State of Minnesota

Report of

PUBLIC RETIREMENT STUDY COMMISSION

A

Legislative Interim Commission

To Study

Public Employee Retirement Systems

Submitted to the
Legislature of the State of Minnesota *January, 1959*

Members of the Senate
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EXECUTIVE SECRETARY

January, 1959

The Honorable Orville L. Freeman, Governor
and Members of the Legislature of the
State of Minnesota:

The work of the Minnesota Public Retirement Commission, as authorized under Chapter 829, Minnesota Session Laws of 1955, and as amended by Chapter 13, Extra Session Laws, 1957.

A summary of the Commission's report and recommendations are hereby respectfully transmitted.

Harry L. Wahlstrand

Harry L. Wahlstrand
Chairman

HLW:mrb

LEGISLATIVE INTERIM COMMISSION

TO STUDY

PUBLIC EMPLOYEE RETIREMENT SYSTEMS

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AN ACT

CREATING AN INTERIM COMMISSION TO STUDY EMPLOYMENT RETIREMENT SYSTEMS AVAILABLE TO EMPLOYEES OF THE STATE AND POLITICAL SUBDIVISIONS OF THE STATE, AND APPROPRIATING MONEY THEREFOR, AS AMENDED BY EXTRA SESSION LAWS 1957, CHAPTER 13.

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

Section 1. There is created a commission to be called legislative commission to report on retirement benefit plans available to government employees. The commission shall consist of five members of the senate to be appointed by the committee on committees of the senate and five members of the house of representatives to be appointed by the speaker.

Sec. 2. The commission shall study the various retirement benefit plans available to employees of the state and employees of the various political subdivisions, political corporations, and school districts of the state, including within the scope of its enquiry the governing law, management, financial condition, and benefits of all such plans, any federal program for which such employees or any of them could be eligible, and such related matters as the commission deems proper for full legislative understanding and action.

The commission shall report fully to the governor and to the legislature and include in the report its recommendations in respect to any matter within the scope of its enquiry.

Sec. 3. Said legislative commission shall make its report to the governor and the sixty-first session of the legislature between November 15, 1958 and January 15, 1959.

Sec. 4. For the accomplishment of its purpose and the performance of its duty the commission and its committees may hold hearings at such times and places as may be convenient for the purpose of receiving evidence, and the commission and its committees may issue subpoenas in the manner provided by its rules. The commission is authorized to secure directly from any board or executive officer managing any retirement program and from any executive department or agency of government, or from any official or employer of the state, such information as it may require, and all such boards, departments and agencies, officials, and employees are authorized and directed to furnish such information directly to the commission or to a committee thereof upon request made by the chairman.

Sec. 5. Members of the commission will serve without pay but they shall be allowed and paid for their actual and necessary expense incurred by them in their performance of their duty. The legislative research commission shall extend to it all practicable assistance. It shall have the authority to employ legal counsel, a secretary, and such other expert, professional, and clerical assistance as it may deem necessary to pay therefor; it may purchase stationary and other supplies, and it may do all things reasonably necessary and convenient to carry out the purpose of this act.

Sec. 6. There is hereby appropriated out of any money in the state treasury not otherwise appropriated $45,000 for the biennium commencing July 1, 1957, or so much thereof as may be necessary to pay expenses incurred by the commission. For the payment of such expenses the commission shall draw its warrant upon the state treasurer, which warrants will be signed by the chairman or by such other or additional member of the commission as the rules of the commission may provide, and the state auditor shall then approve and the state treasurer pay such warrants as and when presented.

THE SECOND BIENNIUM OF PENSION STUDY.

The fact that in a little more than 30 years Minnesota has accumulated public employee pension problems involving over $600 million of pension liability, over $180 million of pension assets and over $437 million of pension deficit is only part of the picture.

The rights, expectations and hopes of nearly 100,000 employees and over 11,000 retired persons must be considered.

The complexity of the pension problems could only be completely explained in a long volume.

During the second biennium of pension study this Commission, like its predecessor, had so extensive an assignment that many important matters remain for future study.

The Commission had regular monthly meetings - many of two day duration - and, in addition, several special meetings. In addition to many other items studied, the Commission:

1. Devoted considerable time to study and evaluation of the first complete set of actuarial surveys of the 58 pension funds established through State legislation.
2. Followed up the study and analysis of the pension legislation of the 1957 session which enacted more significant pension legislation than any other session of the legislature.
3. Expended considerable time and attention on the problems of local police and firemen's pensions.
4. Studied and herein proposes a number of constructive improvements in pension plans including a statewide PERA section for firemen and policemen.

After paying obligations of the previous Commission, the total financial resources available for use by this Commission during this biennium amounted to $40,794. The Commission has stayed within its resources by foregoing some actuarial and legal consultant services that would have been desirable. Even so, over 37% of the total expenditures were for consultant services.

It is interesting to compare the cost of this study with some financial items in the field of public employee pensions.

The $40,794 Commission expense for the two years represents --

Less than 50¢ per year for each $1,000 of annual pension fund receipts of the 58 funds.

Just over 50¢ per year for each $10,000 of public employee payroll subject to pension deductions.

Approximately 35¢ per year for each $1,000 of annual increase in pension liability.

Many of the Commission's recommendations are of considerable financial significance to the pension funds.

Just one of the recommendations that is easily measurable will, if adopted, build up to be worth $850,000 per year to the pension funds collectively.

BOILED DOWN

FINDINGS -- CONCLUSIONS

Public employee pension funds in Minnesota generally provide a higher level of benefits than similar funds in a majority of other states.

For many years Minnesota has been steadily increasing the level of benefits of its pension funds.

Commensorate provisions for financing pensions have lagged far behind costs of increased benefits.

Actuarial surveys show that even the unprecedented increases of financing of public employee pension funds as enacted by the 1957 session of the Legislature are not sufficient to provide minimum essential financing of these funds.

The full impact of some of the financing provisions enacted in 1957 for PERA and TRA has not yet been felt. Even though not sufficient, the last of the increases enacted for these funds do not become operative until July 1, 1959.

THESE FACTS MAKE NECESSARY A SERIES OF CONCLUSIONS:

No increase in benefits, or change in benefits resulting in increased costs, should be approved in regard to any pension fund until the level of financing of such fund is suffinient to prevent further increase in deficit.

No increase in benefits or costs in any fund should be enacted except when adequate financing measures accompany any such change.

The minimum measures that should be adopted as to each pension fund are those necessary to raise the level of financing at least to the point where there will be no further increase in deficit.

It is highly desirable that financing of each fund be raised to a level that will amortize its deficit in no more than 40 years.

If coordination with OASDI is offered to members of PERA and TRA, the benefits and costs of such coordinated PERA or TRA should not exceed 3% employee plus 3% employer normal level costs because, when even this rate of costs is added to the costs of OASDI, future costs of the combined coordinated plans will exceed present costs of PERA and TRA as to both employees and employers.

In addition:

1. This is the basis on which SERA is already coordinated.

2. Even this basis, costing 6% of payroll (employee - 3% and employer - 3%) added to OASDI in 1960 (OASDI 3% plus 3%), results in normal cost of 12% of payroll.

   OASDI costs increase an additional 1% of payroll in 1963, again in 1966, and again in 1969. The result, beginning in 1969, is annual costs of 15% of payroll - 25% higher than the 12% normal level costs of PERA and TRA. Divided, these total costs will be, employee - 7.5% and employer 7.5% of payroll.

3. Both PERA and TRA will, even if coordinated, still have large deficits. This will require financing for many years in addition to normal levels set forth just above.

OVERALL FINANCIAL CONDITION OF
PUBLIC EMPLOYEE PENSION FUNDS IN MINNESOTA.

For the first time in the history of the State of Minnesota, because of Chapter 11, Special Session Laws 1957, it is possible to learn, collectively as well as individually, the condition of the public employee pension funds which have, over the years, been created by the Statutes.

The following tabulation shows for each fund the most significant findings of the actuaries reports on these funds except that the total findings of all of the police pension funds and all of the firemen's pension funds are given here since a separate tabulation of the individual pension funds making up these totals will be found at the beginning of the section dealing with police and firemen's pensions.

Following the tabulation the totals of all public employee pension funds are discussed as if these totals were the finances of a single fund. The discussion therefore is of the total picture but, in addition, it serves to illustrate the manner in which the findings as to each individual fund could well be analyzed. Any person interested in a particular fund can substitute the figures of that particular fund as found in the tabulation columns and be guided thereby through an analysis of that particular fund.

NOTE: The tabulation of the findings of all of the actuarial surveys shows the situation as of January 1, 1958 and, where yearly figures are given, they are based on the year 1957.

TABULATION OF SIGNIFICANT FINDINGS OF 1958 ACTUARIAL SURVEYS OF ALL PUBLIC EMPLOYEE PENSION FUNDS

	A	B	C	D	E	F	G	H
					1957 FINANCIAL SUPPORT			NORMAL COST
	PAYROLL	DEFICIT	ASSETS	REQUIRED RESERVE	MEMBER	EMPLOYER	TOTAL	DOLLARS - PERCENT
General Funds								
P.E.R.A.	$114,055,965	$135,500,000	$ 26,100,000	$161,600,000	$ 6,880,793	$ 6,448,000	$13,328,793	$13,900,000 - 12.20%
S.E.R.A.	84,145,857	26,727,175	42,323,450	69,050,625	2,524,375 (a)	4,207,292 (a)	6,731,667 (a)	5,290,000 - 6.285% (a)
ST. PAUL BUREAU HEALTH	283,662	614,488	186,419	800,907	8,253	21,391	29,644	32,813 - 11.57%
MPLS. MUNICIPAL EMPLOYEES	25,075,896	57,398,153	28,248,013	86,646,166	1,420,804	2,500,000	3,920,804	4,563,813 - 18.20%
Sub-Total	$223,561,380	$220,239,816	$ 96,857,882	$318,097,698	$10,834,225	$13,176,683	$24,010,908	$23,786,626
Teacher's Funds								
STATE	$ 94,300,000	$ 72,400,000	$ 38,697,202	$111,097,202	$ 5,658,000	$ 4,993,200	$10,651,200	$11,300,000 - 12.00%
DULUTH	3,424,000*	1,459,000	8,403,000	9,862,000	137,000 (a)	166,000 (a)	303,000 (a)	250,000 - 7.31% (a)
ST. PAUL	9,957,553*	23,230,314	2,252,483	25,482,797	521,660	792,550	1,314,210	1,394,057 - 14.00%
MINNEAPOLIS	15,872,409	37,406,369	26,517,026	63,923,395	952,345	2,178,566	3,130,911	2,023,732 - 12.75%
Sub-Total	$123,553,962	$134,495,683	$ 75,869,711	$210,365,394	$ 7,269,005	$ 8,130,316	$15,399,321	$14,967,789
Safety Employee Funds								
FIRE FUNDS (21)	$ 8,135,681*	$ 40,735,595	$ 2,612,185	$ 43,347,780	$ 209,375	$ 1,468,985	$ 1,678,360	$ 1,127,714 - 13.9%
POLICE FUNDS (26)	8,609,600*	37,605,646	3,128,230	40,733,876	297,888	1,278,160	1,576,048	1,502,874 - 17.5%
HIGHWAY PATROL	1,582,320	2,787,346	1,226,695	4,014,041	83,742	83,742	167,484	274,276 - 17.3%
GAME WARDEN	686,808*	1,920,729	424,933	2,345,662	44,018	36,139	80,157	100,510 - 14.6%
BUREAU CRIMINAL APPREHENSION	100,128*	185,577	36,071	221,648	6,007	6,007	12,014	16,861 - 16.8%
Sub-Total	$ 19,114,537*	$ 83,234,893	$ 7,428,114	$ 90,663,007	$ 641,030	$ 2,873,033	$ 3,514,063	$ 3,022,235
TOTAL	$366,229,879	$437,970,392	$180,155,707	$619,126,099	$18,744,260	$24,180,032	$42,924,292	$41,776,650

	J	P	K	L	M	N		R
	3% ANNUAL INT. ON DEFICIT	FROZEN DEFICIT	NORMAL PLUS AMORTIZATION	M E M B E R S H I P				ANNUITIES PAYABLE 1958
				ACTIVE	INACTIVE	ANNUITANTS**	TOTAL	
General Funds.								
P.E.R.A.	$ 4,065,000	15.80%	17.40%	35,277	295	2,324	37,896	$ 2.5 million
S.E.R.A.	801,815	7.2%	7.7% (a)	27,968	511	1,984	30,463	2.2
St. Paul Bureau Health	18,435	18.1%	20.9%	62		12	74	.026
Mpls. Municipal Employees	1,721,944	25.10%	28.10%	5,376	50	1,820	7,246	2.9
Sub-Total	$ 6,607,194			68,683	856	6,140	75,679	$ 7.6 million
Teacher's Funds								
State	$ 2,172,000	14.30%	15.30%	22,015	2,981	1,443	26,439	$ 1.5 million
Duluth	43,770	8.6%	9.1% (a)	659	8	207	874	
St. Paul	696,909	21.00%	24.10%	1,705	1	560	2,266	1.0
Minneapolis	1,122,191	19.80%	22.9%	2,861	108	1,370	4,339	2.7
Sub-Total	$ 4,034,870			27,240	3,098	3,580	33,918	$ 5.2 million
Safety Employee Funds								
Fire Funds (21)	$ 1,222,067	28.9%	35.5%	1,612	9	1,127	2,748	$ 1.8 million
Police Funds (26)	1,128,169	30.6%	36.7%	1,651	9	971	2,647	1.6
Highway Patrol	83,620	22.6%	25.0%	329	22	21	372	.047
Game Wardens	57,621	23.0%	26.7%	144		12	156	.014
Bureau Criminal App.	5,567	22.4%	24.9%	17			17	.0
Sub-Total	$ 2,497,044			3,753	40	2,131	5,940	$ 3.5 million
TOTAL	$13,139,108			99,676	3,994	11,851	115,537	$16.3 million

** Annuitants - includes retired members and survivors of deceased members.

* Based on gross payroll. All others participating payroll.

Note: As to totals for the 21 local firemen's funds and the 26 policemen's funds see section of this Report entitled "Local Pension Funds for Paid Firemen and Policemen". In this section the findings as to each fund are tabulated.

B. Deficit - unfunded pension liability.

D. Required Reserve - present value of total pension liability.

J. 3% Annual Interest on Deficit -- Actuarial surveys are based on the assumption that 3% interest can be earned on investments. Since the deficit is equal to the shortage in invested funds, interest must be considered an expense of the fund.

P. Frozen Deficit - Normal cost plus 3% interest on the deficit and is the amount that must be paid into the fund to prevent the deficit from increasing.

K. Normal plus Amortization -- Normal Cost (H) plus interest, plus enough additional to pay off the deficit in 40 years.

(a) Does not include Social Security Tax.

Level Normal Cost (H)

Each year of service by the public employees in the State brings about a net increase of $41,776,650 (H) in the present value of the pension liability. This means the net increase in liability after all deductions have been made for expected release of liability due to deaths, resignations or other terminations of employment.

Another way of stating this same fact is that if all of the pension liability of these pension funds due to previous service of their public employee members was covered by invested assets earning 3% interest, it would still require each year $41,776,650 (H) in addition to finance the added liability accruing due to the current year's service.

Total Present Pension Liability (D)

If these pension funds did in fact have invested assets to cover their present pension liability due to past employee service they would have invested total assets of $619,126,099 (D). This amount plus interest thereon at 3% is necessary to meet, as they fall due, pension payments due to pensioners.

All actuarial surveys anticipated that these assets would earn 3% interest, although this rate of interest is slightly in excess of the actual earnings of most of the funds. The Duluth teacher's fund whose survey assumed 3.5% interest is the sole exception.

Summarizing to this point:

If the funds now had $619 million (D) invested at 3%, then the $41.7 million (H) of new money each year in addition to the interest on the $619 million (D) would keep pace with the increased liability due to the current year's employment plus the pensions paid out. Furthermore, $41.7 million (H) per year would continue in the future to be adequate to meet each future year's liability provided the scale of pension benefit provisions were not increased.

Factors which might change so that more or less than $41.7 million per year would be required will be discussed later.

Assets and Deficits.

In actual fact the pension funds collectively have invested assets of only $180,155,707 (C). The result is that the collective deficit of the public employee pension funds in Minnesota is $437,970,392 (B). Because of this deficit, the pension funds will not receive the needed 3% interest earnings on the $437,970,392 (b) deficit. This interest is necessary if the $41,776,650 (H) before mentioned is to be adequate as an annual basis of support.

Minimum Financing Required Because of Deficits.

Stated another way -- as a result of the deficit, in order to keep the pension funds of the State from falling further behind and accumulating additional deficits for each succeeding year, it will now be necessary to make up each year $13,139,108 (J) of interest not earned on the amount represented by the $437.9 million (B) deficit. Thus, it now will cost $54,915,758 (H plus J) from employer and employee sources combined to keep the pension funds from falling further behind as to financing.

To whatever extent the employer and employee contribution to these pension funds may this year fall short of $54.9 million (H plus J), then to that extent will the $437.9 million (B) of deficit be increased thereby requiring even larger annual contributions in future years for interest not earned on assets not invested.

Present Level of Financing (G)

During the past year the financial support from employer and employees of the 56 funds totalled $42,924,292 (G). Thus, if there were no deficit due to due to previous years service of employees, the present level of support would be $1,147,642 (G minus H) more than enough to meet the increased liability created due to the current year's service.

Consequences of Under-Financing.

As already noted, however, because the necessary additional income of 3% interest cannot be earned on the $437.9 million (B) of liability represented by deficit, the past year falls short by $11,991,400 from holding its own financially as to necessary pension support.

Notwithstanding the fact that the present $42.9 million (G) level of financial support for 1957 is considerably higher than in the past, ten years more at the present level will add approximately $138 million to the deficit raising the total to over $576 million. This will add $4.1 million to the annual interest loss, increasing the amount necessary to finance the annual loss of interest to $17.2 million instead of the present $13.1 million per year.

To summarize:

Collectively the State of Minnesota in 1957, for the first time in history, raised the amount of annual financing of its public employee pension funds to the amount of the normal level support rate of $41.7 million (H) per year only to find this amount approximately $13 million per year short of the financing needed to keep the pension deficits from increasing due to past shortages in financing. $54.9 million (H plus J) per year is now the minimum amount needed.

