Report of the
Blue Ribbon Commission on Pensions

Prepared by the City of Minneapolis
Blue Ribbon Commission on Pensions

October 2004

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BLUE RIBBON COMMISSION ON PENSIONS
Members

Name	Organization
Jay Kiedrowski, Chair	Former Commissioner of Finance, State of Minnesota Executive Vice President, Wells Fargo (retired 09/30/04) Instructor, Hubert Humphrey Institute of Public Affairs, University of Minnesota
Lou DeMars	Former Minneapolis City Council President Independent Consultant, DeMars Consulting
Kent Horsager	President & Chief Executive Officer, Minneapolis Grain Exchange
Lisa Huey	Managing Director, Piper Jaffray Inc. (retired)
Laura M. King	Former Commissioner of Finance, State of Minnesota Vice Chancellor – Chief Financial Officer Minnesota State Colleges and Universities
Dee Long	Former State Legislator and Speaker of the Minnesota House of Representatives Director, Environmental Tax & Incentives Program, Minnesotans for an Energy-Efficient Economy
Stuart Mason	Associate Vice President and Chief Investment Officer, University of Minnesota
John Taft	President, Voyager Management Funds

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Executive Summary

Mayor R.T. Rybak appointed a Commission of eight financial professionals and civic leaders to recommend a plan to reform the City's pension plans. The City is experiencing a significant rise in its financial obligations to its three closed pension plans: the Minneapolis Employees Retirement Fund (MERF), Minneapolis Police Relief Association (MPRA) and Minneapolis Firefighters' Relief Association (MFRA).

The Commission's work was guided by a number of core principles. First among these principles was that there would be no reduction in the value of pension benefits for current and future retirees. The City has an obligation to its retired employees that must not be compromised. The other principles sought to balance this obligation to retirees with the City's responsibilities to its current employees as well as City and State taxpayers. Professional and efficient management of the pension funds was viewed as a key step to achieve this balance.

Stock market losses, earlier than expected retirements and state funding formulas contributed to the rapid rise in City contributions to these funds since 1999. (The amount needed to finance the City's pension costs has substantially increased, not the monthly benefit payments to the retirees.) The City's annual pension obligations have increased from $12 million in 1999 to approximately $54 million in 2003 — and are expected to total $330 million by 2020. The annual pension obligations reflect the amounts necessary to make the City's payments to the pension funds. It does not include interest on City bonds that finance those payments.

The City and State make substantial financial contributions to these plans, but they have little influence over the operations of the funds. Investments are managed by the funds' boards and benefits are administered by the plans. Some of the benefits include provisions that lead to conflicts between responsible fund management and maximum return for beneficiaries. Concerns about fiduciary responsibilities of MPRA and MFRA have been raised by the Office of the State Auditor, staff of the Legislative Commission on Pensions and Retirement and the City of Minneapolis Finance Officer. The City Finance Officer has reported that MERF uses professional investment management and benefit administration practices and employs a professional pension administrator.

The Commission recommends the City support legislation in 2005 that requires the three pension funds be merged into Public Employees Retirement Association (PERA), the statewide public pension plan. As part of this legislation and to provide immediate funding relief, the Commission recommends removal of the MERF "liquidity triggers" and extension of the MPRA amortization date to 2020. The immediate funding relief is viewed as critical, but not sufficient to address the problems with the current system. The long-term issues must be addressed through a transition to PERA.

This reform plan reduces the City's long-term pension costs and provides stable and reliable management and governance of the plans for the benefit of the pension beneficiaries and the City.

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Blue Ribbon Commission on Pensions: Background and Process

In July of 2004, the Mayor assembled a Blue Ribbon Commission on Pensions. The Commission was asked to recommend actions to address the significant financial obligations presented by the City's three closed pension funds – the Minneapolis Employees Retirement Fund (MERF), Minneapolis Police Relief Association (MPRA) and the Minneapolis Firefighters' Relief Association (MFRA). The Commission met between July and September to deliberate on the City's pension challenges. The Commission was staffed by the City Finance Department and the City's pension actuary, Deloitte Consulting.

The three pension funds presented information about their respective funds in August 2004. In addition, some of the Commission members were contacted by representatives from the funds and, on at least one occasion, the Chair of the Commission met with those representatives. Briefing documents provided to Commission members were also provided to the three pension funds. City Finance staff has communicated with the three pension funds throughout the pension reform process and arranged time with each of the funds to review the contents of this report.

Recommendations contained in this report were transmitted to the Mayor and City Council for their review and action.

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Core Principles for Pension Reform

Previous pension reform efforts recommended more scrutiny and improved administration of Minneapolis' local pension plans (1943) or a merger with the statewide retirement plan (1978). In response to the 1978 recommendations, the Legislature approved the merger of the MERF-Coordinated plan with PERA in 1979. The Commission attempted to build on these prior recommendations and actions and used the following core principles to guide their efforts:

No reduction in the value of pension benefits – This refers to the monthly income of retirees, including existing cost of living adjustments.

Fiduciary responsibilities to taxpayers and beneficiaries will be balanced and ***investment policies and practices should support fiduciary responsibilities***

Risks and benefits among City employees, beneficiaries and other parties should be balanced and fairly allocated – Retired and current City employees should be treated comparably. It is unfair to give benefit increases to pensioners at a time when the City is limiting salary increases for current City employees.[1]

State and City funding will be maintained at levels needed to provide for the long-term financial health of the plans, while recognizing long-term commitments of the respective parties – This principle was intended to address two issues. First, City pension obligations have always been met and will continue to be met. However, the financial pressure created by the substantial increases in pension obligations needs to be addressed. Second, state pension aids for MERF, MPRA and MFRA are essential to funding the three plans.

Pension plans will be professionally managed and efficiently administered – Professional management leads to efficient and effective services to pension beneficiaries and reasonable funding by taxpayers.

The Legislative Commission on Pensions and Retirement's "Principles of Pension Policy" will be supported. [2]

City approval for pension legislation relating to Minneapolis closed pension plans

[1] In an effort to reduce the effects of the 2003 LGA cuts and projected demands on the property tax, the City Council passed a 2 percent wage policy; this policy currently limits the annual increases in employee salaries to 2 percent.
[2] The LCPR's "Principles of Pension Policy" can be found at http://www.commissions.leg.state.mn.us/lcpr/princples.pdf

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Commission Findings

The Blue Ribbon Commission on Pensions finds:

1. The City of Minneapolis has paid approximately $115 million to three closed pension plans since 2002 and faces an additional $330 million under current law and actuarial forecasts. This level of funding has caused higher property taxes, reduced funding for basic City services and threatens the City's credit rating. The sudden increase in pension funding has required the City to issue bonds to manage this cost. Issuing bonds to pay pension obligations should be minimized and eliminated, if possible, while avoiding substantial property tax increases or reductions in City services.

2. City property taxpayers are the guarantors of last resort for MPRA and MFRA under state pension laws, yet the City has none of the customary rights of a guarantor to manage costs when the guarantee is called.

3. Recent State Auditor reports as well as reports from the Legislative Commission on Pensions and Retirement call into question the governance and management practices of MPRA and MFRA. Failure to adhere to state law in administering benefits (MPRA/MFRA), failure to balance fiduciary duties to taxpayers and beneficiaries as required by state law (MPRA/MFRA), failure to properly administer the 1995 settlement agreement with the City (MPRA/MFRA), frequent board disputes resulting in turnover among board members (MPRA) and lack of professional investment management practices found by the City Finance Officer (MPRA/MFRA) indicate that current governance and management practices must be improved. These governance and management practices result in increased costs to the taxpayers in the long term and must be addressed in conjunction with any proposed funding solution.

4. By 2010 nearly all employees in the three plans will be retired. None of the three retirement funds has proposed plans to transition to long-term management of the plans. The Public Employees Retirement Association (PERA) and the State Board of Investment (SBI) can provide long-term benefit administration and investment management for these funds.

5. The existing funding structure for the pension plans results in an increasing burden on property taxpayers, requiring the City to pay obligations sooner than the funds are needed to pay benefits to retirees. This structure results in a loss of state aid to the City and payment of supplemental benefits above what are expected by retirees. Savings to the City could be realized by extending the time available to make payments and to maintain state aid at current funding levels.

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Recommended Pension Reform Plan

To reduce the City's long-term funding obligations and provide stable long-term governance and management of the pensions of City employees, the Commission recommends:

1. MERF, MPRA and MFRA should be merged into PERA. The City should seek legislation in 2005 that carries out this recommendation effective July 1, 2005. Individual plan members would elect to receive benefits under either their current benefit structure or under PERA's benefit structure.

To provide near-term pension funding relief for the City the following actions should also be included in the City's 2005 pension legislation:

2. MERF: Remove the "liquidity triggers" that require the City to fully fund each retirement as it occurs.

3. MPRA: Extend the amortization date from 2010 to 2020 and assure that beneficiaries are not harmed by making post-retirement benefit payments as if full funding had occurred by 2010.

MPRA Bill: The MPRA bill currently awaiting City Council action supports some but not all of the core pension principles in this report. The bill reduces City contributions by $22 million (present value) and the City could realize these savings without additional state legislative action.

The bill extends the time period by which the fund must be fully funded (amortization date) to 2020. However, it changes the calculation for the 13th check, gives a permanent benefit increase to all MPRA participants and does not address any of the long-term governance and management concerns identified in this report. If the City Council approves the MPRA bill and the legislature then adopts the Commission's reform plan, the $89 million of projected savings (present value) would be reduced to $73 million.

The Commission defers to the City to judge the appropriate legislative strategy.

Results

If these recommendations are adopted the following results would be expected:

Benefit Impact on Retirees – Current and future retirees in the three closed pensions will have no reduction in the value of their pension benefits. In addition, a post-retirement benefit equal in value to what is currently in law will be preserved. Savings to the City will not come at the expense of current and future retirees. Rather, the savings will be achieved by extending the date by which full funding must be reached and maintaining current funding commitments.

City Funding – City payments are projected to be reduced by $89 million (present value). The City would see funding relief beginning in 2005 with the removal of MERF's "liquidity triggers" and additional relief in 2006 with the extension of the MPRA amortization date if legislation is adopted in 2005 consistent with the above recommendations. Long-term funding concerns would be addressed through a PERA merger.

State Funding – These recommendations are consistent with the original intent of state aid and do not include an increase in the City's pension aids above what is included in the state's current financial forecast.

Assurance of Long-Term Funding – Upon transfer to PERA, all three funds would be fully funded. The City's exposure to the long-term risks associated with the funding of MPRA and MFRA would be eliminated.

Fiduciary Duties – PERA is governed by a Board of Trustees that includes both taxpayer and beneficiary representatives and the State Board of Investment (SBI) is composed of the State's constitutional officers; this governance structure ensures that fiduciary duties will be balanced between taxpayers and beneficiaries.

Investment Management – The merger into PERA would transfer investment authority to SBI, which was created, in part, to provide sound investment management policies and practices for public pensions in Minnesota.

Benefits Management – PERA has a history of professional benefits administration. The cost of benefits administration will be lower over time as these funds decline in size.

Introduction

The City of Minneapolis has four local pension funds to which it provides funding: Minneapolis Employees Retirement Fund (MERF), Minneapolis Police Relief Association (MPRA), Minneapolis Firefighters' Relief Association (MFRA) and the Minneapolis Teachers Retirement Fund Association (MTRFA). Three of these funds are closed funds, meaning they do not accept any new members. City employees hired after these plans were closed were placed into the statewide public pension plan, Public Employees Retirement Association (PERA).

In the past four years, the City's required payments to the three closed funds, MERF, MPRA and MFRA, has increased approximately 350 percent, from $12 million in 1999 to approximately $54 million in 2003. These increases are due, primarily, to an increase in the rate of retirements for MERF and stock market losses for MPRA and MFRA. (The amount needed to finance the City's pension costs has substantially increased, not the monthly benefit payments to the retirees.)

The City has historically levied 100 percent of annual pension obligations; however the increases in these obligations have been too large to manage through the property tax levy alone. If the City had financed the entire increase in pension obligations through the property tax levy, the levy would have increased approximately $37 million in 2003.

As a result of these increases, the City began issuing general obligation (pension) bonds to finance pension obligations in the fall of 2002. The City has issued approximately $120 million in bonds through 2004. If there is no change in state law, it is estimated that the City will issue a total of $330 million in bonds to fully fund pension obligations.

Below is a table that shows the amount of the City's annual MERF, MPRA and MFRA pension obligations (column A) and property tax levy for pensions (column B). Column C displays the total City property tax levy.

