assessment	0.00%	$0	--		
Total Contributions	12.63%	$625,431,000	*		
Total Requirements	14.22%	$704,049,000			
Total Contributions	12.63%	$625,431,000			
Deficiency (Surplus)	1.59%	$78,618,000			
Amortization Target Date	2031				
Actuary	Mercer				

* The employer additional contribution amount and the special employer contribution for MERF-covered employers remain to be specified under S.F. 914 (Betzold); H.F. 1100 (Thissen).

6. Benefit Impact on MERF Members. The policy issue is the impact of the proposed consolidation of MERF into PERA-General will have on MERF active and retired members. As drafted, S.F. 914 (Betzold); H.F. 1100 (Thissen) replicates the MERF retirement annuity, disability benefit, and survivor benefit provision as alternative benefits for former MERF active members transferred to PERA-General coverage, and provides an annuity or benefit adjustment for all former MERF active and retired members to account, on an actuarial present value basis, for the change between the MERF post-retirement adjustment mechanism (Consumer Price Index-based adjustment with 3.5 percent maximum plus investment-based adjustment if the MERF Retirement Benefit Fund is more than fully funded) and the PERA-General post-retirement adjustment mechanism (flat 2.5 percent adjustment as of January 2010). Thus, under the proposed legislation, MERF active and retired members would have no benefit decrease as a result of the proposed consolidation and would gain security of those benefits by its incorporation into PERA-General.

7. Unclear Contribution by MERF Members. The policy issue is the extent to which MERF active and retired members are making any financial contribution in salvaging the financial condition of MERF by consolidating it into PERA-General and whether the MERF membership has any legal or policy obligation to make such a financial contribution. Under the proposed legislation, the MERF membership will have their current benefit levels remain intact after consolidation, including a special adjustment for the actuarial value of a greater post-retirement adjustment maximum under MERF compared to the limit applicable to them under PERA-General, and will gain benefit security through the consolidation, without participating in making any benefit change to reduce the current MERF liabilities or providing any amount to increase the current MERF assets. If the MERF membership were to be asked to provide some financial contribution to the consolidation, the most logical vehicle to do so would be to reduce the amount of or to eliminate the special post-retirement mechanism-related adjustment provided in S.F. 914 (Betzold); H.F. 1100 (Thissen) (see sections 24, 26, 30, and 35, subdivision 5). Employees and retirees covered by MERF have no obligation to participate in the financing of a consolidation into PERA under any legal theory that the Commission staff can identify. MERF members have a legal entitlement to their current levels of benefits and to future post-retirement adjustments from the MERF Retirement Benefit Fund. Although no Minnesota court has clearly adopted the legal theory or principal, in some other states with no latitude or limited latitude to modify public employee pension benefit levels, pension plans facing financial or actuarial distress or calamity are permitted to make necessary benefit adjustments to bolster the financial condition of the retirement plan. If Minnesota courts do not adopt a similar theory or principle, if MERF continues as a freestanding retirement plan, and if MERF defaults in the next decade or so, because MERF is a self-insured vehicle for covered employers to provide retirement coverage, MERF retirees would become unsecured, but priority, creditors of the various employers covered by MERF, with any creditor remedies available at that time, including attaching employer assets and garnishing employer financial accounts. If MERF members wish to avoid that insecurity through a consolidation with