If, for the next forty years, $60.7 million is paid in, the $437.9 million (B) deficit will be paid off and $41,776,650 (H) per year will again become adequate.

The actuarial surveys are all based on the present statutory level of benefits. The fact is obvious that to the extent pension benefits may be increased, then to that extent the annual cost of maintaining the pension schedules will increase.

Additional Annual Costs of Social Security.

All of the above figures relate to public employee pensions enacted by the legislature of the State of Minnesota and do not include the cost of OASDI coverage on employees of the State itself.

For the year 1957 the added cost for OASDI for State employees was $3,810,000, divided $1,905,000 from employees and $1,905,000 from the State as employer. Legislation just enacted by Congress will materially increase these figures in subsequent years including scheduled increases in OASDI taxes as of 1960, 1963, 1966 and 1969.

The section of this report entitled "Social Security and Public Employees" sets forth the increasing costs of social security illustrated as to SERA.

The actuary for SERA advises that coordination of SERA and OASDI reduced the SERA deficit approximately $16 million.

Results of Financing Improvements Adopted by the 1957 Legislature

The 1957 session of the legislature effected a considerable increase in financial support for SERA, PERA and TRA raising the total financing of these three funds to approximately, per year . . . . $ 30,711,660 plus employer OASDI tax on SERA members.

A number of increases in financing for smaller funds were also provided. The increases for the three major funds follows:

State Employees Retirement Association - Prior to the 1957 session SERA had reached a level of employer financing of approximately $1,942,000 for the year 1956. This was greater than any previous year.

The 1957 session of the legislature raised the rate of support from employer sources to $4,207,292 per year for SERA plus approximately $1,905,000 annual rate of employer's OASDI taxes.

For the purpose of this comparison the approximate increase of annual support of SERA alone (not including OASDI) was. . $ 2,250,000

Public Employees Retirement Association - The legislature raised employee contributions from 4% to 6% of pay thus increasing yearly support by $2,293,598. Employer support to PERA was raised from aero to $6,448,000. This increased total financing of PERA per year by . . . . . $ 8,741,598

State Teacher's Retirement Fund Assoc. (TRA) The legislature increased the state tax contributions

from $767,083 in 1956 to $4,993,200 in 1957, increasing total financing by . . . . $ 4,226,117

Thus, the yearly rate of financing for the three major funds of the State was increased by . . . . $ 15,217,715 (plus $1,905,000 for social security).

Effect of Continuation of Under-Financing

Notwithstanding the fact that for the year 1957, financial support of all pension funds was considerably in excess of any previous year, continuation even at the present level will, after many years, cause an eventual increase in necessary financial support all the way to the maximum pay-as-you-go level.

Even if there is no further increase in benefit levels, the ultimate pay-as-you-go level - when reached - will be nearly twice the normal annual level of support. This means that where the normal level annual cost is approximately $41,776,650 (H) per year, following a pay-as-you-go procedure will result in a rising rate of annual cost until eventually a level of probably over $70 million per year will be needed just to pay pension disbursements for each year. To illustrate, the following example shows a sample pension plan financed by pay-as-you-go and by full funding methods.

PAY-AS-YOU-GO vs. ADVANCE FUNDING (Summary)

Basis of pensions of 50% of salary. Costs expressed as percent of level salary.

Entry Age	Retired Age	Annual Cost Ultimate Level Pay-As-You-Go	Normal Cost Annual Level 3% Funding
30	50	53.9%	27.5%
35	55	43.6%	23.3%
40	60	34.1%	19.1%
45	65	25.6%	15.0%

PAY-AS-YOU-GO FINANCING

The State could revert to a general policy of pay-as-you-go financing which at this time would only be slightly lower than the annual financing provided before 1957. This would temporarily reduce annual outlay by the taxpayers and employees slightly more than the amount of the increases effected by the 1957 session of the legislature.

From this lower than 1956 level, a pay-as-you-go policy would result in steadily increasing annual need for financial support even though the pension benefit plans remain the same. On a composite basis, as already stated, the pay-as-you-go basis of support would, within the relatively near future — perhaps ten years — pass the $41.7 million (H) level normal support rate, then a few years later the $54.9 million (H plus J) frozen deficit rate would be passed and then steadily increasing annual amounts would be needed up to a level of over $70 million per year estimated as the ultimate level of pay-as-you-go annual cost.

It is essential for understanding of pension financing to realize that a level of underfinancing that allows deficits to increase at all will, in time if continued, fail to meet annual pension disbursements and will force an increase in cost up to the highest cost level of pay-as-you-go financing.

> If deficits are continuously allowed to increase, in time, whenever assets may have been built up during the first generation of a fund will be gradually dissipated to pay pensions until, when these assets are gone, there will be no alternative but pay-as-you-go financing if pensions are to be paid.

FROZEN DEFICIT FINANCING

An alternative to either pay-as-you-go financing, or increasing deficit financing, is annual "frozen deficit" financing. This figure has been given above on a composite basis as $54.9 million (H plus J) per year of annual financing and consists of normal level support plus annual interest on the accumulated deficit (at 3% for this illustration).

Stated another way, this means that pensions would be supported on the basis of full financing as to liabilities accruing for current service. The past shortages of financing accumulated to some $437.9 million (B) is treated as a perpetual debt on which we would pay 3% interest each year. This debt could be continued on this basis to perpetuity by the annual payment of interest. If the pension plans were closed as to new membership the entire deficit would then in time have to be paid.

FULL FUNDING

Full funding differs from level frozen deficit financing as just described only because over a period of years extra financing is provided to liquidate the deficit by building up assets to the full amount of pension liabilities. The interest on the assets, plus normal level support, would thereafter finance the pension fund. This would require more than $54.9 million per year until the deficit was liquidated but the difference from the frozen deficit system described just above is that after the deficit was paid, the annual level cost of maintaining the pension plan would drop to the $41,776,650 (H) per year normal cost level.

The above options of financing apply to all individual pension plans. There are no pleasanter alternatives. IF PENSIONS ARE TO BE PAID THE QUESTIONS AS TO FINANCING ARE SIMPLY HOW AND WHEN, NOT WHETHER

ULTIMATE ALTERNATIVE TO ADEQUATE FINANCING

If adequate financing is not ultimately provided then only one alternative option of financing pensions is available. This consists of adjusting the level of benefits to financial support that is available or can be made available.

If pension funds are found to be living beyond a level of cost that can be financed, two alternatives present themselves:

A. Continue benefits even though unfinanced until the deficits and pay-as-you-go costs force a drastic reduction in pension benefits.

B. Make modest adjustments in pension benefits to such level as financing will cover and avoid the possibility of later drastic cuts.

How Accurate is Actuarial Measurement of Pension Liabilities?

The foregoing discussion quite naturally raises the question as to how accurate and likely to happen are the foregoing actuarially based projections.

Certain factors will tend to increase pension costs and hence make the figures used herein under-estimates of what will actually happen while other factors will tend to decrease costs and hence make the figures used herein over-estimates of the cost of present pension plans. The likelihood of material change in each factor may well be considered.

1. Factors that in the future will have a tendency to increase pension costs at the present level of benefits are:

   a) Decreasing rates of mortality among either employees or retired persons, or both.

b) A decline in interest earned on invested assets in the case of funding and to the extent funding is used.

c) Liberal interpretation and administration procedure as to disability benefits provided. Experience shows that the costs of a given level of disability benefits can vary tremendously according to the degree of diligence and liberality of administration.

d) A lower turnover or resignation rate in public employment. In the foregoing analysis the actuaries have based their findings on the expected recovery of employer contributions and the expected release of pension liability indicated by current experience.

e) It doubless can be assumed that extension of merit systems, civil service systems, and other tenure systems will, en toto, tend to reduce turnover and increase pension costs.

Few employment opportunities in private industry likewise tend to reduce turnover.

2. Factors that will have a tendency to decrease pension costs are:

a) An increase in death rate among employed persons or retired persons.

b) An increase in interest earned on invested assets to the extent such pension plans are funded.

c) Strict interpretation of administration and disability benefits.

d) High turnover of public employees will materially decrease the cost of pensions to those who retire when considered as a ratio of total payroll.

This would be a reversal of the trend of recent years as already noted in 1-d above.

An increase in the number of public employees is often cited as a factor in reduction of pension costs. This is, in the long run, a delusion, since - all other factors being equal - if the additional pensions are not financed, it only postpones the day of ultimate maximum pay-as-you-go cost.

It is only when funds use a pay-as-you-go system, as so many in Minnesota have done, and when statistics are quoted on a short period of years following an increase in membership that the apparent short term reduction in pension costs in comparison with income are misleadingly assumed to be actual long range reductions.

PAST FINANCING POLICY AS TO PENSION PLANS IN MINNESOTA.

In general, the fire and police pension plans are based on a pay-as-you-go practice of financing. The other pension funds, in varying degrees, recognize the funding principle in regard to employee contributions. SERA, PERA, TRA and, to a lesser extent, Minneapolis public employees and Minneapolis teachers have substantially followed a modified pay-as-you-go practice as to employer financing. Most of these funds have attempted to set up reserves in regard to people actually retired. Exceptions were PERA and the St. Paul Teacher's Retirement Fund. In general it may be stated that some funding was practiced and a great deal more funding was implied in theory in the plans of the pension funds even though not followed in practice.

THE 1957 COMMISSION REPORT MADE THE FOLLOWING RECOMMENDATION CITING REASONS THEREFORE:

"The Commission recommends that: FUTURE PENSION OBLIGATIONS OF ALL RETIREMENT FUNDS IN THE STATE SHOULD BE FINANCED ON A BASIS OF ADVANCE FUNDING."

"Additional reasons cited for this recommendation are:

1. Labor cost of current services will not be postponed to a future generation.

2. Retired former employees would have as security for their pension assets accumulated during their employment rather than an amendable, repealable law.

3. Taxpayers and legislators a generation hence may not feel obligated to keep the unfinanced promises of a previous generation.

4. A funded method will quickly reflect actual costs of further "liberalization" of pension benefits while deferred financing masks costs of even unsound liberalizations.

5. Considerably smaller long range dollar costs are required because current funds for future pensions are invested at interest."

Arguments Frequently Advanced in Favor of Pay-As-You-Go Financing.

Complete consideration of important factors of financing requires that we consider reasons frequently advanced in favor of, or at least in justification of, pay-as-you-go financing:

1. One argument frequently advanced is that - "It is better to leave dollars un-needed for immediate expenditure in the taxpayers pockets instead of building up invested reserves."

This reasoning has supported the development, expansion and liberalization of benefit promises in public employee pension systems. <u>It allowed an approach to the initial question of desirable pension benefits without the complication of considering costs.</u> Perhaps the present level of benefits could never have been obtained if currently accruing costs of pensions had been accurately measured. This approach has the further characteristic that in later years when pay-as-you-go costs are beginning to approach normal financing costs the element of "promised benefits" is a strong argument to persuade public governing bodies to increase pension financing to levels they may never have originally intended.

2. Fears have frequently been expressed that reserves invested for pension funds would be "borrowed" for other public purposes pending the time they were needed for disbursement to pension recipients.

The failure to fund is in effect public borrowing from the pension funds to the extent of the deficits. If pension funds are actually appropriated to other purposes <u>without decreasing the public borrowings from other sources</u> this point would be demonstrated.

3. <u>The increased dollar cost of pay-as-you-go financing is more than offset by the depreciation of dollar value through inflation.</u>

This is very important question and, to the extent that inflation may continue to increase, has considerable validity.

This is precisely the reasoning by which some experts advise individuals and other investors to purchase such items as stocks, real estate and commodidies instead of investing in insurance policies, savings banks, saving and loan associations, bonds, mortgages, etc. <u>Advocates with this point of view prognosticate that it will be easier later on to raise from taxation and employee deductions over $70 million per year than to currently raise $54.9 million per year for level financing.</u>

Should inflation continue to increase, the question must be raised as to how much pension benefits will be increased on an unfinanced (deficit) basis in order to counter loss in purchasing power of the present schedule of benefits.

If pensions should at future times be increased to compensate for inflation, then pay-as-you-go financing would ultimately reach correspondingly higher levels than the $80 million pay-as-you-go financing level of present plans.

If present pensions collectively were brought to a condition of full funding, reducing annual costs to $41,776,650 (H) per year, considerable later "inflation countering" increases in benefits could be provided before annual costs would reach a level of about $70 million as is inevitable if present practices of under-financing are continued.

PUBLIC EMPLOYEES RETIREMENT ASSOCIATION.

As a basis for discussion of the present situation of PERA, it is essential to review briefly developments of the last few years.

A 1956 PERA actuarial survey relative to the condition of the fund as of June 30, 1955 was the first relatively adequate survey that had ever been made of PERA.

Based on this survey the 1955-1957 Commission found that as of June 30, 1955 the --

Unfinance pension liabilities (deficit) amounted to . .	$ 128 million
Pension liabilities were accruing to the fund at the annual rate of	14% of pay
Financial support consisting entirely of member contributions was at the rate of	4% of pay
Annual payroll subject to pension deductions as of that date was	$ 85.5 million

With new deficit accruing at the rate of 10% of payroll, plus 3% interest on the previous deficit, it is obvious that by the time of the 1957 session the deficit had materially increased above $128 million.

The interim commission recommended to the 1957 session of the State Legislature modifications in the PERA law designed to:

1. Improve the financial situation in PERA.
2. Remove so-called "bargain" benefits to some members or groups of members at the expense of the fund. High pensions after short service and buy-back privileges are two examples.
3. Establish a sufficient level of financing so that an actuarial survey as of January 1, 1958 would probably only require relatively minor adjustments in financing rather than additional drastic steps.

The Commission estimated that if its recommendations were followed by the 1957 session of the legislature, the result would be a modified PERA with conditions approximately as follows:

Estimated deficit would be approximately		$ 67 million
Rate of financial support from:		
Employee contributions would be . . .	6.0% of pay	
Employer subdivisions for currently accruing liability would be	6.0% " "	
Employer subdivisions toward financing of deficit would be	2.5% " "	
TOTAL RECOMMENDED FINANCING		14.5% of pay
This means that the rate of accrual of liability for current service was estimated at		12% of pay

The 1957 session of the legislature amended the proposed PERA bills. The principal financial effects of these amendments is revealed by the 1958 actuarial measurement of PERA.

The 1958 actuarial survey provided by PERA was incomplete. It did not include measurement of all of the liabilities that would accrue according to the pension benefit formula. It also did not include the data and findings as to a level annual rate of financial support necessary to meet the average annual accrual of liabilities. The actuarial surveys of all other funds included these items.

The Commission's actuaries, after analysis of the report of the PERA survey, have estimated the adjustments that must be made if the intent of the 1957 actuarial survey law is to be met.

<u>Based on the PERA survey, plus these adjustments, the situation as to to PERA as of January 1, 1958 is as follows:</u>

Accrued liability of PERA	$ 161.6 million
Assets	26.1 "
Unfunded Liability (deficit)	135.5 million
Rate of level annual financing required to keep pace with currently accruing future liability	12.2% of payroll
Rate of annual financing required to keep the $135.5 million unfunded liability from increasing	3.56% " "
Thus, the minimum annual support required as of January 1, 1958 to keep pace with the annual growth of total liabilities of PERA is . .	15.76% of payrolll
The actuary found that to amortize the $135.5 million deficit over 40 years and at the same time adequately support accruing liabilities would require a total of	17.4% of payroll

The payroll subject to pension deduction by PERA members had increased from $85.5 million per year,with 30,822 members in 1955, to $114 million per year, with 37,796 members on January 1, 1958.

The ratio of financing of PERA, based on $114 million annual payroll, is as follows:

Rate of financing before 1957 (4%)	$ 4,560,000
Rate of financing after 7/1/58 (12%)	13,680,000
Thus, the 1957 session of the legislature increased the rate of annual financing by	$ 9,120,000
The 1957 session further provided that beginning 7/1/59, if no amendments are made by the 1959 session, that an additional 2.5% of financing of the deficit will begin. This would provide	$ 2,850,000
After 7/1/59 the total rate of additional annual financing provided by the 1957 session would be	$ 11,970,000
Overall total annual financing of PERA after 7/1/59 is scheduled to be	$ 16,530,000

Financing Needs of PERA.

To provide the 15.76% of payroll minimum financing required to prevent further growth in PERA deficits will require . . . . $ 17,966,400 per year

Current financing after July 1, 1959 . . . . $ 16,530,000 " "

Thus, it is apparent that to keep the PERA deficit from growing the legislature must provide for additional annual financing at the rate of . . . . . $ 1,436,400 per year

or, 1.26% of current payroll in excess of present statutory provision.

Recommendation: An increase in the financing by 1.26% of payroll is a minimum recommendation.

To amortize the deficit over 40 years, the legislature must provide financing of . . . . $ 19,800,000 per year from this point forward.

If financing is provided at the rate of 15.76% of payroll, there will be no reduction in deficit and hence support at that level will be required perpetually.

If the deficit is amortized in 40 years the annual rate required for financing thereafter would be 12.2% of payroll which, on the present payroll, amounts to $13.9 million per year.

Principal Reasons For Increase in PERA Deficit.

The fact that the PERA deficit is now $135.5 million - up $7.4 million from

1955 - instead of $67 million as estimated by the 1957 Commission is due in the most part to four major amendments made by the 1957 session of the legislature to the Commission's bills before adoption.

The four principal causes of increased deficit are:

1. The savings clause preserved previous "bargain" provisions to members with 10 or more years of service. This materially cut the amount by which the $128 million deficit could be reduced and is discussed later.

2. Instead of providing government employer contributions for current liability at 6%, the legislature provided that:

   From 7/1/56 to 6/30/57 the employer rate should be . . . . 4% of payroll

   From 7/1/57 to 6/30/58 the employer rate should be . . . . 5% of payroll

   And not until after 6/30/58 should the rate for normal government support be . . . . 6% of payroll

   Thus, financial support of currently accruing pension liability was less than required until after July 1, 1958 and hence, further deficits have accrued from current service.

3. The Commission's recommendation that a minimum of 2.5% of pay be provided to finance the deficit was postponed as to effective date so as not to commence until after July 1, 1959. This obviously has further increased the deficit since the 1955 survey.