Year	(A) Total Pension Obligations*	(B) Total Pension Levy	(C)Total City Levy**
1996	$19,960,000	$18,168,000	$129,482,000
1997	$15,440,000	$14,157,000	$137,512,000
1998	$17,820,000	$13,413,000	$139,189,000
1999	$11,890,000	$8,098,000	$144,339,000
2000	$10,830,000	$6,833,000	$153,438,000
2001	$8,540,000	$4,612,000	$163,734,000
2002***	$17,660,000	$7,413,000	$146,852,000
2003	$54,210,000	$6,953,000	$158,415,000
2004	$42,210,000	$6,953,000	$172,666,000
2005****	$43,590,000	$11,169,000	$183,975,000

*Total pension obligations for MERF, MPRA and MFRA; does not include City's PERA obligations.
** City funds only
*** The City's pension obligations are funded primarily through its operating budget, noted here as the levy amount. The difference between the levy amount and the pension obligation was financed through bond proceeds.
**** Estimated. The amounts shown for years 2003-2005 include amounts levied for pension bond debt service.
Source: City of Minneapolis Finance Department

In an attempt to better understand and address the City's pension problems, a pension reform effort was undertaken by the City Finance Department in the spring of 2004. The City retained the services of an actuary and, in July of 2004, the Mayor assembled a Blue Ribbon Commission on Pensions. The Commission was asked to analyze the three closed pension funds and recommend a course of action.

History of Pension Reform and Overview of Funds

There have been two previous pension reform efforts pertaining to the City's pension funds. The first was conducted in 1943 by a state-appointed legislative commission that recommended more scrutiny and improved administration of the Minneapolis plans. The second effort was undertaken in 1978 by a special commission appointed by then Mayor Al Hofstede. The 1978 commission recommended a consolidation of MERF with PERA and the placement of all newly hired police and fire personnel into PERA-Police & Fire. As a result of their recommendations, the MERF-Coordinated plan merged with PERA in 1979. (The MERF-Basic plan is what remains of MERF today.)

The following two tables provide a brief overview of the City's closed pension funds:

	MERF	**MPRA**	**MFRA**
Established	1919	1905	1886
Closed to New Members	July 1978	June 1980	June 1980
Amortization Date[3]	2020	2010	15-year rolling amortization[4]
Retirement Age	Age 60 or with 30 years of service	Age 50 with 25 years of service	Age 50 with 25 years of service
Plan Participant Data			
Active Employees	705	24	58
Other Participants[5]	5,149	935	632
Total Participants	**5,854**[6]	**959**	**690**

Sources: Actuarial Valuations of MPRA and MFRA, MERF Comprehensive Annual Financial Report

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[3] The amortization date is the date by which the value of the fund's liabilities must meet or exceed the value of the fund's assets.

[4] According to state statute, when a fund becomes 100 percent funded, subsequent unfunded liabilities are recalculated annually, the City is given 15 years to amortize any new liabilities and certain state aids are eliminated.

[5] Other participants include retirees, terminated vested employees, surviving spouses, disability pensioners, etc.

[6] MERF contains employees from the City of Minneapolis, Minneapolis School District, Minneapolis-St. Paul Metropolitan Airports Commission, Metropolitan Council/Environmental Services, Minnesota State Colleges and Universities and Hennepin County. As of June 2003, the City represented 479 of the 705 remaining active employees in MERF.

Percent of Liabilities Funded					
Year	**MERF**	**MPRA**	**MFRA**	**PERA-PERF***	**PERA-P&F***
1995	78%	82%	83%	78%	116%
1996	80%	84%	83%	80%	122%
1997	84%	91%	90%	83%	127%
1998	89%	93%	105%	87%	134%
1999	93%	95%	109%	90%	134%
2000	93%	88%	108%	86%	123%
2001	93%	75%	104%	87%	122%
2002	92%	67%	87%	85%	121%
2003	92%	65%	81%	81%	107%

*PERA-Public Employees Retirement Fund and PERA-Police & Fire funded ratios
Sources: Actuarial Valuations of MPRA and MFRA, Comprehensive Annual Financial Reports of MERF and PERA

Pension Funding

The City's pension plans are funded through a combination of employee contributions, City (employer) contributions and state aids. The City and State contributions vary, depending on the state law and the funding levels of the plans.

Minneapolis Employees Retirement Fund

City Contributions – The City contributes the normal cost, which is the amount needed to fund one year of retirement benefits for members currently employed by the City, an amount to cover administrative costs and surviving spouse payments. The City also funds a portion of the fund's unfunded liability, which is the difference between fund's assets and liabilities. This payment, also called an amortization payment, is 2.68 percent of the payroll for current active MERF employees. In addition, the City pays a portion of an amount totaling $3.9 million annually. (The total $3.9 million is a payment on the fund's unfunded liability and is paid by all MERF employees.) Finally, when each City employee retires the City pays the difference between the employee's accumulated contributions over the period of their employment and the actuarial cost of the retirement benefits (the "liquidity trigger").

State Contributions – The state contributes a MERF state aid not to exceed $9 million annually to fund its share of the unfunded liability by 2020.

Minneapolis Police Relief Association

City Contributions – The City contributes the normal costs associated with the active MPRA employees plus an amount necessary to fully fund the plan's liabilities by 2010.

State Contributions – There are four state aids that the MPRA receives: Police State Aid, Amortization State Aid, Supplemental Police Amortization State Aid and Additional Amortization State Aid. These four aids are calculated annually according to provisions in state law and vary from year to year. These aids total approximately $9 million annually.

The City receives approximately $6.2 million in Police State Aid and redirects a portion of this aid, approximately $4.1 million annually, to offset PERA Police costs in the City's General Fund.

In years in which post-retirement benefit payments are made, state aid - either Amortization State Aid or Supplemental Police Amortization Aid - is reduced by the total amount of any 13th check payments.

Minneapolis Firefighters' Relief Association

City Contributions – The City contributes the normal costs associated with the active MFRA employees and an amount that amortizes the fund's unfunded liability over 15 years.

State Contributions – There are three state aids that the MFRA receives: Fire State Aid, First Class City Fire Insurance Premium Tax Surcharge and Additional Amortization State Aid. These three aids are calculated annually according to provisions in state law and vary from year to year. These aids total approximately $2.5 million annually.

The MFRA is not eligible to receive Amortization State Aid because the fund was previously 100 percent funded, meaning that at a previous time the fund had sufficient assets to pay its liabilities.

Once a fund reaches 100 percent funding it is no longer eligible to receive Amortization State Aid, even if, as with the MFRA, it subsequently becomes unfunded. In addition, the MFRA is not eligible to receive Supplemental Amortization State Aid because that aid is distributed to only those associations which receive Amortization State Aid.

The City receives approximately $1.8 million in Fire State Aid and redirects a portion of this aid, around $1.2 million annually, to offset PERA Fire costs in the City's General Fund.

In years in which post-retirement benefit payments are made, Supplemental Amortization Aid is reduced by the total amount of any 13th check payments.

City Payment History*			
Year	**MERF**	**MPRA**	**MFRA**
2000	$8,380,000	$1,300,000	$1,150,000
2001	$8,230,000	$0	$310,000
2002	$14,700,000	$2,960,000	$0
2003	$40,270,000	$13,940,000	$0
2004	$21,370,000	$20,840,000	$0
2005**	$13,860,000	$24,970,000	$4,760,000

* In 2001 there was no City contribution (other than the employer's normal cost) to the MPRA because state aids were sufficient to cover the costs associated with that year. No City contribution was required for the MFRA from 2002-2004 as the fund was fully funded during that time period.
**Estimated
Source: City of Minneapolis Finance Department

Current Financial Condition

In the summer of 2002 significant increases in the City's MERF pension obligations occurred. Soon after these increases, the funding ratios of the MPRA and MFRA also began to drop. In the spring of 2003, the State of Minnesota made reductions to the City's allocation of Local Government Aid (LGA), an unrestricted state aid, by $35 million (on an annual basis). The City had adopted a Five-Year Financial Direction that allocated resources to meet future pension obligations, but the increases that began to appear exceeded the City's planned resources and tax policy.

The reasons behind the increases in pension obligations varied by fund:

Minneapolis Employees Retirement Fund – Despite making annual contributions as required by state law, the City's annual payments to MERF were inadequate to fund annual retirements. These annual payments were insufficient because City employees were retiring at an earlier age and at higher salaries than the actuarial assumptions predicted. This became a problem for the City, in part, because of the structure of the MERF funding. MERF has two primary accounts – an Active Account and a Retired Account.[7] All of the City's contributions, employee's contributions and state aids go into the Active Account. Once a person retires, MERF transfers the present value of the full retirement benefit of each employee's Active Account into the Retired Account.

A provision in state law, referred to as the "liquidity trigger", states that if the employee's Active Account is insufficient to fully fund benefits, MERF is to bill the City for the amount of the insufficiency. According to state statute, the City has 72 hours to remit the amount needed to fully fund that retiree's benefits to MERF.

Because City employees were retiring earlier than assumed, the City's contributions to the Active Account were depleted in 2002. This depletion occurred because both the City and the retiree contributed to MERF according to outdated actuarial assumptions, leading to the retiree receiving benefits for a longer period of time than projected.

The City's MERF property tax levy, which had been relatively stable at approximately $5 million annually, was no longer sufficient to keep up with the pace and cost of MERF retirements. To illustrate, in 2002 the City's MERF property tax levy was $4.5 million; this levy would have increased by approximately $35 million in 2003 if the City increased property taxes to fund all of the 2003 City contribution to MERF.[8]

Minneapolis Police Relief Association – The funding challenge for MPRA was due primarily to the poor performance of the stock markets. Like many pension funds throughout the county, the stock market losses experienced in 2000, 2001 and 2002 significantly reduced the value of the fund's assets. To illustrate, the actuarial value of the fund's assets as of December 31, 1999 was $427 million; by 2003 this amount had decreased by 30 percent, to $300 million. This decreased the plan's funding ratio from 95.4 percent in 1999 to 64.5 percent in 2003.[9]

[7] The representation of MERF's funding structure is simplified in order to more clearly explain the MERF funding challenge faced by the City.
[8] The City allocates a portion of the annual MERF normal cost to non-tax funds; the increase of $33 million does not factor in any change to the amount allocated to the non-tax funds as that amount would have remained constant.
[9] The funding ratio is the actuarial value of the plan's assets divided by the plan's actuarial accrued liability.

Minneapolis Firefighters' Relief Association – The funding challenge for the MFRA was also due primarily to the poor performance of the stock markets. To illustrate, the actuarial value of the fund's assets as of December 31, 1999, was $318 million; by 2003 this amount had decreased by 25 percent, to $237 million. This decreased the plan's funding ratio from 109.2 percent in 1999 to 80.6 percent in 2003.[10]

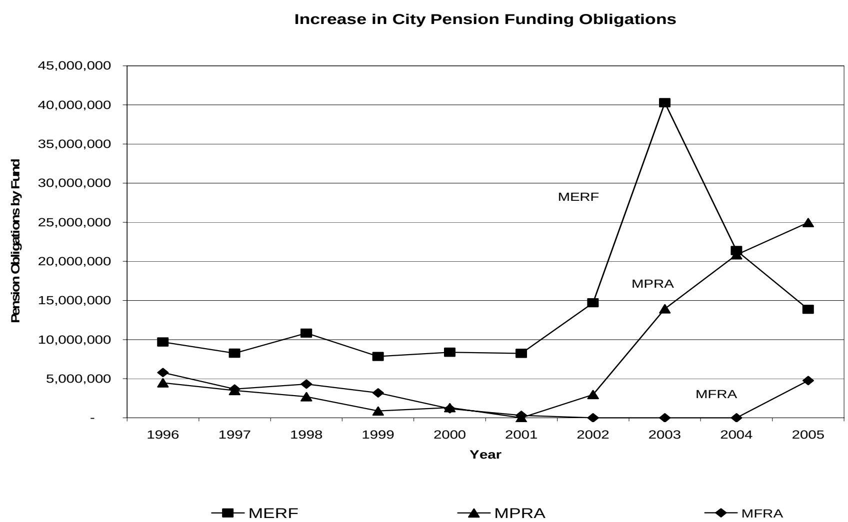
Impact of City's Five-Year Financial Direction –The Five-Year Financial Direction adopted by the City, capped annual property tax increase at 8 percent. This 8 percent cap includes the amount needed to pay the debt service on pension bonds issued by the City. Under current state law, approximately 18 percent of the increase in property taxes between 2005 and 2010 will be used to pay the debt service on the City's pension debt.

[10] The funding ratio is the actuarial value of the plan's assets divided by the plan's actuarial accrued liability.

