Newsletter of the Public Employees Retirement Association of Minnesota mnpera.org

PERA NEWS

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GENERAL | POLICE & FIRE | CORRECTIONAL

WINTER 2019

Uneven investment results for 2018

Investment returns for the fiscal year ending June 30, 2018 were very good. The State Board of Investment Combined Fund experienced a return of 10.3 percent, well above the 8 percent assumption that applied to the fiscal year and the 7.5 percent assumption expected prospectively.

However, at newsletter deadline, financial markets across the world have experienced significant downturns. By the end of December, major U.S. stock indexes were down around 20 percent from the peaks they had reached only months before. What implication does this drop in value have on the plans and the stakeholders? The answer to this question depends on our view of three different types of investment risks.

Actual investment performance

The first risk is actual investment performance. These are the asset gains or losses that we can measure after the fact that differed from our expectations. If the fund does not meet the 7.5 percent assumption, there will be an asset loss. We would first see this measured July 1, 2019 in our annual actuarial valuation. An asset loss would reduce the plan's funding ratio, would increase the actuarial recommended contribution, and would extend the time period expected to reach full funding.

Future assumptions

The second risk is the risk associated with future assumptions. If the late 2018 asset downturn leads to a change in the investment allocation or to different expectations for returns in various investment classes, the future assumption could be challenged. If the assumed investment rate of return is lowered, as it was this past year from 8.0 percent to 7.5 percent, there is risk that benefit or contribution changes will be necessary to ensure the plans head to full funding.

Investment volatility

The third risk is investment volatility. This is different than actual investment performance or future assumption risk. It is the risk of adverse consequences when there is significant fluctuation in markets. PERA members are protected from investment volatility risk in several important ways. The defined benefit nature of the plan generally limits members from investment and mortality risks. A monthly benefit does not vary depending on the market. The protection is not absolute, and future benefit increases for members may still be subject to changes stemming from actual investment performance or assumption changes, but short-term volatility should not be too much concern to members.

Another way members are protected is by the professional expertise of the State Board of Investment (SBI). Because of their dedication to long-term investing and their adherence to strict investment allocation parameters and a diverse portfolio, the impact of market volatility is lessened. The SBI is not inclined to make emotional decisions that individual investors may make.

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Administer and promote sustainable retirement plans and provide services that our members value.

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PRESIDENT'S MESSAGE

Kathryn A. Green
President
PERA Board of Trustees

The December Board of Trustees meeting was the final meeting for three Trustees: Ross Arneson, Rebecca Otto, and Lori Volz. Collectively they served over 35 years on our Board. Trustees Arneson and Otto have helped lead PERA through two significant pension reform bills in 2010 and 2018 as well as several mergers and the creation of the Statewide Volunteer Firefighter Plan.

We will greatly miss their historical knowledge, perspectives, and professional approach. At the same time, we are excited to welcome the new board trustee that we know, State Auditor Julie Blaha, and those that we don't yet know pending the results of the election process. Gradual transition of board trustees helps maintain a level of consistency and stability for PERA's future. An experienced and balanced board recognizes the difference between long-term trends and short-term fluctuations and ensures that actions are consistent with our long-term focus on plan sustainability.

With the transition of board members, it is a good time to ask what is next for the PERA Plans? After the passage of the 2018 Omnibus Pension Bill, which was three years in the making, is there significant work to do now, or are we in a wait-and-see mode? Has the progress that was gained from the past two reforms been lost with the recent decline in the equity markets?

These are difficult questions for trustees to consider regardless of their tenure on the board. The responsibilities of trustees include everything from current issues—considering member appeals about disability eligibility or benefit determinations and overseeing PERA's operating budget—to considering what may happen in the future.

To guide us in our decision making, we rely on investment and actuarial experts to help us understand expected future trends. The magnitude of changes in these predictions help guide our work. Future expectations are often bigger drivers of pension fund changes than actual past results. While the investment returns for the fiscal year ending June 30, 2019 do not look promising at this point, it may be future changes to assumptions that can have a bigger impact (for more on this topic, see the article on page 1). What is next from a legislative perspective for the plans may depend on what assumptions we are most closely evaluating.