4. Substitution of lifetime spouse benefits instead of "mother of minor child benefit" in the Commission recommended bills. Spouse means either husband or wife and benefits are paid for life whether or not there are children of any ages.

Savings Clause.

The so-called "savings clause" (Chapter 935, Section 26, Subdivisions 1, 2 and 3) provides that members with 10 or more years service on July 1, 1957 can chose to receive any benefits they would have received before the PERA law was amended.

Prior to 1957, PERA was found by its own actuary to be a pension fund with benefit provisions requiring average financing of 14% of payroll per year. Failure to provide support at the rate of 14% per year of payroll had accumulatea to the deficit of $128 million by June 1955.

The rate of actual financing was 4% of payroll (less in early years) contributed by employees with no financial support from employers except 2% of payroll for the year 1949.

The 1957 interim commission's recommendations would have modified PERA to a pension plan costing a level annual rate of 12% of payroll. The Commission's recommendations preserved to all members of PERA,for all past service,benefit provisions that would have required financing by employee contributions of 6% and employer support of 6% of payroll,plus employer financing of the deficit.

The Commission's recommendations accepted as a deficit against employers:

a) the 2% of payroll employee contributions for all past service in excess of the 4% employees had actually paid

b) 6% per year of employer contribution for all past service

Substantially, the sum of the above two items, compounded at 3% from the year of each employee's service, could be said to be represented by the $67 million deficit that would have remained in PERA if the Commission recommended modification had been enacted unchanged.

In the proposed modified PERA the estimated cost of 12% of payroll included a recommendation for disability coverage and coverage for minor children and mothers of minor children who are survivors of deceased members.

The 1957 session of the legislature, through the adoption of the savings clause, provided that employees with 10 years service as of July 1, 1957 would, in effect, remain in the 14% of pay pension plan and would also have the new disability and the new spouse benefits. The new benefits were estimated to cost approximately 2% of payroll. Such benefits cannot be financed at presently provided rates. <u>Benefits costing approximately 16% of payroll cannot be financed by 12% of payroll.</u>

Some additional results of the savings clause may well be noted since, in effect, the employee covered under this clause <u>has access to two pension plans and may pick and choose in each instance which plan he wishes to use.</u>

a) When an employee retires he may receive benefits based on a 14% of payroll plan that in some cases costs even more than that.

b) If an employee dies his spouse may receive a lifetime pension under the new plan and his minor children, if any, will receive benefits under the new plan.

c) If an employee is disabled he may receive disability benefits under the new plan.

<u>En toto, the savings clause prevents the establishment of equity between employees as to similar value for similar contributions and increases the inequity between different employees.</u>

It should be noted that the relative difference between the old and new plan changes for different periods of service and age so that the relative advantages of the savings clause are not even equally distributed among those employees under the savings clause.

The following tabulation serves to illustrate from the point of retirement benefit alone the effect of the savings clause as contrasted with the modified PERA benefit provisions.

AN ILLUSTRATION BASED ON AN INCOME OF $3,600 PER YEAR OF PERA BENEFITS UNDER THE SAVINGS CLAUSE AND THE 1957 MODIFIED PROVISIONS.

The basis is retirement at age 65 with the years of service shown.

Years of Service	SAVINGS CLAUSE Percent of Pay	SAVINGS CLAUSE Monthly Pension	1957 LAW Percent of Pay	1957 LAW Monthly Pension	Excess Monthly Income Savings Clause	Extra Deficit to Fund Due to Savings Clause at age 65
10	25%	$ 75.00	10%	$ 30.00	$ 45.00	$ 6,000
15	37.5%	112.50	20%	60.00	52.50	7,000
20	50%	150.00	30%	90.00	60.00	8,000
25	52.5%	157.50	42.5%	127.50	30.00	4,000
30	55%	165.00	55%	165.00	-----	-----
35	57.5%	172.50	70%	210.00	- 37.50	5,000 (gain) *
40	62.5%	187.50	85%	255.00	- 67.50	9,000 (gain) *

* Actually there would never be a gain as employees under the savings clause can always elect to receive benefits under either the old or the new law.

The savings clause applies to approximately 6,127 active employee members of PERA but not to the 29,151 members who, on June 30, 1957, had less than ten years service credit. If the option of buy-back service credit is extended, the number of PERA members under the savings clause will be increased depending upon how many of the 29,151 members not under the savings clause have 10 years of service and elect to buy back.

The Commission's actuaries estimate that the addition of the present savings clause had the following affect on PERA - approximately 10%, or $13.5 million was added to the deficit.

The level normal support rate required to meet average annually accruing liability is also approximately 10%, or 1.2% of payroll, higher than would have been necessary without the savings clause.

This means that in behalf of the 6,127 members, the level annual cost of the savings clause for a number of years will be approximately 1.2% of the payroll subject to pension deductions of all 35,278 active members in PERA.

The $13,500,000 deficit likewise will be a general obligation against all employing units.

Extension of Buy-Back Option in PERA.

The 1957 session of the legislature provided that from July 1, 1957 through June 30, 1958 any member could make payments to receive credit for public employee service before he became a member with matching payments by his employer.

This Commission received a number of complaints from employees that they did not adequately understand their privilege and failed to arrange for "buy-back" in time. The PERA board also requested extension of the buy-back privilege for an additional period.

The PERA law provided that payment for all buy-backs should be completed within five years.

If it were not for the savings clause there would be little adverse financial effect from extending the buy-back privilege since employer support

support is also provided.

The Commission is reluctant, however, to arbitrarily deprive any employees of previous rights.

<u>The Commission recommends that</u>:

> THE BUY-BACK PRIVILEGES WHICH TERMINATED AS OF JUNE 30, 1958 SHOULD BE EXTENDED TO JUNE 30, 1962 PROVIDED THAT ALL PAYMENTS THEREFORE BE MADE TO THE PERA FUND BY THAT DATE.

<u>Need for Revision of Survivor Benefits in PERA</u>.

Surviving mother of minor child, and minor child benefits, similar to benefits of this type in social security were recommended for inclusion in PERA by the previous retirement study commission reporting to the 1957 session of the legislature.

These added benefits were estimated to cost per year approximately .54% of 1% of pay and were to be financed by turnover recovery funds. Turnover recovery comes from two sources, 1) interest on employees contributions which revert to the fund when employees withdraw their contributions upon resignation, and 2) government deposits made because of these same withdrawing employees.

Before enactment the provision for $65 per month benefit for a <u>mother of a minor child</u> became a benefit for a <u>surviving spouse</u>.

The benefit then became a $65 per month life annuity to <u>any spouse</u>, instead of $65 per month to a widow from the death of an employee until his youngest minor child became 18 years of age.

1. Widows of childless employees or those with grown children get life annuities of $65 per month.

   Many women in this group are often employed before becoming widows, or are fully employable.

2. Husbands of employees qualify as "surviving spouse" and get $65 per month life annuities.

This "surviving spouse" benefit is costly. In its first year the surviving spouse benefit cost to PERA was $2,246,677 and was equal to 1.7% of payroll, or over three times the .5% cost estimated for mothers benefits plus minor child benefits.

This cost exceeds the entire turnover recover of PERA notwithstanding the fact that administrative costs, disability benefits, etc., are also supposed to be financed from "turnover recovery".

Since the "spouse benefit" cannot benefit single employees and provides benefits to many who are not dependent on those employees who die, the severe drain on the entire pension fund is not justifiable.

Therefore, the Commission recommends that the PERA law be amended to provide that:

1. DEPENDENT SPOUSE MEANS THE WIDOWER OF A DECEASED MEMBER WHO HAS NOT RE-MARRIED, WAS LIVING WITH AND DEPENDENT UPON THE MEMBER AT THE TIME OF DEATH FOR MORE THAN ONE-HALF OF HIS SUPPORT AND HAS ATTAINED THE AGE OF 65, OR WIDOWER OF DECEASED MEMBER WHO HAS NOT RE-MARRIED AND IS TOTALLY AND PERMANENTLY DISABLED.

2. A WIDOW MUST HAVE BEEN LIVING WITH AND DEPENDENT UPON A MAN AT THE TIME OF HIS DEATH.

ALL SUCH BENEFITS SHALL CEASE UPON RE-MARRIAGE. WHENEVER A WIDOW OR WIDOWER, WHO HAS QUALIFIED FOR MONTHLY BENEFITS UNDER THIS PROVISION, HAS AN INCOME FROM ALL SOURCES IN EXCESS OF $1,800 FOR ANY YEAR, THE AMOUNT OF SUCH EXCESS SHALL BE DEDUCTED PRO RATA FROM THE MONTHLY BENEFITS PAYABLE IN THE SUCCEEDING YEAR.

NO CHANGE IN THE MINOR CHILD BENEFIT PROVISIONS ARE CONTEMPLATED IN THIS RECOMMENDATION.

Problem of "Service as a Member".

This problem occurs as to PERA, just covered, and TRA discussed in the next section of this report.

The 1957 legislation as to PERA and TRA required a minimum of 10 years "service as a member" to obtain eligibility for benefits. This has prevented eligibility for benefits on the part of members of each of these funds who have made contributions covering many years of service but have not acquired the service "as a member".

The Commission is of the opinion that people in such a category should be eligible for benefits because of their long years of service and the Commission is also of the opinion that the 1957 session did not intend to prevent such people from being eligible for benefits until they had performed years of additional service as a member.

The Commission therefore recommends:

THAT REMEDIAL LEGISLATION SHOULD BE ENACTED REMOVING THE QUALIFICATION "AS A MEMBER".

STATE TEACHER'S RETIREMENT FUND ASSOCIATION (TRA)

The previous Public Retirement Study Commission, which reported to the 1957 session, found it necessary to use quite general and inexact estimates in connection with the teacher's retirement fund.

This primarily was due to two causes:

1) Teachers had never had its financial condition measured by an adequate actuarial study.

2) Methods of keeping records and accounts made it impossible for the TRA staff to furnish the Commission's actuaries with certain data essential to a relatively accurate estimate.

Therefore, in the 1957 report it was estimated that, as of 1956, the deficit was in excess of . . . . $ 34,000,000

Pension liabilities were accruing to the fund at an annual rate of . . . . 14.5% of pay

Teachers were contributing 6% of pay (up to $4,800 per year) on a payroll of $53.8 million per year.

The State in 1956 contributed from a tax levy . . . . $ 767,083

This amounted to . . . . 1.42% of pay

Teachers were therefore increasing liabilities at the rate of 14.5% of pay plus 3% annual interest on the deficit.

These costs were, in 1956, financed by 6% of pay from teachers, plus 1.42% from tax sources or, total financing provided was only . . 7.42% of pay

Principle on Which Teacher's Pensions Are Based

The 1957 Commission found that TRA had deviated to a considerable degree from the fundamental principle of equal matching of employer and employee funds which is the basis of the State Teacher's Retirement Fund Association law.

The Principles on Which TRA is Based

1. Each teacher's total pension at retirement will be the annuity that can be purchased by equal employer and employee matching.

   a) The teacher's accumulated deductions (6% of pay up to $4,800 per year) plus interest

   plus

   b) An equal annuity provided by funds raised through tax levy.

2. Disability and survivors benefits added in recent years are an obligation of the taxpayers and are intended to be financed by turnover recovery of taxpayers contributions.

Deviation from the principles of the teacher's fund were found to arise from two actions of the Teacher's pension board which provided excessive annuities and called for considerably more than financing on an equal matching basis. This will be set forth in detail following the discussion of the findings of the 1958 actuarial survey.

The 1957 Commission recommended modifications of TRA designed to:

1. Return the teacher's fund to the fundamental principle of sound, equal employer-employee matching as to all future service.
2. Add improved disability and surviving widow with minor children benefits.
3. Provide a "savings clause" preserving to each teacher as to all

service prior to July 1, 1957, all of the excess annuity provisions made by the Teacher's pension board.

The 1957 session adopted these recommended measures and, in addition, provided:

1. A second "savings clause" providing the inflated annuity rates for all future service to all teachers with 10 or more years service.

2. A tax levy raising government support of TRA from the $767,083 provided in 1956, to $4,993,200 in 1957. After July 1, 1959 the levy will provide approximately $6,600,000 per year.

<u>1958 Actuarial Survey of Teacher's Retirement Fund (TRA)</u>

The first accurate measurement ever provided of the condition and liabilities of the Teacher's Retirement Fund became available as a result of the 1958 actuarial survey ordered by the 1957 session of the legislature.

<u>The situation as to TRA as of January 1, 1958 is</u>:

Accumulated liability of TRA is.	$ 111,097,202.
Assets are	38,697,202.
<u>Unfunded liability</u> (deficit)	$ 72,400,000. *
Rate of <u>level annual financing</u> required to keep pace with currently accruing future liability, (level normal cost)	12.0% of payroll
Rate of annual financing required to keep the $72.4 million (B) unfunded liability from increasing (3% interest)	2.3% of payroll

Thus, the minimum total annual support required as of January 1, 1958 to keep pace with the annual growth of total liabilities of TRA (keep deficit from increasing) is . . . . 14.3% of payroll

To amortize the $72.4 million deficit over 40 years while supporting currently accruing liabilities will require . . . . 15.3% of payroll

The payroll subject to pension deduction for TRA has increased from $53.8 million per year in 1956 to $94.3 million (A) on 22,015 (L) active members as of January 1, 1958.

As Shown Above:

Minimum financing needed for TRA as now constituted is 14.3% of $94.3 million payroll, or . . . . $ 13,473,150 per year.

Financing Now Provided:

Teachers contributions	- 6%	-	$ 5,658,000
Government support scheduled to be effective after 7/1/59	- 7%	-	$ 6,601,000

Total support scheduled after July 1, 1959 . . . . $ 12,259,000 per year.

Thus, it is apparent that to keep the TRA deficit from growing, the legislature must provide for additional annual financing to the extent of . . . . . $ 1,214,150 per year.

This is equal to . . . . 1.28% of pay

Recommendations as to financing will be made at the end of this section on TRA.

* The actuarial survey revealed a considerably larger deficit in the TRA fund than the 1957 Commission had been able to estimate on deficient data.

The Nature of the Teacher's Pension Problem.

The deficit of the Teacher's fund arises from two general causes. The problem of the fund can best be understood if the deficit due to each cause is considered separately.

The two general sources of deficit arose from:

1. Failure of government to match teachers contributions during periods of active service as is inherent in the fundamental principle of TRA.

2. Failure of Teacher's pension board to adopt or change to annuity purchase rates in accord with mortality and interest experience of TRA membership.

1. The deficit of TRA, due to failure to match the teachers contributions during periods of active service as is inherent in the basic equal matching principle of the fund.

This deficit amounts to $72.4 million and is due to the fact that employer financing to provide equal matching of each teacher's accumulated contributions, plus the cost of disability, surviving spouse, and minor children benefits has not been provided.

2. The deficit due to deviation from the fundamental principle of TRA by action of the Board of that fund.

This deficit amounts to $25.1 million and is due to two actions of the Board of the State Teacher's Retirement Fund Association.

a) The adoption by an early board of annuity rates paying benefits that could not be financed by matching, and the continuation of those rates until 1957.

b) Failure to make available to any session of the legislature an actuarial survey revealing the unsoundness of the annuity rates.

This $25.1 million is in excess of the cost of the equal matching principle of the fund and results from actions of the Board which inflated the benefits entirely at taxpayer expense. <u>This was not a decision of the Legislature</u>.

<u>Perpetuation of this action as to all future teachers services would cause additional deficits and require a considerable increase in costs of financing TRA</u>.

The Background, Present Status, and Dangers of TRA Deviation from the Principle of Matching

Much of the confusion and misunderstanding concerning TRA pensions arises from failure to clearly understand the basic principles of the Teacher's fund and the nature and consequences of the deviations from those principles. A constructive approach to the problems of the Teacher's fund requires this understanding.

Prior to 1957 the TRA pension law provided that teachers pensions would be determined as follows:

1. The teacher's accumulated deductions, plus interest thereon, was used in accordance with annuity rates as "determined by the Board" to purchase one-half of the pension.

2. The State was obligated to provide an equivalent amount of pension.

3. The State was also obligated to assume responsibility for any deficits of the fund. A substantial portion of the total has, in fact, arisen due to unrealistic annuity purchase rates allowed by the Board.

The significance of the above points becomes clear as the following facts are summarized:

1. The TRA pension board from the first adopted annuity rates that provided annuities approximately 30% in excess of amounts that the money could buy. No competent authority recognizes such a table for annuities, and no insurance company has used such a table for annuities.

2. The TRA pension board has, since 1931, adhered to this unrealistic mortality table and interest assumption, even though constantly in possession of authority to adopt annuity tables based on actual mortality experience and interest earned on investments.

3. Today, under these annuity tables, women receive 30% more annuities than the money involved will buy. Men receive 26% more annuities than the money involved will buy.

The manner and extent that these annuity rates of the TRA Board deviate from the principle of matching may be summarized as follows:

<u>In addition to State matching of the teacher's accumulated deductions, plus interest thereon, the pension fund incurs additional deficits to the extent of</u> --

1. 30% of the teacher's accumulated deductions, plus interest, to cover the excess cost of the annuity provided by the TRA board rates.

2. A second deficit equal to 30% of the teacher's accumulated deductions to cover the cost of duplicating the excess annuity TRA board rates provide the teacher or the teacher's funds.

The result - an extra deficit equal to 60% of the teacher's accumulated deductions which is above and beyond the cost of matching the teacher's dollars.

In other words, under the TRA board annuity rates the State must provide $1.60 for each $1.00 of teacher's accumulated deductions.

For example: A retiring woman teacher gets $1,300 of value for each $1,000 of her accumulation applied to purchase her annuity. Government must match this annuity which she purchases, which is worth $1,300. Therefore government is obligated to provide an annuity worth $2,600 but has received only $1,000 from the retiring teacher.

The financial effect is seen to be a deficit of $600, or 60% of the teacher's deposit.

Some significant questions arise:

When we note the Legislature adopted the teacher's pension law enunciating the principle of equal matching and delegated to the TRA board the responsibility of selecting annuity tables, some questions are raised:

1. Did the Legislature expect that the board would select annuity rates that would conform to the equal matching principle of the law?

2. Did the Legislature delegate to the Board the power to select annuity rates so that these rates could be revised as mortality experience and interest on investments might indicate?