Problems with the Current System

Before outlining a solution, the Commission attempted to define the problems with the current pension system. Generally, the problems were determined to be either investment management or plan administration. The following section describes some of the problems identified by the Commission.

Level of Funding – Increasing City payments to MERF, MPRA and MFRA result in higher property taxes, reductions in City services and threaten the City's credit rating. Despite the City and State assuming the majority of the funding responsibility for the three funds, representation on their governing boards is limited.[11] In the past four years, the amount of required payments to City's three closed funds, MERF, MPRA and MFRA, has increased approximately 350 percent, from $12 million in 1999 to approximately $54 million in 2003.



Source: City of Minneapolis Finance Department

Post-retirement benefits (PRB's) can be and have been distributed to members even when the funds are not fully funded. Under current state law, MPRA and MFRA members are paid PRB's (commonly referred to as "13th checks"), based on a five-year averaging of investment returns and benefit increases. PRB's can be and have been distributed to members even when the funds are not fully funded.

The 13th check, combined with the City's assurance to make up any losses, encourages investment policies and practices designed to maximize returns without regard for risk or volatility. If that strategy is successful and the fund experiences a high rate of return, the profits are shared between the fund, to reduce the unfunded liabilities and to the retirees in the form of a 13th check.[12] If the strategy is unsuccessful and the fund experiences a lower rate of return or sustains losses, City and State contributions must be increased to fully fund future liabilities.

[11] City representatives hold two positions on the 7-member MERF Board, two positions on the 10-member MPRA Board and two positions on the 13-member MFRA Board. A state law change is required to modify the composition of the funds' boards.
[12] When a 13th check is paid, 1 percent of the excess investment income is utilized with 0.5 percent being used to reduce the unfunded liability of the fund and 0.5 percent being distributed to beneficiaries.

Summary of Post-Retirement Benefit Amounts Per Person		
	MPRA	**MFRA**
1994	$ -	$ 1,836
1995	$ -	$ -
1996	$ 1,956	$ 2,127
1997	$ 2,053	$ 2,253
1998	$ 2,139	$ 2,637
1999	$ 2,154	$ 9,196
2000	$ 2,243	$ 10,195
2001	$ 2,039	$ 8,698
2002	$ -	$ 7,612
2003	$ -	$ -

Source: Minneapolis Police Relief Fund, Minneapolis Firefighters' Relief Fund

The City's funding of MERF is affected by a state law provision, referred to as the "liquidity trigger." MERF's fund structure requires the City to fully fund retirements as they occur. Due to an increased rate of retirements, the City's MERF account has been depleted. The City has had to issue bonds to finance its share of retirement costs. The accelerated rate of retirements and the resulting City payments to fully fund these retirements have reduced MERF state aids below levels originally planned. A May 2004 memo, written by the staff of the Legislative Commission on Pensions and Retirement (LCPR), detailed the original intent of state MERF aid and stated that, "The addition of a State contribution to MERF accompanied a reduction in the local government aid payable to the City of Minneapolis and represented an attempt by the Legislature to freeze the Minneapolis city contribution to the plan." [13]

Balancing of Fiduciary Duties – State law imposes a fiduciary duty on the boards of public pension plans to balance the interests of pension beneficiaries and taxpayers. In its 2003 management report that accompanied the annual audit, the Office of the State Auditor (OSA) criticized the MPRA's balancing of their fiduciary duties. The report stated:

> "The MPRA Board consistently seeks to maximize benefits for its beneficiaries without regard to either the integrity of the fund to provide future benefits or the impact funding those benefits has on the taxpayers of the City of Minneapolis and the State of Minnesota." [14]

In their response to the OSA's criticism, the MPRA wrote, "We feel that our fiduciary duty to pay benefits consistent with the specific provisions of statutes and applicable law is primary to our general duty to the taxpayers to properly manage the plan."

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[14] State of Minnesota Office of the State Auditor, Management Letter for the Minneapolis Police Relief Association, for the year ended December 31, 2003, Page 2.

In contrast to the criticism made of the MPRA, the OSA has not voiced concerns over MERF's balancing of fiduciary duties to pension beneficiaries and taxpayers.

City as Guarantor – The City is the financial guarantor for MPRA and MFRA. As such, the City is responsible indefinitely for the unfunded liabilities of these two funds. Unlike most parties with financial guaranty responsibilities, the City has little or no input into the investment management or governance of the two funds, despite having a perpetual responsibility for any unfunded liabilities.

In contrast to its relationship with MPRA and MFRA, the City does not have an indefinite funding responsibility to MERF. Once each retirement is funded the City only has the responsibility for gains or losses due to changes in mortality for MERF retirees.

Benefits Administration – The benefits administration practices of the MPRA and MFRA have also been criticized by the LCPR and the OSA. In their 2003 audit of both MPRA and MFRA, the OSA criticized the benefit calculations of these two funds saying their calculations maximized benefits inappropriately. The OSA stated that the MPRA was not in compliance with their interpretation of a 1995 agreement between the MPRA and City.[15] In addition, the OSA and the LCPR questioned the MFRA's compliance with state law when determining benefit levels for disability pensioners. These practices increase benefit levels without regard to the impact on the financial condition of the funds.

In addition, as the membership of the plans is reduced it will become inefficient to operate three separate funds. A consolidation of operations to reduce operational expenses will eventually become necessary to maintain costs at an efficient level.

Investment Management – The soundness of the MPRA and MFRA's investment management practices have been questioned by the City and LCPR. The MPRA had the poorest individual performance of Minnesota's largest public pension plans during the period 1994-2001. The MFRA had the best performance during this same time, but, as the LCPR reported, "there does not appear to be any structural reason for this success." [16] The City is concerned that the structure of the MPRA and MFRA portfolios is not consistent with public pension principles and is not appropriate for closed pension funds.

[15] The 1995 settlement between the City and the MPRA and MFRA funds established the elements of salary used to determine benefit levels and annual benefit increase amounts.

[16] Memo from Larry Martin, Executive Director of the LCPR, to Representative Phyllis Kahn dated October 16, 2002 and title "Draft Proposed Legislation LCPR02-153: Minneapolis Public Pension Plan Funding Problem Alleviation".

Average Rates of Return				
Year	**MERF**	**MPRA**	**MFRA**	**SBI-Combined**
3-Year Return	-4.00%	1.96%	1.59%	-4.40%
5-Year Return	-0.90%	3.08%	3.83%	1.40%
10-Year Return	6.96%	6.94%	9.95%	8.20%

Sources: The averages shown in this table were either derived from information contained in Legislative Commission on Pensions publications ("Major Minnesota Pension Plan Investment Performance 1990-1998" and "2004 Overview Information on Minnesota Public Pension Plans and Actions in Other States to Solve Pension Funding Problems") or taken from actuarial valuations or annual reports of the respective funds.

Options Considered by the Commission

The Commission considered the following range of options:

Option 1: No Action
Total Estimated Savings: $0

This option would entail a "do nothing" approach meaning the City would continue to fund pension obligations by issuing general obligations bonds, making annual payments through 2010 for MPRA and 2020 for MERF and seeking no change to state law.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
No	No	No	No	No	No	No

Option 2: Removal of MERF Liquidity Triggers and Approval of MPRA Bill
Total Estimated Savings: $22 million - $44 million

Approve the MPRA Bill: The MPRA bill passed as part of the 2004 Omnibus Pension Bill (Minnesota Statutes 2004, Chapter 267, Article 18) had several provisions: extending the amortization date to 2020, changing the calculation of the "13th check", increasing benefits by one-unit for all plan members and guaranteeing pension benefits. This bill contained a local approval clause and is currently awaiting City Council action.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
Yes	Yes	No	No	No	No	No

Removal of MERF Liquidity Triggers: As mentioned previously, the liquidity triggers currently in state law require the City to fully fund retirements as they occur. The liquidity triggers combined with the retirement patterns result in large City payments that effectively pre-pay state aids to MERF. Removal of the MERF liquidity trigger would allow state aid to function as originally intended and allow the City more time to finance retirements through a system in which the Retired Fund would lend the Active Fund a portion of its assets. This loan would be paid back by the City, with the help of state aid, over the intended amortization period. The Retired Fund is also guaranteed a rate of return on the assets loaned to the Active Fund. The Retired Fund would never loan more than 20 percent of its assets at one time.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
Yes	Yes	No	NA	NA	NA	NA

Conditional Approval of the MPRA Bill: A second option would be for the City Council to approve the MPRA bill, but with conditions. These conditions would address as many of the stated core pension principles as possible and should be in the form that is binding on the parties.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
Yes	Yes	No	No	Yes	Yes	Yes

Option 3: Removal of MERF Liquidity Triggers and Alternate City MPRA Proposal
Total Estimated Savings: $22 million - $60 million

Alternate Proposal to MPRA Bill: An alternative to the MPRA bill would extend the amortization date of the fund to 2020, make members "whole" on the 13^{th} check, fund the plan to 100 percent (no contributions would be required until the plan became unfunded) and cap the "super 13^{th} check" (the post-retirement benefits distributed when the fund reaches the 102 percent funding levels) at the monthly benefit for the previous year.[17]

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
No	Yes	Yes	No	Yes	Yes	Yes

Removal of MERF Liquidity Triggers: As mentioned previously, the liquidity triggers currently in state law require the City to fully fund retirements as they occur. The liquidity triggers combined with the retirement patterns result in large City payments that effectively pre-pay state aids to MERF. Removal of the MERF liquidity trigger would allow state aid to function as originally intended and allow the City more time to finance retirements through a system in which the Retired Fund would lend the Active Fund a portion of its assets. This loan would be paid back by the City, with the help of state aid, over the intended amortization period. In addition, the assets loaned to the Active Fund have a guaranteed rate of return. The Retired Fund would never loan more than 20 percent of its assets at one time.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
Yes	Yes	No	NA	NA	NA	NA

[17] Making members "whole" on 13^{th} checks would mean that the City would pay post-retirement benefits as if the amortization date of the fund were still 2010. This benefit is a percentage of the fund's assets and if the amortization date is extended the fund's asset base would grow more slowly, in effect reducing the amount of any 13^{th} checks. The City's plan would be to calculate what the amount of the 13^{th} check would have been if there had been no change in amortization date and distribute PRB's based on that amount.

Option 4: PERA Merger
Total Estimated Savings: $24 million - $89 million

PERA Merger (Full): A full PERA merger would transfer all asset management to SBI and benefit administration to PERA. In addition, this option would require the benefit structures of all three plans to be adjusted to provide benefits equivalent to those of the PERA post-fund. Upon a full merger into PERA the City would have to fully fund the retirement plans (including that associated with a mortality assumption update). Once merged into PERA, the City no longer has any funding (guarantor) or mortality risk. Current law requires a vote of the funds' memberships for a full PERA merger to occur.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
No	Yes	Yes	Yes	Yes	Yes	Yes

PERA Sub-Fund Merger (Proposed): This option would have the same attributes as the Sub-Fund Merger (Current), but would be accompanied with the approval and implementation of an alternative to the MPRA bill. This would mean the MPRA amortization date would be extended to 2020 and the beneficiaries would be made "whole" on any 13th checks, the plan would be funded to 100 percent and the "super" 13th checks would be capped at the monthly benefit for the previous year.

Decreased Level of City Funding			Removes City as Guarantor	Improves Balancing of Fiduciary Duties	Improves Investment Management	Improves Benefits Management
2005	2006-2020	Post-2020				
Yes	Yes	No	No	Yes	Yes	Yes

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Table I: Average Annual Benefit

Plan	Average Benefit of Recent Retirees	Average Benefits of All Retirees
Minneapolis Police Relief Association	$38,687	$38,687
Minneapolis Firefighters' Relief Association	$37,358	$37,358
PERA – Police & Fire	$38,123	$40,555
State Patrol Retirement Plan	$42,295	$49,409
PERA – General Basic Program	$31,970	$28,085
Minneapolis Employees Retirement Fund	$34,062	$28,879

Source: Legislative Commission on Pensions & Retirement memo to Members of the Legislative Commission on Pensions & Retirement dated March 8, 2004 regarding H.F. 2844: Minneapolis Police Relief Association; Benefits Increases and Amortization Target Date Revision.

Table II: Actuarial Value of Plan Assets

Year	MERF	MPRA	MFRA
1999	$1,327,660,000	$418,122,000	$318,043,000
2000	$1,416,491,000	$391,083,000	$315,900,000
2001	$1,507,159,000	$349,170,000	$304,887,000
2002	$1,504,221,000	$309,667,000	$255,194,000
2003	$1,519,421,000	$300,154,000	$236,991,000

Source: 2003 MPRA and MFRA Actuarial Valuations and MERF's 2003 Comprehensive Annual Financial Report

SUMMARY OF ANNUAL AND SUPPLEMENTAL BENEFIT INCREASE MECHANISMS

Minneapolis Employees Retirement Fund (MERF) –

Annual Benefit Increase: Annual post-retirement benefit increases are based on the CPI and investment performance on a five-year, smoothed basis.

