S.F. 1191 (Rosen) **H.F. 1383** (Gunther)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	Fairmont Police Relief Association
Relevant Provisions of Law:	Minnesota Statutes, 69.77, Subd. 4
General Nature of Proposal:	Extends the Fairmont Police Relief Association amortization target date from 2010 to 2020
Date of Summary:	March 10, 2009

Specific Proposed Changes

- Changes the Fairmont Police Relief Association required full funding date from 2010 to 2020.

Policy Issues Raised by the Proposed Legislation

1. Sufficient need for the change.
2. Implication for relief association 13^{th} check.
3. Appropriate full funding date.
4. Lack of local approval provision.
5. Proper scope of the proposal.
6. Additional amortization aid program issue.

Potential Amendments

Technical Amendment

S1191-1A is a technical clarification requested by the Minneapolis Firefighters Relief Association (MFRA) actuary to clarify that the operative amortization date for MFRA is specified in Minnesota Statutes, Section 423C.15, Subdivision 3

Substantive Amendments

S1191-2A allows the Commission to set specify an amortization date for the Fairmont Police Relief Association, by filling in the blank in the amendment, instead of the proposed December 31, 2020, date found in the bill.

S1191-3A provides a local approval clause.

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: S.F. 1191 (Rosen); H.F. 1383 (Gunther): Fairmont Police Relief Association; Extending the Amortization Target Date From 2010 to 2020

DATE: March 10, 2009

Summary of S.F. 1191 (Rosen); H.F. 1383 (Gunther)

S.F. 1191 (Rosen); H.F. 1383 (Gunther) amends Minnesota Statutes, Section 69.77, Subdivision 4, to extend the Fairmont Police Relief Association required full funding date from 2010 to 2020.

Background Information

A. Fairmont Police Relief Association. Background information on the Fairmont Police Relief Association is found in Attachment A.

B. Police State Aids-Overview. A brief overview on the four types of police state aid is found in Attachment B.

Discussion and Analysis

S.F. 1191 (Rosen); H.F. 1383 (Gunther) extends the Fairmont Police Relief Association required full funding date from 2010 to 2020.

The requested change reflects an effort to provide the City of Fairmont relief from the contribution requirements for the Fairmont Police Relief Association. Typically, the contribution requirement for a relief association is the sum of normal cost, expenses, and the amortization requirement needed to pay off the unfunded by the full funding date. Because the entire membership of this plan is retired, this plan has no normal cost, leaving a contribution requirement composed of expenses plus the amortization requirement. Fairmont is responsible for paying any portion of that requirement not covered by other sources. The usual other sources are employee contributions and the various state aids. In the case of Fairmont, there are no active members in the relief association so there are no employee contributions, and the city receives no aid, at least not specifically for the relief association. The city does receive police state aid based the city's active police officers covered by the Public Employees Police and Fire Retirement Plan (PERA-P&F). If amounts it receives due to those active police officers is in excess of the employer contributions to PERA-P&F, any leftover amount could be used to assist with the employer's financial obligations to the Fairmont Police Relief Association.

According to the most recent actuarial valuation (December 31, 2007), the plan was 89 percent funded and had unfunded liabilities of $884,281. The total required contribution for the year to cover expenses and the amortization contribution to retire the unfunded obligation by the full funding date (2010) was $346,393.

Below is an actuarial presentation for the Fairmont Police Relief Association using information from the plan's actuarial reports. Prior to 2003, in providing this presentation it was assumed that the total contributions made was equal to the total requirements. Since 2003, Commission staff has used the employer contribution made, as indicated by the employer contribution shown in the Statement of Change in Plan Net Assets or the Schedule of Employer Contributions, both found in the plan's actuarial report. When these amounts are used the total contributions do not equal the total requirements, suggesting deficiencies or surpluses. The results suggest that in 2003 through 2006 the city did not contribute enough to cover the contribution requirements. If the actuarial presentation is an accurate reflection, part of the problem facing the city is self imposed. If the city had stayed on schedule, the task of fully funding the plan in 2010 would be less formidable.

