St. Paul Teachers' Retirement Fund Association

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March 11, 2014

TO: Members, Legislative Commission on Pensions and Retirement
FM: Paul Doane, Executive Director, St Paul Teachers' Retirement (SPTRFA)
RE: SPTRFA's 2014 Legislative Initiative SF 1802 HF 2520

Dear Commission Members:

The Board respectfully seeks Commission's approval of the above referenced matter which includes:

1) **Extension of the current $7 million annual Supplemental State Aid payment**. The 2013 Legislature approved a $7 million annual State aid package to SPTRFA but limited to only FY 2014 and FY 2015. We received the FY'14 payment this past October. The actuarial cost for SPTRFA to seek a merger with the state TRA is estimated to cost over $40 million/year for the next 25 years. However, we are requesting, in the alternative, to remain a separate Plan and not merge. One of the main reasons for not merging is cost. Our actuary projects that by remaining a separate Plan, we will be able to achieve the desired full funding no later than 2042 provided we met various Plan assumptions AND we continue to receive the additional $7 million in supplemental State aid until the sooner of 2042 or upon achieving full funding.

2) **Establish a Fixed Amortization Date of 2042** for achieving full funding in lieu of the existing "25-year rolling" amortization structure (**MN Statutes 356.215 subd 11(j)**). This provision would amend the current Legislative set amortization schedule. The date of 2042 is based on taking a standard 25 year funding timeframe and applying it once all Legislative sanctioned contribution increases are fully in effect, which will be 7/1/2017 (i.e. 25 years +2017 =2042). By inserting a fixed date to meet all plan obligations in place of the "rolling" provision, now in law, you remove the concern that little or no progress is being made on meeting all Plan liabilities.

Enclosed are several attachments associated with this legislative initiative including: 1) Our actuary's (Gabriel Roeder Smith) graph indicating the Plan "sufficiency" potentially accomplished with the continued State supplemental appropriation and the newly imposed "fixed" amortization date; 2) various considerations which the Board weighed in deciding on its preference to remain separate from TRA; 3) various actions the Board has taken on its own initiative to further improve the Plan's financial sustainability; 4) an examination of the cost differences with merger and no merger; 5) reasoning behind seeking additional State funds ($7 million through 2042); and 6) a table demonstrating the lost opportunity cost to the Plan which resulted from the State action to eliminate the critical additional employer contribution for members of the newly created Coordinated Plan from 1978 until 1994.

These attachments address why SPTRFA is requesting the State to correct a wrong done only to the St. Paul Teachers' Plan that has largely led to the level of the current underfunding. It also outlines the approach to resolve the matter within a relatively timely and cost conscious strategy. It needs to be noted that this approach relies on the Plan achieving its actuarial assumptions based on Plan experience.

1) Estimated Actuarial Status based on the Market Value of Assets

St. Paul Teachers' Retirement Fund Association
Estimated Actuarial Status based on the Market Value of Assets
(dollars in millions)

Scenario 1 - baseline; assumes $7 million state contribution paid in 2013 and 2014 only and 25-year rolling amortization
Scenario 2 - assumes $7 million state contribution paid in 2013 and 2014 only and 28-year closed amortization effective July 1, 2014
Scenario 3 - assumes $7 million state contribution paid annually until the earlier of 100% funding or July 1, 2042 and 28-year closed amortization effective July 1, 2014

	July 1, 2013 Results	**Estimated July 1, 2017 Results**			**Estimated July 1, 2042 Results**		
		Scenario 1	**Scenario 2**	**Scenario 3**	**Scenario 1**	**Scenario 2**	**Scenario 3**
Actuarial Accrued Liability	$1,467.3	$1,600.1	$1,600.1	$1,600.1	$3,322.8	$3,322.8	$3,322.8
Market Value of Assets	933.1	995.0	995.0	1,010.2	$2,782.8	2,782.8	3,466.0
Unfunded Actuarial Accrued Liability	$ 534.2	$ 605.1	$ 605.1	$ 589.9	$ 540.0	$ 540.0	$ (143.2)
Funding Ratio	63.6%	62.2%	62.2%	63.1%	83.7%	83.7%	104.3%
Statutory Contributions, percent of pay							
1. Employee contributions	6.27%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
2. Employer contributions	9.11%	10.34%	10.34%	10.34%	10.34%	10.34%	10.34%
3. Supplemental Contributions							
a. 1996 and 1997 Legislation	1.36%	1.14%	1.14%	1.14%			
b. Additional State Contribution	2.59%			2.21%			
4. Total	19.33%	18.98%	18.98%	21.19%	17.84%	17.84%	17.84%
Required Contributions, percent of pay							
1. Normal cost	7.83%	7.67%	7.67%	7.67%	7.67%	7.67%	7.67%
2. Amortization of Unfunded Liability	12.88%	12.61%	12.61%	12.30%	4.25%	66.91%	(1.02)%
3. Allowance for Admin Expenses	0.29%	0.29%	0.29%	0.29%	0.29%	0.29%	0.29%
4. Total	21.00%	20.57%	20.57%	20.26%	12.21%	74.87%	6.94%
Contribution Sufficiency/(Deficiency) (% of pay)	(1.67)%	(1.59)%	(1.59)%	0.93%	5.62%	(57.03)%	10.90%

