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MINNESOTA
STATE GOVERNMENT

ISSUES

ANALYSIS OF

MINNESOTA PENSION FUNDS

Executive Branch Policy Development Program
1984-1985

ANALYSIS OF

MINNESOTA PENSION FUNDS

August, 1984

Executive Summary
Analysis of Minnesota Pension Funds

For several years, serious questions had been raised about the soundness of Minnesota's public pension plans. In order to help answer some of these questions, the Legislative Advisory Commission in 1982 authorized the Department of Finance to conduct a study of the financial condition of four of the largest plans - the Minnesota State Retirement System (MSRS), the statewide Teacher's Retirement Association (TRA), the Public Employees' Retirement Association (PERA) and the Minneapolis Employees' Retirement Association (MERF). The study was conducted by professional consulting actuaries directed by Dr. Howard Winklevoss (a professor of insurance and actuarial science at the Wharton School of Finance). The study, completed in June, 1983 found that:

- Total resources being contributed to the 4 pension funds were annually $45 million greater than needed to fully fund liabilities by the Legislature's target date for full funding.

- These resources, however, were not being efficiently allocated among the four funds. MSRS, PERA and MERF were annually receiving more resources than needed, while TRA's funding was short by $15 million.

- Contribution rates and liabilities were calculated using low salary growth and rate-of-turn assumptions that were neither consistent with history nor long-term economic forecasts. Use of these assumptions with the Minnesota plans would have continued to overstate both costs and liabilities, requiring excess contributions.

- The combination of funding methods and financial assumptions used to determine contribution rates was placing disproportionately high burdens on current generations of tax payers.

The following recommendations were contained in the study and implemented by the 1984 Legislature.

Recommendation 1: Use more realistic investment and salary growth assumptions

Accurately evaluating the financial condition of pension funds and calculating the costs of benefits requires choosing realistic assumptions about the most likely long-term investment return and salary growth. The old assumptions of an investment return of 5% annually and salary growth of 3.5% a year did not reflect recent experience, and are not consistent with the long-term outlook for inflation. Assumptions of 8% annual investment return, 6.5% yearly salary growth and 6% annual inflation were adopted.

Recommendation 2: Use level percent amortization of unfunded liabilities

Minnesota Statutes required calculating supplemental contribution rates for amortizing unfunded liabilities assuming no inflation in future payroll. Setting contribution rates in this manner when some inflation is, in fact, expected yielded contribution rates that were substantially higher in the early part of the amortization period. The consultants recommended that the contribution rates be evened out so that they are the same percent of payroll over the entire amortization period. The Legislature adopted this recommendation.

Recommendation 3: Adjust Employer Contributions

The consultants estimated that the following changes could be made in annual employer contributions (in thousands) for 1983 and future years if their recommendations were implemented:

Retirement Association	Employer Contributions	Proposed Changes	Legislated
MERF	$ 23,376	$ (9,321)	-0-
MSRS	46,024	(13,673)	(13,000)
PERA	79,743	(38,038)	(13,000)
TRA	88,042	15,381	18,000
TOTAL	$ 237,185	$(45,651)	(8,000)

The rate changes adopted by the Legislature reflected some policy concerns not addressed by the consultants, including:

- a concern that more time was needed to study the adequacy of benefits for basic plan members

- recognition of a portion of each fund's unrealized capital gains in its statement of assets

- a need to equalize survivor's benefits among plans

- provision for 2 and 1/2 years of an early retirement option known as the "rule-of-85"

- returning a supplemental employee contribution enacted for 6 months in F.Y. 1983 to reduce state budget problems

In addition to improvements in pension financing policy, the bill enacted by the 1984 Legislature (S.F. 147) provided significant enhancements in the state's actuarial oversight responsibilities.