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Minnesota State Retirement System

http://www.msrs.state.mn.us/

AT A GLANCE

- Established in 1929
- Defined benefit retirement funds managed – 5
- Total defined benefit members – 121,335
- Net defined benefit fund position (net assets held at trust) - $13.39 billion
- Defined contribution retirement funds managed – 4
- Total defined contribution participants – 187,232
- Net defined contribution fund position (net assets held in trust) - $7.08 billion
- Total participating employers – 849
- Fiscal year 2017 administrative and recordkeeping budget - $23.4 million
- Number of employees – 125

Source: MSRS 2015 Comprehensive Annual Financial Report

PURPOSE

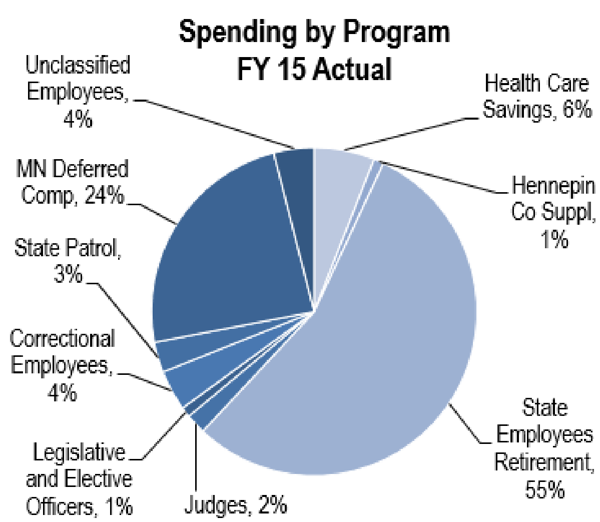
Minnesota State Retirement System's (MSRS) mission is to administer financially secure retirement plans for its members, assure timely benefit payments, be proactive in public pension policies, and provide exemplary customer service through a one-stop shopping source.

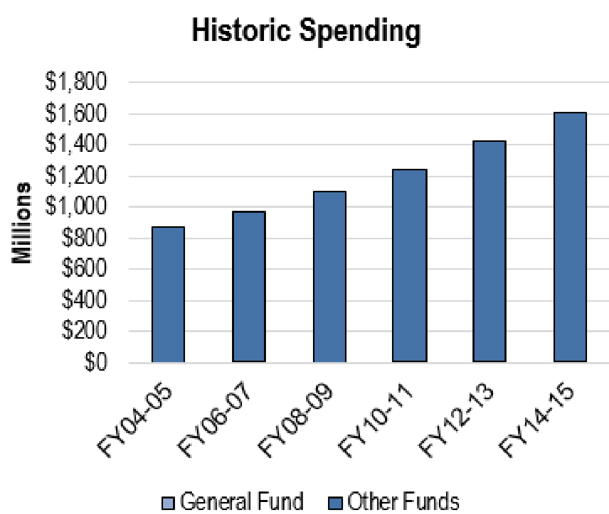
MSRS supports the following statewide outcomes

- A thriving economy that encourages business growth and employment opportunities by allowing retirees to remain self-supportive and purchase goods and services in the local community.
- Minnesotans have optimal health by allowing public employees access to a Health Care Savings Plan.
- Strong and stable families and communities, with over 90% of MSRS retirees living in Minnesota.
- Efficient and accountable government services.

An 11-member board of directors governs MSRS' administration. The MSRS Board has statutory authority to appoint an Executive Director to manage the system.

BUDGET





Footnotes about the pie chart:

1. *Spending includes retirement benefit payments, distributions to participants, and administrative expenses.*

Source: MSRS 2015 Comprehensive Annual Financial Report

Footnotes about the bar chart:

1. *Other Funds includes MSRS' pension trust funds.*
2. *Although indiscernible on the bar chart, MSRS only utilized state General Fund appropriations to finance retirement benefits and other administrative expenses for the Legislators and Elective State Officers Retirement Plans.*

Source: MSRS Fiscal Year 2014 and 2015 Comprehensive Annual Financial Reports

MSRS administers five defined benefits funds internally: the State Employees, State Patrol, Correctional Employees, Judges, and Legislators Retirement Plans. All of these plans, except the Legislators Retirement Plan, are funded primarily with investment earnings comprising 72 percent of revenues over the ten-year period ending June 30, 2015. Plan member and employer contributions each comprised about 13 percent of revenues in the same period. MSRS contribution rates continue to remain relatively stable, currently at 5.5%. The fund has realized an annualized investment rate of return of 7.8% for the ten-year period ending June 30, 2015. MSRS' administrative expenses for these funds continue to be less than 1/10 of 1% of plan net assets.

For the Legislators Retirement Plan, MSRS receives state General Fund appropriations to finance monthly regular retirement and survivor benefit payments, and the plan's proportionate share of MSRS' administrative expenses on a pay-as-you-go basis.

For the Judges Retirement Plan, the legislature appropriated MSRS General Fund appropriations totaling $3 million in fiscal year 2017 and $6 million annually thereafter until the plan reaches full funding.

MSRS also administers four defined contribution funds: the Unclassified Employees Retirement Plan, the Minnesota Deferred Compensation Plan, the Health Care Savings Plan, and the Supplemental Retirement Plan for Hennepin County. For these plans, participants' tax-deferred contributions are invested daily and held in trust until retirement or termination of employment. Participant administrative fees include recordkeeping, custodial, and other MSRS administrative expenses. These plans require no state appropriation for funding purposes.