It is important to note that:

While the TRA board had the authority to "determine annuity rates" it had authority to increase or decrease teachers annuity purchase rates at any time before retirement without the knowledge or consent of the Legislature. Thus, as to teachers not retired, the annuity rates were neither a promise nor a guarantee by the Legislature or the TRA Board.

Recommendation of the 1957 Public Retirement Study Commission Relative to the Matching Principle.

The 1957 Commission recommended that for all teachers service after July 1, 1957 there should be adherence to the principle of equal matching of the teachers accumulated contributions.

To that end it recommended that thereafter accurate and realistic annuity rates be followed.

The 1957 Commission took note of several human factors:

1. The excessive annuity rates of the TRA pension board had been in effect for many years.

2. Many illustrations of retirements had been published and circulated to teachers based on those rates.

3. Many teachers were approaching retirement and anticipating pensions based on the excessive rates.

4. To project the rates forward for future service would perpetuate the deviation and render difficult later adjustments.

1957 Commission "Savings Clause".

Therefore, the 1957 Commission recommended a "savings clause" providing that as to all teachers' accumulated deductions for service prior to July 1, 1957, the annuities provided for the teachers deductions and State matching would be on the basis of the old TRA Board rates.

This recommendation, based on human considerations for people, obligated the taxpayers to a deficit in excess of equal matching which the 1958 actuarial survey reveals to be $12.8 million.

In dollars, the Commission's "savings clause" treated all teachers alike.

For each teacher's dollar of contribution before July 1, 1957, there would be $2.60 of pension value on the old deviation from matching principle rates.

For each teacher's dollar of contribution plus interest earned after July 1, 1957, re-establishment of the matching principle - hence, $2.00 of pension value.

The 1957 Commission, and again this Commission later in this report, has recommended investment procedure designed to increase interest earned. This would increase TRA pensions.

Extra "Savings Clause" Added at 1957 Session.

The 1957 session added a second, or additional, "savings clause" to TRA at the same time it added a first, or only, "savings clause" to PERA and SERA. The Commission recommended bills for the latter two funds did not contain "savings clauses". The result was that TRA received a second savings clause which had a different effect on TRA from the effect on SERA and PERA of the single savings clause placed in these last two funds.

This second, or additional savings clause, provided that any teacher with ten years of service on July 1, 1957 would have the right to have his pension annuity due to future service after July 1, 1957 computed on the old TRA board rates.

This means that for the teachers covered by this seeond savings clause, the deviation from the equal matching principle will be perpetuated as many as 30 or 35 years into the future. These teachers will receive $2.60, or perhaps more, pension value for each $1.00 contributed from future salary. This clause would be even more adverse to the fund if life spans continue to lengthen.

All other teachers will be on equal matching and thus receive $2.00 of pension value for each $1.00 future contribution.

The following illustration is one of the many that could be shown demonstrating the inequity of the operation of the "second savings clause".

Basis of illustration - retirement in 1987 at age 65.

Three female teachers, age 35 in 1957, have each - by 1987 - built up accumulated deductions from salary of . . . . $ 12,960.

Teacher "A", age 35, had 10 years of service in 1957
" "B", " 35, " 9 " " " " 1957
" "C", " 35, had just started working in 1957.

For $12,960 accumulated deductions in 1987 -

Teacher "A" - under the extra savings clause will receive a pension of . . . . $ 2,446.87 per yr.

Teacher "B" - (no benefit under second savings clause) for 10 years service and approximately $2,200 deductions subject to original savings clause will receive a pension of ..... $446.87 per year and for the $10,760 accumulated after July 1, 1957, subject to equal matching rates, will receive a pension of $1,573,20 per year

Therefore teacher "B" will receive actual pension of . . . . $ 1,987.56 " "

Teacher "C" - on $12,960 accumulated deductions all occurring after 1957, will receive a pension totalling . . . . $ 1,894.80 " "

Under the equal matching principle the cost to the taxpayers for each of the three teachers would be $12,960 to match the teacher's accumulated contributions.

The extra cost to the taxpayers, because of the savings clause, would be:

For teacher "C" (all service after 1957)		no extra cost
" " "B" (9 years service under the first, or Commission savings clause)		$1,320 extra cost
" " "A" 10 years service prior to 1957 under first, or Commission savings clause	- $1,550	
30 years service after 1957 under second, or extra savings clause	- $6,250	
Total taxpayers extra cost over matching due to two savings clauses		$7,800 extra cost

All teachers who participate in the second, or extra savings clause, would also have already participated in the first, or Commission's saving clause.

As already pointed out, the first or Commission savings clause, has been found by the actuaries to cost in deficit of the TRA fund.	$12.8 million
The actuarial survey reveals that the second, or extra savings clause, accounts for an additional part of the TRA deficit in the amount of	$12.3 million

The Difference in Principle of the Two Savings Clauses.

The Commission, or first savings clause, was substantially based on the principle of saving or preserving to the individual those values already provided due to service already performed.

As has been pointed out, these values often were excessive when compared to the principles of the pension plans involved but <u>they were principally values the employees thought they had acquired due to past service</u>.

The second, or "extra savings clause" added to TRA provided that <u>to some members of the fund, for future service not yet performed, a return in excess of that provided within the principle of the fund would be given</u>.

To PERA with over 36,000 members the legislature added
a savings clause costing . . . . $13.5 million
For TRA with 22,000 members the first type of
savings clause (past service) costs - $ 12.8 million
The second, or future savings clause, adds a
second cost of . . . . - $ 12.3 million
<u>Therefore, in the case of TRA, for 22,000 members, the</u>
<u>cost of the two savings clauses totals</u> . . . . $ 25.1 million

The actuary of the TRA fund pointed out that for female teachers under the second, or extra savings clause, it will in the future require 15.6% of pay each year to keep pace with the growth of pension liabilities.

If it is considered essential that pensions build up that fast then, in order to maintain the equal matching principle, the teachers contribution rate would have to be raised to 7.8% of pay with government matching it at that same rate of contribution and with accurate annuity rates as set forth in the 1957 legislation.

On that basis, if teachers are willing to raise the rate of deductions to 7.8% of pay and the legislature is willing to match that rate of contribution, then all teachers would be able to provide the high rate of pension provisions and the principles of the TRA would be maintained.

The Commission questions whether TRA can ever be placed, or for long maintained, on a sound basis if for future service some members receive considerably larger benefits than do others when all make the same rate of contribution.

Therefore the Commission Recommends:

> THE SECOND SAVINGS CLAUSE IN THE STATE TEACHERS RETIREMENT FUND SHOULD BE REPEALED IN ORDER THAT, FOR FUTURE SERVICE, THE EQUAL MATCHING PRINCIPLE BE RESTORED TO THE TEACHER'S RETIREMENT FUND. This clause is Minnesota Statutes, 1957, Section 135.55, Subdivision 1.

Provisions as to "Turnover Recovery".

Minnesota Statutes 1957, Section 135.44, Subdivision 2 (2)(b) and Subdivision 3; and Section 135.33, Subdivision 1 (c) and Subdivision 2, could do considerable damage to the TRA fund unless remedial measures are enacted.

These provisions were added to the proposed 1957 legislation so late that there was not time to examine meaning or effect.

Section 135.44, Subdivision 3, provides -

> "The board shall annually credit to each member's individual account an amount pro rated which represents the net accumulation or surplusin the fund other than interest. This surplus shall include the net amount of employers contributions of members who have withdrawn from the fund taking a refundment of their accumulated deductions plus other accumulation less the amounts expended by the fund as authorized by law."

The apparent intention is to increase the pensions of teachers serving until retirement by applying turnover recovery to that purpose. Turnover recovery consistsprimarily of government contributions released from pension obligation to match employees contributions when the employee withdraws his or her funds in cash. In addition, there is turnover recovery when the withdrawäl does not include accumulated interest.

The Commission is advised that as yet no action has been taken by the board as to these turnover provisions since they are so ambiguous and confusing as to defy clear understanding. If this clause stays in the law, there will eventually have to be some interpretation of meaning.

1. The fund will have no actual "surplus" until the $72.4 million deficit has been eliminated. This interpretation will postpone the effect of the above provision until there is no deficit.

2. What is the "net accumulation" since the"fund" referred to in Subdivision 3 above is defined in Section 4, Subdivision 1, as "the teachers retirement fund consisting of employee contributions, employer contributions and other amounts authorized by law including amounts in the fund when this act takes effect. From this fund there is appropriated the payments authorized by this Chapter in the amounts in the manner and at such time provided herein." Thus there could be no "surplus" in the fund as long as there is a deficit.

3. If there were funds to be distributed in the manner described in Subdivision 3, the adverse effects would be serious and, in the opinion of the Commission, contrary to what was actually intended by the 1957 Legislature.

The Commission is of the opinion that the real intention of subdivision 3 was to provide that any turnover recovery of tax funds in excess of the amount needed to finance disability and survivor benefits, plus the operating expense of the fund, would be devoted to increasing the prospective pensions of active teachers instead of being applied against the deficit of the fund or toward the reduction of governmental contributions.

The benefit formulas in SERA and PERA at present require the use of turnover gain on approximately such a basis.

Neither SERA or PERA have "second savings clauses" which will considerably inflate pension benefits on a rising plane for future service in behalf of a substantial segment of its membership.

The Commission is of the opinion that the taxpayers cannot be expected to finance both a second savings clause and, in addition, lose all recovery of turnover.

Certainly if any turnover gain is used to increase any teachers pensions it should under no circumstances be applied to people under a double savings clause.

The Commission Recommends that:

> IF, AND ONLY IF, THE "SECOND SAVINGS CLAUSE" IS REPEALED AS HERETOFORE RECOMMENDED THEN SOUND AND WORKABLE TURNOVER RECOVERY PROVISIONS BE ENACTED TO INCREASE TEACHERS PENSIONS IN ADDITION TO THE EQUAL MATCHING PROVISION.

To accomplish this objective, Section 135.44, Subdivision 2 (2)(b) and Subdivision 3, plus Section 135.33, Subdivision 1 (c) and Subdivision 2 should be repealed and in place thereof provisions should be added as follows:

Within the Teacher's Retirement Fund there should be established an "operation account" into which would be transferred:

1) Interest left in the fund by teachers withdrawing their "accumulated deductions".

2) Accumulated employer normal contributions that have been paid into the fund since July 1, 1957 by reason of the service of teachers who withdraw their accumulated deductions, plus interest on such employer normal contributions.

3. Such turnover retirement credits as hereafter provded as are released by withdrawal of accumulated deductions by teachers to whom turnover retirement credits had been recorded.

From such operation account shall be withdrawn.

1. The cost of operation of the Teacher's Retirement Fund.
2. The full adequate reserve of each disability claim allowed by the board.
3. The full adequate reserve of survivors benefit claim allowed by the board.
4. The full amount of reserve of such additional benefits, if any, as may in the future be added except when specific financing is provided for such additional benefit.

At the end of any fiscal year, when the balance in the operations account is found to exceed 2% of the total payroll from which the TRA received deductions during the preceding year, the board may transfer such excess to a turnover recovery reserve.

Each transfer of such "excess" from this operation account shall be used to provide turnover retirement credits to be entered to the credit of the individual teachers.

Each teacher's turnover retirement credit shall be determined in proportion the amount of those teachers accumulated deductions plus interest credits in the fund at the time of determination which, upon retirement, will not be eligible toward the purchase of an annuity at the rates in use before July 1, 1957.

Upon the retirement of a teacher, such turnover retirement credits as have been recorded from time to time on the teacher's record, plus interest thereon to the date of retirement, shall be applied to annuity rates adopted after July 1, 1957 to provide an additional pension over and above the total pension otherwise determined in accordance with this Act.

No turnover retirement credit shall be withdrawable or added to amounts payable by reason of death prior to retirement.

If the Commission's recommendations as to TRA are enacted, including the recommendation as to modification of surviving spouse benefits, and if employer contributions are made as now provided by statute, there will be substantial turnover retirement credits. It will require several years to build the "operation account" to the proper level to provide "excess" after which turnover retirement credits should regularly accrue.

<u>The Commission Further Recommends</u>:

> THAT IF THE "SECOND SAVINGS CLAUSE" IS NOT REPEALED, SECTION 135.44, SUBDIVISION 2 (2)(b) AND SUBDIVISION 3, PLUS SECTION 135.33, SUBDIVISION 1 (c) AND SUBDIVISION 2, SHOULD BE REPEALED BUT THE FOREGOING TURNOVER RECOVERY PROVISIONS SHOULD NOT BE ADOPTED.

Need for Revision of Survivor Benefits in TRA.

Surviving mother of minor child and minor child benefits similar to comparable benefits in social security were recommended for TRA by the Public Retirement Study Commission reporting to the 1957 session of the State Legislature.

Because TRA has such a small proportion of married men teachers with minor children - the only members whose death would cause benefit payments to become payable - it was contemplated that the total cost to the fund would be a small fraction of the cost of such benefits to other pension funds. (Estimated cost to PERA - .5% of payroll).

This benefit is among those financed by turnover recovery described in the preceding paragraphs.

Before the 1957 amendments to the TRA law became enacted, the"$65 per month for a mother of a minor child" terminology was changed to "surviving spouse".

The benefit thus became a $65 per month life annuity to any spouse instead of to a mother of a minor child under 18 years of age.

1. Widows without children, or with grown children, get $65 per month life annuities. Many of these women are employed, or are fully employable.

2. Husbands of deceased teachers are surviving spouses and get $65 per month life annuities.

For the first year of operation the survivors benefits cost the TRA $567,000 - or approximately .6% of payroll. Several years experience will be needed to more closely determine the average cost but it is obvious this surviving spouse clause will cost much more than the mother of minor child provision.

Because the "spouse benefit" is of no value to single teachers and provides benefits to many who are not dependent on teachers who die, the cost to TRA does not appear warranted.

<u>The Commission therefore recommends that the TRA law be amended to provide that:</u>

1. DEPENDENT SPOUSE MEANS THE WIDOWER OF A DECEASED MEMBER WHO HAS NOT RE-MARRIED, WAS LIVING WITH AND DEPENDENT UPON THE MEMBER AT THE TIME OF DEATH FOR MORE THAN ONE-HALF OF HIS SUPPORT AND HAS ATTAINED THE AGE OF 65, OR WIDOWER OF DECEASED MEMBER WHO HAS NOT RE-MARRIED AND IS TOTALLY AND PERMANENTLY DISABLED.
2. A WIDOW MUST HAVE BEEN LIVING WITH AND DEPENDENT UPON A MAN AT THE TIME OF HIS DEATH.

   ALL SUCH BENEFITS SHALL CEASE UPON RE-MARRIAGE. WHENEVER A WIDOW OR WIDOWER, WHO HAS QUALIFIED FOR MONTHLY BENEFITS UNDER THIS PROVISION, HAS AN INCOME FROM ALL SOURCES IN EXCESS OF $1,800 FOR ANY YEAR, THE AMOUNT OF SUCH EXCESS SHALL BE DEDUCTED PRO RATA FROM THE MONTHLY BENEFITS PAYABLE IN THE SUCCEEDING YEAR.

   NO CHANGE IN THE MINOR CHILD BENEFIT PROVISIONS ARE CONTEMPLATED IN THIS RECOMMENDATION.

STATE EMPLOYEES RETIREMENT ASSOCIATION

SERA is one part of a two part coordinated employee pension plan which is completed by social security (OASDI).

SERA members adopted the plan for coordination with OASDI by referendum in October 1957 when the members of the Public Employees Retirement Association and the State Teacher's Retirement Association Fund rejected similar coordination plans.

In the section of this report dealing with "Social Security and Public Employees" the combined costs of SERA plus OASDI and the increase in the OASDI benefits and costs since the 1957 referendum are set forth.

While considering SERA it should be kept in mind that for 1957 the cost of OASDI to the State was $1,905,000, or 2.25% of pay. The cost of OASDI for 1959 will be 2.5% of a higher payroll, or considerably over $2,117,000.

In 1960 the OASDI tax will increase an additional .5% making the cost 3% of pay for both the employer and the employee. The costs to the employees for OASDI are equal in amount to the costs to the employer.

In 1957, before coordination with OASDI, based on estimates of the SERA actuary and the Commission's actuaries, the report of the Commission stated:

The estimated deficit of SERA was in excess of . . . . . $ 40. million

Normal level cost was estimated as . . . . 12% of pay

divided - 6% employee contribution
6% employer contribution

Cost of amortizing the deficit in 40 years was found to be - 2.4% of pay

The recommended changes in costs and benefits of SERA in case of coordination with OASDI were, in 1957, estimated to result in the following financial condition of SERA.

Remaining deficit would be . . . . $ 9.5 million

Employee contributions would be 3% of pay
Employer costs for normal support would be 3% of pay

Total normal level support costs would be . . . . . 6% of pay

<u>The 1958 actuarial survey reveals the following situation of SERA as modified by both the legislature of 1957 and the referendum of members</u>:

Accrued liability of SERA	$ 69,050,626
Assets	42,323,450
Unfunded Liability (deficit) . . .	$ 26,727,175

Reasons for the difference between estimated deficit of $9.5 million and the actual deficit of $26.7 million are primarily the following:

1. The 1957 Commission recommended a plan with benefits which would be covered by equal employer and employee contributions of 3% of payroll, or a total contribution of 6% of payroll.

   The plan actually passed by the legislature is more liberal than that recommended by the 1957 Commission; it therefore costs more. The level cost as brought out by the 1958 actuarial survey is 6.3% of payroll; this increase in cost is reflected in a higher liability of the fund.

2. The 1957 Commission's estimate of deficit was based on the liability due to retired members as of 1955, the latest data available at the time of study. Since 1955 there have been many additional retirements so that as of January 1, 1958, the liability as to retired members was $21.9 million.

The combination of these two causes raised the deficit to $26.7 million as of January 1, 1958.

SERA payroll for pension purposes - $84,145,857 for 27,968 active members.

Normal level annual cost rate at which pension liabilities accrue as to active members . . . . 6.285% of pay

Employees contributions . . . . . 3% of pay
Employers normal contribution . . 3% of pay

<u>Present total rate of financing as to current costs</u> - 6.0% of pay

Rate by which normal level cost is under-financed - .285% of pay

Rate of financing needed for 3% interest on deficit - <u>.95%</u> of pay

<u>Additional rate of financing required to keep</u>
<u>the deficit from increasing</u> . . . . 1.235% of pay

To amortize the deficit over 40 years would require that, instead of 1.235%, the additional financing would have to be . . . . 1.7% of pay

There are important reasons why the deficit of SERA should be amortized more rapidly, at least in the next few years, than may be provided for funds not involved in coordination with OASDI.