Fairmont Police Relief Association
Actuarial Valuation Results

	2007	2006	2005	2004	2003	2002	2001	2000	1999
Membership									
Active Members	0	0	0	0	0	0	0	0	0
Service Retirees	10	10	10	10	10	11	11	12	12
Disabilitants	0	0	0	0	0	0	0	0	0
Survivors	4	4	4	4	4	3	3	3	4
Deferred Retirees	0	0	0	0	0	0	0	0	0
Nonvested Former Members	0	0	0	0	0	0	0	0	0
Total Membership	14	14	14	14	14	14	14	15	16
Funded Status									
Accrued Liability	$7,932,388	$7,882,160	$7,733,819	$7,909,793	$7,560,132	$7,830,552	$7,573,377	$7,245,193	$7,174,075
Current Assets	$7,048,107	$6,709,629	$6,480,110	$6,437,777	$6,393,853	$6,431,374	$6,960,424	$7,169,851	$7,113,030
Unfunded Accrued Liability	$884,281	$1,172,531	$1,253,709	$1,472,016	$1,166,279	$1,399,178	$612,953	$75,342	$61,045
Funding Ratio	88.85%	85.12%	83.79%	81.39%	84.57%	82.10%	91.91%	98.96%	99.15%
Financing Requirements									
Covered Payroll	$0	$0	$0	$0	$0	$0	$0	$0	$0
Benefits Payable	$579,723	$555,661	$518,434	$535,864	$494,954	$454,858	$462,784	$456,130	$450,528
Normal Cost	$0	$0	$0	$0	$0	$0	$0	$0	$0
Administrative Expenses	23,683	23,189	28,143	21,366	$21,316	$20,272	$19,597	$19,231	$19,460
Normal Cost & Expense	$23,683	$23,189	$28,143	$21,366	$21,316	$20,272	$19,597	$19,231	$19,460
Normal Cost & Expense	$23,683	$23,189	$28,143	$21,366	$21,316	$20,272	$19,597	$19,231	$19,460
Amortization	$322,710	$328,444	$336,725	$323,808	$218,835	$230,291	$90,321	$10,095	$7,529
Total Requirements	$346,393	$351,633	$364,868	$345,174	$240,151	$250,563	$109,918	$29,326	$26,989
Employee Contributions	$0	$0	$0	$0	$0	$0	$0	$0	$0
Employer Contributions	$365,853	$336,725	$323,808	$218,835	$230,291	$250,563	$109,918	$29,326	$26,989
Employer Add'l Cont.	$0	$0	$0	$0	$0	$0	$0	$0	$0
Direct State Funding	$0	$0	$0	$0	$0	$0	$0	$0	$0
Other Govt. Funding	$0	$0	$0	$0	$0	$0	$0	$0	$0
Administrative Assessment	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total Contributions	$365,853	$336,725	$323,808	$218,835	$230,291	$250,563	$109,918	$29,326	$26,989
Total Requirements	$346,393	$351,633	$364,868	$345,174	$240,151	$250,563	$109,918	$29,326	$26,989
Total Contributions	$365,853	$336,725	$323,808	$218,835	$230,291	$250,563	$109,918	$29,326	$26,989
Deficiency (Surplus)	($19,460)	$14,908	$41,060	$126,339	$9,860	($0)	$0	$0	$0
Amortization Target Date	2010	2010	2010	2010	2010	2010	2010	2010	2010

Another likely contributor is recent turmoil in the investment markets, although that effect is too recent to show up in the above actuarial presentations. If the pension fund was exposed to the equity markets or mortgage backed securities, it may have suffered considerable asset value losses in 2008 and 2009. That would add directly to the unfunded liability, adding to the challenge of retiring the unfunded liability by the end of 2010.

The bill raises the following pension and related public policy issues:

1. Sufficient Need for Change. The issue is whether there is sufficient need for the proposed change, and whether equity supports the city's request. The actuarial presentations suggest that the city in some recent years has not met its funding requirement. If that is the case, then some of the current difficulty is self-imposed. The Commission may wish to determine through testimony the city's position on the question of whether it made proper contributions. The Commission may also wish to establish through testimony or other means the size of amortization payments the city would have to pay in 2009 and 2010 to fully retire the unfunded amount. Presumably, the city has information more recent than that available in the actuarial valuation report. Presumably, the city or relief association also has information on the expected yearly payments if the full funding date is extended to 2020.