The most important assumption is the investment return assumption. Although the legislature sets this, we, as board trustees, will promote changes when necessary. According to the fund's actuary, despite the recent change, the current 7.5 percent remains on the high end of their range of reasonableness and it is relatively high compared to other pension funds nationally. The likelihood and timing of another assumption change is difficult to gauge. However, if it occurs relatively soon, it likely would be smaller and less impactful than the recent change to 7.5 percent.

Mortality assumption changes were also a big influence on the 2018 Omnibus Pension Bill. A new model for predicting future life expectancy improvements was introduced in 2014 by the Society of Actuaries. The model first added two years to expected future lifespans. Since that time, the model has been adjusted annually and has actually decreased the expected future lifespan estimates. It is unlikely that we will see another significant mortality assumption change soon.

As a Board, we have noticed a demographic trend in the Police & Fire Plan that needs more evaluation. Disability rates in the Police & Fire Plan have doubled over the past five years. At this point, we have only identified the overall trend. More evaluation will need to be done to understand the exact causes or the overall increased cost of disability benefits to this plan. What we know is that about 17 percent of the estimated total cost of active member benefit accruals is due to disability benefits (about 75 percent goes for retirement). Given the magnitude of the costs, further evaluation of the rate of disability occurrence and the benefits provided seems to be in order.

Finally, there is one other assumption, or lack of assumption, that will be under closer scrutiny in the upcoming year. There is no specific assumption to estimate the cost of increased overtime in pension benefits. This is only an issue when overtime is back-loaded in a career and impacts a member's benefit disproportionately to contributions made earlier in a career. Historically there has not been enough data to create an assumption that might capture this potential cost. PERA has only captured data for a few years making evaluation difficult. We will study this to determine if there is an issue and what changes, if any, are appropriate.

There are many other assumptions as well, but the ones I have addressed are either key drivers of sustainability (interest and mortality), or important indicators of whether we are providing equitable benefits within our plans. Both sustainability and equitability are important. With good progress on our sustainability goals, we now have the opportunity to focus more on equitability issues.

Pension plans have long lifespans and we can only assess the balance of current benefits and costs if the assumptions for the future are accurate. PERA's Board and staff will closely monitor these assumptions and develop an action plan for the future.

Introducing PERA's new Board Trustee

Julie Blaha
State Auditor

Julie Blaha is the newest Trustee on the PERA Board. Blaha won the 2018 election for Minnesota State Auditor. The State Auditor is a member of the PERA Board of Trustees by statute.

Blaha earned her Bachelor of Science from St. Cloud State University and her Master of Arts in education from Saint Mary's University of Minnesota. Along with being a former math teacher, Blaha served as the secretary-treasurer of the Minnesota American Federation of Labor and Congress of Industrial Organizations. She also served as president of Anoka-Hennepin Education Minnesota. Blaha was a member of the Public Employee Pension Coalition, working on the bipartisan pension bill last year.

Blaha and her husband, Roger, live in Ramsey, MN.

Investment returns

Continued from page 1

Another protection for members is the deliberate process PERA's Board and legislature undertake. Actuarial valuations are only done annually. They also include a mechanism to smooth out the asset gains or losses over five-year intervals. The development of the actuarial recommended contribution further spreads the amortization payment for gains or losses over the period ending June 30, 2048. Changes to assumptions typically occur less often than annually. As we have seen in recent years, changes to the plans require the involvement of many parties and may take years to enact. The slow process is helpful to ensure there is no overreaction to short-term volatility.

So, what do we make of the investment downturn in late 2018? Will it become an actual asset loss in the July 1, 2019 actuarial valuation? Will it spark a change in investment allocation that will suggest a lower future assumed return or will deflated asset values create an expectation for a higher expected return? Or, is it just short-term volatility with losses recouped by the time you read this article?

Put another way, are these actual losses to recognize, a cause to change future expectations, or just volatility that the plan can endure and of no significant concern to members? Only time will be able to tell us the answer with certainty. Until then, the Board will continue to rely on the investment and actuarial professionals to assess the information available and make prudent decisions in fulfilling our mission.

PERA educational program dates set for winter 2019

Whether you just started your public service career or you are close to retirement, PERA's educational programs will give you valuable information. PERA offers educational sessions in our St. Paul, Duluth, and Mankato offices, as well as locations across the state.