Approximately $21,261,763 of the $26.7 million deficit in SERA is due to pensions payable to <u>people already retired</u> in whose behalf there will be neither employee or regular employer contributions. All of the money to pay these pensions will have to be disbursed long before 40 years from now. It is doubtful if even one person now retired will survive 40 years.

Referring to the section of this report dealing with OASDI, it is set forth that state employer contributions to social security will increase .5% of pay in 1960 and additional .5% increases are scheduled for 1963, 1966 and 1969. Of course employee costs increase at the same rate.

OASDI employer costs in 1969 will be over $1,908,000 more per year than in 1957. Here again employee costs will experience the same increase.

The Commission Recommends:

BECAUSE OF THE FOREGOING TWO REASONS, IT IS THE OPINION OF THE COMMISSION THAT THE EMPLOYER FINANCING TOWARD CONTROL OF SERA DEFICIT SHOULD NOT BE LESS THAN 2% OF EMPLOYEE PAY IN ADDITION TO THE NORMAL EMPLOYER SUPPORT OF 3% OF PAY ON THE AMOUNT OF EACH EMPLOYEE'S PAY SUBJECT TO PENSION DEDUCTIONS.

Remedy of an Oversight: The Commission Further Recommends:

THE EXTRA PENSION BENEFIT OF $5 PER YEAR OF PENSION FOR EACH YEAR OF SERVICE BEFORE RETIREMENT WHICH, BEFORE THE 1957 SESSION, HAD BEEN REGULARLY PAID TO THOSE SERA EMPLOYEES WHO HAD RETIRED SHOULD BE RESTORED TO THOSE RETIRED, FORMER EMPLOYEES AS OF JULY 1, 1957 THE DATE THE REPEAL OF THESE BENEFITS BECAME EFFECTIVE.

Reasons for this recommendation are:

The Commission is unanimously of the opinion that repeal of these benefits was accidental. The 1957 session of the legislature did not in any other instance reduce pension benefits of persons already on retirement.

MISCELLANEOUS REMEDIAL RECOMMENDATIONS

During the past biennium the study of the existing pension laws called attention to the fact that a number of minor changes, principally remedial in nature, were needed.

Most of these changes are mechanical or technical, and some are to remedy minor injustices. In the opinion of the Commission they are not sufficiently noteworthy to warrant detailed explanation and specific recommendation in this report.

Some of these remedial measures are incorporated in bills of major importance dealing with matters discussed in the report.

Any remedial measures noted by the Commission that cannot be included in major bills will be introduced separately by various members of the Commission

MINNESOTA HIGHWAY PATROLMEN'S RETIREMENT ASSOCIATION.

This fund, as might be expected, follows the general pattern of policemen and firemen's pension funds. Its most notable deviation from the pattern of such funds in Minnesota is that highway patrolmen contribute 7% of their salary while members of local police funds contribute 4% or less.

The level of benefits, of costs, and the total deficit of the highway patrolman's fund has increased considerably in recent years.

As of January 1, 1958 the last actuarial survey finds:

The accrued liabilities of the fund are		$ 4,014,041
Assets of the fund		1,226,695
Unfunded liability (deficit)		$ 2,787,346
The normal level annual cost (annual level amount by which pension liabilities to active patrolmen increase each year) is		$ 274,276
Interest on deficit at 3%		83,620
Minimum annual financing necessary to prevent an increase in the deficit is		$ 357,896
Financing scheduled for 1958:		
Members contributions at increased 7% rate provided in 1957 legislation	$ 108,232	
Matching Highway Department support	108,232	
Total financing scheduled for 1958		$ 216,464
Additional annual financing needed to prevent annual increase in deficit at present basis of financing . . .		$ 141,432

Section 172.02, Minnesota Statutes 1953 and Section 1, Chapter 869, Session Laws 1957, amending the laws of 1953 both provide in the last sentence of each respective section:

> "The amount of contribution required from state highway patrolmen may be increased from time to time to insure the actuarial soundness of the highway patrolmen's retirement fund created by Laws 1943, Chapter 637".

There are no provisions in the statutes to bring about compliance with the above citation.

The minimum standard of soundness would be to place the fund in the position where the deficit would not increase. As noted above, this will require additional financing of at least $141,000 per year.

The highway patrol gross payroll is $1,582,000 per year but the <u>total payroll subject to pension deductions is $1,546,171 per year</u> and will be used in the following computations.

The financing of this fund is based on equal matching of employees and employer contributions.

The normal level annual cost of	$ 274,276
which does not include financing of deficit is	17.74% of pay
On this basis employer and employee rates of contributions should each be increased from 7% of pay to 8.87% of pay.	
If this is not done the 3.74% of pay required for normal support is added to the deficit and becomes entirely a government liability unless the employer normal contribution rate is increased to	10.74% of pay
Interest on the present deficit amounts annually to .	5.4% of pay

The minimum rate of pay necessary to place the highway patrolmen's fund on the minimum standard of soundness is		23.14% of pay
If patrolmen's rate of contribution remains at		7.00% " "
Highway department contributions would have to be . .		16.14% of pay
To amortize the deficit in 40 years the annual contributions by the highway department would have to be (in addition to 7% employee contribution)		18.14% of pay

The deficits of the highway patrolmen's fund have increased rapidly in recent years:

The 1952 actuarial report showed a deficit of	$	361,613
The actuarial survey as of June 30, 1955 showed a deficit of	$	1,800,196
The actuarial survey as of January 1, 1958 shows a deficit of	$	2,787,346

The increase in deficit in 6 years is - $2,425,733.

Reasons for Increase in Deficit.

There are two causes of this increase in deficit:

1. Annual under-financing is the smaller of the two causes accounting for less than one-quarter of the increase.

2. The major increases in deficit are due to doubling of the level of pension benefits on an escalator basis.

   a) At the 1953 session the level of basic pension benefits was increased approximately 50%.

   b) At the 1957 session primary pension benefits were raised one-third to a level double the pre-1953 basis.

   c) Both raises followed the pattern of the escalator clause described in the chapter on "Local Police and Fire Funds".

   Pensions were raised for those retired and those soon to retire as well as those with a number of years of active service.

Both the patrolmen and the Highway Department have contributed on the basis of the lower rates of contribution, lower salaries for lower pension benefits of the past but all pensions are paid as if rates of contributions and salaries had always been at the present level.

The Level of Benefits:

Primary pension benefits and disability benefits have been considerably increased.

— Before 1953 primary benefits were $100 per month after 20 years service at age 58.

— The 1953 session increased benefits for 20 years service to $150 per month and reduced the age to 55 yrs.

— The 1957 session increased the benefits for 20 years service to $200 per month at age 55.

An additional provision adding to the cost to the fund is that after 10 years or more of service a patrolman can resign and at age 55 receive benefits at a full pro rata proportion to the full benefits after 20 years service.

This is indicated by the fact that as of January 1, 1958 there were only 15 retired patrolmen on pension but there were 22 deferred annuitant members who had left the patrol with 10 or more years of service but were not yet 55 years of age.

GAME WARDENS RETIREMENT ASSOCIATION

This fund, similar in plan to policemen and firemen's funds, was established by the 1955 session of the legislature. Game warden members of SERA and their accumulated past contributions were transferred to the new fund. No employer funds were transferred.

In 1957 the rate of employer contributions was increased from 6% to 7% of pay.

The level of benefits is average for this type of fund requiring 25 years of service and attained age of 55 for retirement at one-half average pay for five highest years of salary.

The condition of this fund as of January 1, 1958 was found by the actuarial survey to be:

Accrued liabilities of the fund are		$ 2,345,662
Assets amount to		424,933
Unfunded liability (deficit)		$ 1,920,729
Normal level annual cost (amount per year necessary to meet accruing liabilities		$ 100,510
Interest on deficit at 3%		57,622
Minimum annual financing necessary to prevent an increase in the deficit		$ 158,132
Members contributions in 1957. . . .	$ 44,018	
State financing	36,139	
Total 1957 financial support		$ 80,157
Additional annual financing necessary to prevent increase in deficit		$ 77,975

The Statutory provision for State support as set forth in Chapter 881, Session Laws 1957, Section 2. is ".... a sum equal to one per cent of the total amounts received from licenses as referred to in provisions of Minnesota Statutes 1953, Section 97.49, subdivision 1 ......"

This is not a satisfactory basis of financial support either in principle or in amount.

The $36,139 State support from this source in 1957 did not equal employee contributions and will never provide adequate support.

A more realistic and appropriate basis of financing is a necessity for this fund.

The January 1, 1958 deficit of $1,920,729 is $30,672 larger than the $1,890,057 deficit indicated in the report of the 1957 Commission. Principal reason for the small increase, in view of the degree of under-financing, is that the 1958 report found average retirement age under this fund has been age 61 instead of age 60, as estimated in 1957.

In addition to the inherent under-financing of this plan, the additional principal reason for the deficit is that when the membership was transferred from SERA no State contributions, and hence no employer financing, was transferred.

Expressed in terms of percent of gross payroll of all Game Wardens:

Normal support of this fund is	14.6% of pay
Minimum support to prevent further increase in deficit (normal support plus 3% on deficit)	23.6% of pay
Amount necessary to amortize the deficit over 40 years . .	26.7% of pay

This fund does not include "escalator" provisions. Pensions of retired game wardens are not subject to increase when salaries of active game wardens are raised. Thus, the additional unfinanced deficits that result from escalator provisions are not in the plan of this fund.

The pension plan for policemen and firemen in PERA is, in the judgment of the Commission, a liberal yet balanced retirement plan for employees in the safety field.

The benefit plan is described in the section of this report entitled "Policemen and Firemen in PERA".

<u>The Commission Recommends</u>:

There should be set up in SERA a separate section for safety employees. In this section should be placed the present members of the Game Wardens Retirement Association as well as officers of the Bureau of Criminal Apprehension.

Financing of this section should be separate and it should be actuarially examined so as to yield full data and actuarial findings separate from SERA generally. The deficit of this section should be separately financed.

Enforcement employee members in this section should contribute 6% of pay not to exceed $4,800 per year. Employing units of such officers will be required to contribute an amount equal to 9% of the pay of each such employee up to a maximum of $4,800 salary per year as to any employee.

An actuarial survey of this enforcement section should be made as of July 1, 1960 with all findings required by Statute.

This survey should be delivered , not later than October 1, 1960, to whatever agency of the Legislature as is designated to study and receive reports as to public employee pension funds.

In addition to normal financing, employing units should contribute to the enforcement section an additional 2% of employees pay subject to pension deductions for the purpose of financing the deficit in this section. After an actuarial survey the rate of financing of the deficit should be adjusted to the findings of the survey.

OFFICERS IN THE BUREAU OF CRIMINAL APPREHENSION

The "Tabulation of Significant Findings of 1958 Actuarial Surveys of all Public Employee Pension Funds" published in this report includes findings as to the Bureau of Criminal Apprehension. Even though this "fund" does not actually exist as a separate pension system, the 17 officers of the Bureau of Criminal Apprehension who now are members of SERA were surveyed as a group according to the benefit formula of the Highway Patrol. The purpose was to obtain suitable data necessary to contemplate various solutions to the present pension problems of this group of 17 enforcement officers.

As police officers these employees are not eligible to join other SERA members under OASDI coverage.

Criminal Apprehension officers now constitute a small group in SERA continued under the old pre-cordination with OASDI basis.

The members of the Bureau of Criminal Apprehension are police officers subject to the hazards and physical requirements of typical police work.

The pre-cordination SERA benefits, and likewise the coordinated benefits (if Congress should change eligibility for OASDI coverage) do not provide the early retirement benefits and other provisions typical of those provided for police officers throughout the United States.

The Commission is of the opinion that it would not be advisable to establish a separate 17-man pension fund for the 17 officers of the Bureau of Criminal Apprehension

The Commission Recommends:

OFFICERS OF THE BUREAU OF CRIMINAL APPREHENSION SHOULD BE INCLUDED ALONG WITH THE MEMBERS OF THE GAME WARDENS RETIREMENT ASSOCIATION IN A SAFETY OFFICERS RETIREMENT PLAN AS SET FORTH IN THE RECOMMENDATIONS IN THE GAME WARDEN'S SECTION OF THIS REPORT.

SOCIAL SECURITY AND PUBLIC EMPLOYEES.

The 1957 report of the previous Public Retirement Study Commission stated on page 53 -

"Whether or not OASI should be generally adopted as part of public employees retirement provisions cannot be dogmatically answered in either the affirmative or the negative."

"If OASI coverage is substituted for part of the present pension plans there will be definite advantages to some individual employees and definite disadvantages to other individuals with mixed effects as to many employees."

This Commission finds no reason to differ with its predecessor in this conclusion. The 1957 report did not recommend for or against the coordination of OASDI with the three major pension plans but it did set forth principles and limitations to which any coordinated plan should conform if serious consequences were to be avoided.

Principles of a Combined System of OASDI and Pension Funds.

As did the 1957 report (pages 53-57), it is most important to emphasize that any coordination plan of OASDI and a Minnesota pension plan should be required to conform to certain fundamentals. Adoption of any plan at variance with the following principles will contain elements of injustice or unsoundness.

1. Maximum combined benefits under any coordination plan must not at at any time exceed for any person the most that a similar person can acquire in the future entirely under the coordination combination.

To conform to this principle, reduced level of benefits payable by the pension fund must be effective in all respects simultaneously with the effective date of coordination with OASDI.

Principle Reasons Are:

a) Those retiring soon under OASDI windfall provisions get benefits from OASDI far in excess of what they have paid for thus causing a deficit to OASDI.

Unless the benefit level of the pension fund is adjusted at once to the long range future level so that the deficit to OASDI is offset by a reduction in the deficit of the pension fund, those retiring in the near future will get benefits far in excess of what they have paid for and the taxpayers will be liable for two deficits instead of one deficit in behalf of such persons.

b) Failure to observe this principle will result in a system of inflated total benefits on a progressively decreasing scale each year for a generation.

This would make inevitable future pressures for additional unsound measures based on the precedent of unsoundness if once started.

2. No combination plan including OASDI should be allowed which seeks to differentiate between OASDI benefits "earned as a public employee" as against those earned elsewhere. Such measures would be contrary to the principles on which OASDI is based and are fallacious. Such provisions in the laws of several states have proved severely disruptive as well as unsound.

3. A pension fund and OASDI should be entirely separate as to benefit payments and administration.

Recommendation:

IT IS STRONGLY RECOMMENDED THAT IF THE LEGISLATURE SHOULD SEE FIT, ON ANY BASIS, TO ENABLE COORDINATION OF OASDI AND ANY OF THE MINNESOTA PENSION FUNDS, IT IS IMPERATIVE THAT THE ABOVE PRINCIPLES BE FOLLOWED.

Some OASDI Problems For 1959.

The 1959 session of the legislature will have before it additional problems to those before the 1957 session. Since 1957 SERA has adopted coordination by reason of a referendum of all employees. PERA and TRA have rejected coordination by reason of a similar referendum. The 1959 session will have these additional problems:

1. Congress in 1958 increased both the costs and the benefits of OASDI.

2. Congress has enabled additional "all or none" referendums for funds like PERA and TRA who turned down the first referendum.

3. The "split system" amendment to Section 218 (d)(6) of the Federal Social Security Act (referred to in Commission discussion as Public Law #227) whereby a split system is permitted to the local pension funds, in effect allows each employee to select a coordinated program with OASDI but commits all new employees to the coordinated basis.

Increases In Costs Of OASDI.

The increases in costs of OASDI enacted by Congress in 1958 not only increase the costs of the coordination plans enabled by the 1957 session of the legislature but the financing of deficits is also rendered more difficult.

The increase in OASDI costs as to SERA members, where coordination was adopted, furnishes a good illustration of what the increased costs would have been in the cases of PERA and TRA had coordination been adopted in connection with these funds.

The SERA payroll is $84 million per year. TRA is $94 million, and PERA is $114 million so, from OASDI costs as to SERA, it is possible to estimate what costs would have been in regard to either of these two funds had they adopted coordination.

OASDI Costs in SERA Coordination.

The 1958 session of Congress in addition to raising benefits, increased the total OASDI tax one-half percent (.5%) and, beginning with 1960, setps up the schedule of OASDI tax increases to three year intervals instead of the previously planned five year intervals, thus reaching the planned maximum tax rate in 1969 instead of in 1975.

The following table compares the OASDI costs on the previous basis where $4,200 was the maximum salary subject to OASDI tax. In addition to the increase in OASDI costs shown below, there will be the additional cost of the entire OASDI tax on salaries over $4,200 per year up to a maximum of $4,800 per year.

The following costs are all estimated on the basis of the $1,905,000 OASDI cost to the State for the year 1957 at the employer rate of 2.25% of pay.

YEAR	New Employer OASDI Rate as Percent of Payroll	New Estimated OASDI Cost	Previous OASDI Rate Percent of Payroll	Previous OASDI Cost	Cost of Increased OASDI Tax
1959	2.5%	$ 2,117,000	2.25%	$ 1,905,000	$ 212,000
1960	3.0%	2,541,000	2.75%	2,329,000	212,000
1961	3.0%	2,541,000	2.75%	2,329,000	212,000
1962	3.0%	2,541,000	2.75%	2,329,000	212,000
1963	3.5%	2,965,000	2.75%	2,329,000	636,000
1964	3.5%	2,965,000	2.75%	2,329,000	636,000
1965	3.5%	2,965,000	3.25%	2,753,000	212,000
1966	4.0%	3,389,000	3.25%	2,753,000	636,000
1967	4.0%	3,389,000	3.25%	2,753,000	636,000
1968	4.0%	3,389,000	3.25%	2,753,000	636,000
1969	4.5%	3,813,000	3.25%	2,753,000	1,060,000
1970	4.5%	3,813,000	3.75%	3,177,000	636,000
1971	4.5%	3,813,000	3.75%	3,177,000	636,000
1972	4.5%	3,813,000	3.75%	3,177,000	636,000
1973	4.5%	3,813,000	3.75%	3,177,000	636,000
1974	4.5%	3,813,000	3.75%	3,177,000	636,000
1975	4.5%	3,813,000	4.25%	3,601,000	212,000
TOTAL		$ 55,493,000		$ 46,791,000	$ 8,592,000

The above table is based on one-half the total tax for OASDI and thus represents equally well either the employer or employee OASDI tax and, when doubled, represents the total taxes payable to OASDI from both employer and employee.