Minneapolis Police Relief Association (MPRA) –

Annual Benefit Increase: Equal to the percentage increase in the base rate of pay for the active top step patrol officer.

90% funded (423B.09): When the value of the assets in the fund is greater than 90% of the fund's liabilities the maximum pension benefit increases.

Less than 102% funded (423B.15): The value of excess investment income[18] up to 1% of the assets of the fund must be applied.

- First 0.5% of the assets that constitute excess investment income distributed to members
- Second 0.5% of assets that constitute excess investment income used to reduce state aid

102% funded or greater (423B.15): The dollar amount of excess investment income up to 1.5% of the assets of the fund are divided up among the members.

110% funded or greater (423B.151): 20% of the fund's net total excess assets are divided up among the members.

Minneapolis Firefighters' Relief Association (MFRA) –

Annual Benefit Increase: Equal to the percentage increase in the base rate of pay for the active top step firefighter.

Less than 92.49% funded: Pension benefits increase as funding increases from 90% to 02.5% and 92.5% and higher.

Less than 102% funded (423C.06): The value of excess investment income[18] up to 1% of the assets of the fund must be applied.

- First 0.5% of assets that constitute excess investment income distributed to members
- Second 0.5% of assets that constitute excess investment income used to reduce state aid

102% funded or greater (423C.06): The dollar amount of excess investment income up to 1.5% of the assets of the fund are divided up among the members.

110% funded or greater (423C.06): 20% of the fund's net total excess assets are divided up among the members.

[18] Excess investment income means the amount, if any, by which the average time-weighted total rate of return earned by the special fund in the most recent prior five fiscal years has exceeded the actual average percentage increase in the most recent prior five fiscal years plus two percent.

REFORM OPTIONS – CITY COST PROJECTIONS
Revised November 2004

Options	MERF		MPRA		MFRA		Total Cost	
	Actual Amount*	Present Value Amount*	Actual Amount*	Present Value Amount*	Actual Amount*	Present Value Amount*	Actual Amount*	Present Value Amount*
1. No action	$113M	$87M	$167M	$146M	$59M	$45M	$339M	$278M
2. Approve MPRA bill and remove MERF liquidity triggers	$99M	$65M	$170M	$122M	$59M	$45M	$328M	$232M
3. MPRA alternate city proposal and remove MERF liquidity triggers	$99M	$65M	$142M	$109M	$59M	$45M	$300M	$219M
4. PERA merger with retention of state aids (effective July 1, 2005):								
- Sub-Fund: Proposed (2005-2010)	$93M	$72M	$93M	$72M	$43M	$29M	$229M	$173M
- Full Merger (2010) with retention of state aids**	$0M	$0M	$15M	$10M	$7M	$5M	$22M	$15M
Total	**$93M**	**$72M**	**$108M**	**$82M**	**$50M**	**$34M**	**$251M**	**$188M**
5. PERA merger without retention of state aids (effective July 1, 2005):								
- Sub-Fund: Proposed (2005-2010)	$93M	$72M	$93M	$72M	$43M	$29M	$229M	$173M
- Full Merger (2010) without retention of state aids**	$34M	$20M	$45M	$31M	$14M	$10M	$93M	$61M
Total	**$127M**	**$92M**	**$138M**	**$103M**	**$57M**	**$39M**	**$322M**	**$234M**

***Actual Amount: The actual dollar value of future pension payments.**
Present Value Amount: The present value of future pension payments, discounted at a 6% interest rate.

****These costs are in addition to the $173M cost (present value) of the Sub-Fund: Proposed option and assume that transferring to the PERA post-fund would require a small incentive, in excess of actuarial equivalence, primarily for the loss of the 13th check. The Full Merger date of 2010 was assumed for cost estimate purposes.**

City of Minneapolis Blue Ribbon Commission on Pensions
Summary of Estimated Pension Costs (in millions)

Minneapolis Employees Retirement Fund (MERF)	Actual Amount	Present Value Amount
Current Required Contribution	$ 113	$ 87
Proposed Required Contribution	$ 99	$ 65
Full Merger (2010) with Retention of State Aids	$ 93	$ 72
Full Merger (2010) w/o Retention of State Aids	$ 127	$ 92
Minneapolis Police Relief Association (MPRA)		
Current Required Contribution	$ 167	$ 146
MPRA Bill Required Contribution	$ 179	$ 124
Proposed Required Contribution	$ 142	$ 108
Full Merger (2010) with Retention of State Aids	$ 108	$ 82
Full Merger (2010) w/o Retention of State Aids	$ 138	$ 103
Minneapolis Firefighters' Relief Association (MFRA)		
Current Required Contribution	$ 59	$ 45
Full Merger (2010) with Retention of State Aids	$ 50	$ 34
Full Merger (2010) w/o Retention of State Aids	$ 57	$ 39

Deloitte Consulting Analysis:
Assumptions Used in Projecting the City's Contribution Requirements for MERF, MPRA and MFRA under the Various Reform Options

Mortality Table –	Male:	1983 Group Annuity Mortality Table for males setback one year (PERA mortality)
	Female:	1983 Group Annuity Mortality Table for females setback one year (PERA mortality)
Return on Investments –	8.5%	
Discount Rate after Merger with PERA –	8.5%	
Discount Rate for Present Value of Projected Contributions –	6%	
Probability of Retirement for MERF participants –	50% at first eligibility, 20% in subsequent years (smoothed to 100% retirement by 2015)	
Plan Expenses after Merger with PERA –	None	
State Aid for MPRA –	Level at $5,863,000 until fully funded	
State Aid for MFRA –	Level at $1,300,000 until fully funded	
State Aid for MERF –	Capped at $7,000,000 for proposed removal of liquidity triggers	
Other Assumptions –	All other assumptions are the same as used in the most recent valuation reports for each individual fund	

STATE OF MINNESOTA
Office of the State Auditor

Patricia Anderson
State Auditor

MANAGEMENT LETTER

MINNEAPOLIS POLICE RELIEF ASSOCIATION
MINNEAPOLIS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2003

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MINNEAPOLIS POLICE RELIEF ASSOCIATION
MINNEAPOLIS, MINNESOTA

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2003

COMPLIANCE

ITEMS ARISING THIS YEAR

03-1 Shift Differential Component of Unit Value

Pension benefits for the Minneapolis Police Relief Association (MPRA) are based on a unit value. Minn. Stat. § 423B.01, subd. 20 and the MPRA's Bylaws define a unit as 1/80th of the current monthly salary of a first grade patrol officer.

Following is a schedule of the calculation of per unit value for the period October 15, 2003, to October 14, 2004:

COMPONENT	HOURLY RATE	NUMBER OF HOURS	ANNUALLY	MONTHLY	PER UNIT
Base wages	$27.08	2088	$56,532.60	$4,711.05	$58.59
Shift differential	1.04	2089	2,172.79	181.07	2.26
Clothes/equipment			836.89	69.74	.87
Longevity	2.71	2088	5,657.81	471.48	5.89
60 hours accumulated comp time	30.83	60	1,849.52	154.13	1.93
Health club dues			354.6	29.55	.37
Sick leave credit pay	30.83	96	2,959.23	246.60	3.08
Vacation credit pay	30.83	40	1,233.01	102.75	1.28
Performance premium (2%)			1,130.65	94.22	1.18
Holiday pay	30.83	25	770.63	64.22	.80
Overtime (@1.5)	46.24	137.55	6,360.15	530.01	6.63
Total			$79,857.89	$6,654.82	$83.19

The sum of the hourly rate for base wages, shift differential, and longevity is the rate used to calculate the unit value for 60 hours of accumulated comp time, sick leave, vacation, holiday pay, and overtime components.

The MPRA's Bylaws identify that the components of salary be included to the extent they are payable under a collective bargaining agreement. Those salary components added after the 1995 Settlement Agreement between the MPRA and the City of Minneapolis should be included at the average amount paid to those top grade patrol officers who received the compensation item. Therefore, the actual payroll practices of the City of Minneapolis were reviewed to determine that the salary components used by the MPRA in the unit value calculation were not inconsistent with payments to active patrol officers.

The actual payroll practice of the City of Minneapolis, for the 60 hours of accumulated comp time, 96 hours of sick leave, and 40 hours of vacation--which are the maximum amounts allowed by contract that eligible patrol officers may elect to cash-out each year--are not paid at a rate which includes shift differential. Therefore, neither should the unit value calculation for the MPRA include shift differential in those components. The unit value is overstated by .21/unit or approximately $106 per year per beneficiary at the maximum 42 units.

We recommend the unit value be corrected. In the future, the actual payroll practice of the City of Minneapolis for these and any other components of salary that are also used by the MPRA as the basis for calculating the unit value for pension benefits should be reviewed to ensure consistency.

Client's Response:

See pages 43-46.

Auditor's Reply:

See pages 51-52

03-2 Fiduciary Duty - Plan Funding

Pursuant to Minn. Stat. § 356A.04, subd. 1, the MPRA Board has a fiduciary duty that extends beyond its duty to those members who are its beneficiaries. The Board also owes a fiduciary duty to taxpayers of the City of Minneapolis and the State of Minnesota who fund the plan. As identified in Minn. Stat. § 356A.05, these duties apply specifically to providing authorized benefits and to proper management of the plan.

The MPRA Board consistently seeks to maximize benefits for its beneficiaries without regard to either the integrity of the fund to provide future benefits or the impact funding those benefits has on the taxpayers of the City of Minneapolis and the State of Minnesota. These maximized benefits are reflected in the components of salary used to determine the unit value for pension benefits.

The MPRA Bylaws reflect the terms of the 1995 Settlement Agreement that defines salary to include shift differential and longevity pay. Shift differential is an additional $1.04 per hour for all hours worked by patrol officers on shifts where the majority of the work hours fall between 6:00 p.m. and 6:00 a.m. according to the Labor Agreement between the City of Minneapolis and the Police Officers' Federation of Minneapolis for the period October 15, 2003, to October 14, 2004. According to this same agreement, longevity pay increases the hourly rate of pay for patrol officers from a range of $0.16 for 8 years of service to $2.71 for 26 years of service. The maximum number of regular hours of possible work per year is approximately 2088.

Components of salary used by the MPRA in the unit value calculation should be consistent with the actual payroll practices of the City of Minneapolis. In the unit value approved by the MPRA for benefit payments, the components for shift differential and longevity are calculated using the maximum regular hours of possible work per year and the maximum hourly longevity rate of pay. Clearly, City of Minneapolis patrol officers are not usually being paid shift differential for every regular hour of possible work or for the maximum longevity rate allowed.

The MPRA's tendency to maximize current benefits is even more evident as additional items of compensation have been added to its calculation of unit value. The 1995 Settlement Agreement empowered the MPRA to add new items of compensation, as granted to patrol officers in the collective bargaining process, as components of salary used to determine unit value. Since the 1995 Settlement Agreement, the MPRA has added the following new items to its unit value calculation:

Vacation credit pay
Holiday pay
Overtime cash out
Performance premium

Vacation, holiday, and overtime benefits were provided for in some form in police officers' collective bargaining agreements prior to 1995. However, in collective bargaining agreements entered into since 1995, these benefits have been reconfigured, usually to provide for cash-out mechanisms. The MPRA determined that these constituted new items of salary and increased unit value calculations. The total unit value for these four new items is $9.89. At 42 maximum units, these new items of compensation have increased monthly benefits by $415.38. When calculated using 900 beneficiaries and $415 per month, the increase is approximately $4.5 million a year.

Like the shift differential and longevity unit value components used to calculate benefits, the four new components of compensation have been included at the maximum amounts allowed. The terms of the 1995 Settlement Agreement indicate that the amount of compensation to be included in salary is to "be the average amount paid to those top grade patrol officers who received the compensation item." For the vacation credit pay and holiday pay components, there is no indication that actual amounts paid by the City are reflected in the amounts for the calculation of unit value. Overtime cash out assumes approximately 137.5 hours of overtime based on an "averaging" of a number of years of "average" overtime hours. Whether this bears any relationship to current actual or average amounts of overtime paid is not known.

When the Board approves increases in benefit levels, there is no indication that it does so with the effects of the MPRA's unfunded actuarial accrued liability in mind. Understanding the financial impact on the fund of decisions made by the Board is not only essential to the professional conduct of MPRA business, it is fundamental to the Board's role as a fiduciary. Between 1999 and 2003, the MPRA's funding ratio dropped from 95.4% to 64.5%. Although a significant portion of this decrease is due to the effects of declines in the market value of the investment portfolio, continued increases in pension benefits is also a contributing factor.