25-year rolling amortization assumed for 2013; amortization changed to a 28-year closed period on July 1, 2014 in Scenarios 2 and 3
Amortization period as of July 1, 2013: 25 years
Amortization period as of July 1, 2017: 25 years
Amortization period as of July 1, 2042: 25 years (Scenario 1), 1 year (Scenario 2), 30 years (Scenario 3 - surplus assets amortized over 30 years)

Investment return is assumed to be 8% for the first four years; 8.5% thereafter (consistent with statutory assumption)
COLA's are assumed to remain at 1% indefinitely. Projected results do not reflect additional liabilities or benefit payments due to potential higher COLA's

2

The SPTRFA Board Prefers to Remain Separate from the State's TRA

Its reasoning is outlined on pages 60-61 of the "*Consolidation Study Report*"

Among the items considered to support this decision:

1) Preference to maintain a 1% COLA as more prudent
2) Newly implemented Pension Administration System with expected Plan efficiencies
3) Board governance better represents current and former Educators
4) Sole Employer structure with resultant administrative advantages
5) Smaller, more nimble and adaptive structure to respond to Member needs
6) Desire to avoid possible future adjustments as State TRA addresses Plan finances
7) Responsible to members, City and State taxpayers to pursue least costly, workable option

3

Unilateral Steps taken by SPTRFA Board to improve the Plan's Financial Sustainability

1) Employer and Employee Contribution Rates were increased TWICE, by nearly 40%;
2) Post retirement adjustments (COLAs), suspended in 2011, were reduced to 1% from originally 2%;
3) Operational savings were realized with reduced Interest credited on Refunds of member contributions, Deferred annuity Augmentation, and eliminating interest on excess earnings accounts;
4) Other savings achieved by ending the policy of returning excess earnings account principal;
5) Increased the "break in service" requirement from 30 to 90 days for eligibility to return to work;
6) Requiring the Employer to contribute its full share and part of the employee contribution for Return to Work employees;
7) Early Retirement Reduction rates were increased for ages under 62;
8) Transferred of over $250 Million of Plan assets to management by the State Board of Investment to achieve further Plan operational savings of nearly $1 million/ year

Impacts of the above steps taken are already being realized by the Plan.
In FY 2014, for the first time, the rate of annual growth in Plan contributions exceeded the annual rate of growth in annuitant payments.

4

Actuarial Determined Cost Difference between Merging and Remaining as a Separate Plan

<u>In a Merger into TRA:</u>

TRA would require SPTRFA to contribute all currently received annual payments:

a) Employer Contributions (10.34% of payroll) + additional annual payment $800,000

b) Employee Contributions (7.5% of payroll)

c) State's (1997) Amortization Payments (approximately $3 million)

d) State's (2013) Supplemental Additional payment ($7 million)

PLUS

e) $46 million annually for 25 years as determined by Plan actuaries in the Consolidation Study

<u>By remaining a Separate Plan:</u>

SPTRFA would require continuing receipt of the above referenced annual payments (a,b,c,) and continuing the $7 million additional payment (d) until 2042 or upon achieving full funding.

WHY the Difference?

The major reasons for the less expensive (1/6 of the cost) alternative relate to not merging with a Plan (TRA) that has:

a) Higher COLA;

b) Uses different Plan assumptions, different methodologies of calculating amortization of liabilities; and

c) SPTRFA, by remaining separate, assumes its <u>own plan risks</u> (performance return, payments, mortality, other assumptions) rather than passing those risks to another party (i.e. TRA) requiring "offsetting" compensation.

5

Why the State Should Act to Make Up the Difference needed to Meet Unfunded Obligations?

1) Current Employees are already being asked to do MORE than their share-

Normal Costs (funding needed to meet future obligations of the current workforce) represent approximately 7.67% of salary. Employees will contribute 7.5%, or 98% of the normal cost! Generally, employees contribute 40-50% of normal cost with balance coming from investment growth.