Total costs will be higher than the table shows since income between $4,200 and $4,800 will hereafter also be subject to the OASDI tax, all of which is additional cost.

The SERA plus OASDI rates of combined cost to employees can be obtained by adding 3% of pay to the above new rates. Combined OASDI plus SERA costs on all salaries up to the maximum of $4,800 per year per person for employees are as follows:

For 1959	5.5%
1960-62 inclusive	6.0%
1963-65 "	6.5%
1966-68 "	7.0%
1969 and on	7.5%

The combined employee plus employer normal cost of SERA plus OASDI is 11% in 1959, will be 12% of pay beginning in 1960, and will increase at three year intervals to 15% of pay from 1969 on.

To Summarize:

The 1958 OASDI increases in cost on the old basis of $4,200 maximum salary subject to tax will -

In 17 years cost the State over . . . . $ 8,592,000

In 17 years cost the employees over . . . . $ 8,592,000

From 1975 on, State employees and the State will each pay over $212,000 more in OASDI tax than before the 1958 increase in rates.

From January 1, 1959 on, the total tax on incomes between $4,200 and $4,800 will be additional increases in all costs shown above.

OASDI costs become 9% of payroll in 1969 when they were contemplated to be still at 6.5% of payroll under the schedule available to the 1957 session.

In 1969 the combined OASDI plus SERA cost becomes 15% of payroll in the year when it had previously been scheduled to only reach the level of 12.5% of payroll. This is .5% of pay higher than the previously scheduled level, reached 6 years earlier than the lower maximum had been scheduled.

Thus, SERA-OASDI employees are already in a combined pension program greater in benefits and costs than contemplated at the time of the referendum.

This is a simple fact, but the underlying factors and their implications merit special notice:

-- The long range annual normal cost level of this coordination plan, 15% of payroll, is 3% of payroll higher than the 12% normal cost of SERA alone before coordination.

-- This raises the cost to employees by 1.5% of payroll to a level of 7.5%, instead of 6% of payroll.

-- The cost to the employer is raised in the same manner.

-- The increased level of cost in OASDI obviously makes it more difficult for the State to finance the $26,727,175 deficit of SERA.

-- <u>This increase by Congress in costs and benefits of OASDI is beyond the control of the Legislature or state employees</u>.

Additional increases in costs of OASDI may well result in either or both of the following occurrences:

1. Employees may insist in reduction in SERA to reduce pension deductions from pay

and/or

2. Taxpayers may force reduction in SERA in order to reduce taxpayer pension costs.

QUESTION OF PERA AND STATE TEACHER'S RETIREMENT FUND ASSOCIATION (TRA) AND COORDINATION.

PERA and TRA offer some additional problems. Comparatively, the deficits of these two funds are larger in proportion to the number of members than the SERA deficit. This is particularly true for PERA . In addition, the coordinated plans offered in 1957 and rejected by referendum in these two funds was offered when the ultimate ceiling of 14.5% of pay on a coordinated basis was not to be reached until 1975.

If the same plan and a new referendum should be re-offered, the alternative would be to continue under the normal cost 12% PERA and TRA system or go - by 1969 - to the 15% level of total financing in the manner just shown as to SERA. Financing of deficits would in either case be additional.

If the 1959 session of the legislature should find that the accelerated cost increase of OASDI results in a greater cost than employees or taxpayers, or both, are willing to finance, then the 1957 coordinated plan for TRA and PERA would have to be revised downward as to benefits and cost in case new referendums should be enabled.

Recommendation:

THE COMMISSION RECOMMENDS THAT IF THE LEGISLATURE SHOULD ENABLE AN ADDITIONAL REFERENDUM AS TO OASDI COORDINATING EITHER ON AN "ALL OR NONE" BASIS OR ON THE "SPLIT SYSTEM" BASIS, THE COORDINATION LEVEL OF COSTS AND BENEFITS FOR PERA AND TRA AUTHORIZED BY THE 1957 SESSION OF THE LEGISLATURE IS HIGHER IN COST THAN THE PRESENT PLANS AND IS THE MAXIMUM LEVEL THAT CAN BE JUSTIFIED.

Reasons cited are:

1. The 1957 basis whereby PERA and TRA were placed on a 6% of pay basis costing employees 3% and employers 3% results, when added to OASDI, in a 15% of pay level of total cost by 1969 even if there are no additional increases in OASDI.

2. This basis, due to increases in OASDI benefits, represents an increase in total benefits over the combination offered in the 1957 referendum.

3. Both PERA and TRA would still leave the taxpayers large deficits to finance if coordination should occur on the 1957 basis.

4. To exceed the 1957 basis would offer to PERA and TRA members even higher total benefits than SERA members have obtained under coordination.

Question of Coordination With OASDI Under the "Split System" Frequently Referred to as "Public Law #227".

If the Legislature should enable coordination of TRA or PERA, or both, with OASDI in accordance with the provisions of the "split system" - or individual option - allowed by Section 218 (d)(6) of the Federal Social Security Act (frequently referred to as Public Law #227) several additional factors merit consideration:

1. In effect, under this system each employee makes his individual election between continuation under his pension fund alone or selection of a coordination plan of reduced payments and benefits under his pension fund with addition of OASDI coverage.

2. Under the Social Security Act all new employees would not have an option but would automatically be under the coordination plan.

3. Pension funds placed under the "split system" would thereafter have two classes of members each with different costs and benefits. That is, members coordinated with OASI and members not coordinated with OASDI.

The Commission Considers it a Duty to Recommend That:

IF THE LEGISLATURE SHOULD ENABLE COORDINATION UNDER THE SPLIT SYSTEM OF OASDI WITH ANY PENSION FUND THEN, IN ADDITION TO THE RECOMMENDATION ALREADY SET FORTH REGARDING COORDINATION ENABLEMENT, THE LEGISLATURE FURTHER REQUIRES THAT:

1. No so-called "savings clause" be allowed in any enablement providing individual,voluntary selection.

2. It is important that an actuarial survey of any fund for which the "split system" is enabled should be required as of July 1, of the year following the inception of the split system.

   Such actuarial survey must be completely in accordance with the statutory requirements for actuarial surveys with separate findings as to the members of such a pension fund who are under OASDI coordination and separate findings as to those members not under coordination. And also, separate findings as to any other class or groups of members if there be such who are subject to separate benefit provisions and financing provisions.

   The complete actuarial surveys should be delivered not later than October 1, following the July 1 date of the survey to any agency of the Legislature concerned with the study of public employee pensions.

This Commission has pointed out principles and recommended safeguards that should govern any coordination plan of any Minnesota pension plan with OASDI in case the Legislature should decide to enable such plan or plans. This, it should be clearly understood, does not constitute approval or recommendation of coordination.

THE COMMISSION WISHES TO CITE AGAIN THE FACT THAT THE COSTS AND BENEFITS OF OASDI ARE UNPREDICTABLE AND BEYOND THE CONTROL OF THE STATE. THIS IS WELL ILLUSTRATED BY THE FACT THAT WITHIN TWO YEARS THE EMPLOYEE AND EMPLOYEE COSTS OF THE SERA-OASDI COORDINATION HAVE INCREASED.

Public Employees For Whom OASDI Is Clearly Advisable.

The 1957 Public Retirement Study Commission report sets forth on pages 58 and 59 the conclusion that coverage under OASDI rather than inclusion in membership of either of the three major pension plans is definitely advisable for public employees in the following three categories.

1. Part-time, seasonal, and temporary employees.
2. Persons entering public employment in the future at ages in excess of 50 years.
3. Present employees 60 years of age or over who have less than six years membership in a public employee pension fund.

This commission concurs in the opinions of the previous commission as set forth on pages 58 and 59 of the 1957 Report and urges that there be further efforts to obtain from Congress appropriate legislation to implement these recommendations.

To make effective such federal legislation, should it be forthcoming, this Commission recommends that the statutes governing SERA, PERA and TRA be amended to provide that the governing board of each fund be authorized to declare ineligible for membership in such funds employees in the categories above described provided that such employees, if declared ineligible, can be provided with coverage under OASDI.

LOCAL PENSION FUNDS FOR PAID FIREMEN AND POLICEMEN

The 21 paid firemen' funds and 26 policemen's funds are local as to membership and operation,but are all the result of legislative enactment.

The laws governing these funds follow a general pattern although there are numerous amendments and provisions applicable to single funds or groups of funds. There has never been a complete codification of all of the laws governing policemen and firemen's pensions.

The pattern of earlier retirement eligibility in contrast to other public employee funds, and the similarity of practices as to financing are sufficient to enable treatment of these funds in a group.

For most of the firemen and policemen's funds the 1958 actuarial surveys are the first extensive measurement ever made as to the condition and prospective future costs of these funds.

Paid Firemen and Policemen

The cost of a pension fund may be paid for either by postponing cost until the date of benefit payment (pay-as-you-go financing), or by regular deposits on a scientific, orderly basis of accrual over the entire working career of each member of the fund. Under the latter method, the total individual members' annual cost is called the "normal cost" of the fund.

Under this method of advance preparation for the ultimate cost of a fund, the periodic deposits build up a fund. This fund, when invested at interest, provides an investment return which materially reduces the dollar cost of the plan. The required size of the fund at any given time is measured by the "accrued liability" or "required reserve" of the plan.

To the extent that a given plan does not have assets equal to this accrued liability, it has a "deficit" equivalent to the excess of accrued liability over assets.

The following tabulations "Results of Actuarial Surveys as of January 1, 1958." show the condition of each fund. The significance can be illustrated by taking the total of the firemen's funds and the total of the policemen's funds and their financing in 1957.

(see next page for tabulations)

RESULTS OF ACTUARIAL SURVEYS AS OF JANUARY 1, 1958

FIREMEN'S FUNDS

	A	B	C	D	G	H	K	P	O	S
Name of Fund	Payroll	Deficit	Assets	Required Reserve	Support in 1957 Dollars-Percent	Normal Cost Dollars -Percent	Normal Plus Amortization	Normal Plus Frozen Deficit	Membership	Current Annuities Payable
Albert Lea	$ 66,840	$ 25,139	$ 91,045	$ 116,184	$ 11,607 - 17.4%	$ 6,884 - 10.3%	11.9%	11.4%	27	$ 3,660
Austin *	152,286	474,551	149,767	624,318	21,943 - 14.4	27,258 - 17.9	31.4	27.2	52	11,464
Chisholm	66,672	282,318	74,641	356,959	18,238 - 27.4	8,442 - 12.7	31.0	25.4	28	12,060
Cloquet	69,900	138,563	84,629	223,192	11,584 - 16.6	7,911 - 11.3	19.9	17.3	24	8,040
Crookston	16,320	52,839	52,038	104,877	8,845 - 54.0	3,896 - 23.8	37.8	33.6	33	3,060
Duluth *	736,488	4,553,991	360,728	4,914,719	195,055 - 26.5	128,132 - 17.4	44.1	35.9	286	222,568
Eveleth	70,973	200,323	50,792	251,115	21,259 - 30.0	5,969 - 8.4	20.6	16.9	31	15,540
Faribault *	45,000	215,065	72,338	287,403	8,662 - 19.2	6,278 - 14.0	34.6	28.3	16	5,640
Hibbing	182,550	819,184	171,023	990,207	37,274 - 20.4	19,520 - 10.7	30.1	24.2	70	29,941
Mankato	121,716	538,483	111,242	649,725	20,089 - 16.5	20,213 - 16.6	35.7	29.9	50	3,760
Minneapolis *	3,155,136	19,245,008	347,569	19,592,577	667,886 - 21.2	446,161 - 14.1	40.5	32.4	974	790,128
Red Wing	54,600	140,802	91,481	232,283	10,290 - 18.8	5,619 - 10.3	21.4	18.0	25	4,090
Richfield	55,128	212,367	85,965	298,332	12,417 - 22.5	23,500 - 42.6	59.3	54.2	30	5,063
Rochester	335,664	751,815	108,514	860,329	40,995 - 12.2	42,809 - 12.8	22.4	19.5	97	29,340
St. Cloud	126,528	301,168	81,445	382,613	19,109 - 15.1	11,298 - 8.9	19.2	16.1	46	19,500
St. Louis Park	98,498	309,522	83,012	392,534	27,210 - 27.6	31,594 - 32.1	45.7	41.5	39	0
St. Paul	2,335,428	10,877,856	342,979	11,220,835	491,566 - 21.0	278,071 - 11.9	32.1	25.9	764	612,882
South St. Paul	87,034	167,157	121,467	288,624	8,588 - 9.9	11,570 - 13.3	21.6	19.1	19	3,796
Virginia	134,880	749,415	68,464	817,879	21,350 - 15.8	20,783 - 15.4	39.4	32.1	57	25,452
West St. Paul	51,000	1,578	14,153	15,731	2,186 - 4.3	2,692 - 5.3	5.4	5.4	11	0
Winona	173,040	678,451	48,893	727,344	22,207 - 12.8	19,114 - 11.0	28.0	22.8	69	33,180
TOTAL	$8,135,681	$40,735,595	$2,612,185	$43,347,780	$1,678,360 20.6%	$1,127,714 13.9%	35.5%	28.9%	2,748	$1,839,164

* Has "escalator clause" Funds with an escalator clause provide automatically higher pensions for retired members with increase of active member's salary.

A Annual payroll as of January 1, 1958.

O Membership includes active members, deferred annuitants, retired members, disabled members, and widows and children of deceased members now receiving benefits.

S Annual annuity payments for all classes of annuitants as of January 1, 1958.

RESULTS OF ACTUARIAL SURVEYS AS OF JANUARY 1, 1958

POLICEMEN'S FUNDS

	A	B	C	D	G	H	K	P	O	S
Name of Fund	Payroll	Deficit	Assets	Required Reserve	Support in 1957 Dollars- Percent	Normal Cost Dollars - Percent	Normal Plus Amortization	Normal Plus Frozen Deficit	Membership	Current Annuities Payable
Albert Lea	$ 68,856	$ 225,654	$ 58,900	$ 284,554	$ 8,872 - 12.9%	$ 14,867 - 21.6%	35.8%	31.4%	22	$ 9,018
Anoka *	58,080	36,268	26,053	62,321	5,443 - 9.4	11,831 - 20.4	23.1	22.2	12	0
Austin	158,172	467,715	62,632	530,347	16,120 - 10.2	27,368 - 17.3	30.1	26.2	45	10,242
Brainerd	60,448	173,535	25,203	198,738	5,380 - 8.9	11,543 - 19.1	31.5	27.7	15	1,404
Chisholm	33,276	185,171	43,994	229,165	7,260 - 21.8	5,827 - 17.5	41.6	34.2	16	6,668
Crookston	20,220	16,661	14,221	30,882	3,772 - 18.7	1,578 - 7.8	11.4	10.3	8	1,656
Columbia Heights *	49,336	111,508	11,794	123,302	636 - 1.3	9,026 - 18.3	28.1	25.1	9	0
Duluth *	592,476	3,631,834	343,157	3,974,991	189,103 - 31.9	89,085 - 15.0	41.6	33.4	227	173,048
Eveleth	57,852	154,029	50,080	204,109	7,157 - 12.4	3,841 - 6.6	18.2	14.6	21	6,105
Fairmont *	50,880	102,735	30,904	133,639	7,683 - 15.1	8,470 - 16.6	25.4	22.7	14	2,760
Faribault	69,240	195,802	6,428	202,230	6,428 - 9.3	14,969 - 21.6	33.9	30.1	20	4,560
Hibbing	78,540	510,908	53,091	563,999	28,604 - 36.4	13,659 - 17.4	45.5	36.9	44	28,978
Mankato *	117,624	346,666	82,967	429,633	15,858 - 13.5	17,502 - 14.9	27.6	23.7	35	12,990
Minneapolis *	3,598,524	18,405,322	728,360	19,133,682	712,549 - 19.8	606,353 - 16.9	39.0	32.2	1,122	836,491
Moorhead	61,248	182,198	47,560	229,758	8,297 - 13.5	13,081 - 21.4	34.2	30.3	19	3,060
Nashwauk	13,560	34,958	17,882	52,840	2,077 - 15.3	1,611 - 11.9	23.0	19.6	3	0
New Ulm	46,913	150,188	46,984	197,172	7,145 - 15.2	8,625 - 18.4	32.2	28.0	16	3,480
Red Wing	55,620	106,791	69,249	176,040	6,995 - 12.6	9,594 - 17.2	25.6	23.0	15	4,140
Rochester *	243,056	703,986	128,831	832,817	12,891 - 5.3	37,010 - 15.2	27.8	23.9	60	15,411
St. Paul *	2,509,678	9,840,627	882,373	10,723,000	412,259 - 16.4	482,000 - 19.2	37.2	31.0	713	428,697
St. Cloud *	123,353	394,848	81,166	476,014	13,651 - 11.1	20,628 - 16.7	30.6	26.3	48	19,862
St. Louis Park *	148,657	159,379	50,547	209,926	33,209 - 22.3	29,338 - 19.7	24.4	23.0	29	0
South St. Paul *	116,611	513,156	94,768	607,924	27,127 - 23.3	23,805 - 20.4	39.5	33.6	30	14,789
Thief River Falls	36,120	44,071	11,137	55,208	3,750 - 10.4	7,286 - 20.2	25.5	23.8	11	600
Virginia	100,380	455,447	68,771	524,218	18,118 - 18.0	11,338 - 11.3	30.9	14.9	44	24,450
Winona *	140,880	456,189	91,178	547,367	15,664 - 11.1	22,639 - 16.1	30.1	25.8	49	17,257
TOTAL	$8,609,600	$37,605,646	$3,128,230	$40,733,876	$1,576,048 18.3%	$1,502,874 17.5%	36.7%	30.5%	2,647	$1,625,666

* Has "escalator clause" Funds with an escalator clause provide automatically higher pensions for retired members with increase of active member's salary.

A Annual payroll as of January 1, 1958.

O Membership includes active members, deferred annuitants, retired members, disabled members, and widows and children of deceased members now receiving benefits.