STRATEGIES

MSRS utilizes the following strategies to accomplish its stated mission:

- Develop, implement, and maintain retirement programs that are responsive to its members' needs.
- Seek approval of legislative initiatives designed to ensure the financial stability of the retirement plans.
- Deliver pension benefits and services in a customer-oriented and cost-effective manner.
- Educate members to make informed decisions leading to a financially secure retirement future through counseling, workshops, newsletters, and web-based services and tools.
- Promote a respectful, ethical, high performance work environment that supports staff development, technological enhancements, and business process improvements.

MSRS operates from its main office in St. Paul and branch offices located in St. Cloud, Mankato, Detroit Lakes, and Duluth. MSRS is organized around two functional areas: retirement services and administrative support processes. Retirement Services staff provide education, benefit determinations, and retirement counseling to members of all MSRS retirement plans by phone, through onsite visits, and through the MSRS web site. Administrative divisions support accounting, contract administration, information technology and systems, financial reporting, records management services.

For MSRS' defined benefit plans, MSRS collects member and employer contributions through payroll deductions and transfers these assets to the Minnesota State Board of Investment where they are pooled with the assets of other statewide retirement associations and invested in various securities. MSRS disburses monthly benefit payments to retired members, survivors, and disabled employees; and processes lump-sum withdrawals and rollovers to members who have terminated employment.

For MSRS' defined contribution plans, participants' tax deferred contributions flow from the employer to the recordkeeper and custodian for daily investment. Individual participants select their own investments from the various options offered. At MSRS' direction, the recordkeeper will make distributions to participants and vendors, and reimburse MSRS for each plan's proportionate share of administrative expenses. Financial transactions of these funds are not captured in the state's accounting system. Thus, the fiscal pages of this budget document omit the financial activities for these plans.

RESULTS

Three measure of a defined benefit plan's financial health are:

- Contribution Sufficiency/Deficiency Rate – This rate is the difference between the actuary's computation of required employer and employee contributions rates and the statutory contribution rates, expressed as a percent of payroll. A sufficiency indicates that the plan is on target to reach a 100% funded ratio before its full funding date; conversely, a deficiency means the retirement system is not collecting enough contributions to its full funding target date.

- Unfunded Actuarial Accrued Liability – This is the difference between the actuary's valuation of assets and the present value of member's future benefits. The more plan assets that a retirement fund has at a particular point in time, the lesser the unfunded actuarial accrued liability amount will be.
- Funded Ratio – This ratio is the percent of a retirement fund's net assets, calculated for actuarial purposes, that is available to pay the present value of benefits that employees already earned. The higher the ratio, the better positioned the retirement plan is to pay future benefits when they become due.

The table below presents performance measurement data for MSRS' defined benefit funds as of June 30, 2010, and June 30, 2015, based on computations using the market value of assets.

Type of Measure	*Performance Measure by MSRS Fund*	*Previous*	*Current*	*Trend*
	MSRS State Employees Retirement Fund			
Quantity	Contribution Sufficiency/(Deficiency)	(3.9)%	(0.45)%	Improving
Quantity	Unfunded Actuarial Accrued Liability	$1.5 billion	$1.9 billion	Worsening
Results	Funded Ratio	74.95%	88.89%	Improving
	State Patrol Retirement Fund			
Quantity	Contribution Sufficiency/(Deficiency)	(15.05)%	(5.52)%	Improving
Quantity	Unfunded Actuarial Accrued Liability	$116 million	$193 million	Worsening
Results	Funded Ratio	71.54%	79.77%	Improving
	Correctional Employees Retirement Fund			
Quantity	Contribution Sufficiency/(Deficiency)	(6.99)%	(4.56)%	Improving
Quantity	Unfunded Actuarial Accrued Liability	$247 million	$361 million	Worsening
Results	Funded Ratio	61.71%	73.55%	Improving
	Judges Retirement Fund			
Quantity	Contribution Sufficiency/(Deficiency)	(6.41)%	(10.85)%	Worsening
Quantity	Unfunded Actuarial Accrued Liability	$96 million	$147 million	Worsening
Results	Funded Ratio	52.46%	55.31%	Improving
	Legislators Retirement Fund is funded by the General Fund on a pay-as-you-go basis and therefore performance trends are not measurable.			

Specific Legal Citations:
State Employees Retirement Fund – M.S. Sections 352.01-352.87 (https://www.revisor.mn.gov/statutes/?id=352)
State Patrol Retirement Fund – M.S. Chapter 352B (https://www.revisor.mn.gov/statutes/?id=352B)
Correctional Employees Retirement Fund – M.S. Sections 352.90-352.955 (https://www.revisor.mn.gov/statutes/?id=352)
Judges Retirement Fund – M.S. Chapter 490 (https://www.revisor.mn.gov/statutes/?id=490)
Legislators and Constitutional Officers Plan – M.S. Chapter 3A (https://www.revisor.mn.gov/statutes/?id=3A)
Unclassified Employees Retirement Fund – M.S. Chapter 352D (https://www.revisor.mn.gov/statutes/?id=352D)
Health Care Savings Plan – M.S. Chapter 352.98 (https://www.revisor.mn.gov/statutes/?id=352.98)
Minnesota Deferred Compensation Fund – M.S. Section 352.965 (https://www.revisor.mn.gov/statutes/?id=352.965)
Hennepin County Supplemental Retirement Plan – M.S. Section 383B.46 (https://www.revisor.mn.gov/statutes/?id=383B.46)

