Winter 2016

Messenger

Minnesota State Retirement System (MSRS)

"While longer life expectancy may present some new challenges, we can be confident in knowing that the MSRS Board, the Legislature, employers, our members and benefit recipients have repeatedly stepped up to help us remain one of the best funded retirement plans in the country."

Dave Bergstrom
Executive Director

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MSRS BOARD TO PROPOSE FUNDING PACKAGE TO OFFSET LONGER LIFE EXPECTANCIES

As reported in our last newsletter, people are living longer – much longer. A 65-year-old male today is expected to live two years longer compared to the life expectancy projected by the actuarial profession just 15 short years ago; and a 65-year-old female is expected to live two years and four months longer. While that is good news for retirees, it is not such good news when funding a pension plan.

At age 65, a typical General Employees Retirement Plan monthly payment is $2,000 per month. That retiree is now expected to collect benefit payments for an additional two years, which means that person will receive $48,000 more over his/her lifetime. The MSRS General Employees Retirement Plan has 36,500 benefit recipients, 49,000 active members, and 17,000 deferred members who have left state government, but will someday be eligible to collect monthly benefits. When the MSRS actuaries calculated the impact on the General Employees Retirement Plan, the longer life expectancies increased total liabilities by approximately $700 million. It is important to remember that MSRS has $11.6 billion in assets.

To cover the increase in liabilities, the MSRS Board of Directors has developed a legislative package to bring the General Employees Retirement Plan funding into balance. As in 2010, the Board is taking a balanced approach to solving the funding challenge.

The Board's proposal to the Legislature will be as follows:

> Increase employee contributions from 5.5 percent to 6 percent effective July 1, 2017

> Increase employer contributions from 5.5 percent to 7 percent effective July 1, 2017

> Lower cost-of-living adjustments (COLAs) from 2 percent to 1.75 percent effective January 1, 2017

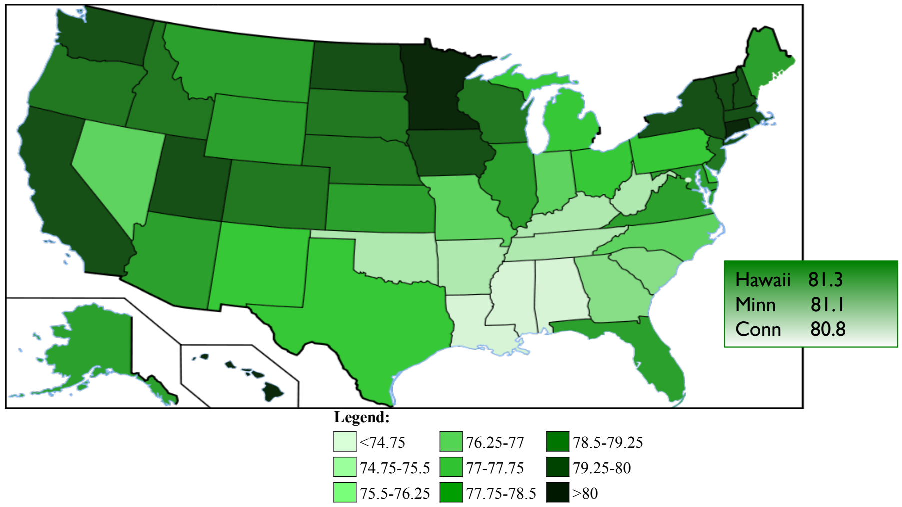
> Eliminate the provision that automatically increases the COLA to 2.5 percent when the Plan reaches 90 percent funded

WHAT IS THE IMPACT OF PEOPLE LIVING LONGER?

Minnesotans are a hardy bunch. The map to the right illustrates the life expectancy at birth of residents in all 50 states. It reveals that Minnesotans have the second longest life expectancy in the U.S. Only residents of Hawaii are expected to live longer. The map also shows that life expectancy in Minnesota is as much as five years longer than in some other states.

Minnesota's Life Expectancies

- Minnesotans are living longer than those in any other state except Hawaii.



Source: American Human Development Report, by Cavanaugh Macdonald

HOW MUCH LONGER ARE MSRS MEMBERS AND RETIREES EXPECTED TO LIVE?