2. Implication for Relief Association 13th Check. An issue is the implication of this proposal on the relief association 13th check provision. One of the requirements under law applicable to this plan is that the plan must be at least 102 percent funded to pay a 13th check. Delaying the full funding date to 2020 is likely to delay the date that a 13th check could be paid for at least another decade, unless favorable investment markets help to retire unfunded liability earlier than expected. Given the ages of the retirees and survivors in this plan, many may never receive a 13th check. If none of the benefit recipients have died since the last actuarial valuation, at the current time the average age of the ten Fairmont Police Relief Association service retirees is about age70, while the average age of the four surviving spouses would be 77. Thus the Commission may choose to be aware that relief association retirees and survivors may oppose this proposal. On the other hand, from a policy standpoint delaying the possibility of a 13th check may actually be desirable. The Commission's policy statement states (in Principle II.C.8) that "Retirement benefits should be increased during the time period of retirement of offset the impact of inflation over time in order to maintain a retirement benefit that was adequate at

the time of retirement." The preferred form of adjustment is an increase which matches inflation. A 13th check is not consistent with this concept. A 13th check is a lump sum windfall with no relation to inflation. This plan's retirement and survivor benefits are indexed to changes in the top grade patrol office salary. Given the changes in that salary, that mechanism should be more than sufficient to keep retirees whole. Adding a 13th check on top of that indexing had little clear public purpose.

3. Appropriate Full Funding Date. If the Commission concludes that a change in the Fairmont Police Relief Association full funding date is appropriate, an issue is whether the best change is a change from 2010 to 2020, as proposed, or whether some other date is more suitable. In 2005, the Legislature changed the Minneapolis Police Relief Association full funding date from 2010 to 2020. The proposed change for Fairmont would match the full funding date used for the Minneapolis police relief association. In deciding on a year to specify as the full funding date for the relief association, the Commission may wish to consider the age of the benefit recipients to avoid too extensive an intergenerational transfer. In 2020, the average age of this plan's service retirees will be about age 80, while the survivors will be about age 87. Corresponding age information for the Minneapolis Police Relief Association membership is not generally available in that plan's actuarial report. At the current time, the average age of the dozen or so remaining active members in the Minneapolis Police Relief Association is about age 60, but no information is presented on the age of that plan's retirees.

4. Lack of Local Approval Provision. The question is whether a local approval clause should added to the bill, rather than having the effective date be the day following final enactment. While extending the amortization date does lower the city's contribution requirement in the short run, the city will need to make contributions for many more years and over the longer term the city is likely to pay more interest than if the relief association is brought to full funding in 2010. A local approval clause may also provide an opportunity for the city and the relief association members to decide this amortization date issue at the local level.

5. Proper Scope of the Proposal. The issue is the proper scope of the proposal. The issues facing Fairmont and the Fairmont Police Relief Association may be little different than those facing other cities. Rather than taking action on this bill, the Commission may wish to consider addressing the issue more globally. The Commission may wish to consider that any action taken on this proposal may establish a model for other requests that may come to the Legislature this year or next.

6. Additional Amortization Aid Issue. An issue which the Commission may wish to consider longer term, but which is beyond the scope of the current bill, is whether the additional amortization aid program should be revised to include the Fairmont Police Relief Association. If it is included, an additional question is what share of that aid it should receive. The Commission may choose to be aware that including the Fairmont Police Relief Association in that aid program will mean a reduction of aid otherwise available to other organizations which share that aid.

Potential Amendments for Commission Consideration

- Amendment S1191-1A is a technical clarification requested by Mr. Mark Meyer, the actuary for the Minneapolis Firefighters Relief Association. Despite the references to a December 31, 2010, amortization date for the Minneapolis Firefighters Relief Association on page 2, lines 22 and 23, and lines 32 and 33, the operative amortization date for that association is actually specified in Minnesota Statutes, Section 423C.15, Subdivision 3. This amendment makes that clear.

- Amendment S1191-2A allows the Commission to set specify an amortization date for the Fairmont Police Relief Association, by filling in the blank in the amendment, instead of the proposed December 31, 2020, date found in the bill.

- Amendment S1191-3A provides a local approval clause.

Attachment A

Background Information on the Fairmont Police Relief Association

The Fairmont Police Relief Association membership in 2009 consists of ten retirees and four surviving spouses. The last active member retired in 1999.