(Dollars in Thousands)

Expenditures By Fund

	Actual	Actual	Actual	Estimate	Forecasted Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
7210 - Correctional Employees Retire	52,552	57,521	61,716	62,571	65,365	68,284	65,365	68,284
7230 - Highway Patrol Retirement	53,978	55,747	58,023	59,335	61,407	63,552	61,407	63,552
7240 - Judicial Retirement	20,896	21,994	22,468	25,674	26,763	27,899	26,763	27,899
7250 - Legislative Annuities	8,528	8,502	8,576	8,719	8,893	9,071	8,893	9,071
7260 - State Employees Retirement	655,886	698,608	739,071	749,973	783,081	817,778	783,081	817,778
Total	**791,840**	**842,371**	**889,854**	**906,273**	**945,510**	**986,584**	**945,510**	**986,584**
Biennial Change				161,915		135,967		135,967
Biennial % Change				10		8		8
Governor's Change from Base								0
Governor's % Change from Base								0

Expenditures by Program

	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Program: Mn State Retirement System	762,416	811,876	858,810	871,879	909,853	949,614	909,853	949,614
Program: Judges Plan	20,896	21,994	22,468	25,674	26,763	27,899	26,763	27,899
Program: Legislators Plan	8,528	8,502	8,576	8,719	8,893	9,071	8,893	9,071
Total	**791,840**	**842,371**	**889,854**	**906,273**	**945,510**	**986,584**	**945,510**	**986,584**

Expenditures by Category

	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Compensation	8,812	9,380	10,147	12,839	12,991	13,251	12,991	13,251
Operating Expenses	12,871	11,345	8,815	9,762	9,956	10,157	9,956	10,157
Other Financial Transactions	770,158	821,627	870,892	883,672	922,562	963,176	922,562	963,176
Capital Outlay-Real Property		20		0	0	0	0	0
Total	**791,840**	**842,371**	**889,854**	**906,273**	**945,510**	**986,584**	**945,510**	**986,584**
Full-Time Equivalents	**104.2**	**108.2**	**114.7**	**130.0**	**130.0**	**130.0**	**130.0**	**130.0**

(Dollars in Thousands)

1000 - General

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Direct Appropriation	0	0	0	3,000	6,000	6,000	6,000	6,000
Open Appropriation	3,539	3,369	5,177	8,719	8,893	9,071	8,893	9,071
Net Transfers	(3,539)	(3,369)	(5,177)	(11,719)	(14,893)	(15,071)	(14,893)	(15,071)

6000 - Miscellaneous Agency

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Balance Forward In	15	5	3	0	0	0	0	0
Receipts	(10)	(2)	(3)	0	0	0	0	0
Balance Forward Out	5	3	0	0	0	0	0	0

7210 - Correctional Employees Retire

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Open Appropriation	52,552	57,521	61,716	62,571	65,365	68,284	65,365	68,284
Expenditures	**52,552**	**57,521**	**61,716**	**62,571**	**65,365**	**68,284**	**65,365**	**68,284**
Biennial Change in Expenditures				14,214		9,362		9,362
Biennial % Change in Expenditures				13		8		8
Gov's Exp Change from Base								0
Gov's Exp % Change from Base								0

7230 - Highway Patrol Retirement

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Open Appropriation	52,978	54,747	57,023	58,336	60,408	62,553	60,408	62,553
Net Transfers	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Expenditures	**53,978**	**55,747**	**58,023**	**59,335**	**61,407**	**63,552**	**61,407**	**63,552**
Biennial Change in Expenditures				7,634		7,601		7,601
Biennial % Change in Expenditures				7		6		6
Gov's Exp Change from Base								0
Gov's Exp % Change from Base								0

(Dollars in Thousands)

7240 - Judicial Retirement

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Open Appropriation	20,896	21,994	22,468	22,674	20,763	21,899	20,763	21,899
Net Transfers	0	0	0	3,000	6,000	6,000	6,000	6,000
Expenditures	**20,896**	**21,994**	**22,468**	**25,674**	**26,763**	**27,899**	**26,763**	**27,899**
Biennial Change in Expenditures				5,252		6,520		6,520
Biennial % Change in Expenditures				12		14		14
Gov's Exp Change from Base								0
Gov's Exp % Change from Base								0

7250 - Legislative Annuities

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Open Appropriation	4,989	5,133	3,399	0	0	0	0	0
Net Transfers	3,539	3,369	5,177	8,719	8,893	9,071	8,893	9,071
Expenditures	**8,528**	**8,502**	**8,576**	**8,719**	**8,893**	**9,071**	**8,893**	**9,071**
Biennial Change in Expenditures				265		669		669
Biennial % Change in Expenditures				2		4		4
Gov's Exp Change from Base								0
Gov's Exp % Change from Base								0