S Annual annuity payments for all classes of annuitants as of January 1, 1958.

As to the firemen's funds:

The 21 funds have built up pension liabilities because of firemen's services to 1/1/58, (but payable after that date), amounting to	$ 43,347,780 (D)
If funds to finance these pensions had been accumulated as all services were performed, they would now have in assets	$ 43,347,780 (D)
Instead, total assets actually are	$ 2,612,185 (C)
Thusm the deficit of all funds as of 1/1/58 is	$ 40,735,595 (B)
If the funds had built up this $43,347,780 in assets instead of the $40,735,595 in deficit, each year's new pension liability could be financed by combined employer and employee support equal to a normal cost of	13.9% of pay
For the 21 fire departments in 1957 this would have provided the needed normal cost of	$ 1,127,714 (H)
Because of the deficit it now requires . . . . to currently finance these funds and prevent the $40,735,595 deficit from growing larger.	28.9% of pay
In 1957 this 28.9% of pay would have amounted to . . .	$ 2,351,212
The total financial support actually afforded these funds in 1957 amounted to	$ 1,678,360 (G)
or, as a percent of payroll	20.6% of pay
While this is $550,646 more than would be required to maintain these funds if there were no deficit (at normal cost) it is still, because of the deficit	$ 672,852

short of the amount required to keep pace with the year's increase in pension liability.

Pay-as-you-go financing has, in the past, been required by law because funding was "too expensive" but these funds have now reached the point where the current rate of cost of pay-as-you-go financing exceeds by $550,646 in 1957 the cost that would have been now required had there been funding in the past.

Thus, each year that financial support equal to 28.9% of payroll $672,852 more than 1957 actual support) is not provided as financial support of these 21 funds, the result will be a further increase in deficit and subsequently a required annual cost still high than the 28.9% of payroll that would "hold the line" if provided beginning in 1958.

If, instead of the 28.9% of payroll required to hold the line, financial support of 35.5% (K)of payroll should be provided,and benefits should remain as now provided, then in 40 years the $40,735,595 (B) deficit would be paid off and the 13.9% (H) of payroll,cited as normal cost, would be adequate thereafter to keep these pension funds financed.

<u>This does not include any additional deficits that might result from the "escalator clause"</u> in such funds as have this provision.

Persons interested in any of the firemen's funds in this tabulation may determine the situation as to that fund by substituting in the above analysis of totals the appropriate figure from the same column as shown for the individual fund.

As to the policemen's funds:

The 26 funds have built up pension liabilities because of policemen's service to 1/1/58, (but payable after that date), amounting to . . . . $ 40,733,876 (D)

If the funds to finance these pensions had been accumulated as all services were performed, they would have in assets . . . . $ 49,733,876 (D)

Instead, total assets actually are . . . . $ 3,128,230 (C)

Thus, the deficit of all funds as of 1/1/59 is . . . $ 37,605,646 (B)

If the funds had built up this $40,733,876 in assets instead of the $37,605,646 in deficit, each year's pension liability could be financed by combined employer plus employee normal support equal to 17.5% of pay

For the 26 funds, in 1957, this would have provided the needed normal cost of . . . . $ 1,502,874 (H)

Because of the deficit <u>it now requires</u> . . . . 30.5% of pay to currently finance these funds and prevent the $37,605,646 deficit from growing larger.

In 1957 this 30.5% of pay would have amounted to . . $ 2,631,043

The total financial support afforded these funds in the year 1957 amounted to . . . . $ 1,576,048 (G)

or, as a percent of payroll . . . . 18.3% of pay

While this is $73,174 more than would be required to maintain these funds if there were no deficit, it is still - because of the deficit - . . . . $ 1,054,995

short of the amount required to keep pace with
the year's increase in pension liability.

Here again, pay-as-you-go financing has been required by law. Had accrual financing - which in the past was thought "too expensive" - been followed resulting in no deficits at this time, the 1957 full normal support cost would have been adequate to prevent deficits instead of inadequate to prevent growing deficits.

<u>To summarize</u>: Each year that financial support equal to 30.5% of payroll is not provided to support these 26 funds, there will be further increase in deficits and a subsequent minimum required annual cost will thereafter be even higher than the 30.5% of payroll which would hold the line in 1957.

In the case of these policemen's funds, if instead of 30.5% of pay required to hold the line, financial support to the extent of 36.7% of payroll is provided, the $37.6 million deficit could be retired in 40 years and thereafter full financial support could be maintained at the rate of 17.5% of payroll except as to changes in benefit schedules might cause additional financial cost.

<u>This does not include any additional deficits that might result from the "escalator clause" in such funds as have this provision.</u>

As in the case of the firemen's funds, persons interested in a particular fund may determine the situation as to that fund by substituting in the above analysis of totals the appropriate figures of the individual fund from the same column as the total figures used for all funds.

RESERVE PROVISIONS IN PRESENT STATUTES RELATIVE TO FIREMEN AND POLICEMEN'S PENSION SYSTEMS.

Present statutory limits on reserves in the firemen and policemen's pension funds have prevented these funds from making a material amount of advance financial preparation for the inevitably high pension outlays that are required as soon as each fund is old enough to have a normal number of retired members on pension.

The various statutes governing the local policemen and firemen's funds set up what are termed "reserves". The size of these reserves vary according to the different statutory provisions for cities of the first class, second, class, etc., and for some individual funds but, in each case, a "reserve" is specified with a provision that the authority to levy taxes or receive insurance premium surtaxes is reduced whenever the so-called "reserve" of each fund is exceeded.

The term "reserve" is unfortunate, particularly in view of the limitation placed in the statutes on the size of "reserves". The term is unfortunate because throughout the insurance industry the term "reserve" is used to indicate a fund for future liability, or to meet contingent liabilities.

In the case of Minnesota Statutes relative to firemen and policemen's pensions, the "reserves" provided are so small that in many instances they do not amount to as much as a current year's pension disbursement in respect to the various funds whenever they are, or become, old enough to have a normal proportion of people on pension.

The "reserves" provided by law are thus not even adequate revolving funds if the funds remain on a pay-as-you-go basis.

This situation has brought about the following results:

1. Whenever the amount of these "reserves" is reached the funds have been stopped by law from making preparation to meet future pension liabilities.

2. Frequently funds are placed in the position where slight economies would in individual years push their "reserve" above the statutory amount causing the funds to lose material amounts of income which would be sorely needed in the future.

3. "Reserve" requirements have destroyed any incentive that firemen and policemen might have to make more substantial contributions toward their own pensions.

Members of the Minnesota policemen and firemen's funds contribute less as a percent of salary to their pension funds than do public employees in other pension funds in the State. They likewise contribute a smaller proportion of pay than firemen and policemen in funds in many other states.

Due to the reserve provisions in their statutes, should firemen and policemen increase their rate of contribution they would, from time to time, cause their fund to lose in tax levy or insurance tax income rather than to provide more adequate financing for their pension funds.

The serious adverse effects of the statutory "reserve" limitations, besides those already cited, can be demonstrated when it is realized that:

1. None of the funds in the State can reach a position of adequate level annual financing on the basis of the <u>maximum levies</u> and allowances now provided by law.

2. The "reserve" provisions in the Statutes forcing minimum levies and allowances only serve to hasten the need for "stop-gap" additional financing thus forcing an even higher ultimate level of cost. This prevents even the inadequate advance financing allowed by maximum levies.

It should be noted that the older funds such as the fire funds in Minneapolis, Duluth, St. Cloud, St. Paul, Virginia and Winona -- and the police funds of Minneapolis, St. Cloud and Virginia now require maximum levies higher than would have been required at any time had they provided for funding on a level basis. It follows then that --

Some of the older funds have, from time to time, obtained increases in millage. Or, in the case of fire funds, in insurance tax allocations. These increased maximums are in most cases insufficient and will subsequently have to be raised still higher.

To summarize: Present statutes make impossible even a minimal degree of financial preparation on the part of the fire and policemen's funds. Removing present minimums on reserves will not allow adequate provision for future liabilities but it will permit a small degree of advance preparation and will allow employees, through increased contributions, to enhance the degree of advance preparation.

In most funds considerably more than the presently allowable maximum financing permitted by law will be required to permit adequate financing.

Recommendation:

THE COMMISSION THEREFORE AS A MINIMUM STEP RECOMMENDS THAT LEGISLATION BE URGED TO PROVIDE THAT, AS REGARDS EACH PAID FIREMEN OR POLICEMEN'S PENSION FUND. UNTIL AN ACTUARIALLY DETERMINED FUND IS ACCUMULATED EQUIVALENT TO THE THEN PRESENT VALUE OF EACH FUND'S PENSION LIABILITY, NO REDUCTION IN ANY MAXIMUM AUTHORIZED TAX LEVEY - INCLUDING INSURANCE PREMIUM TAX - SHOULD BE MADE MANDATORY BY LAW.

FIREMEN'S FUNDS AND THE INSURANCE PREMIUM TAX.

For a considerable number of years the regular premium tax levied by the State on fire insurance premiums has been allocated to the communities in which the insured property is situated. Whenever the community has an incorporated firemen's relief association the tax is earmarked for the benefit of that association, but if there is no such relief association the tax is to be used toward local fire protection purposes.

This applies to associations of volunteer firemen as well as paid fire departments.

All premium taxes except on fire insurance premiums are retained by the State as general revenue.

In recent years the total amount of extended coverage written in conjunction with fire insurance has been increasing.

Currently the total fire insurance premium tax allocated to local communities firemen's relief associations amounted to $541,077 for 1957.

Currently the premium tax on extended coverage insurance amounted to approximately $385,156 for 1957.

Representatives of the various organizations of firemen's relief and pension funds submitted to the Commission resolutions urging that the State premium tax on extended coverage insurance should be allocated to the communities and the various firemen's relief associations in the same manner as is the premium tax on fire insurance.

Because of the present inadequate level of financing now provided for firemen's pension funds, and

Because extended coverage insurance is companion insurance to fire insurance, and

Because the total additional financing that would be provided if the extended coverage premium tax should be allocated in the same manner as the fire insurance premium tax would still only be a helpful but not an adequate amount to finance firemen's pension funds -

The Commission Therefore Recommends:

THAT THE PREMIUM TAX ON EXTENDED COVERAGE INSURANCE SHOULD HEREAFTER BE ALLOCATED TO THE COMMUNITIES AND FIREMEN'S RELIEF ASSOCIATIONS IN THE SAME MANNER AS THE STATE TAX ON FIRE INSURANCE PREMIUMS.

Some Highlights of Unfinished Business

This report does not include a full set of recommendations and proposals to meet all of the needs or remedy all of the defects of the various local pension funds for policemen and paid firemen.

The funds range in size from the Nashwauk policemen's fund of three members to the Minneapolis policemen's fund of 1,122 members.

The large number of laws governing the funds and the confusion as to these laws indicate a basic need that all laws pertaining to these funds should be codified and analyzed as to provision and possible recommendations for improvement.

The 1958 actuarial surveys and the problems of the various funds thus revealed are new to the members of the funds and to the tax levying authorities in the various communities. More time and study by these groups is needed.

Several local funds have started studies of their funds and carried on discussions with local authorities. A notable example is the Winona Policemen's Fund.

The ultimate objective of all activities should be an adequate level of benefits, justice within each fund, and adequate and orderly financing.

POLICEMEN AND FIREMEN IN P.E.R.A.

Characteristics of Police and Fire Pensions Throughout the U.S.

Generally throughout the United States pension provisions for policemen and firemen (paid) are different from those for other public employees.

Minimum ages to qualify for retirement are invariably lower and usually subject to a minimum number of years of service. Frequently encountered are jurisdictions with minimum age 50, more frequently age 55, and often age 60. Minimum service requirements at age 55, or later, are most frequently 25 years of service.

Substantial disability benefits for injury in line of duty are found.

Principal reasons are generally recognized as the hazardous nature of their work and the importance of physical strength and agility in adequate performance of duties.

Summary Relative to Minnesota Problem

In Minnesota the only way that policemen and firemen have been able to obtain pension provisions different from those of other public employees has been to form a separate local policemen's or firemen's fund.

By referring to the tabulation of "Results of Actuarial Surveys" for firemen's and policemen's funds we find:

1. Only three of 21 firemen's funds have over 100 members.
2. Three of the 21 firemen's funds have less than 20 members.
3. Only three of the 26 policemen's funds have over 100 members.
4. Eleven of the 26 policemen's funds have less than 20 members.

All law enforcement and firemen employees of the counties, municipalities and townships who are not in the local policemen's and paid firemen's funds are required by law to be members of PERA under the same terms as all other employees.

The number of small local policemen's or firemen's pension funds is steadily increasing as more PERA members from these occupations seek pension benefits of the type they consider suited to their occupations.

Before considering this problem further several items of information merit consideration:

1. In many states and cities firemen and policemen are combined for pension purposes because the typical pension plans of the two groups are similar.

2. A number of states and cities, among them Baltimore, Boston, Milwaukee, San Fransisco, Oregon and Washington include policemen and firemen in their general employee pension funds but <u>with a separate schedule of financing and benefits from other employees</u>

3. There is a distinct trend through the nation toward consolidating local and small pension funds of all kinds in to fewer and larger funds.

<u>Development of Proposed PERA-Policemens and Firemens Plan.</u>

PERA requested from the counties and municipalities employing its members data as to those members who were firemen and policemen. This data was used by the Commission's actuaries to prepare for the Commission's consideration feasible pension plans for policemen and firemen members of PERA.

The counties and municipalities returned to PERA data as to 1,167 policemen and firemen. Since response by the political subdivisions was not 100%, the total membership in these two occupations exceeds 1,167.

Of this total number, 884 men had become policemen or firemen at ages under 46 and were considered suitable for inclusion in the proposed new pension plan.

A fund with 884 actively employed members would have over 200 more active members than the Minneapolis Police Fund which is the largest of the local policemen's or firemen's funds in Minnesota.

After considerable study and consultation with representatives of peace officers and firemen's groups, the Commission has developed a pension plan for law enforcement officers and fire fighters within the membership of PERA.

In the opinion of the Commission this plan will be of considerable benefit to peace officers and firemen. The cost of financing the plan is slightly lower than the average cost of the local policemen's funds.

Without exception, the local policemen's and firemen's funds in Minnesota place considerably more than half of the financing burden on the employing municipalities.

<u>The Commission therefore recommends:</u>

THAT THE PERA LAW BE AMENDED SO AS TO SET UP WITHIN THE MEMBERSHIP OF PERA A "POLICE AND FIRE FUND" SUBJECT TO CONDITIONS AS FOLLOWS:

1. ANY POLICE OFFICER OR FIREFIGHTER EMPLOYED ON JULY 1, 1959 SHALL HAVE THE OPTION TO BECOME A MEMBER OF THE "POLICE AND FIRE FUND" ON APPLICATION MADE NO LATER THAN JUNE 30, 1960.

2. ANY POLICE OFFICER OR FIREFIGHTER NEWLY EMPLOYED AFTER JULY 1, 1959, IF REQUIRED TO BE A MEMBER OF PERA, SHALL HAVE HIS MEMBERSHIP IN THE "POLICE AND FIRE FUND".

3. THE SERVICE CREDITS IN PERA OF ANY MEMBER TRANSFERRING AS HEREIN PROVIDED TO THE "POLICE AND FIRE FUND" SHALL BE SO TRANSFERRED.

4. WITHIN PERA THERE SHALL BE A SPECIAL FUND KNOWN AS THE "PUBLIC EMPLOYEE'S POLICE AND FIRE FUND".

   IN THAT FUND THERE SHALL BE DEPOSITED EMPLOYEE CONTRIBUTIONS, EMPLOYER CONTRIBUTIONS, AND OTHER FUNDS AUTHORIZED BY LAW, INCLUDING INTEREST AS EARNED.

   TO THIS FUND SHALL BE TRANSFERRED FROM THE PUBLIC EMPLOYEES RETIREMENT ASSOCIATION (PERA) ALL ACCUMULATED EMPLOYEE CONTRIBUTIONS OF MEMBERS TRANSFERRED ALONG WITH ALL EMPLOYER CONTRIBUTIONS THAT HAVE BEEN MADE BECAUSE OF SUCH TRANSFERRED MEMBERS.

5. EMPLOYEE CONTRIBUTIONS SHALL BE AT THE RATE OF 6% OF SALARY UP TO A MAXIMUM OF $4,800 IN ANY YEAR.

6. EMPLOYER CONTRIBUTIONS SHALL BE AT THE RATE OF 9% OF SALARY OF EACH MEMBER UP TO A MAXIMUM OF $4,800 IN ANY YEAR.

7. AN ADDITIONAL EMPLOYER CONTRIBUTION SHALL BE MADE TO THE FUND EACH YEAR BASED ON 3.5% OF THE SALARY UP TO A LIMIT OF $4,800 OF EACH MEMBER FOR THE PURPOSE OF

FINANCING THE DEFICIT IN THE FUND.

8. RETIREMENT PROVISIONS SHALL BE:

a) MINIMUM QUALIFICATION, AGE 58 AND NOT LESS THAN 20 YEARS OF ALLOWABLE SERVICE.

b) NORMAL ANNUITY, 2% OF AVERAGE SALARY TIMES YEARS OF SERVICE UP TO 30 YEARS AND 1% THEREAFTER.

c) PRIVILEGE OF OPTIONAL ANNUITIES, INCLUDING JOINT SURVIVOR ANNUITIES SIMILAR TO OTHER PERA MEMBERS.

9. SURVIVOR BENEFITS:

a) SURVIVOR BENEFITS, AS PROVIDED IN PERA.

b) AFTER 20 YEARS SERVICE, OPTIONAL DEFERRED ANNUITY TO SPOUSE OF 75% OF EMPLOYEE'S ANNUITY CREDIT AS NOW PROVIDED IN PERA.

10. DISABILITY:

FOR INJURY IN LINE OF DUTY, IMMEDIATE COVERAGE TO PROVIDE 40% OF AVERAGE SALARY.

FOR OTHER DISABILITY, AFTER 10 YEARS OF CREDITED SERVICE AS NOW IN PERA.

11. POLICEMEN AND FIREMEN IN PERA:

IN ANOTHER SECTION OF THIS REPORT, THE COMMISSION RECOMMENDS THAT AN ACTUARIAL SURVEY BE MADE OF THIS GROUP IF ITS FORMATION IS AUTHORIZED BY THE LEGISLATURE.