Between 1999 and 2003, actual benefit expenses rose from $25.9 million to $31.9 million, or $6 million. Of this increase, $4.8 million occurred between 1999 and 2000 and appear to be the result of adding the four new components of salary discussed above. There was a net increase of 18 beneficiaries from 1999 to 2003.

We recommend the MPRA Board address its fiduciary duty to manage future benefits as well as its duty to the City and State taxpayers who fund those benefits. Actual and average City payroll amounts should be used, as applicable, as the basis for calculating unit value. Increases in benefits should not be approved without consideration of the effect they will have, when coupled with other factors, such as market value declines in the investment portfolio, on the unfunded actuarial accrued liability.

<u>Client's Response:</u>

See pages 47-49

<u>Auditor's Reply:</u>

See pages 53-55

STATE OF MINNESOTA
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REPORT ON LEGAL COMPLIANCE

Board of Directors
Minneapolis Police Relief Association

We have audited the basic financial statements of the Minneapolis Police Relief Association as of and for the year ended December 31, 2003, and have issued our report thereon dated March 29, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government,* promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains three main categories of compliance to be tested in audits of relief associations: deposits and investments, conflicts of interest, and relief associations. Our study included all of the listed categories.

In addition, we reviewed for compliance with other statutes, bylaws, and administrative rules that we deemed necessary. This review did not include all possible regulatory provisions which may be applicable and was not intended to provide assurance of full compliance with all regulatory provisions.

The results of our tests indicate that for the items tested, the Minneapolis Police Relief Association complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 03-1 and 03-2.

This report is intended for the use of the Association's Board of Directors and management and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Pat Anderson	*/s/Greg Hierlinger*
PATRICIA ANDERSON STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

End of Fieldwork: March 29, 2004

Minneapolis P... lief Association

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By Fax and U.S. Mail

June 29, 2004

Patricia Anderson
Office of the Minnesota State Auditor
525 Park Street, Suite 500
St. Paul, MN 55103-2139

Re: Client Response to Schedule of Findings and Recommendations

Dear Auditor Anderson:

I am writing on behalf of the Board of the Minneapolis Police Relief Association ("MPRA") in response to the Draft Schedule of Findings and Recommendations issued by the Auditor's Office revised as of June 24, 2004 (hereafter the "Findings").

1. **Inclusion of Shift Differential in Rate of Pay for Comp Time, Sick Leave Credit Pay and Vacation Cash Out.**

Historically, the MPRA has relied on its own interpretation of the collective bargaining agreement between the City and the Police Officers Federation of Minneapolis (the "CBA") for the purpose of calculating the monthly salary of a top grade patrol officer. Based on its interpretation of the CBA, the MPRA has for years included shift differential in the hourly rate used with regard to salary components that are based on a certain number of hours.

The issue underlying your question is who has the final authority to determine the salary of a top grade patrol officer has been previously raised and resolved. The authority to determine what constitutes salary is vested in the Board of the MPRA. *See Attorney General Opinion, October 2, 1987.* In rendering this opinion, the office of then Attorney General Humphrey, acknowledged that "if the City of Minneapolis disagrees with the determination of the Relief Association, it is likely that it would have standing to challenge that determination." *Id.*

Those words from the 1987 Opinion were prophetic. In 1994, the City of Minneapolis sued the MPRA alleging that the MPRA was including in salary items that should not be included. The lawsuit was ultimately settled and on or about September 15, 1995, the parties entered into a settlement agreement documenting the terms of their settlement. One of the provisions of the Settlement Agreement was an agreement as to the definition of "Salary" which specifically

web site: www.mpra.net
e-mail address: mppension@aol.com

included both the 60 Hours of Comp Time and Sick Leave Buy Back. Vacation Credit Pay was added as a new component of compensation to Minneapolis Police Officers as of January 1, 1997 under the collective bargaining agreement between the City and the Police Officers Federation of Minneapolis. Pursuant to the terms of the Settlement Agreement, this new component of compensation was added to "salary" after 1999. The Settlement Agreement did not specify the hourly rate that was to be used for these items. However, the long-standing practice with regard to the hourly rate for these items was to include base wages, longevity and shift differential. The City could have, but did not, challenge the practice of including shift differential in the hourly rate used to calculate the unit value for these individual components of salary at the time of the lawsuit and subsequent settlement agreement. Given that the practice has continued for several years, the interpretation of the MPRA Board should be given great weight. *See The Matter of Kern Grain Company, 369 N.W.2d 565 (1985)(a long-standing administrative interpretation of a provision is entitled to great weight.).*

Moreover, we believe that the terms of the CBA mandate that shift differential should be included in the payment for comp time, sick leave credit pay and vacation credit pay notwithstanding the payroll practices of the MPD. The CBA contains the following language regarding payment for these items of compensation:

- Payment for Comp Time Cash Out shall be "based on the *regular hourly rate* of pay for the employee in effect as of the date on which payment is made." Section 10.2(c) of the CBA (emphasis added).

- Payment for the Sick Leave credit pay plan is based on "the employee's *regular rate of pay* in effect on December 31 of the Accrual Year." CBA Section 17.1(c) (emphasis added).

- Payment for Vacation Cash Out is based on "the employee's *regular base rate of pay* in effect on December 31 of the Accrual Year." CBA Section 12.3(d) (emphasis added).

The "regular rate of pay" is not defined in the CBA. However, we have been given the legal opinion from our attorneys (who also represent the Police Federation and who drafted these provisions) that the "regular rate of pay" consists of three components: base wages, shift differential and longevity. You have not raised the question of whether base wages or longevity are included in the "regular rate of pay." The concern raised in the Findings seems to focus on the issue of whether shift differential is included in the "regular rate of pay." One of the fundamental principles of construction is that a document must be read to give meaning to all provisions. In Section 7.8, entitled "Performance Premium," the compensation for that component item is based on "the employee's base annual wage, exclusive of shift differential, overtime or other forms of additional compensation." This provision supports the conclusion that: a) "base wage" is different from "regular rate;" and b) when the employer intends to exclude shift differential, the language will specify that shift differential is to be excluded since there would have been no need to specifically exclude shift differential if it were not already considered as part of an employee's regular rate of pay.

Further, the parties have agreed that the "regular rate of pay" does result in the stacking of benefits. After Holiday Pay was introduced, a dispute arose between the City and the Police Federation as to whether additional compensation was payable for overtime on a qualifying holiday based on the definition of Overtime in Section 10.2 as "one and one-half times the employee's regular hourly rate." The Federation maintained that on a qualifying holiday, the "regular hourly rate" was already time and one-half and, therefore, overtime on a holiday must be compensated at 2.25 times (1.5 x 1.5) the employee's normal hourly rate. The representatives from the Police Department and Labor Relations agreed as to the Federation's interpretation.

We acknowledge that Section 7.4 of the CBA, entitled Shift Differential, provides that the differential shall be paid "for all hours worked on such shifts." We also acknowledge, sick leave and vacation represent hours accrued to a bank for paid leave and, as such, do not represent "hours worked." Compensatory time, however, is earned based on hours worked and, therefore, it is clear that the shift differential should be included when an employee is paid for hours that were worked between 6:00 pm and 6:00 am. However, the practices of the MPD and the Federation have departed from the strict interpretation that the differential is paid only for "hours worked" between 6:00 pm and 6:00 am. Beginning in 1999, patrol officers bargained for the right to bid for a permanent shift on an annual basis. Included in the bidding language was the provision that when an officer suffers a change in assignment "for any reason other than discipline or voluntary reassignment [he/she] shall continue to receive the night shift differential . . . for the duration of the payroll year." CBA Section 9.4, subd. (i).

Ultimately, we believe that, pursuant to the cited Attorney General Opinion, the Settlement Agreement and the laws governing the MPRA, the MPRA Board has the final authority to determine what constitutes the monthly salary of a top grade patrol officer. This authority cannot be exercised in an arbitrary or capricious manner. Thus, a determination of the MPRA Board regarding a component of salary would not be proper where there is no legitimate legal or factual basis for such determination.

However, with regard to the issue raised in your finding, there is apparently a dispute involving the interpretation of the CBA and there has not yet been a definitive decision by a court or arbitrator. We maintain that the inclusion of shift differential in the hourly rate is consistent with the long-standing practices of the MPRA (which have not been challenged by the City), the terms of the Settlement Agreement and the most reasonable interpretation of the CBA.

We understand that you are troubled that our interpretation of the CBA is not consistent with the interpretation of the head of the MPD's payroll unit; however, we do not have standing to challenge the MPD's current payroll practices. We have notified the President of the Police

Federation as to the MPD's payroll practices. He indicated that he also believed the City's payroll practice to be in violation of the CBA and that he intends to pursue a remedy. If an arbitrator rules that shift differential should not be included in the hourly rate for the payment of comp time, sick leave credit pay or vacation credit pay, I will recommend to the MPRA Board that they act to conform the MPRA practices to the decision of the arbitrator. However, we believe that unless and until such a ruling is made; our current practice is proper and reasonable under the authorities cited above and, therefore, should be maintained. Moreover, with regard to any new items of compensation that may arise in the future, we will consider the payroll practices of the MPD as a significant factor in our determination as to how the unit value for such item should be calculated.

2. Fiduciary Duties

You have recommended that MPRA Board address our fiduciary duty to the taxpayers of City of Minneapolis and the State of Minnesota who fund the benefits based on your opinion that the Board has acted "without regard to either the integrity of the fund to provide future benefits or the impact funding those benefits has on the taxpayers of the City of Minneapolis and the State of Minnesota." This highly prejudicial language is inaccurate and unfair.

The MPRA acknowledges that it has had and continues to have a fiduciary duty to the taxpayers of the City of Minneapolis and the State of Minnesota in addition to its fiduciary duty to the members of the MPRA. However, your statement apparently ignores the statutory requirement that the MPRA Board base the pension benefit of a retired Minneapolis police officer on the monthly salary of a top grade patrol officer. This provision creates a specific and absolute fiduciary duty to pay benefits based on the terms of the CBA. When the City of Minneapolis negotiates pay raises and new items of compensation for its police officers and when the Minneapolis City Council votes to implement such negotiated benefits, the City inherently acts to raise the pension benefit of a retired Minneapolis police officer. The MPRA has a fiduciary duty to implement such benefit increases to its members. Following the course implied in Audit Finding 03-2 would itself be a breach of fiduciary duty.

The fiduciary duties of the MPRA can occasionally be conflicting, especially regarding issues relating to benefits since there is a duty to members to maximize benefits and a duty to the taxpayers to operate the fund in a manner that will minimize the burden of funding benefits. When our duties are conflicting, we believe we are obligated to balance the interests of all parties to whom we owe a duty. Moreover, a fundamental provision of statutory construction provides that the specific supersedes the general. Thus, we feel that our fiduciary duty to pay benefits consistent with the specific provisions of statutes and applicable law is primary to our general duty to the taxpayers to properly manage the plan.

We believe that over the years we have maintained a proper balance between our competing fiduciary duties with regard to benefits. Further, it is well established in law that a party entrusted with a fiduciary duty may rely on the advise of experts, such as legal counsel. When considering whether to add a new component of compensation, we have always requested and followed the opinion of competent legal counsel as to whether the benefit should be added and as to the value of the benefit.

We have also relied on the advice of our actuary. Each year the MPRA actuary prepares an actuarial valuation report, which determines the status of the plan and the financial requirements for the following year. The report includes an analysis of the sources of changes in the unfunded actuarial accrued liability, whether from a decline in fund assets, changes in unit value or other actuarial gains or losses. The actuary also prepares a summary showing the key results from the actuarial report, which is used, in their annual presentation to the Board. In that presentation, the actuary reviews the status of the plan, causes of changes in funded status, and where appropriate discuss the potential effect of expected changes in financial conditions, benefit levels or the statutes affecting the plan.

The Board also seeks the actuary's analysis during the course of the year as issues arise that might affect the funding of the plan. In 2000 and 2003, the Board had the plan actuary and financial advisor, respectively, prepare asset/liability modeling studies to project the long-term funded status of the plan. The 2000 study considered the effects of various alternative potential scenarios including a significant downturn in the financial markets and the effect of certain changes in benefits. Also, the Board in 2003, asked the actuary to conduct a mortality study to assess whether the actuarial assumptions used in the annual valuation reports continued to reflect the actual mortality experience of participants in the plan.

