

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director

RE: S.F. 1556 (Betzold, by request), H.F. 2101 (Murphy): MnSCU IRAP; Making State Board of Investment Supplemental Funds Optional Rather than Mandatory Investment Options

DATE: March 28, 2005

General Summary of S.F. 1556 (Betzold, by request), H.F. 2101 (Murphy)

S.F. 1556 (Betzold, by request), H.F. 2101 (Murphy) makes the State Board of Investment (SBI) Supplemental Investment Fund investments optional rather than mandatory Minnesota State Colleges and Universities (MnSCU) Individual Retirement Account Plan (IRAP) offerings.

Background Information on the Individual Retirement Account Plan

The Minnesota State Colleges and Universities System (MnSCU) Individual Retirement Account Plan (IRAP) stems from the late 1980s, when state university and state college teachers and related employees sought coverage by a defined contribution plan rather than by TRA, which is a defined benefit program. That IRAP plan, currently coded as Minnesota Statutes, Chapter 354B, was established by the 1988 Legislature, but was not implemented until mid-1989 due to problems in ensuring proper Social Security coverage. The plan was expanded to include technical college managerial employees in 1993 and technical college faculty in 1994. The Higher Education IRAP plan covers faculty members and upper-level administrators at MnSCU, but does not cover faculty or administrators at the University of Minnesota.

When the Higher Education IRAP plan was initially implemented, IRAP coverage was mandatory for new hires without prior covered service, while employees in eligible positions who had prior TRA service were given an option to elect IRAP rather than continuing defined benefit coverage. Election rights and election procedures have been frequently revised over the years. In 1994, the current procedure was established, permitting individuals with prior defined benefit plan coverage to continue that coverage or to elect IRAP, and permitting new hires to choose within 90 days between IRAP and the defined benefit plan that would otherwise provide the coverage. The election is irrevocable.

The argument made by the initial proponents of a defined contribution plan for higher education faculty and administrators is that higher education faculty, as a group, are highly mobile. If an individual changes employment to another college in another state, the individual retains the full value of the IRAP account, and the account continues to grow in value over time due to the continuing investment earnings on the account. A defined benefit plan may be a better choice for higher education faculty members who are less mobile, by reason of personal choice or lack of opportunity, particularly as these individuals become long-term employees. A defined benefit plan may also be best for higher education faculty members who have considerable prior TRA or first class city teacher plan covered service. The MnSCU higher education faculty is also covered by the Higher Education Supplemental Retirement Plan, which is also a defined contribution plan. Higher education faculty and administrators are covered by the Supplemental Retirement Plan whether the individual is a TRA member or an IRAP member. The Supplemental Retirement Plan was created in 1968. At that time, TRA provided the primary coverage for higher education faculty and the Supplemental Retirement Plan was created to address deficiency in the benefits provided by TRA. Those deficiencies in TRA benefits were addressed decades ago when TRA moved to use of the high five average salary to compute benefits, and benefits were further enhanced in more recent years. The problem that the Supplemental Retirement Plan was intended to address has been eliminated. Given that elimination, the purpose for continuing the Supplemental Retirement Plan currently is unclear.

Background Information on the State Board of Investment Supplement Fund

Current IRAP investment offerings include all SBI Supplemental Investment Fund offerings, in addition to various other investment offerings. The SBI Supplemental Investment Fund investment options are:

- Income Share Account, a balance portfolio of common stock and bonds;
- Growth Share Account, an actively managed common stock portfolio;
- Common Stock Index Account, a passively managed portfolio tracking the domestic stock market;

- International Share Account, which contains non-United States stock and uses both passive and active management;
- Bond Market Account, an actively managed bond portfolio of investment-grade securities;
- Money Market Account, a portfolio of short-term, liquid debt securities; and
- Fixed Income Account, which contains guaranteed investment contracts (GIC's) and similar investments that offer a fixed return for a specified time period.

Other MnSCU IRAP Investment Options

In addition to the SBI Supplemental Fund investments, MnSCU IRAP members may choose to invest in various investment options offered by the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), and various mutual funds. In all, including the SBI Supplemental Fund offerings described above, members may choose between 23 different investments, including several money market funds, fixed income funds (SBI Fixed Income Account, TIAA Traditional Annuity, and Wells Fargo Stable Return Fund), bond funds, balanced funds (containing both stocks and bonds), a real estate fund, various stock growth and income funds, stock growth funds, a stock aggressive growth fund, and international funds containing foreign stocks. An attachment downloaded from the MnSCU website describes each of these offerings.

General Comments

Under current law, Section 354B.25, Subdivision 3, all investment options provided to IRAP members must first be reviewed and recommended by the SBI, after giving consideration to the experience of fund managers, the nature of the investments a given mutual fund offers, the cost of managing the particular mutual fund, and any other relevant factors.

Volunteer firefighter relief association plans and other non-SBI Minnesota public investment funds are permitted to invest in the SBI Supplemental Investment Fund offerings. The Supplemental Investment Fund also serves as some of the investment vehicles for the Minnesota State Retirement System (MSRS) Deferred Compensation Plan.

The SBI Supplemental Fund serves as the sole investment vehicle offered to Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) members, including all legislators who are in that plan.

Discussion and Analysis

S.F. 1556 (Betzold, by request), H.F. 2101 (Murphy) raises the following pension and related public policy issues:

1. Need for Change. The issue is whether there is sufficient need to make the change. It is unclear what harm the current set of State Board of Investment offerings is causing. The Commission may wish to hear brief testimony from MnSCU to explain why they contend this change is needed.
2. Suitability of Offerings for Other Plans. State Board of Investment Supplemental Investment Fund investments are the only investments offered to MSRS-Unclassified Program members. Members of that program include all legislators who were first elected after 1997, and many legislators elected earlier who chose to transfer coverage to that program. A broad issue for legislators is whether the Unclassified Program should continue to offer certain Supplemental Fund Investments that MnSCU feels should not be offered to its IRAP members.