7260 - State Employees Retirement

	Actual	Actual	Actual	Estimate	Forecast Base		Governor's Recommendation	
	FY14	FY15	FY16	FY17	FY18	FY19	FY18	FY19
Open Appropriation	656,441	699,165	739,643	750,545	783,653	818,354	783,653	818,354
Net Transfers	(555)	(557)	(572)	(572)	(572)	(576)	(572)	(576)
Expenditures	**655,886**	**698,608**	**739,071**	**749,973**	**783,081**	**817,778**	**783,081**	**817,778**
Biennial Change in Expenditures				134,550		111,815		111,815
Biennial % Change in Expenditures				10		8		8
Gov's Exp Change from Base								0
Gov's Exp % Change from Base								0
Full-Time Equivalents	104.2	108.2	114.7	130.0	130.0	130.0	130.0	130.0

Change Item Title: General Employee Retirement Plan Funding

Fiscal Impact ($000s)	FY 2018	FY 2019	FY 2020	FY 2021
General Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Other Funds				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact = (Expenditures – Revenues)	0	0	0	0
FTEs	**0**	**0**	**0**	**0**

Note: Pension funding approved by the Governor for state agencies is reflected in each agency's proposed budget.

Recommendation:

The Governor recommends a comprehensive package of changes to the State's General Employee's Retirement Plan designed to improve the plan's funding status. This package includes an increase in employer and employee contribution rates, as well as a reduction to retiree post retirement increases.

This proposal will increase state contributions for General Plan covered employees by 1.0% of payroll in FY18, 1.5% in FY19, 2% in FY20, 2.5% in FY21.

Rationale/Background:

The Minnesota State Retirement System's General Employee Retirement Plan (General Plan) provides retirement benefits to approximately 112,000 members including more than 49,000 current employees employed across state government. As of June 30, 2016 the General Plan held $11.7 billion in assets invested by the State Board of Investments. The General Plan paid approximately $730 million in retirement and disability benefits to over 38,000 beneficiaries in FY2016.

In 2015, MSRS conducted an experience study designed to measure the accuracy of the assumptions used to determine the funding needed to pay pension benefits. The study found that plan members are now living an average of two years longer than was previously measured. This finding, along with other assumption changes, lead to a net increase in liabilities of $700 million.

In 2016, the State Board of Investments conducted studies on the investment returns expected for the 10 and 20 year investment horizons. Those studies indicated that an 8% investment return was no longer a realistic expectation given today's investment environment and historically low interest and inflation rates. The MSRS Board of Directors considered these studies along with other important factors before recommending a reduction in the investment assumption from 8% to 7.5%. This change increases the General Plan's liabilities an additional $800 million and will require legislative action to be implemented.

The combined impact of these two changes is projected to lower the funded ratio by 12.1% from 88. 9% (2015) to 76.8%. It also has the effect of increasing the unfunded liability from $1.9 billion (2015) to $3.4 billion. Looking to the future, the funded ratio is projected to drop below 70% by 2025 and below 50% by 2040. This funding trajectory is not sustainable.

The Governor and the MSRS Board of Directors believes in proactively addressing this funding shortfall to protect the long-term health of the pension plan and to minimize the cost to stakeholders for funding future benefits guaranteed by statute. This funding proposal adheres to past Minnesota pension funding practices of equitably distributing the funding cost between the three major stakeholder groups: employers, employees, and retirees.

Proposal:

To achieve a positive funding trajectory, the Governor proposes several changes:

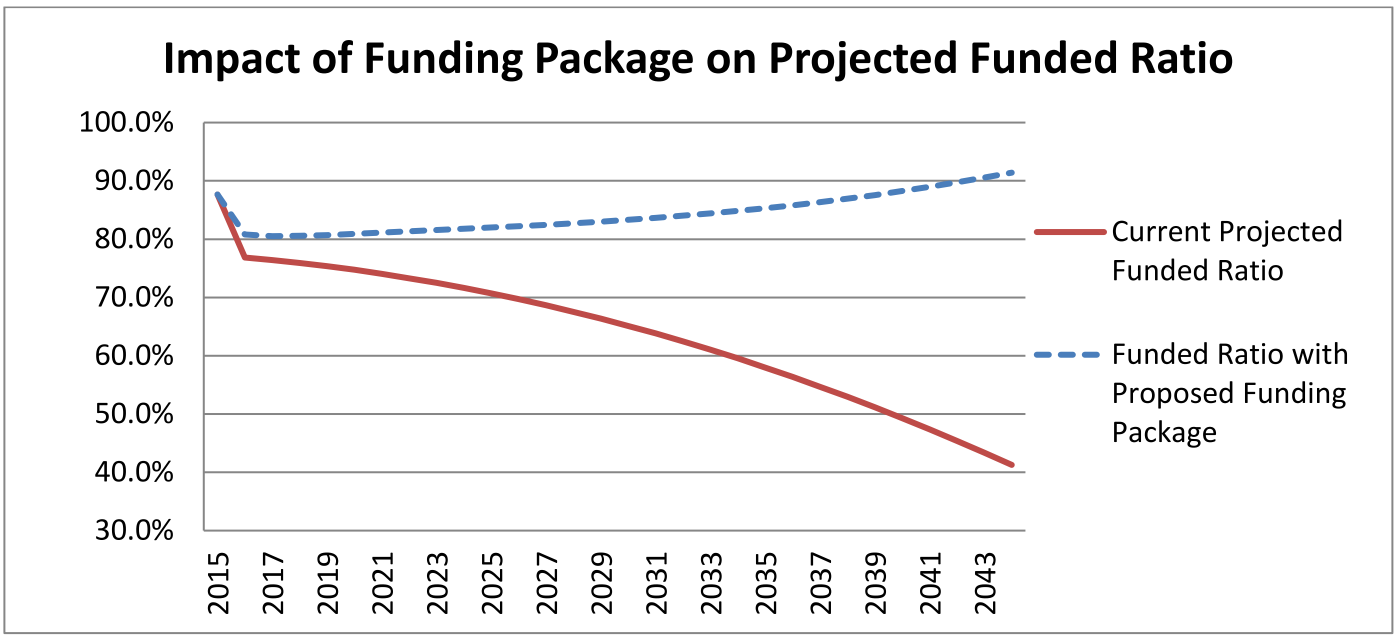
The recommended increase in employer contributions is one part of a proposed funding package which also includes:

- a re-amortization of payments on unfunded liabilities from a 26 year period to a 30 year period;
- a reduction in postretirement increases (COLAs) from 2% per year to 1.5% per year beginning in January of 2018;
- the removal of triggers which would automatically increase COLAs to 2.5% once the fund achieves a 90% funded ratio for two consecutive years;
- an increase in employee contributions from 5.5% to 6% beginning in FY 2018; and
- an increase in regular employer contribution rates from 5.5% to 7%, with an additional supplemental employer rate of 1.0%. These increases would be phased in over time.

The proposed contribution rate increase represents a shift from a policy of equal contributions by the employer and the employee. The Governor believes this is necessary to keep generational inequity within the plan to a minimum. Under this plan, employees pay for approximately half of their additional cost by accepting a lower COLA and by increasing their contribution rate by 0.5%. The employer increase of 2.5% pays for half of the current employee cost as well as a portion of the current retiree cost.

The Governor also recommends lowering the assumed rate of return on investments/discount rate to 7.5%.

Results:
MSRS measures pension funding health using three different measurements: contribution rate sufficiency/deficiency, current funded ratios, and projected funded ratios. The proposed funding package lowers the contribution rate deficiency from 5.7% of pay deficient to 0.4% of pay deficient. It would also immediately increase the current funded ratio from 76.8% funded to 80.7% funded by removing $700 million in liabilities. The proposed funding package also has the effect of improving projected funding ratios from 40% funded in 2045 to 92% funded in 2045.



Statutory Change(s):
Minn. Stat. § 352.04 State Employees Retirement Fund, Contributions by Employee and Employer.
§ 356.415 Postretirement Adjustments; Statewide Retirement Plans.
§ 356.215 Actuarial Valuations and Experience Studies.

Note:
All data on current and projected funded ratios as well as contribution deficiencies are based on studies performed by the actuarial firm Gabriel Roeder Smith & Company

Change Item Title: State Correctional Retirement Plan Funding

Fiscal Impact ($000s)	FY 2018	FY 2019	FY 2020	FY 2021
General Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Other Funds				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact = (Expenditures – Revenues)	0	0	0	0
FTEs	**0**	**0**	**0**	**0**

Note: Pension funding approved by the Governor for state agencies is reflected in each agency's proposed budget

Recommendation:

The Governor recommends a comprehensive package of changes to the State Correctional Plan designed to improve the plan's funding status. This package includes an increase in employer and employee contribution rates, as well as a reduction to retiree post retirement increases.

This proposal will increase state contributions for State Correctional Retirement Plan covered employees by 1.55% in FY18, 3% in FY19, 4.5% in FY20, and 6% in FY21.

Rationale/Background:

The Minnesota State Retirement System's State Correctional Retirement Plan (Correctional Plan) provides retirement benefits to approximately 9,400 members including 4,500 current employees employed by Department of Corrections or Department of Human Services within state government. Employees covered by the Correctional Plan must be employed at a state correctional facility, state-operated forensic services program or the Minnesota sex offender program. As of June 30, 2016, the Correctional Plan held $897 million in assets invested by the State Board of Investment. The Correctional Plan paid approximately $61 million in retirement and disability benefits to 3,000 beneficiaries in FY2016.

A key strategic objective of the plan is to recruit and retain personnel in positions that require specialized skills and training which are often physically demanding and dangerous. To be eligible for the plan, at least 75% of employee's working time must be in direct contact with inmates or patients. Like other public safety pension plans in Minnesota, the Correctional Plan allows members to retire as early as age 50 and has full retirement benefits available at age 55. Unlike other Minnesota public safety plans, the Correctional Plan is coordinated with Social Security, which requires members and employers to pay into social security in addition to the Correctional Plan.

In 2016, MSRS conducted an experience study designed to measure the accuracy of the assumptions used to determine the funding needed to pay current and future pension benefits. The study found that plan members (active and retired) are now living an average of about two years longer than was previously measured. This finding, along with other assumption changes, lead to a net increase in liabilities of $95 million.

Also in 2016, the State Board of Investment conducted studies on the investment returns expected for the 10 and 20-year investment horizons. Those studies indicated that an 8% investment return was no longer a realistic expectation given today's investment environment and historically low interest and inflation rates. The MSRS Board of Directors considered these studies along with other important factors before recommending a reduction in the investment return assumption from 8% to 7.5%. This change increases the Correctional Plan's liabilities by an additional $82 million and will require legislative action to be implemented.