Therefore, contrary to your assertion, we believe that we have at all times properly considered the integrity of the fund to provide future benefits and the impact funding those benefits has on the taxpayers of the City of Minneapolis and the State of Minnesota. Moreover, we feel obligated to respond to the specific items you cite in support of your assertion.

Holiday Pay. Holiday pay, namely the practice of paying time and one-half for hours worked on five specified "major" holidays, was added to the Labor Agreement for the first time effective October 15, 1999. Thus, holiday pay constitutes an additional five hours of straight-time pay for each holiday worked. Since 1999, all top grade patrol officers are entitled to bid for a 10-hour shift. Thus, the compensation is included in the unit value since more than 50% of top grade patrol officers are eligible to receive it. When Holiday Pay became eligible to be added to the unit value pursuant to the terms of the Settlement Agreement, our legal counsel asked the City to provide the number of holidays worked by each top grade patrol officer so that they could calculate the average holiday pay that was paid to top grade patrol officers. Our attorney was told that the City's payroll system had no way to sort the data to determine the number of "major" holidays worked by individual officers. Thus, based on the City's inability (or unwillingness) to provide our attorney with the number of holidays actually worked by individual officers so that we could calculate the benefit based on annual holiday pay, we were forced to determine the holiday pay based on each individual holiday. The amount for each individual holiday is a fixed amount for each top-grade officer who works the day. Since there are five qualifying holidays, we based the unit value calculation twenty-five hours (five hours per holiday, i.e. a 10 hour shift time 1.5 equals five additional hours for five qualifying holidays) times the regular rate of pay. Thus, we believe that our determination was appropriate based on the best data we had available to us.

Vacation Credit Pay. Vacation Credit Pay first became available to Minneapolis Police officers effective with the 1997 payroll year. Pursuant to the settlement agreement between the City and the MPRA, new components of compensation could not be added to the calculation of the unit value until 1999. The Vacation Credit Pay is essentially the same as the Sick Leave Credit Pay in that an individual officer may elect to cash out nothing or a variable amount up to the maximum number of hours specified in the Labor Agreement. Payment is based on the number of hours elected by the officer at his/her "regular hourly rate." Notwithstanding the fact that eligible officers could, and no doubt did, sell back less than 96 hours, the Sick Leave Credit Pay to be included in the unit value was specifically addressed by the parties in the Settlement Agreement as "96 hours of sick pay." In fact, since 96 hours represents the maximum sick leave accrual during a year, any officer who used sick leave could not sell 96 hours since the benefit is limited to the number of accrued *and unused* hours of sick leave. Therefore, 96 hours was then and remains the maximum number of hours, which can be sold back under the Labor Agreement. Consistent with the parties' agreement to include in the unit value the maximum number of hours of sick leave which could be cashed out, we determined that the proper amount of vacation to be included in the unit value is also the maximum amount of 40 hours. We acknowledge that as to this particular component of salary we did not evaluate the actual payments made to top grade patrol officers. However, as explained herein, this decision was based on the opinion of legal counsel that the value of the benefit should be determined in a manner consistent with the application of the Sick Leave Credit Pay since the Vacation Credit Pay was created to work like and in conjunction with the Sick Leave Credit Pay provisions of the CBA. No one has questioned the practice until now.

Cash Overtime. The basis for the overtime calculation was fully addressed in the letter of our attorney, James Michels, to your office dated May 6, 2004. The overtime provision does represent historical overtime earned by top-grade patrol officers. After a data collection period of several years, the MPRA Board determined that it was more appropriate to determine a standard amount of overtime to be included in the calculation to provide some stability to the unit value and avoid wild fluctuations from year to year. While reasonable minds could differ as to whether the data collection period should be longer or whether the final number should be an actual average, we exercised our judgment in good faith in a manner that we believed prudent at the time the decision was made.

In examining the practices of the MPRA Board as to items included in the unit value calculation, it is appropriate also to consider the Board's action with regard to an item removed from the calculation. Effective with the 1999 to 2002 CBA, the City and Federation created a 5% premium for patrol officers assigned to corporal duties. Since all top grade patrol officers were eligible for corporal pay, the 5% premium was added to the unit value at the time the 1999 to 2002 CBA was implemented. However, in the 2002 to 2005 CBA, the City and Federation agreed to eliminate the corporal pay differential effective upon ratification and implementation of the new CBA by the parties. When notified that top grade patrol officers were no longer eligible to receive corporal pay, the MPRA Board voted to remove that 5% pay differential from the unit value calculation. We believe the action of reducing this significant component of the unit value to the financial detriment of its members demonstrates that the MPRA Board has exercised the balance between competing fiduciary duties fairly and appropriately.

We agree with your findings that we have a fiduciary duty to the taxpayers of the City and the State. We also agree that we will attempt to use actual and average payroll amounts in calculating values for compensation components when available and when consistent with established practices. Moreover, we have and will continue to consider the impact that increases in benefits have relative to the market value of the MPRA's assets and the unfunded actuarial accrued liability. However, we respectfully disagree with any assertion that we have acted in any manner inconsistent with our fiduciary duties to all interested parties.

Sincerely,

Renee E. Tessier

Renee E. Tessier
Executive Director

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Auditor's Reply

In response to the Minneapolis Police Relief Association's (MPRA's) client response dated June 29, 2004, the Office of the State Auditor makes the following clarifications:

03-1 Shift Differential Component of Unit Value

The comment identifies that the MPRA includes shift differential in the rate for salary components used in benefit calculations that is inconsistent with the terms under which shift differential should be paid.

In its response, the MPRA maintains that the regular rate of pay is not defined in the collective bargaining agreement (CBA); therefore, the MPRA is empowered to determine what is and is not included in the regular rate of pay used to determine the salary of a top grade patrol officer. As an additional basis for its position, the MPRA cites a 1987 letter from the Attorney General advising the MPRA that determining salary is within its authority to administer the fund.

The issue, however, is not about the interpretation of the MPRA's statutory authority. It is about the MPRA's compliance with its own bylaws and contracts in terms of calculating benefits. Whether the MPRA has the general authority to determine salary is irrelevant in the context of the finding because the MPRA entered into agreements, and incorporated in its bylaws, the definition of salary. In addition, whether or not the City objected to the MPRA's practice is also irrelevant, again, because the MPRA is required to comply with its bylaws and contracts.

Compliance Terms

The 1995 Settlement Agreement and the MPRA's Bylaws clearly state that components of salary, such as shift differential, can only be used in the unit value calculation "to the extent they are payable under a collective bargaining agreement." The MPRA admits in its response there is nothing in the CBA that indicates shift differential is to be used in the calculation of "regular rate of pay." The CBA does, however, define shift differential and clearly indicates when shift differential is applicable. The current Labor Agreement between the City of Minneapolis and the Police Officers' Federation of Minneapolis states in Section 7.4 - Shift Differential: "Employees in the Department who work a scheduled shift in which a majority of the work hours fall between the hours of 6:00 p.m. and 6:00 a.m., shall be paid a shift differential. . . ." (Emphasis added.)

Sick leave and vacation, by definition, represent hours not worked. An employee has no claim to a shift differential payment under the clear terms of the CBA for sick leave and vacation hours, in any form, because they are not hours worked. The City's actual payroll practice is consistent with these terms of the CBA. That is, shift differential is only paid on eligible hours worked. It is not paid on the cash out of sick leave credit or vacation credit. It is also not paid on any sick leave or vacation time used/taken off.

For the cash out of accumulated comp time, we can find no provision within the CBA, or its attachments, that supports the contention of the MPRA that shift differential is included in the calculation of pay for this benefit. According to the City's payroll practice, if an employee works overtime that is eligible for shift differential, that amount representing the shift differential is paid currently regardless of whether the overtime hours themselves are also paid currently or banked and accumulated as comp time. Thus, accumulated comp time does not have shift differential associated with it. Again, the City's actual payroll practice is consistent with the terms of the CBA. That is, accumulated comp time is not paid at a rate that includes shift differential whether it is being used as time off or cashed out.

Further application of shift differential requirements indicates additional questionable components in the MPRA's unit value calculation. Holiday hours included in the unit value calculation that represent the additional compensation for working one of five designated holidays, but not the actual hours worked for the holiday, are not eligible for shift differential. Furthermore, the possibility that a police officer <u>works</u> every hour of a year, including all holidays, with no leave time off is remote. It is unreasonable then to include shift differential for every hour of the year in the MPRA's unit value calculation.

The position of the MPRA to include shift differential in the value of these components for benefits is not supported by either the language in the CBA or the custom and practice of the parties to that agreement. In fact, there is no basis for this position. Thus, the MPRA's statement to wait to make changes to its practice for a possible arbitrator's ruling on this matter lacks merit.

<u>Conclusion</u>

As originally recommended in our comment, the MPRA should correct its unit value calculation. This should include a thorough review and analysis of all components. The result should reflect compliance with the terms of the 1995 Settlement Agreement, the CBA, and the actual payroll practices of the parties to the CBA in terms of consistency in defining values for components of salary used in calculating the unit value for pension benefits.

03-2 Fiduciary Duty – Plan Funding

The MPRA Board's consistent practice of maximizing benefits for its beneficiaries to the detriment of city and state taxpayers was fully set forth in the comment and will not be restated here. However, we do have a responsibility to disclose that the MPRA's response contains information that is misleading and irrelevant to the context of the finding and, in fact, contrary to its bylaws, state law, and fiduciary law.

Fiduciary Duty

While maintaining that it balances its fiduciary duties to the various parties, the MPRA states in its response that it feels a greater duty to its beneficiaries. The MPRA bases this feeling on its analysis that its duty to pay benefits is primary over its more general duty to taxpayers and proper management of the plan. This analysis and conclusion are contrary to law.

The duty to pay benefits is not in question. Indeed, the duty to make timely benefit payments to beneficiaries is one of the primary functions of a pension plan. The issue is the consistent increase of benefit levels without appropriate consideration of the MPRA's fiduciary duty, specifically set forth in Minn. Stat. § 356A.04, to all beneficiaries (active, deferred, and future) and the taxpayers of Minneapolis and the State of Minnesota. See Application of Allers, 533 N.W. 2d 646 (Minn. App. 1995). This statute creates no hierarchy among the statutory designees of the MPRA's fiduciary duty. Management of the plan is a specific fiduciary duty identified in Minn. Stat. § 356A.05. When the MPRA Board is making benefit calculations, it is engaged in a "fiduciary activity" under state law and must act in good faith towards all those to whom it owes a fiduciary duty.

There is no duty to maximize benefits to beneficiaries. On the contrary, there is a duty not to prematurely deplete the trust fund, and this is a duty owed to all beneficiaries and taxpayers equally. The MPRA's assertion of a hierarchy between beneficiaries and taxpayers of its fiduciary duty is not only contrary to state law, it is contrary to fiduciary law across the United States. In Withers vs. Teachers Retirement System of the City of New York, 447 F. Supp. 1248, 1258 (S.D.N.Y. 1978), the federal district court specifically rejected the claim by plaintiff beneficiaries that the public pension board owed them a greater fiduciary duty than that owed to the integrity of the fund and to future retirees.

Equally erroneous is the MPRA's assertion that it has an absolute fiduciary duty to raise benefits based on new items of compensation in the collective bargaining agreement (CBA). Though it is true that the unit determination will increase automatically with base salary changes in the CBA, the 1995 Settlement Agreement and the MPRA's own bylaws specifically say that new items of compensation "may" be added to the benefit calculation by an action of the MPRA Board. The Board's determination to include these new items is a decision that must be made in light of its fiduciary duty to all statutory designees as required by law. The MPRA's assertion that it has an absolute duty to raise benefits is thus contrary to the 1995 Settlement Agreement, its own bylaws, and its fiduciary duty under state law.

Calculation of "New Item" Benefits

In its response, the MPRA discusses at length various aspects of its benefit calculations that do not directly address the issue identified in the finding and that have the effect of misleading the reader to draw inaccurate conclusions.

The issue is really a simple one. Are the MPRA Board's efforts to maximize benefits in compliance with its contracts and bylaws or not?

The 1995 Settlement Agreement and the MPRA Bylaws specifically state: "The amount to be included in salary for any such new compensation item shall be the average amount paid to those top grade patrol officers who received the compensation item." (Emphasis added.) By its own admission, the MPRA is not in compliance because it is not using the average amount paid to top grade patrol officers; it is instead estimating amounts or assuming the maximum amount possible. The 1995 Settlement Agreement does not empower the MPRA Board to estimate or assume the maximum amounts available in making these benefit determinations.

Maximizing Benefit Calculations

While reviewing issues related to the client response for this comment, the extent to which the MPRA attempts to maximize benefits became even more evident. For example, the definition of top grade patrol officer used by the MPRA appears to vary, depending on the individual component of salary, to maximize the particular benefit being calculated.