For a schedule, visit our website at mnpera.org

PERA does require registration for our programs. It's easy to register. Simply use your MY PERA account or call our Member Service Center at 651.296.7460 or 1.800.652.9026.

Your benefit recipient COLA letters sent in December

In December, letters were sent to advise benefit recipients of their new benefit amounts after the annual cost of living adjustments (COLA). After December 2018, these letters will be discontinued. For income verification and detailed gross to net pay information on monthly benefits, recipients are encouraged to register for MY PERA and manage PERA account information online.

On the PERA homepage (mnpera.org), recipients will be advised of the COLA adjustment percentages and the date the January payment details will be available in MY PERA. For those not able to use MY PERA, detailed income verification letters will be available by contacting our Member Service Center at 1.800.652.9026 or 651.296.7460.

ATTENTION:

Members who terminated prior to Jan. 1, 2012

If you terminated your public service prior to Jan. 1, 2012, recent legislation may reduce your benefit if you return to public employment. Members should contact PERA prior to returning to public employment to discuss their options.

PERA Board receives actuarial update on three largest plans

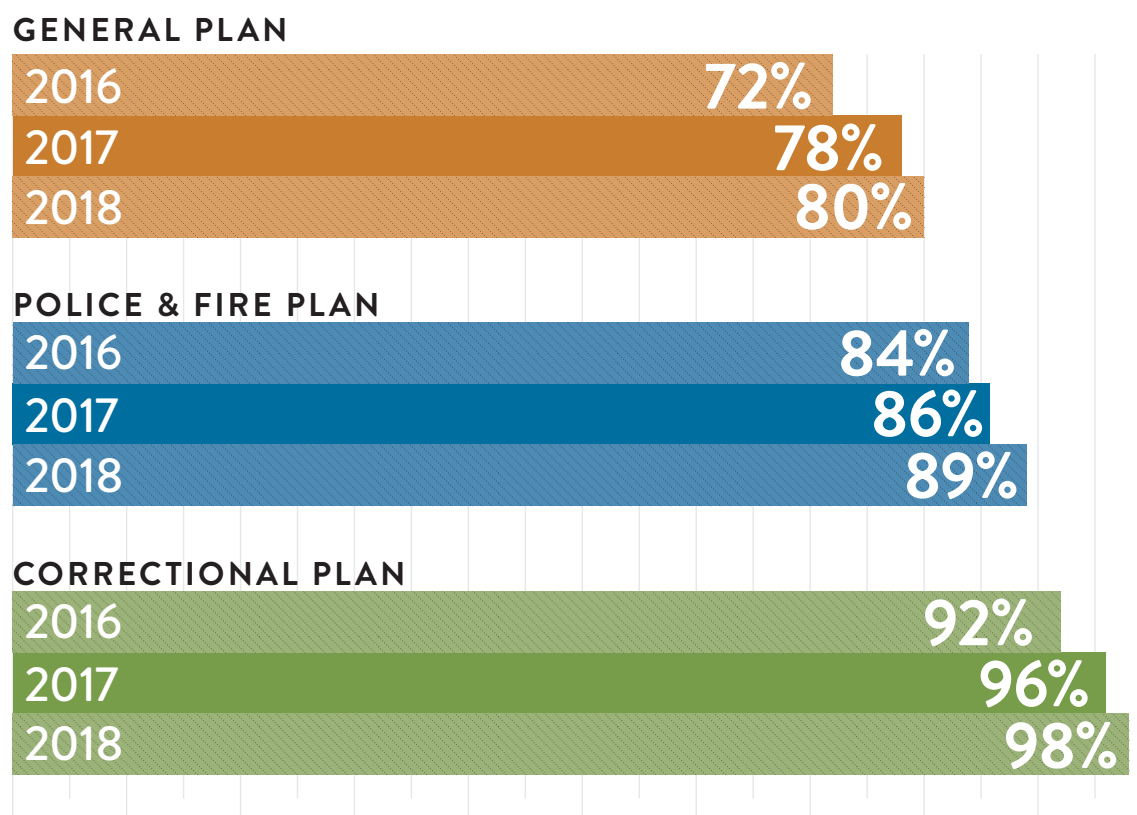
The Board of Trustees received an actuarial update on the financial health of PERA's three largest plans from its actuary, Gabriel Roeder Smith & Co., at the Dec. 13, 2018 board meeting. The actuarial valuation results were determined as of July 1, 2018 and reflect all of the changes contained in the 2018 Omnibus Retirement Bill as well as positive investment returns through June 30, 2018.