The combined impact of these two changes is projected to lower the plan's funded ratio by 10% from 73.4% (2015) to 63.4%. It increases the plan's contribution deficiency from 5.45% deficient to 11.6% deficient. It also has the effect of increasing the unfunded liability from $361 million (2015) to $519 million. Looking to the future, the funded ratio is projected to drop below 60% by 2032 and below 50% by 2043. This funding trajectory is not sustainable.

The Governor and the MSRS Board believes in proactively addressing this funding shortfall to protect the long-term health of the pension plan and to minimize the cost to stakeholders for funding future benefits defined by statute. This proposal adheres to past Minnesota pension funding practices of equitably distributing the funding cost between the three major stakeholder groups: employers, employees, and retirees.

Proposal:

To achieve a positive funding trajectory, the Governor proposes several changes:

The increase in employer contributions is one component of a proposed funding package which also includes:

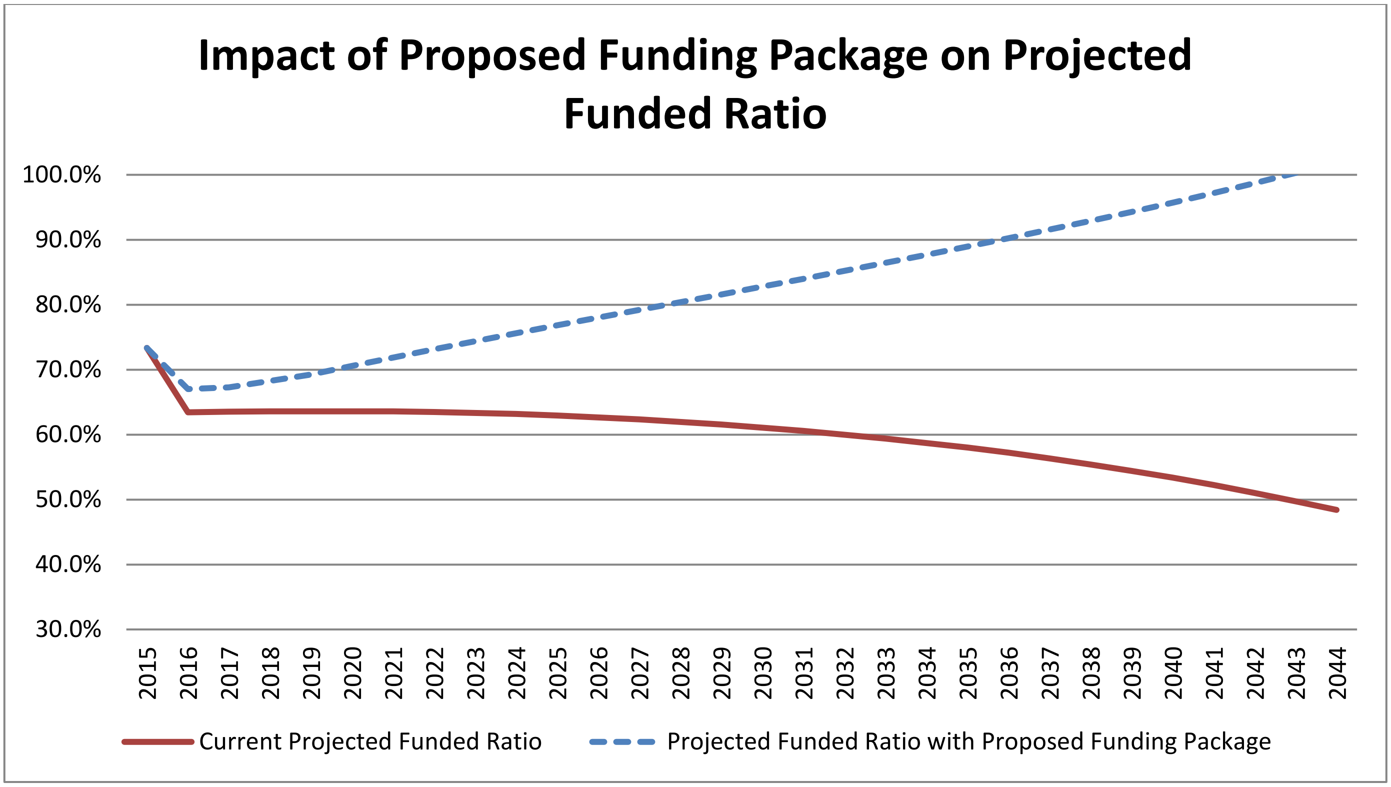
- a re-amortization of payments on unfunded liabilities from a 22 year period to a 30 year period;
- a reduction in the postretirement increase (COLA) rate from 2% to 1.5% effective January of 2018;
- the removal of triggers which would automatically increase the COLA from 2% to 2.5% once the plan achieved a 90% funded ratio for two consecutive years;
- an increase in employee contributions from 9.1% to 9.6% effective in FY 2018; and
- an increase in employer contribution rates from 12.85% to 18.85%, phased in over four years. The employer contribution would remain at 18.85% until the fund attains a funded ratio of 100%, at which time it would return to 14.4%.