In a letter dated May 6, 2004, the MPRA's attorney addressed the question "How do you calculate the 'monthly salary' of a 'top grade patrol officer'?" Included in the response, the MPRA's attorney stated:

> "A 'top grade patrol officer' is a patrol officer who has completed at least 25 years of service."

The City of Minneapolis payroll records indicate that, for 2003, there were only three individuals in the Minneapolis Police Department who were at the rank of police officer at Step 7 with more than 25 years of service. The total number of sworn employees in the police department in all ranks is nearly 800; approximately one-half are at the rank of police officer at Step 7 without applying the 25 years of service criteria.

When determining the amount of longevity pay applicable to the pension benefit calculation, the MPRA uses the 25-year criteria to include the maximum longevity pay possible. Thus, the level of compensation eligible to only three police officers is used as the basis for the longevity component in the pension benefits of more than 900 beneficiaries.

The MPRA includes shift differential in its benefit calculation using the maximum regular hours of possible work per year. None of the three police officers with more than 25 years of service worked a shift eligible for shift differential for 2003.

Pension benefits also include components representing the maximum possible 60 hours of accumulated comp time, 96 hours of sick leave credit, and 40 hours of vacation credit cash out. None of the three police officers with more than 25 years of service received the accumulated comp time cash out; only one of the three received the sick leave and vacation credit cash out.

The unit value calculations used by the MPRA for holiday pay and overtime are also overstated compared to the actual benefits of these three police officers.

As the examples above show, the MPRA uses different criteria to define top grade police officer for longevity pay than it does for other salary components when determining benefits. Reasonable and representative criteria should be consistently applied by the MPRA when defining top grade police officer for the purpose of determining benefits.

Conclusion

As originally recommended in our comment, the MPRA should appropriately address its fiduciary duty owed to both taxpayers and beneficiaries as required by statute. This includes analyzing the financial impact resulting from the addition of new items of compensation to its unit value used to determine benefits. Amounts representative of the City's actual payroll for police officers should be used by the MPRA to comply with the 1995 Settlement Agreement, the CBA, and its own bylaws; these amounts should be incorporated in the calculation of the corresponding unit value for pension benefits. The MPRA should consistently define and apply the criteria for top grade patrol officer when calculating benefits.

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STATE OF MINNESOTA

Office of the State Auditor

Patricia Anderson
State Auditor

THE MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION
MINNEAPOLIS, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2003

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MINNEAPOLIS FIREFIGHTERS' RELIEF ASSOCIATION
MINNEAPOLIS, MINNESOTA

Schedule 3

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2003

COMPLIANCE

ITEMS ARISING THIS YEAR

03-1 Components of Unit Value

Pension benefits for the Minneapolis Firefighters' Relief Association (MFRA) are based on a unit value. Minn. Stat. § 423C.01, subd. 28 and the MFRA's Bylaws define a unit as 1/80th of the maximum monthly salary of a first grade firefighter on the first day of the month in which pension benefits are paid.

Following is a schedule of the calculation of per unit value used for the year ended December 31, 2003:

COMPONENT	HOURLY RATE	NUMBER OF HOURS	ANNUALLY	MONTHLY	PER UNIT
Base wages	$18.65	2,851	$53,165.70	$4,430.48	$55.38
Selection premium	.70	2,851	1,995.08	166.26	2.08
Clothes/equipment			795.68	66.31	.83
Longevity	.93	2,851	2,662.20	221.85	2.77
Sick leave buy back	20.29	144	2,921.46	243.45	3.04
Health club dues			343.63	28.64	.36
Vacation cash out	20.29	48	973.82	81.15	1.01
FLSA overtime	10.14	80	813.41	67.78	.85
Performance premium (2%)			1,063.31	88.61	1.11
Holiday pay	30.43	40	1,217.27	101.44	1.27
Overtime (@1.5)	30.43	136	4,138.73	344.89	4.31
Total			$70,090.30	$5,840.86	$73.01

The sum of the hourly rate for base wages, selection premium, and longevity is the rate used to calculate the unit value for hours of sick leave buy back, vacation cash out, FLSA overtime, holiday pay, and overtime components.

The MFRA's Bylaws identify that the components of salary be included to the extent they are payable under a collective bargaining agreement. Those salary components added after the 1995 Settlement Agreement between the MFRA and the City of Minneapolis should be included at the average amount paid to those first grade firefighters who received the compensation item. Therefore, the actual payroll practices of the City of Minneapolis were reviewed to determine that the salary components used by the MFRA in the unit value calculation were not inconsistent with payments to active firefighters.

The actual payroll practice of the City of Minneapolis, for the 48 hours of vacation, 144 hours of sick leave, and 40 hours of holiday pay--which are the maximum amounts allowed by contract that eligible firefighters may elect to cash out each year--is that these components of pay are not paid at a rate which includes selection premium. The City's practice is consistent with the terms of the collective bargaining agreement in that selection premium is paid only on hours worked as a firefighter. Therefore, the unit value calculation for the MFRA should not include selection premium in those components because they do not represent hours worked. The unit value is overstated by approximately .19/unit or $94 per year per beneficiary at the maximum 42 units.

The 1995 Settlement Agreement states that salary includes "an average of overtime actually worked in excess of FLSA overtime amounts by firefighters with 25 years or more of service, up to a maximum of 136 hours, in the immediately preceding year." The MFRA uses the maximum 136 hours of overtime in its unit value calculation. However, there is no indication that any actual average overtime amounts of eligible firefighters paid by the City are reflected in this amount. The MFRA maintains that 136 hours of overtime was intended to be the agreed upon amount to remain unchanged as negotiated during the 1995 Settlement Agreement. Nevertheless, this is not what the express language of that agreement reflects. In fact, the City of Minneapolis payroll records indicate that, for 2003, there were only four firefighters at Step 7 with more than 25 years of service. Two of these four firefighters worked 12 hours of overtime each. The average overtime worked for the four qualifying firefighters is then 6 hours. This results in the unit value being overstated by approximately $4.12/unit or $2,076 per year per beneficiary at the maximum 42 units. In addition, current payroll records indicate there will likely soon be a period of years where there may be no firefighters who meet the criteria upon which an overtime pension benefit could be based.

Any new item of compensation granted to first grade firefighters in the collective bargaining process after the 1995 Settlement Agreement may be included in salary by action of the MFRA at the average amount paid to those first grade firefighters who received the compensation item. For the unit value calculation, the MFRA uses 48 hours for its vacation cash out component--the maximum hours available under the collective bargaining agreement. There is no indication that actual average amounts paid by the City are reflected in this amount as required by the specific terms of the 1995 Settlement Agreement. There is also no indication that the unit value calculation used by the MFRA for holiday pay reflects actual average amounts paid by the City.

We recommend the unit value be corrected. This should include a thorough review and analysis of all components. The results should reflect compliance with the terms of the 1995 Settlement Agreement and the collective bargaining agreement. The actual payroll practice of the City of Minneapolis should be reviewed for the components of salary that are used by the MFRA as the basis for calculating the unit value for pension benefits to ensure consistency.

<u>Client's Response:</u>

A: Use of premium pay with vacation buy back, sick leave and holiday pay

The collective bargaining agreement provides that the vacation and sick leave credit pay plans are paid at the employees' "regular hourly rate of pay." Base wages, longevity and the selection premium pay are all elements that are included in regular rate of pay of a top grade firefighter. The selection premium is paid only to a top grade firefighter, unlike the shift differential in the police department, which is paid to any officer who works the hours between 6:00 p.m. and 6:00 a.m. Firefighters, because they have a twenty-four hour schedule, are entitled to the rate of pay continuously when they work. It is not an hours worked issue; it is just an element of compensation that was included in the broad definition of "salary."

For example, when a firefighter takes a vacation day, his pay is the amount of his base wages, selection premium and any longevity he has coming to him. When a firefighter has a vacation day, he is paid at that full rate of pay. Vacation and sick leave are earned under the collective bargaining agreement. They are earned at the employee's regular rate of pay, including selection premium pay. Hence, it makes no sense to say that a benefit was earned at one rate of pay and then compensated at another rate. We have checked the language of the Firefighters' Contract and we feel that the City has not been paying the proper amount to the Active Firefighters for the benefit items in question. We intend to request that Local 82, the Minneapolis Firefighters' Union, examine these issues and take any appropriate action to correct the situation. It is our belief that we are using a correct application of the principles involved in the Firefighter's contract to calculate our benefits.

B: Overtime Hours

Since the 1995 settlement, the MFRA has taken the view that the terms of the settlement language, which is incorporated into the Bylaws, provide that the reference to the "immediately preceding year" is the year immediately preceding the settlement agreement in 1995. That was the year in which the hours worked far exceeded 136 *hours. The MFRA has included 136 hours in every unit calculation since it was allowed to do so under the settlement agreement. The MFRA believes that its practices are in compliance with its Bylaws and the settlement agreement.*

This question also arose some time ago and at that time I requested an opinion from our Fiduciary Attorney, Robert Klausner. His opinion is as follows: Once the decision was made to include imputed overtime, it became part of the Association's (and the City's) contractual promise to its firefighters and beneficiaries. The benefit was never based on actual overtime, but was an agreement to define salary in a particular way to fairly reflect the compensation earned by firefighters. No compelling state interest can justify the ex post facto (after the fact) diminution of these contractual rights and the legitimate expectations of the firefighters who have rendered valuable service in reliance on that formula. All of the members of the MFRA have relied on the inclusion of the imputed overtime for the calculation of their benefits. Those who have retired are protected against post-retirement reduction by the terms of both the United States and Minnesota Constitutions and the contractual rights of the Association.

The proposed change to the definition of salary is contrary to the terms of the agreement reached between the City and the Relief Association when the issue of the inclusion of overtime and other elements of compensation was first an issue. That agreement expressly provides that all retirements after 1995 would include the additional elements of salary.

All of the members of the Association are currently eligible to retire or are retired. We have had the matter of the readjustment of the salary definition reviewed by our fiduciary counsel who has opined that such an action resulting in a diminution of member benefits would violate the state constitution. A copy of that opinion is available for your inspection upon request.

Those who, as active members, contributed to the plan and rendered labor on the basis of a benefit calculation that included imputed overtime are entitled to the benefits of that contract. I would also note that all but three of the remaining active members of the plan are eligible to retire immediately on a full benefit. The remaining three will qualify on October 1, 2004. While Minnesota has not addressed the precise question, at least one state appeals court has found that eligibility to retire is equivalent to the status of retiree for benefit protection purposes. See, O'Connell v. Division of Retirement, 557 So. 2d 609 (Fla. 3d DCA 1990).

Auditor's Reply:

A. Selection Premium Pay

In the unit value calculation used by the MFRA, there is already a component of salary that represents the value of every possible hour of work for a top grade firefighter at the selection premium rate. This is not the amount in question; rather, it is the inclusion of the selection premium rate of pay in vacation, sick leave, and holiday components of salary that do not represent hours worked. As stated in the original comment, the collective bargaining agreement clearly specifies that firefighters are only eligible to receive selection premium pay for hours they actually work. The parties to this agreement are paying and receiving compensation in compliance with the terms of this agreement. These facts support our finding. The MFRA's position to include selection premium pay in the vacation, sick leave, and holiday components of unit value is unsupported.

B. Overtime

The MFRA agreed to the terms of the 1995 Settlement Agreement--a legal contract approved by its own Board and the District Court. The terms of this contractual agreement clearly state that salary includes "an average of the actual overtime worked in excess of FLSA overtime amounts by firefighters with 25 years or more of service, up to a maximum of 136 hours, in the immediately preceding year." Thus, the MFRA agreed to a benefit formula, not an amount, the results of which may vary. This benefit formula, used since 1996 and relied upon by the firefighters, remains unchanged. If the amount of the overtime benefit had been intended to remain the same, then the terms of the agreement should simply have stated a specific amount. Again, the MFRA has not supported its position.

03-2 Service Pension Units

Minn. Stat. § 423C.05, subd. 1, states that the MFRA "shall" pay benefits in accordance with this statute. Minn. Stat. § 423C.05, subd. 2(b), provides that, based on the funding level as determined in the "most recent annual actuarial valuation," the amount of a service pension be based on a scheduled number of units corresponding to years of service. The number of units payable increases as funding levels move from under 90 percent, to between 90 and 92.5 percent, and to over 92.5 percent.