2) The Employer will contribute 10.34% of salary-

This level of payment (greater for the remaining Basic Plan members) is among the highest in the State, in addition to other assessments, such as the recently revised Return to Work program and its separate annual $800,000 payment to the Plan.

3) The State, in 1978 and until 1994, chose to eliminate the nearly 4% supplemental payment for all SPTRFA Coordinated Plan members, funds intended to address the Plan's prior unfunded liabilities-

This action was unique to the St. Paul Teachers' Plan. It has cost the Plan a projected more than $300 million in opportunity cost (see accompanying chart **#6**). It is the primary reason that the Plan never achieved greater than 80% funded level while other large MN plans enjoyed over 100% funding. Had those funds not been eliminated by State action, the Plan today could have over $1.3 billion in assets based on actual Plan investment returns, which could translate into a current funded ratio of over 87%.

The State gradually reinserted the omitted increase in Employer share beginning in 1994, but at levels insufficient to make up for the amount of unrealized "opportunity cost" by its actions from 1978-1994.

6

6) Table - *SPTRFA Lost Opportunity Cost to Plan*

"SPTRFA Lost Opportunity Costs Due to Legislative Change in Additional Employer Contribution- 354A.12, Subd 2a(4)"

Year	ROR	Shortfalls	5.0% 1978	7.0% 1979	14.0% 1980	2.0% 1981	25.0% 1982	13.0% 1983	12.0% 1984	15.0% 1985	31.5% 1986
1978	5.0%	$ 225,000	$ 236,250	$ 252,788	$ 288,178	$ 293,941	$ 367,427	$ 415,192	$ 465,015	$ 534,767	$ 703,219
1979	7.0%	$ 345,000		$ 369,150	$ 420,831	$ 429,248	$ 536,560	$ 606,312	$ 679,070	$ 780,930	$ 1,026,923
1980	14.0%	$ 409,000			$ 466,260	$ 475,585	$ 594,482	$ 671,764	$ 752,376	$ 865,232	$ 1,137,780
1981	2.0%	$ 500,000				$ 510,000	$ 637,500	$ 720,375	$ 806,820	$ 927,843	$ 1,220,114
1982	25.0%	$ 600,000					$ 750,000	$ 847,500	$ 949,200	$ 1,091,580	$ 1,435,428
1983	13.0%	$ 690,000						$ 779,700	$ 873,264	$ 1,004,254	$ 1,320,593
1984	12.0%	$ 735,000							$ 823,200	$ 946,680	$ 1,244,884
1985	15.0%	$ 822,000								$ 945,300	$ 1,243,070
1986	31.5%	$ 1,180,000									$ 1,551,700
1987	10.6%	$ 2,470,000									
1988	-5.3%	$ 2,650,000									
1989	14.0%	$ 2,850,000									
1990	14.0%	$ 4,740,000									
1991	11.5%	$ 4,990,000									
1992	9.2%	$ 5,250,000									
1993	12.3%	$ 5,880,000									
		$ 34,336,000	$ 236,250	$ 621,938	$ 1,175,269	$ 1,708,774	$ 2,885,968	$ 4,040,843	$ 5,348,945	$ 7,096,586	$ 10,883,711
Cumulative Shortfalls			$ 225,000	$ 570,000	$ 979,000	$ 1,479,000	$ 2,079,000	$ 2,769,000	$ 3,504,000	$ 4,326,000	$ 5,506,000
Cumulative Shortfall from ROR			$ 11,250	$ 51,938	$ 196,269	$ 229,774	$ 806,968	$ 1,271,843	$ 1,844,945	$ 2,770,586	$ 5,377,711