SUCH A SURVEY WILL PROVIDE COMPLETE INFORMATION AS TO COST AND LIABILITY WHICH COULD ONLY BE ESTIMATED BASED ON INCOMPLETE DATA. SINCE MEMBERSHIP IN THE "POLICE AND FIRE FUND" IS OPTIONAL AS TO PRESENT ELIGIBLE MEMBERS, THE ACTUAL MEMBERSHIP OF THE FUND MAY BE CONSIDERABLY DIFFERENT FROM THAT UPON WHICH ESTIMATES WERE BASED.

INVESTMENT OF THE PENSION FUNDS

The investment of the assets of public employee pension funds is of considerable importance, not just to public employees but to all of the taxpayers of the State.

If, as the present laws contemplate, the taxpayers are to finance all accumulated deficits and current shortages of income for public employee pension funds it is obvious that the entire public and its employees have a double stake in the investment of pension funds.

Safety of investment is obvious but should not divert attention from the importance of earning as large an interest return as is compatible with safety.

Assets of all public funds now in excess of $170 million are growing rapidly as additional pension liabilities accrue each year and as deficits are financed. It the present value of pension liabilities had been financed, total funds for investment would even now be over $600 million.

The 1957 report of the previous commission sets forth important reasons why the investment of pension funds in Minnesota could and should be improved. This report suggests those interested read in full pages 92 - 100 of the 1957 report which are summarized here.

Summary of 1957 Report as to Investment of Pension Funds

"Discussion here does not contemplate any change in the statutory requirements intended to safeguard the security of invested funds."

"The investment return on assets of the three major Minnesota pension funds has in recent years been smaller than the return realized by similar funds in this and other states which were invested under equally conservative investment laws."

"Investment return of the three major funds has in recent years averaged 2.75% interest. Under the same laws, based on the experience of similar funds, it appears reasonable to estimate that interest yields could have been averaged as high as 3.25%."

It is pointed out that an investment board of ex-officio members, such as Minnesota has, whose regular duties do not require experience or skill in investment cannot accomplish maximum results in a field requiring experience, skill and constant, careful study.

The 1957 Report emphasizes:

"The Commission wishes to state with all possible emphasis that no adverse criticism of the present State Board of Investments, either individually or collectively, is in any way intended."

Desirable characteristics of an investment board were enumerated as follows:

"1. The members of the board should be persons selected to serve on the board instead of persons elected or appointed to other positions but serving on the board in an ex-officio capacity.

2. Board membership should include persons experienced and skilled in the investing of funds.

3. Board membership should include representation of the pension funds.

4. The method of selection of board members should minimuze the probability of politics.

5. The functions of the board should be administered by personnel trained and experienced in investment management.

6. No member of the board should be in a position to benefit from transactions of the board.

7. The board should select, manage, and control the investment of the pension funds.

8. The assets of each fund should be invested within the statutory provisions governing that fund."

The report outlined in detail a suggested investment board embodying all of the enumerated desirable characteristics and recommended the creation of such a board.

Additional Material as to Investment of Pension Funds.

The 1957 session postponed, because of insufficient time, consideration of establishing an investment board.

This Commission has been urged by a number of groups to recommend to the 1959 session of the Legislature, steps to increase the investment return of the pension funds.

Both Minnesota Educators Association and the Teacher's Federation have so recommended, as has the employee's committee of SERA. PERA groups and representatives of some of the smaller pension funds have made similar requests.

Additional interest return, if earned, would be available for all or any of the following purposes:

1. increase benefits
2. reduce deficit
3. reduce employee or employer costs

The Commission's actuaries and actuaries of several of the pension funds have pointed out that one-half of one percent (.5) increase in interest earnings on the reserve of a pension fund is equivalent to an increase in financial support greater than 1% of payroll contributions.

Stated another way — .5% more interest would reduce the necessary contribution cost of a pension fund by from 10% to 12%.

Recommendation:

IT IS RECOMMENDED THAT AN INVESTMENT BOARD HAVING THE DESIRABLE CHARACTERISTICS HEREIN ENUMERATED SHOULD BE ESTABLISHED TO SELECT AND MANAGE THE INVESTMENT OF THE THREE MAJOR STATEWIDE PUBLIC EMPLOYEE PENSION FUNDS WITH SERVICES AVAILABLE TO SUCH ADDITIONAL PUBLIC EMPLOYEE FUNDS AS DESIRE SUCH SERVICES, OR FOR WHOM THE LEGISLATURE MAY PRESCRIBE SUCH SERVICES.

ACTUARIAL SERVICES AND THE PENSION FUNDS

If it is important to know about the hundreds of millions of dollars in pension promises and costs of publicly supported pension funds, then actuarial surveys are necessary. There is no other way to measure the financial effect of a pension plan.

The 1958 actuarial surveys ordered by the 1957 session provide Minnesota with its first opportunity to know about all of the public employee pension funds. Tabulation of key findings of these surveys are included elsewhere in this report.

These actuarial surveys are not theoretical; they are scientific measurements and estimates of net pension liability, financial resources, rate of accrual of liabilities and costs.

Every favorable and unfavorable factor is measured according to the membership and experience of each fund itself as the fund is at the time of survey.

When important factors of a pension plan change or are changed, a new actuarial measurement is essential. For instance, if pension benefits or membership eligibility is changed, or if interest earnings on investments, or death rates of members change, then a new actuarial survey should be made.

At reasonable intervals there should be actuarial surveys to detect and measure unanticipated changes in experience that may develop.

When the 1957 session ordered the 1958 actuarial surveys for each pension fund, it deleted the recommended additional provision that each fund have an actuarial survey each four years. Until pension conditions in Minnesota have become more stabilized, none of the pension funds should operate for more than four years without a complete actuarial survey.

The cost of an actuarial survey is small in relation to its importance.

The combined cost of the 1958 surveys of the firemen and policemen funds was less than 50¢ for each $1,000 of annual payroll.

Averaged over four years this would be 13¢ per year for $1,000 of payroll.

For the larger funds the surveys cost approximately 10¢ for each $1,000 of annual payroll which, averaged over four years, would be 2½¢ per $1,000 annual payroll.

Various sections of this report discuss possible divisions of various pension funds into groups or sections with different pension benefits or financing , or both. In these sections the need for an actuarial survey, completed in time for study and evaluation before the 1961 session of the legislature,is emphasized.

Between actuarial surveys there should be an annual actuarial evaluation of experience as to recently added coverages such as disability, spouse benefits, minor child benefits, etc.

Upon receipt of the 1958 actuarial surveys the Commission discovered that one of the pension funds differed from all other funds and from the understanding of the Commission as to the precise meaning of the Statutes in regard to content and findings of actuarial surveys. In this report the Commission's actuaries have adjusted all survey reports to a uniform basis of approach.

The Commission's experience also indicates the wisdom of its actuarial consultants recommendation that the Statutes require some additional breakdown as to experience and costs of important elements of the pension benefit formulas.

<u>The Commission's Recommendations are two phase:</u>

1. Individual pension fund laws should include provisions for actuarial surveys when changes in the laws are enacted.

2. The general Statute as to actuarial surveys should be amended to:

   a) Require an actuarial survey as to each fund at least once in every four years.

   b) Require each survey to show all liabilities in accordance with the benefit plan of the fund.

   c) Require each survey to show the annual level normal support rate required to adequately finance the pension fund according provisions of the plan.

   d) Require any fund undergoing a basic change in benefit plan or of financing in regard to part or all of the members to provide a complete actuarial survey with complete findings separately as to each group or section differentiated as to any of the following: membership, eligibility, financing provisions, or benefits.

   Where such change in benefits or establishment of a section or group within a pension fund extends to members of the total pension fund an option as to inclusion in a section or group, the actuarial survey shall be made as of a date one year from the date the option is first made available.

   If such change is made effective at a particular time, without a period for exercise of an option, the actuarial survey should be made as of the first day of the first month following the effective date of the change.

Each actuarial survey must be delivered to whatever agency of the legislature as is authorized to study public employee pension problems. Each such survey should be delivered as soon as possible and in no case later than 90 days after the date as of which the survey is made.

THE IMPORTANCE OF EVALUATION OF PENSION BILLS.

Pension plans are not simple. Minnesota plans deal in hundreds of millions of dollars of promises for future delivery to over a hundred thousand employees. They may include equivalent treatment of all employees or they may not.

Many amendments to pension funds cause side effects and have far reaching consequences which are neither apparent or intended when proposed. Minnesota pension laws adequately illustrate this fact.

The complete significance of a proposed amendment to a pension fund can only be determined by careful analysis which frequently requires both legal and actuarial study.

For best results this requires an agency of informed persons well grounded in sound public policy, assisted by staff and expert counsel both legal and actuarial.

A number of state legislatures have provided themselves with agencies to perform this service in regard to all pension matters. Usually some, and sometimes all of the members of such advisory boards, commissions, or committees are members of the legislature.

Members of the Public Retirement Study Commission have devoted considerable time to the study of pensions; four members for two years and six members for four years.

The Commission's files contain valuable material and the Commission's counsel and actuarial consultants are familiar with all Minnesota pension plans.

The Public Retirement Study Commission suggests to both bodies of the

Minnesota Legislature that this Commission, if allowed to retain as needed the services of its staff, counsel, and actuaries, can perform a valuable service to the legislature and its committees by analyzing and reporting on all pension bills.

Such reports should include probable costs effect on actuarial soundness of each pension fund involved, side effects, if any, and probable effect on other pension funds.

PROGRESS REPORT AND UNFINISHED BUSINESS

This is a progress report because there still remains considerable unfinished business in the field of pension study.

After more than a generation of steadily accumulating pension confusion in Minnesota, the 1957 session of the legislature took the first major steps in the direction of order. Fundamental principles of financing and of pension benefits were recognized and very considerable steps taken toward implementation of these principles.

The Commission now reporting to the 1959 session of the State Legislature has continued the study and herein recommends a number of changes, some remedial in nature but most designed toward continuing the progress of the 1957 session.

Human values prevent immediate or summary transition of pension plans to a basis of complete soundness and equity. There must be adjustments and transition stages to alleviate surprise and hardship to individual plans and anticipations.

Some of the most important of the numerous items of unfinished business, and areas for further improvement, are set forth here:

One of the most urgent needs of all Minnesota pension funds is for clarification and codification of all present pension laws. This will require expert counsel plus considerable assistance and participation by the officers of each pension fund. It is very doubtful if an adequate job could be completed in two years.

Pension laws governing many of the funds are collections of amendments and involved provisions often so confusing that they only function by benefit of attorney general's opinions and clarification.

Employees, who are the beneficiaries of the retirement systems, are in many cases unaware of, or misinformed as to, their rights because the pension laws are so difficult to understand.

The Legislature, when called upon to act on matters of pension legislation, experiences considerable extra difficulty due to confusing maze of laws in the field.

Laws governing local police and firemen's funds are so many and confusing that some of the funds are in doubt as to all of the laws applicable to them. Many of these laws have never been coded and are found only in the Session Laws of the year when they were enacted.

Record keeping and accounting methods , and particularly accounting division, by function is for many funds in need of improvement.

Source and method of selection of members on various pension boards , including the number of ex-officio members, is an important item of unfinished business.

— The Minnesota League of Municipalities urges a study as to P.E.R.A.

-- The M.E.A. and Teachers Federation suggest changes in the membership of T,R.A. board.

The question is so important and complicated that careful study should be made before changes should be recommended.

Proposals of employee groups, pension boards and other organizations should be submitted to an interim agency for study and evaluation rather than introduced at legislative sessions too late for careful study.

Three items of unfinished business are important even though obvious:

1. Examination and evaluation of 1959 pension legislation is important. Follow-up study of new benefit provisions, changed benefit formulas, etc., is essential.

2. Re-examination of recommendations and proposals rejected or postponed by the 1959 session.

3. Follow-up study of remaining steps toward sound financing.

The considerable progress toward soundness and understanding of pension funds will only continue if an agency of the Legislature continues to function as long as there remains unfinished business.

The Commission Therefore Recommends:

THE IMPORTANCE CANNOT BE OVEREMPHASIZED THAT AN AGENCY OF THE LEGISLATURE CONTINUE TO STUDY, EVALUATE,AND REPORT ON PENSION PROBLEMS.

THE PUBLIC EMPLOYEE RETIREMENT STUDY COMMISSION SHOULD BE CONTINUED BUT, IF IT IS NOT, THE LEGISLATURE IS URGED TO PROVIDE AN AGENCY WITH THE AUTHORITY, RESPONSIBILITY, AND RESOURCES TO CONTINUE THE JOB.

LEAGUE OF MINNESOTA MUNICIPALITIES - PENSION POLICY.

A report on public employee pensions would be incomplete without reference to the thinking of the League of Minnesota Municipalities.

The League publication, "Minnesota Municipalities" in the February, 1959 issue, includes a "Pension Policy Statement" (p.57) and a resolution on "Pension Policy" (p.49). The full text of these items merits attention since the following summary of the items loses some clarity in the condensation.

Summary of "Pension Policy Statement" of the League of Minnesota Municipalities.

General comments:

A. Recognize desirability of sound and adequate pension system.

B. There is a moral obligation that "changes in the system do not jeopardize financial capacity of the system to pay the promised benefits." No modification in PERA "..... should be considered which does not adequately meet the problem of future financing both for employers and employees."

C. "To provide all parties concerned with the necessary up to date knowledge .... the various pensions laws should require at the cost of the respective pension systems a periodical actuarial study at least once in four years under existing conditions."

"In addition, some objective study and report on the financial implications of amendments to pension laws should be required before legislative action;". "Without actuarial advice neither council nor legislature can possible realize the financial implications of proposed amendments ....".

Amendments to PERA Law:

A. "It is not in the municipal interest to postpone adequate provisions for tax levies and employee contributions sufficient to finance all anticipated future pension costs since without such action, excessive levies later will be inevitable if the promised benefits are to be paid." The 1957 legislature is commended for improvements in PERA financing. Actuarial survey shows these measures not sufficient. The 1959 session is requested to change financing or benefit structure so as to prevent further increase in the actuarial deficit.

B. "A sound pension plan ought to provide for employer-employee matching of contributions on a 50-50 basis." Employers must assume the obligation for amortizing the deficit.

C. "For employees hired after the effective date of the 1957 law, the pension plan should be set up on the basis of providing at age 65 after 30 years of service in covered employment an annuity of approximately one-half of the salary on which deductions are made."

D. "Governmental units as employers as well as representatives of the tax-paying public have a substantial interest along with employees in the PERA pension system, ...". "While composition of the board administering the fund may appropriately recognize that employees as well as the public have a stake in the fund, the managing board should be of the fiduciary type used in many other states and not a board selected by the membership. As long as the present type of board is continued, composition of the board should be altered to provide substantial employer representation."

Police and Fire Pension Plans.

A. "The municipalities recognize that special aspects of police and fire service require pension plans which permit an earlier retirement than in the case of other municipal employees. Yet, because such plans add significantly to pension costs, police and fire pension plans should contemplate payment of no more than half salary as the basic pension after at least 20 years of service and not before age 58."

B. "A single state fund for policemen and firemen is a desirable eventual legislative objective."

C. "As in the case of PERA, financing provisions of police and fire pension funds should be revised in the light of current actuarial surveys to make them actuarially sound." .... "Considering the special aspects of police and fire service, a 60%-40% apportionment represents a fair distribution of current pension costs between employer and employee."

D. "In order to make actuarial soundness possible, the required employer contribution should be on a payroll rather than a millage basis. There should be no statutory limits on the size of the funds except the actuarial measurement of pension liabilities nor any other relation between dollar balance in the fund and municipal contributions."

E. "Special provisions should be made within the PERA fund for policemen and firemen not covered by special funds on the basis suggested in paragraph A. However, any such special provisions in the PERA law should not impose any of the burden of additional police and fire pensions on other PERA members."

OASDI Extension to Minnesota Municipal Employees under Public Law 227.

A. "If Minnesota were to consider a combined OASDI-PERA plan, the following points should be embodied in any such plan:"

1. "No plan should be considered which does not retain PERA on levels otherwise applicable to present members who elect not to come under the OASDI plan and which does not provide for other employees a combination OASDI-PERA plan of substantially comparable benefits."

2. "Any combination plan considered should provide retirement and other benefits on a scale which can be financed by employer-employee contributions for current costs substantially comparable to those required under the present PERA plan."

3. "Any such combination plan should provide retroactive coverage to the latest date that this can be done and still give incumbent employees a fully insured status by the date of the coverage agreement. The necessary enabling act should be adopted at the 1959 legislature if it is to be adopted at all."

B. "Council opinion is too divided to justify the conclusion that the municipal viewpoint is either for or against Minnesota legislative action to take advantage of Public Law 227". "The League of Minnesota Municipalities therefore takes no official position on this issue."

LEAGUE OF MINNESOTA MUNICIPALITIES RESOLUTION ON PENSION POLICY

"WHEREAS, work of the Public Retirement Study Commission over the past four years, including surveys which have for the first time given an actuarial picture of all of Minnesota's public pension funds, show clearly the lack of adequate financing of pension plans in the past and demonstrate the need for the development and maintenance of a consistent and sound pension policy in the future, and the 1957 legislature made a commendable effort to establish such a policy for the major pension funds,

AND WHEREAS, a statement of the municipal viewpoint on basic pension problems presented to the commision by the League Committee on Pensions, Personnel, and Insurance as a revision of the League policy statement of 1956 contains the major components of a sound pension policy which recognized the obligation of municipalities to provide adequate pensions to employees while at the same time facing up to the serious financial implications involved.

RESOLVED, That the League of Minnesota Municipalities endorse as the expression of the League the attached statement on pension policy prepared by the League Committee on Pensions, Personnel, and Insurance;

RESOLVED FURTHER, That the League commend the 1957 legislature for embarking on a long range program of improving public pension systems, express its appreciation to the Public Retirement Study Commission for its conscientious and time-consuming work and its forthcoming report, and recommend to the 1959 session of the legislature continuance of the interim commission for the next biennium with an adequate appropriation to finance its work.

RESOLVED FURTHER, That the commission, if continued, be specifically requested to consider methods by which any police or fire pension plan can be consolidated with the PERA plan for police and firemen and to make recommendations thereon to the 1961 legislature."