The MFRA is currently paying benefits based on the maximum possible 42 units which is payable when the funding level is over 92.5 percent. Starting with the December 31, 2002, actuarial valuation, the MFRA's funding level dropped below 90 percent. That actuary report, dated April 2003, calculated the funding level of the plan to be 87 percent. Therefore, the appropriate benefit level, according to the current state law, is a reduced amount reflecting a funding level now below 90 percent.

We understand the statute may not appropriately reflect the intent of the MFRA or other concerned parties. We acknowledge the correspondence between the MFRA and the Legislative Pension Commission disputing the appropriate statutory language and potential legislative changes needed to correct the law to accurately reflect the legislative intent. Nevertheless, the statutory language currently in effect is clear and unambiguous. The number of units being paid for benefits by the MFRA is not in compliance with the number of units payable based on the funding level as clearly specified in Minn. Stat. § 423C.05, subd. 2(b). Regardless of what any previous intentions were, steps must be taken by the MFRA to either correct the units being paid for pension benefits or correct the statutory language so that the two agree.

We recommend the MFRA take appropriate and timely steps to ensure that the number of units paid to beneficiaries reflect compliance with state law.

Client's Response:

The issue of service pension units being divided into different benefit levels based on different levels of funding is a matter of the current laws being drafted incorrectly into the recodification of the laws applicable to the MFRA. We intend to work with the LCPR and the State Legislature to correct these discrepancies during the next possible opportunity. Comments not reflected in 3-02 by the Auditor include correspondence from the Legislative Commission on Pensions and Retirement, wherein they expressly stated that it was unlikely that it was the intention of the MFRA or the legislature and they referred to faulty drafting. In fact, the savings clause provided in the MFRA recodification law made very clear what the intent of the legislature was and the manner in which it should be remedied. The Secretary of the MFRA will advise the 2005 legislature of the need to change this and suggest legislation to clarify the matter.

It is absolutely clear that when reading the law which 423C.05, subd. 2, recodified, which was Laws of Minnesota 1997, Chapter 233, Article 4, Section 17, that when the MFRA's actuarial accrued liability exceeded 92.5%, a schedule of 42 units applied to "all active members and retired service pensioners who otherwise met the existing requirements to receive the benefit."

03-3 Disability Pension

The MFRA pays a disability benefit at the rate of 41 units per month until such members meet age and years of service requirements. When the disability benefit is then converted to a service pension, the MFRA increases the number of units to 42 per month. The MFRA's Bylaws state that retired members on a disability pension shall be placed on the pension roll and receive a pension of 41 units per month. Thus, this increase in units upon conversion of a disability benefit to a service pension is not in compliance with the MFRA's Bylaws. It is also contrary to state law.

Minn. Stat. § 423A.11 governs the recomputation of a disability benefit as a service pension. This statute requires that a member's disability benefit be converted to a service pension when one of the following two events occurs:

The member reaches age 50 and:

a. has active service that qualifies the member for a service pension equal to the disability benefit (41 units); or

b. has combined active service and years of disability benefits that qualify the member for a service pension equal to the disability benefit (41 units).

Under both of these scenarios, the triggering mechanism for converting a disability benefit to a service pension occurs at the time when the benefit amount for the service pension equals the disability benefit. For the MFRA, this is 41 units. Only those members who had already met the age and years of active service requirements before becoming eligible for disability benefits would possibly qualify for a service pension at a higher unit level (dependent on the MFRA's funding level).

We recommended the MFRA take appropriate steps to ensure that disability benefits are converted and paid as service pensions at amounts that are in compliance with state law and its own bylaws.

Client's Response:

The MFRA does not have a 41-unit service pension. When law requires a disabled member to be converted to a regular service pension, we have had the history of converting them to a regular service pension. Our regular service pension is a 42-unit service pension. We have been advised by our Fiduciary and General Counsel that in all likelihood the conversion law cited by the OSA is a violation of State and Federal anti-discrimination laws prohibiting discrimination on account of age and disability. The

Board of Trustees will be examining this issue in further detail at the Board meeting of August 16, 2004. At that meeting the Board of Trustees will be informed as to the concerns expressed by the State Auditor as well as the LCPR staff and the Board's determination as to how this issue is to be addressed will be forwarded to both of the concerned entities immediately following a determination. Following is a commentary from our Fiduciary Counsel Robert Klausner:

> *The issue of the unit value for disability retirees has also been subjected to a comprehensive legal review. Our fiduciary counsel advises that the forced conversion of disability retirees based on age violates both state and federal age and handicap discrimination laws as it affects a mandatory retirement at a lower pay level than other retirees. The disability payment at 41 units is not subject to federal income taxation as it is in the nature of workers' compensation. The conversion to a service retirement results in the loss of favorable tax treatment. By treating all retirees on service pensions equally at a benefit of 42 units, the Association is able to avoid any claim that it has treated older or disabled workers on a disparate basis. Copies of those opinions are available for review.*

<u>Auditor's Reply</u>:

The MFRA has not disputed that it is not in compliance with state law regarding the conversion of disability benefits to service pensions. Rather, the MFRA has stated that complying with the law (a) <u>may</u> violate anti-discrimination laws, and (b) would result in unfavorable tax treatment for the beneficiary. If the MFRA strongly believes that following the express directives of the state law would subject it to liability under federal law, it should seek protection from the supposed liabilities through proper application to the court or seek to change the state law. Regardless, the MFRA must take steps to ensure compliance with state law governing disability and service pensions.

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REPORT ON LEGAL COMPLIANCE

Board of Trustees
Minneapolis Firefighters' Relief Association

We have audited the basic financial statements of the Minneapolis Firefighters' Relief Association as of and for the year ended December 31, 2003, and have issued our report thereon dated July 27, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government,* promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains three main categories of compliance to be tested in audits of relief associations: deposits and investments, conflicts of interest, and relief associations. Our study included all of the listed categories.

In addition, we reviewed for compliance with other statutes, bylaws, and administrative rules that we deemed necessary. This review did not include all possible regulatory provisions which may be applicable and was not intended to provide assurance of full compliance with all regulatory provisions.

The results of our tests indicate that for the items tested, the Minneapolis Firefighters' Relief Association complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 03-1 through 03-3.

This report is intended for the use of the Association's Board of Trustees and management and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Pat Anderson	*/s/Greg Hierlinger*
PATRICIA ANDERSON STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

End of Fieldwork: July 27, 2004

Minneapolis
City of Lakes

Finance Department
Patrick P. Born
City Finance Officer

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MEMORANDUM

Date: August 1, 2002

To: Members of the Intergovernmental Relations Committee
Council Member Scott Benson – Chair
Council Member Lisa Goodman
Council Member Barret Lane
Council Member Natalie Johnson Lee
Council Member Paul Ostrow
Council Member Paul Zerby

From: Patrick P. Born, City Finance Officer

Re: Minneapolis Police Relief Association

City Council Resolution 2000R-061 (February 18, 2000) includes the following policy statement:

> "if the Minneapolis Police Relief Association fails to maintain pension fund management practices consistent with professional fiduciary responsibilities, the City will seek legislation that would transfer responsibilities for investing pension assets from the local association to the State Board of Investment."

The purpose of this memorandum is to provide a status report to the Mayor and IGR Committee on the pension fund management practices of the Minneapolis Police Relief Association (MPRA). The table below lists the pension fund management practices recommended by the City Finance Officer in a December 13, 1999 letter to the Intergovernmental Relations Committee and the current state of pension fund management practices. This report has been distributed to the MPRA Board Chairman and Executive Secretary so that MPRA may comment on the findings herein.

The Mayor and IGR Committee may wish to use the information of this report as well as MPRA's response to this report in making any determination that would result in proposed legislation.

www.ci.minneapolis.mn.us

Recommended Practice	Status
Hire independent investment advisor	***Satisfied.*** MPRA appointed Ennis Knupp as independent investment advisor in 2001.
Hire general counsel	***Satisfied.*** The law firm of Rice, Michels & Johnson has been engaged as general counsel to MPRA.
Hire professional pension administrator	***Satisfied in part***. MPRA has employed two professional pension administrators, but the most recent administrator resigned in May 2002. His interim replacement is an employee of MPRA that does not have the requisite skills of a professional pension administrator.
Hire experienced custodial bank	***Satisfied.*** Wells Fargo serves as custodial bank.
Use competitive procurement practices	***Satisfied.*** The investment advisor, general counsel, and custodial bank were hired using competitive procurement practices and are qualified to serve in these capacities.
Adhering to investment practices that advance the interest of the Association membership and beneficiaries	***Satisfied in part.*** MPRA has satisfied all but one of the investment practices recommended by the Finance Officer. The interim Executive Secretary does not have the requisite skills to act as the permanent pension administrator. MPRA could fully satisfy the criteria with the permanent appointment of a pension administrator or by entering into a service agreement with other pension plans to share professional staff services if such arrangement included qualified professionals.

By this letter I am informing the Mayor and members of the IGR Committee of these findings. If the Committee agrees with this finding the City would support legislation transferring the investing activities of the MPRA to the State Board of Investment.

cc: R.T. Rybak, Mayor
John Moir, City Coordinator
Andrea Hart-Kajer, Director- Intergovernmental Relations
Gerald Bridgeman, President – MPRA
Renee Tessier, Executive Director - MPRA

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MEMORANDUM

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Council Member Scott Benson, Chair – IGR Committee
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From: Patrick P. Born, City Finance Officer

Re: Minneapolis Fire Relief Association

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The purpose of this memorandum is to provide a status report to the Mayor and Intergovernmental Relations Committee on the pension fund management practices of the Minneapolis Fire Relief Association (MFRA). The table below lists the pension fund management practices recommended by the City Finance Officer in a December 13, 1999, letter to the Intergovernmental Relations Committee and the current state of pension fund management practices. This report has been distributed to the MFRA Board President and Executive Secretary so that MFRA may comment on these findings.

The Mayor and IGR Committee may wish to use the information of this report as well as MFRA's response to this report in making any determination that would result in proposed legislation.

Recommended Practice	Status
Hire independent investment advisor	***Satisfied in part.*** MFRA has contracted with Standard Valuation to provide investment advisor services, however, Standard Valuation may not be qualified to serve as an investment advisor. In May 2000 MFRA selected Jeffrey Slocum & Associates, Inc. as independent investment advisor using a competitive procurement process. On July 31, 2001 Slocum terminated its agreement with MFRA, and MFRA engaged Standard Valuation, Inc. as independent investment advisor. The selection of Standard Valuation was made without benefit of a competitive selection process. During the process that resulted in the appointment of Slocum as independent investment advisor, Standard Valuation was judged by a subcommittee of MFRA's Board not to be qualified to act as independent investment advisor. MFRA's Board subsequently overrode the subcommittee's judgement and entered into a contract with Standard Valuation for investment advisory and valuation services. Unless Standard Valuations has acquired the expertise to serve as independent investment advisor, Standard Valuations may not be qualified to serve in this capacity for MFRA.
Hire general counsel	***Satisfied in part***. The law firm of Rice, Michels & Johnson has been engaged as general counsel to MFRA, but was appointed without a competitive selection process.
Hire professional pension administrator	***Not satisfied***. MFRA does not employ a professional pension administrator. The Executive Secretary to the MFRA is a fire service professional, and is not a professional pension administrator.
Hire experienced custodial bank	***Not satisfied***. Union Bank and Trust serves as custodial bank, however, Union was hired after a truncated competitive procurement process and Union may not be qualified to serve as custodial bank. Within the past two years

	MFRA has issued a request for proposal for custodial bank service, but did not fully evaluate proposals before re-appointing Union Bank as custodial bank. Based on the findings of a consultant (Mercer) completed prior to MFRA's appointment of Union Bank to the Minneapolis Police Relief Association (MPRA) Union Bank & Trust was determined not to be a full service bank and not qualified to act as a custodial bank to MPRA..
Use competitive procurement practices	***Not satisfied***. MFRA has not used a competitive procurement practice in the hiring of its investment advisor, general counsel, or custodial bank.
Adhering to investment practices that advance the interest of the Association membership and beneficiaries	***Not satisfied.*** In addition to the above findings, MFRA is not currently following Board approved investment policies in the selection and direction of investment managers. The failure of MFRA to follow its investment policies combined with failing to fully meet any of the criteria for professional investment management practices call in question the ability of MFRA to manage its investments in a manner that is in the best interests of the Association.

By this letter I am informing the Mayor and members of the IGR Committee of these findings. If the Committee agrees with these findings the City would support legislation transferring the investing activities of the MFRA to the State Board of Investment.

cc: R.T. Rybak, Mayor
John Moir, City Coordinator
Andrea Hart-Kajer, Director- Intergovernmental Relations
Thomas Fyle, President – MFRA
Walter Schirmer, Executive Secretary - MFRA