The funding ratios are 80 percent for the General Employees Plan, 89 percent for the Police & Fire Plan, and 98 percent for the Correctional Employees Plan. These funding ratios represent the ratio of the market value of assets to the actuarial accrued liabilities for each plan. In other words, they represent the percentage of benefits that have been earned by plan members that are currently funded.

Making progress towards 100 percent funded plans is important. The results confirmed that as of the valuation date, all three funds are expected to reach full funding within the targeted 30-year time frame established by the legislature. Subsequent asset losses will have an adverse impact unless those losses are reversed by the next valuation date (see related articles).

The Board also received results as reported under rules from the Governmental Accounting Standards Board (GASB) as well as several measurements demonstrating maturity and volatility measurements for each plan. A full understanding of the financial health of pension plans requires understanding not just the current funding status, but also the direction in which the plan is heading and all of the assumptions that go into those projections. The plans are all expected to trend towards a better funding status. However, that path is certain to be less than smooth.

Funding Ratio of Plans



PERA's 2018 Comprehensive Annual Financial Report (CAFR) is available on website

PERA's 2018 *Comprehensive Annual Financial Report* (CAFR) is available online. The CAFR provides an extensive review of PERA's financial status, as well as information about PERA's structure, investments, and demographics.

PERA also released its *Summarized Annual Financial Report*. This is a summary of the CAFR highlighting PERA's mission and vision statements, a summary of the financial statements, along with a few interesting facts.

Applications accepted Feb. 19 - March 19, 2019

Board to fill vacant trustee position

The PERA Board of Trustees is seeking candidates to fill the Retired, Disabled, and Survivor Representative seat on the Board. The four-year term ends in January 2023. PERA will accept applications from Feb. 19 through March 19, 2019. Interested applicants must be a member of PERA who is either receiving a retirement annuity or disability benefit, and can apply by completing a brief biography and answering three questions concerning the position.

If there are more than five candidates for the position, a subcommittee of the Board will review the candidate statements and present a slate of three to five candidates for consideration by the Board of Trustees at the April 11, 2019 Board meeting.

Trustees meet seven times a year to oversee the administration of the pension funds. Board members act as PERA fiduciaries in accordance with Minnesota law and establish the policies and procedures that govern operations at PERA, hear and rule on appeal matters of disabled, retired, and active members, and direct the dissemination of information to PERA's members. Further information about the duties and powers of the Board, can be found under Minnesota Statutes 353.03.

The application materials can be found on PERA's website, mnpera.org, under *About/Board of Trustees/Becoming a Trustee*, or you may call 651.201.2691. Interested candidates should complete the *Biographical Sketch* form and return it to Gladys Rodriguez by email at Gladys.rodriguez@mnpera.org, or regular mail to 60 Empire Drive, Suite 200, St. Paul, MN 55103-2088. The application must be received in our office by 4:30 p.m. March 19, 2019.

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BOARD DIRECTORY

The PERA Board of Trustees consists of 11 members. The State Auditor is a member of the Board by statute. Five trustees are appointed by the Governor to represent cities, counties, school boards, retirees and the public, respectively. The remaining five members are elected by the PERA membership at large to represent the general active membership, Police & Fire Plan members, and all benefit recipients. Board members serve four-year terms.

Kathryn A. Green, President
Appointed School Board Representative
Email: kathryn.green@mnpera.org

Thomas Stanley, Vice President
Elected General Membership Representative
Email: thomas.stanley@mnpera.org

Paul Bourgeois
Elected General Membership Representative
Email: paul.bourgeois@mnpera.org

Mary Falk
Appointed Public Representative
Email: mary.falk@mnpera.org

Barbara Johnson
Appointed Cities Representative
Email: barb.johnson@mnpera.org

Leigh Lenzmeier
Appointed County Representative
Email: leigh.lenzmeier@mnpera.org

Julie Blaha
State Auditor
Email: julie.blaha@mnpera.org

Lawrence J. Ward
Appointed Annuitant Representative
Email: larry.ward@mnpera.org

Paul Ford
Elected Police & Fire Representative
Email: paul.ford@mnpera.org

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