The proposed contribution rate increase represents a shift from a policy of splitting contributions to allow 40% of the cost to be paid by employees and 60% of the cost to be paid by the employer. The Governor believes this is necessary to minimize generational inequity within the plan. A large portion of the cost created by the actuarial change and investment assumption change is attributable to current retiree liabilities. The Governor does not believe that active employees should shoulder more of the debt incurred by current retirees than they are already carrying, and does not want to undermine the strategic objective of recruitment and retention of correctional personnel.

The Governor also recommends lowering the assumed rate of return on investments/discount rate to 7.5%.

Results:

MSRS measures pension funding health using three different measurements: contribution rate sufficiency/deficiency, current funded ratios, and projected funded ratios. The proposed funding package lowers the contribution rate deficiency from 11.6% of pay deficient to 0.0% of pay deficient. The proposed funding package also has the effect of improving projected funding ratios from 48% funded in 2045 to more than 100% funded in 2045.



Statutory Change(s):

Minn. Stat. § 352.92 Correctional Employee Contributions

§ 356.415 Postretirement Adjustments; Statewide Retirement Plans.

§ 356.215 Actuarial Valuations and Experience Studies.

Note:

All data on current and projected funded ratios as well as contribution deficiencies are based on studies performed by the actuarial firm Gabriel Roeder Smith & Company

Change Item Title: State Patrol Retirement Plan Funding

Fiscal Impact ($000s)	FY 2018	FY 2019	FY 2020	FY 2021
General Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Game And Fish (Operations)				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Trunk Highway				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Other Funds				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact = (Expenditures – Revenues)	0	0	0	0
FTEs	**0**	**0**	**0**	**0**

Note: Pension funding approved by the Governor for state agencies is reflected in each agency's proposed budget.

Recommendation:

The Governor recommends a comprehensive package of changes to the State Patrol Retirement Plan designed to improve the plan's funding status. This package includes an increase in employer and employee contribution rates, as well as a reduction to retiree post retirement increases.

This proposal will increase state contributions for State Patrol Retirement Plan covered employees by 2.5% of payroll in FY18, 4.5% in FY19, 6.5% in FY20, and 8.5% in FY21.

Rationale/Background:

The Minnesota State Retirement System's State Patrol Retirement Plan (Patrol Plan) provides retirement benefits to approximately 1,940 members including 843 current employees employed in various law enforcement positions within state government. As of June 30, 2016 the Patrol Plan held $631 million in assets invested by the State Board of Investment. The Patrol Plan paid approximately $57 million in retirement and disability benefits to over 1,045 beneficiaries in FY2016.

In 2016, MSRS conducted an experience study designed to measure the accuracy of the assumptions used to determine the funding needed to pay pension benefits. The study found that our plan members are now living an average of two years longer than was previously measured. This finding, along with other assumption changes, lead to a net increase in liabilities of $25 million.

In 2016, the State Board of Investments conducted studies on the investment returns expected for the 10 and 20 year investment horizons. Those studies indicated that an 8% investment return was no longer a realistic expectation given today's investment environment and historically low interest and inflation rates. The MSRS Board of Directors considered these studies along with other important factors before recommending a reduction in the investment assumption from 8% to 7.5%. This change increases the Patrol Plan's liabilities an additional $43 million and will require legislative action to be implemented.

The combined impact of these two changes is projected to lower the Patrol Plan's funded ratio by 9.7% from 79.8 % (2015) to 70.1%. It increases the contribution deficiency from 8% deficient to 13.7% deficient. It also has the effect of increasing the unfunded liability from $168.5 million (2015) to $269.7 million. Looking to the future, the funded ratio is projected to drop below 70% by 2017 and below 60% by 2043. This funding trajectory is not sustainable.

The Governor believes in proactively addressing this funding shortfall to protect the long-term health of the pension plan and to minimize the cost to stakeholders for funding future benefits guaranteed by statute. This proposal differs somewhat from the approach taken with the General Employees Retirement Plan, and Correctional Employees Retirement Plan in that it does not include a reduction in postretirement (COLA) benefits for retirees. There is a cost to retirees in the form of a removal of the COLA triggers. Patrol Plan members currently receive a fixed 1% per year COLA. Patrol Plan members also do not pay into Social Security and most receive little or no social security benefit in retirement. Since Social Security benefits are adjusted for increases in the cost of living, Patrol Plan members are more vulnerable to experiencing a loss in purchasing power than are the members of plans coordinated with Social Security. The General Employees Retirement Plan and Correctional Employees Retirement Plan are both coordinated with Social Security. The Governor believes that a further reduction in COLAs would place an unfair burden on retirees within the Patrol Plan.