While the map shows life expectancy of all Minnesotans, the MSRS Board looks at the actual experience of our plan members. Every four or five years, the MSRS actuaries compare what is projected to happen regarding life expectancy with what actually happened.

The charts below show the life expectancies at various ages for males and females.

Males

Age	Old Life Expectancy	New Life Expectancy
40	82.1	84.1
50	82.5	84.2
60	83.7	85.9
65	84.6	86.6

Females

Age	Old Life Expectancy	New Life Expectancy
40	84.4	86.0
50	84.7	86.7
60	85.6	87.5
65	86.4	88.8

WHAT IMPACT DOES LONGER LIFE EXPECTANCY HAVE ON OUR FUNDING?

The MSRS General Employees Retirement Plan is not only the best funded plan in the state, it is one of the best funded plans in the country.

The MSRS Board and the Minnesota Legislature have been proactive to make sure there are sufficient assets to pay lifetime benefits, not only for those in retirement, but also for those just beginning their careers in public service. The General Employees Retirement Plan has $11.6 billion in assets. The funding ratio on a market value of assets as of June 30, 2015, is 89 percent.

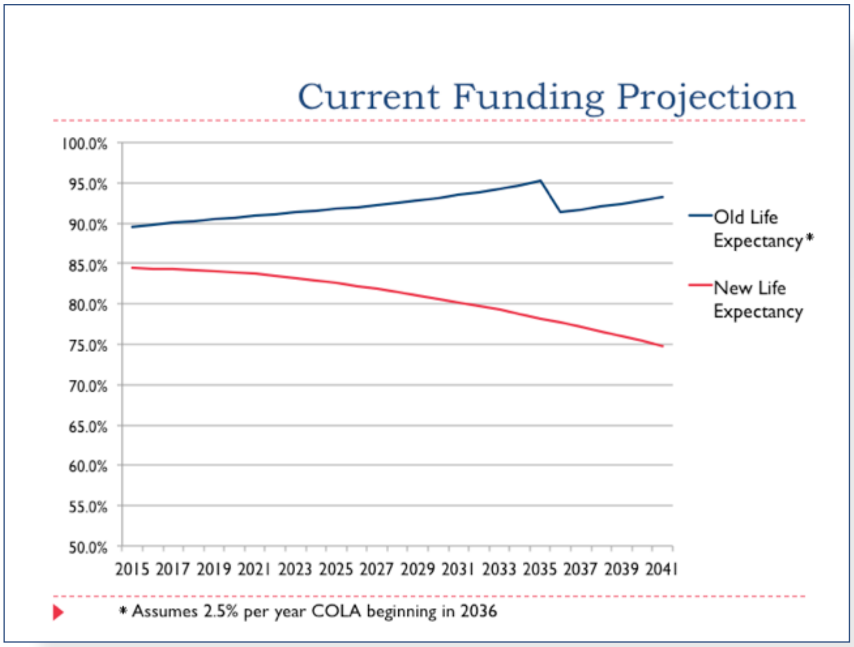
However, once the new life expectancy tables are applied, the funding ratio decreases to 84 percent because the plan's liabilities increase by $700 million. This increase in liabilities is due to payments of monthly benefits for a longer period of time. In addition to the funding ratio, the Board looks at contribution rates. The Board needs to make sure that the contribution rates coming into the plan are adequate enough to move the plan back to a 100 percent funding level. Using the market value of assets on June 30, 2015, our contribution rates were only 0.5 percent short of what they needed to be.

After making the adjustments for the longer life expectancy, the contribution rates were not sufficient to maintain our current funding level. The chart below shows the funding before and after the assumption changes.

	June 30, 2015	June 30, 2015 (with life expectancy)
Actuarial Accrued Liability	$13.1 billion	$13.8 billion
Market Value of Assets	$11.6 billion	$11.6 billion
Funding Ratio	88.9%	83.9%
Required Contributions	11.45%	13.8%
Actual Contributions	11% (5.5% employee and 5.5% employer)	11% (5.5% employee and 5.5% employer)
Additional Contributions Needed to Reach Full Funding	0.45%	2.8%

Source: GRS

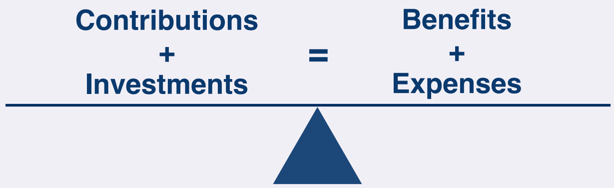
The graph to the right shows that MSRS funding falls from 89 to 84 percent because of longer life expectancies. If no funding changes are made, future funding levels are expected to decline.