Regarding benefits provided by the plan, the normal retirement benefit was 50 percent of base pay at age 50 with 20 years of service, plus an additional two percent per year of service up to a maximum of 60 percent of base pay. The survivor benefit was 35 percent of base pay. The service pension and survivor benefit amount escalates over time in dollar terms because both are based on the current base pay of a first class patrolman for the City of Fairmont. As base pay increases over time the service and survivor benefits increase by comparable percentages. According to the plan's most recent actuarial valuation (December 31, 2007, actuarial valuation completed on June 27, 2008), the average retired police officer was receiving $46,444, and the average annual survivor benefit was $28,822.

In 1999 a special law requiring local approval was passed by the Legislature providing an additional benefit for this plan, a "13th check," payable if the funding ratio is at least 102 percent and if the average rate of return for the fund for the most recent five year period exceeds by two percent the average increase in base salary for the same period. If these conditions are met, one percent of the assets of the fund can be divided among the benefit recipients. This relief association has not been fully funded in 1999 or later, so this benefit has never been paid.

According to the association's actuarial reports, the relief association was fully funded in 1997, but subsequently became less than fully funded. Because it did achieve full funding, the association lost eligibility for amortization aid and supplemental amortization aid. The organization was also not allocated any additional amortization aid when that program was reformulated in 1999 and 2000. It receives no police state aid, at least not directly, because that aid is allocated based on the number of active police officers, and there no longer are any active police officers in this plan.

Attachment B

Background Information on Police State Aids – A Brief Overview

Cities and other local units of government receive considerable state aid to help these units of government meet their public pension obligations. There are four different aids specifically for police pension purposes, although not all local police and fire pension plans and consolidation accounts qualify for all four. The four aids are state police aid, amortization aid, supplemental amortization aid, and additional amortization aid. This attachment provides an overview of these four aids.

1. Police State Aid. The police state aid program is the primary police aid program and is funded principally from a portion of the automobile insurance premium taxes collected by the State of Minnesota. The aid is distributed on a per-officer basis, and in recent years has exceeded $6,000 per police officer. Excess police state aid is used to finance the additional amortization aid program. Excess police state aid occurs when the police state aid to a given government unit is in excess of the amount needed to fully cover the employer contribution requirement for that employer's police officers.

   In the last few years, the contribution requirements for PERA-P&F have increased considerably, due in part to increased utilization of disability benefits under that plan and increased life expectancies. In 2006 the employee contribution rate was 10.5 percent of pay, but has been increased to 14.1 percent of pay in 2009 and thereafter. This will increase the dollar amounts needed to meet the PERA P&F employer contribution amounts and will result in less excess aid.

2. Amortization Aid. The local police and paid fire relief association amortization state aid was established in 1980 (Laws 1980, Chapter 607, Article XV, Section 5). In that year local police and salaried firefighter relief associations were closed to new members, with all new hires were redirected to the Public Employees Retirement Association Police and Fire Plan (PERA-P&F). Since the local relief associations would eventually terminate due to closing the plans to new members, there was a need to address funding and bring closure to their actuarial accrued liabilities. The plans were required in 1980 to amortize their unfunded actuarial accrued liabilities by the year 2010. As additional state assistance, the amortization aid program was established. The aid was funded from the state general fund and was designed to cover a portion of the annual amortization requirement, given the unfunded actuarial accrued liabilities that existed as of the 1978 actuarial valuation of the fund. The amortization aid to the relief association equaled the difference between the full amortization requirement on the relief association's 1978 unfunded actuarial accrued liability and the interest only requirement on the same unfunded actuarial accrued liability. The aid was meant to be a fixed amount, leaving local governments responsible for any increases in unfunded actuarial accrued liabilities due to future poor investment returns, high expenses, benefit improvements, mortality losses, or any other cause that acts to increase unfunded actuarial accrued liabilities. The intent was to provide some state assistance while still providing incentives for prudent local management of the assets of the fund.

   The amortization aid program original distributed over $6 million annually, but amounts have declined considerably over time, as various pension funds no longer qualified for the aid. The aid to a given recipient terminates when the pension fund becomes fully funded and may not be resumed. By 2007, the total amortization aid paid to all eligible police pension funds had declined to slightly over $200,000. If a relief association or consolidation account becomes fully funded, amortization aid terminates and may not be restarted.