Year	ROR	Shortfalls	10.6% 1987	-5.3% 1988	14.0% 1989	14.0% 1990	11.5% 1991	9.2% 1992	12.3% 1993	Total Loss
1978	5.0%	$ 225,000	$ 777,760	$ 736,539	$ 839,655	$ 957,206	$ 1,067,285	$ 1,165,475	$ 1,308,829	$ 1,083,829
1979	7.0%	$ 345,000	$ 1,135,777	$ 1,075,581	$ 1,226,162	$ 1,397,825	$ 1,558,575	$ 1,701,964	$ 1,911,305	$ 1,566,305
1980	14.0%	$ 409,000	$ 1,258,385	$ 1,191,691	$ 1,358,527	$ 1,548,721	$ 1,726,824	$ 1,885,692	$ 2,117,632	$ 1,708,632
1981	2.0%	$ 500,000	$ 1,349,446	$ 1,277,925	$ 1,456,834	$ 1,660,791	$ 1,851,782	$ 2,022,146	$ 2,270,870	$ 1,770,870
1982	25.0%	$ 600,000	$ 1,587,583	$ 1,503,441	$ 1,713,923	$ 1,953,872	$ 2,178,567	$ 2,378,996	$ 2,671,612	$ 2,071,612
1983	13.0%	$ 690,000	$ 1,460,576	$ 1,383,166	$ 1,576,809	$ 1,797,562	$ 2,004,282	$ 2,188,676	$ 2,457,883	$ 1,767,883
1984	12.0%	$ 735,000	$ 1,376,842	$ 1,303,869	$ 1,486,411	$ 1,694,509	$ 1,889,377	$ 2,063,200	$ 2,316,973	$ 1,581,973
1985	15.0%	$ 822,000	$ 1,374,835	$ 1,301,969	$ 1,484,244	$ 1,692,038	$ 1,886,623	$ 2,060,192	$ 2,313,596	$ 1,491,596
1986	31.5%	$ 1,180,000	$ 1,716,180	$ 1,625,223	$ 1,852,754	$ 2,112,139	$ 2,355,035	$ 2,571,699	$ 2,888,018	$ 1,708,018
1987	10.6%	$ 2,470,000	$ 2,731,820	$ 2,600,910	$ 2,949,218	$ 3,362,109	$ 3,748,751	$ 4,093,636	$ 4,597,154	$ 2,127,154
1988	-5.3%	$ 2,650,000		$ 2,509,550	$ 2,860,887	$ 3,261,411	$ 3,636,473	$ 3,971,029	$ 4,459,466	$ 1,809,466
1989	14.0%	$ 2,850,000			$ 3,249,000	$ 3,703,860	$ 4,129,804	$ 4,509,746	$ 5,064,445	$ 2,214,445
1990	14.0%	$ 4,740,000				$ 5,403,600	$ 6,025,014	$ 6,579,315	$ 7,388,571	$ 2,648,571
1991	11.5%	$ 4,990,000					$ 5,563,850	$ 6,075,724	$ 6,823,038	$ 1,833,038
1992	9.2%	$ 5,250,000						$ 5,733,000	$ 6,438,159	$ 1,188,159
1993	12.3%	$ 5,880,000							$ 6,603,240	$ 723,240
		$ 34,336,000	$ 14,769,204	$ 16,509,863	$ 22,054,425	$ 30,545,644	$ 39,622,243	$ 49,000,490	$ 61,630,790	$ 27,294,790
Cumulative Shortfalls			$ 7,976,000	$ 10,626,000	$ 13,476,000	$ 18,216,000	$ 23,206,000	$ 28,456,000	$ 34,336,000	
Cumulative Shortfall from ROR			$ 6,793,204	$ 5,883,863	$ 8,578,425	$ 12,329,644	$ 16,416,243	$ 20,544,490	$ 27,294,790	

	0.60% 1994	18.8% 1995	16.6% 1996	18.9% 1997	16.7% 1998	9.5% 1999	10.8% 2000	-2.4% 2001	-3.7% 2002	2.9% 2003
Total Loss	$ 62,000,575	$ 73,656,683	$ 85,883,692	$ 102,115,710	$ 119,169,033	$ 130,490,091	$ 144,583,021	$ 141,113,029	$ 135,891,847	$ 139,832,710
Earnings Loss	$ 27,664,575	$ 39,320,683	$ 51,547,692	$ 67,779,710	$ 84,833,033	$ 96,154,091	$ 110,247,021	$ 106,777,029	$ 101,555,847	$ 105,496,710

	20.1% 2004	12.1% 2005	13.0% 2006	20.1% 2007	-6.3% 2008	-18.8% 2009	13.4% 2010	25.0% 2011	0.0% 2012	13.9% 2013	9.0% FY 2014 TD
Total Loss	$ 167,939,085	$ 188,259,714	$ 212,733,477	$ 255,492,906	$ 239,396,853	$ 194,390,245	$ 220,438,537	$ 275,548,172	$ 275,548,172	$ 313,849,368	$ 342,095,811
Earnings Loss	$ 133,603,085	$ 153,923,714	$ 178,397,477	$ 221,156,906	$ 205,060,853	$ 160,054,245	$ 186,102,537	$ 241,212,172	$ 241,212,172	$ 279,513,368	$ 307,759,811