The MSRS FY 2015 Comprehensive Annual Financial Report is available online at www.msrs.state.mn.us/financial-information. The 2015 Actuarial Valuations can be found at www.msrs.state.mn.us/actuarial-reports.

THE BOARD'S PROPOSAL

The Board's primary responsibility is to make sure the plans administered by the Minnesota State Retirement System are financially sound. The Board takes that responsibility very seriously because they know that members and retirees are counting on having lifetime retirement income. The Board also wants the proposal to be balanced. The graphic below shows the balance the Board is trying to achieve.



The MSRS Board aggressively dealt with the impact of the market decline in 2008 and 2009. Since 2009, the Board lowered COLAs, adjusted other benefits, and increased employee and employer contributions. These changes, along with strong investment returns, helped MSRS climb to a funding ratio of 90 percent. The median funding level of the U.S. large pension plans is 74 percent.

While the funding issue caused by longer life expectancy is not nearly as severe as it was after the Great Recession in 2008 and 2009 (General Employees Retirement Plan funding had dropped to 65 percent), the Board wants to act quickly to make sure that the plan moves back toward 100 percent funding.

"I understand that this proposal reduces the take home pay of active employees, lowers the future growth of benefits for retirees and will have a significant impact on the budgets of the employers contributing to MSRS. However, all parties involved want to have a retirement plan that is financially strong," said Dave Bergstrom, Executive Director of MSRS.

Increase employee contribution by 0.5%

The fact that people are living longer not only increases the cost of a pension plan for retirees, it also increases the cost for members in their 30s, 40s and 50s. The employee contribution increase of 0.5 percent will help pay for this increased cost. The new life expectancy tables also project that today's younger employees will have even longer life expectancies than current retirees. For example, the new tables project that the average 40-year-old female, who retires at 65, will live to age 90.

The impact that higher employee contributions can have on funding is illustrated in the table below. Since the contributions are tax-deferred, the impact on take-home pay will be less than indicated.

Annual Salary	0.5% Contribution Rate Increase
$40,000	$200
$50,000	$250
$60,000	$300
$70,000	$350
$80,000	$400
$90,000	$450
$100,000	$500

The additional employee contributions will increase revenue for the General Employees Retirement Plan by about $13.6 million annually.

Increase employer contribution by 1.5%

Roughly 0.5 percent of the 1.5 percent employer contribution increase will go to pay for the increased life expectancy for active employees. The other 1 percent will help fund the longer life expectancy for those who are already retired. The higher employer contribution will bring in $40.9 million per year into MSRS.

Benefit recipients

The proposal impacts retirees in two ways:

- It lowers future COLAs from 2.0 percent to 1.75 percent per year
- It eliminates the automatic escalation of the COLA to 2.5 percent when the plan reaches 90 percent funded for two consecutive years

Lowering the COLA from 2.0 percent to 1.75 percent slows the future growth of retirement benefits. Because the MSRS General Employees Retirement Plan has 36,500 benefit recipients and many others who are close to retirement, lowering the COLA has a big impact on funding the plan. The lower COLAs reduce our existing liabilities by about $400 million.