3. Supplemental Amortization Aid. The supplemental amortization aid program commenced in 1984 as a way to provide some additional aid to organizations which qualify for amortization aid. The total amortization aid for distribution was originally $1 million annually. If an organization loses eligibility for amortization aid, this aid also terminates.

4. Additional Amortization Aid. The additional amortization aid program is funded from the state policy aid program, using half of any excess police state aid. The additional amortization aid program was created in 1995. When it was enacted, for a local police or paid fire relief association to qualify for additional amortization aid the local relief association had to comply with the 1969 Police and Paid Fire Relief Association Financing Guidelines Act, Minnesota Statutes, Section 69.77, and had to have an unfunded actuarial accrued liability in the most recent actuarial valuation report. Additional amortization state aid was allocated in proportion to the relationship that each local police or paid fire relief association or local police or paid fire consolidation account's unfunded actuarial accrued liability bears to the total unfunded actuarial accrued liability of all eligible relief associations or consolidation accounts.

   The eligible organizations for additional amortization aid was revised in 1999 (Laws 1999, Chapter 222, Article 4, Sections 15 through 18) and 2000 (Laws 2000, Chapter 461, Article 9, Section 1). Under these revised procedures, beginning in 2000 64.5 percent of the additional amortization aid was allocated to municipalities with relief associations consolidating with PERA P&F and which had to make additional contributions to PERA because of the relatively low funding condition of the consolidation accounts; 34.2 percent is allocated to Minneapolis to help cover amortization requirements for its two relief associations; and 1.3 percent is allocated to Virginia to help amortize the Virginia Fire Department Relief Association. If there was no unfunded liability in the Minneapolis relief associations or Virginia fire, the aid that would have gone to those organizations is reallocated to the St. Paul Teachers Retirement Fund Association, and to TRA on behalf of the Minneapolis Teachers Retirement Fund Association which consolidated into TRA, and to provide additional financing for the minimum floor volunteer fire aid.

.... moves to amend S.F. No. 1191; H.F. No. 1383, as follows:

Page 2, line 32, delete "and" and insert "amortization date is determined under section 423C.15, subdivisions 3 and 4."

.... moves to amend S.F. No. 1191; H.F. No. 1383, as follows:

Page 2, after line 33, insert "The Fairmont Police Relief Association special fund amortization date is December 31, ..."

Page 2, lines 34 to 35, delete "and the Fairmont Police Relief Association special fund"

Amend the title accordingly

.... moves to amend S.F. No. 1191; H.F. No. 1383, as follows:

Page 3, delete lines 14 to 15 and insert:

"**EFFECTIVE DATE; LOCAL APPROVAL.** This section is effective the day after the Fairmont City Council and the chief clerical officer of the city of Fairmont timely complete their compliance with Minnesota Statutes, section 645.021, subdivisions 2 and 3."

Amend the title accordingly

Senators Rosen and Betzold introduced–

S.F. No. 1191: Referred to the Committee on State and Local Government Operations and Oversight.

A bill for an act

relating to retirement; extending Fairmont Police Relief Association amortization target date from 2010 to 2020; amending Minnesota Statutes 2008, section 69.77, subdivision 4.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. Minnesota Statutes 2008, section 69.77, subdivision 4, is amended to read:

Subd. 4. **Relief association financial requirements; minimum municipal obligation.** (a) The officers of the relief association shall determine the financial requirements of the relief association and minimum obligation of the municipality for the following calendar year in accordance with the requirements of this subdivision. The financial requirements of the relief association and the minimum obligation of the municipality must be determined on or before the submission date established by the municipality under subdivision 5.

(b) The financial requirements of the relief association for the following calendar year must be based on the most recent actuarial valuation or survey of the special fund of the association if more than one fund is maintained by the association, or of the association, if only one fund is maintained, prepared in accordance with sections 356.215, subdivisions 4 to 15, and 356.216, as required under subdivision 10. If an actuarial estimate is prepared by the actuary of the relief association as part of obtaining a modification of the benefit plan of the relief association and the modification is implemented, the actuarial estimate must be used in calculating the subsequent financial requirements of the relief association.

(c) If the relief association has an unfunded actuarial accrued liability as reported in the most recent actuarial valuation or survey, the total of the amounts calculated under clauses (1), (2), and (3), constitute the financial requirements of the relief association for