Proposal:

To achieve a positive funding trajectory, the Governor proposes several changes:

The recommended increase in employer contributions is one part of a proposed funding package which also includes:

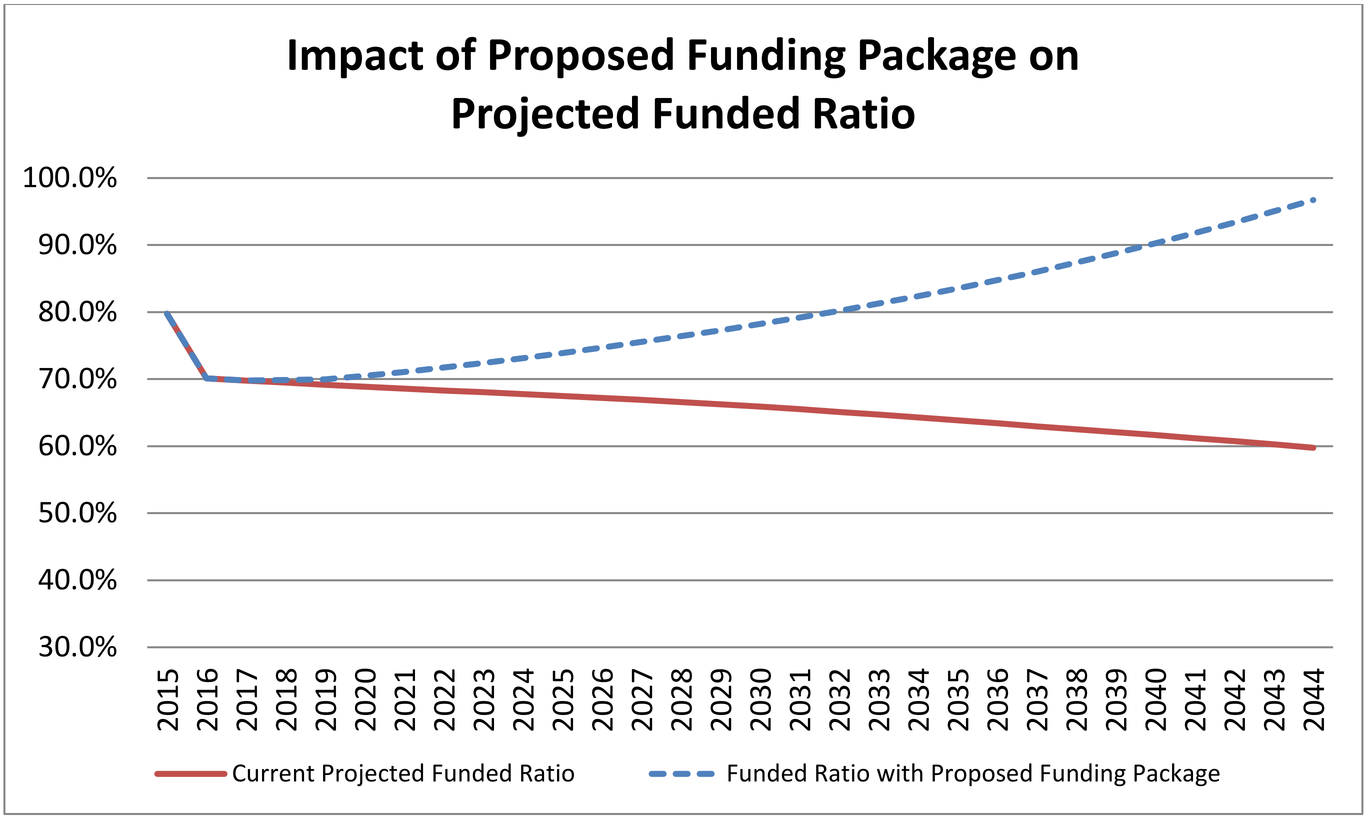
- a re-amortization of payments on unfunded liabilities from a 22 year period to a 30 year period;
- the removal of triggers which would automatically increase COLAs to 1.5% once the fund achieves a 80% funded ratio for two consecutive years and 2.5% once the fund achieved a 90% funded ratio for two consecutive years;
- an increase in employee contributions from 14.4% to 15.4% phased in over time; and
- an increase in employer contribution rates from 21.6% to 30.1%, phased in over time. The employer contribution would remain at 30.1% until the fund attains a funded ratio of 100%, at which time it would return to 23.1%.

The proposed contribution rate increase represents a shift from a policy of splitting contributions to allow 40% of the cost to be paid by employees and 60% of the cost to be paid by the employer. The Governor believes this is necessary to keep generational inequity within the plan to a minimum. The majority of the liability increase created by the actuarial change and investment assumption is attributable to retiree costs. A 1% increase for current employees covers half of their cost plus some of the unfunded liability they are creating. The Governor does not believe that active employees should shoulder more of the debt incurred by current retirees than they are already carrying. The employer increase of 8.5% pays for half of the current employee cost as well as most of the current retiree cost.

The Governor also recommends lowering the assumed rate of return on investments/discount rate to 7.5%.

Results:

MSRS measures pension funding health by using three different measurements: contribution rate sufficiency/deficiency, current funded ratios, and projected funded ratios. The proposed funding package lowers the contribution rate deficiency from 13.7% of pay deficient to 0.0% of pay deficient. Removing the COLA triggers has an impact of increasing the funded ratio from 70.1% funded to 70.4% and lowers liabilities by 3.6 million. The proposed funding package also has the effect of improving projected funding ratios from 60% funded in 2045 to 98% funded in 2045.



Statutory Change(s):
Minn. Stat. § 352B.02 State Patrol Retirement Fund
§ 356.415 Postretirement Adjustments; Statewide Retirement Plans.
§ 356.215 Actuarial Valuations and Experience Studies.

Note:
All data on current and projected funded ratios as well as contribution deficiencies are based on studies performed by the actuarial firm Gabriel Roeder Smith & Company