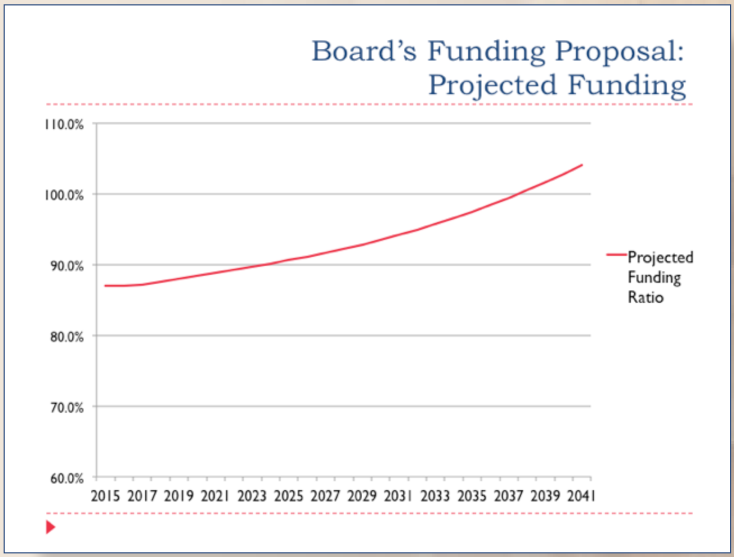
The annual impact on retirees of lowering the COLA from 2 percent to 1.75 percent is shown below:

Monthly Benefit Amount	2% COLA	1.75% COLA	Difference
$1,000	$20	$17.50	$2.50
$1,500	$30	$26.25	$3.75
$2,000	$40	$35.00	$5.00
$2,500	$50	$43.75	$6.25
$3,000	$60	$52.50	$7.50
$3,500	$70	$61.25	$8.75
$4,000	$80	$70.00	$10.00

The Board decided to propose eliminating the automatic trigger to increase the COLA to 2.5 percent when the plan reaches 90 percent funding for several reasons. First, based on the longer life expectancy, the plan was not expected to trigger a higher COLA for more than 20 years. Second, the Board believes it gives a false sense to retirees that they could expect a higher COLA. And third, the contribution rates necessary to fund a higher COLA well into the future would have increased employee and employer contributions significantly higher than currently proposed.

WHAT DOES OUR FUNDING PROJECTION LOOK LIKE AFTER THE CHANGES?

The graph to the right shows the impact of the changes proposed by the Board. If the changes are adopted by the Legislature, our actuary projects that we move back toward achieving our goal of full funding. The Board's primary responsibility is to make sure that the plan has sufficient assets to pay benefits today, 20 years from now, and in 2100.



ONGOING BOARD REVIEW

The MSRS Board regularly monitors funding of the plans administered by MSRS and will continue to do so in the future.

Once the General Employees Retirement Plan is more than 90 percent funded and is comfortably on track to reach a funding level of 100 percent, the Board will revisit the COLAs and contribution rates. The Board can propose a comprehensive solution to determine future COLAs and appropriate contribution rates. Likewise, if the Board is faced with further funding issues, it will propose a solution to resolve those issues.

"It is difficult to predict what will happen in the future," Bergstrom said. "In my 24 years at MSRS, I have seen great market returns in the 90s, the technology bubble in 2002 and 2003, the Great Recession in 2008 and 2009, and now the increase in life expectancies. It is reassuring to know that the MSRS Board, the Legislature, employers, our members and benefit recipients, have always stepped up and dealt with the challenges to keep MSRS a leader in the retirement field."

WE ARE NOT ALONE

All public and private pension plans are dealing with the fact that people are living longer. The impact of increased life expectancy is not something that is unique to MSRS and Minnesota. Even states with substantially lower life expectancies than Minnesota are dealing with the ramifications of people living longer. While MSRS is one of the first public plans to recognize the impact of longer life expectancies on financial sustainability, other public pension plans around the country have also come to recognize their need to address this issue.

MSRS Minnesota State Retirement System
Your Foundation for Retirement

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Contact Us – MSRS Office Locations

To help us serve you better, we encourage you to make an appointment to see one of our retirement counselors. To speak to one of our retirement counselors at any of our locations, call **651-296-2761 or 1-800-657-5757**. Our main office is located in St. Paul, and we also have offices in Greater Minnesota.

St. Paul Main Office

60 Empire Drive, Suite 300
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Monday - Friday
8 a.m. - 4:30 p.m.

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Detroit Lakes, MN 56501
Tuesday - Friday 8 a.m. - 4:30 p.m.

Duluth
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324 West Superior Street, Suite 530
Duluth, MN 55802-1707
Tuesday - Friday 8 a.m. - 4:30 p.m.

Mankato
Former Bretts Building
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