

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 1741 (Betzold); H.F. 1934 (Wardlow): Supplemental Pension Plans; Public Funds Contribution Restriction Exemption Clarification

DATE: March 29, 2005

Summary of S.F. 1741 (Betzold); H.F. 1934 (Wardlow)

S.F. 1741 (Betzold); H.F. 1934 (Wardlow) amends Minnesota Statutes, Section 356.24, Subdivision 1, the restriction on the creation of employer-funded supplemental retirement plans and exceptions to that restriction, by clarifying that supplemental retirement plan contributions wholly and solely funded from employee accumulated sick leave, vacation leave, or severance pay are those amounts as of the date of retirement or active employment termination.

Background Information on Restrictions on Employer Funded Supplemental Retirement Plans

Minnesota Statutes, Section 356.24, when initially enacted in 1971 (Laws 1971, Chapter 222, Section 1), was intended to end a growing 1960s practice in local government (primarily by school districts) of creating supplemental employer-funded pension plans beyond the regularly applicable statewide pension plan for that type of public employee. At that time, public pension benefits were considerably more modest than they are currently and some of the more affluent jurisdictions were attempting to readjust their employees' pension coverage by local action, without the approval of or notice to the Legislature. The Legislature decided that this practice was inappropriate and that the creation of additional pension plans was an unwise policy. The Legislature also apparently felt that pension benefits should be as uniform as possible geographically throughout public employment. In 1973, the Legislature considerably improved pension benefits payable under the public employees primary pension coverage by moving from career average salary plans to pensions that were based on the average salary of the individual close to retirement. The intent at the time was to provide an adequate retirement benefit through the primary pension plan and eliminate the need, or the ability, to create supplemental plans. Those supplemental plans that were in effect prior to 1971 were grandfathered. Substantial statewide general employee retirement plan benefit increases occurred in 1980, 1989, 1992, and 1997.

A number of exceptions to the restriction on supplemental employer-funded pension plans have been enacted. Beyond the pre-1971 grandfathered supplemental pension plans, the 1971 legislation also excluded from its application group health, hospital, disability, or death benefits. In 1980 (Laws 1980, Chapter 600, Section 7), an exception was added for severance pay plans authorized under Minnesota Statutes, Section 465.72. In 1988 (Laws 1988, Chapter 605, Section 9), the State Deferred Compensation Program was modified to include a matching employer contribution in addition to the member's deferred compensation amount. The State Deferred Compensation Program is governed by Minnesota Statutes, Section 352.96. The State Deferred Compensation Program is the sole government sponsored retirement thrift or savings program for most public employees. Although the plan is administered by the Minnesota State Retirement System (MSRS), public employees throughout the state are authorized to participate. For purposes of the State Deferred Compensation Program, public employment includes volunteer firefighters. The State Deferred Compensation Program, akin to the somewhat similar Internal Revenue Code, Section 403(b), plans, function to encourage additional saving for retirement, supplementing income during retirement from the primary public pension plan, Social Security, or other income sources. State Deferred Compensation Program was established in 1971, by Extra Session Laws 1971, Chapter 32, Section 19. The matching employer contribution to the State Deferred Compensation Plan, authorized under Minnesota Statutes, Section 356.24, under the 1988 legislation was required to be made solely to the State Deferred Compensation Program, was required to be provided for in either a personnel plan or a collective bargaining agreement, was required to be a dollar for dollar match, and was limited to \$2,000 per year per employee. While not restricted in use to fund retiree health insurance premiums, the employer matching contribution authorization was part of a broader legislative enactment pertaining to retiree health benefits, and the conferees on Laws 1988, Chapter 605, discussed the potential for the savings promoted by the employer matching contribution authorization to be used in part to defray post-retirement health insurance premium costs.

In 1992 (Laws 1992, Chapter 487, Section 4), similar authority for an employer matching contribution feature for teacher tax-sheltered annuity insurance contracts under federal Internal Revenue Code, Section 403(b), was established by adding an additional exception to Minnesota Statutes, Section 356.24. The

applicable tax-sheltered annuity insurance contracts are those issued by one of up to ten qualified insurance companies licensed to do business in this state, engaged in the life insurance or annuity business, determined by the Commerce Commissioner to be among the top two rating categories of a national insurance rating entity, and selected by the Minnesota State Board of Investment as providing competitive options and investment returns. Internal Revenue Code, Section 403(b), tax-sheltered annuity plans are vehicles for teachers, church workers, and certain other personnel of charitable institutions, to save on a tax deferred basis. These plans are not any public employee's primary retirement coverage; rather they act to supplement the primary plan. This permits eligible employees to have some individual control over their eventual retirement income. Internal Revenue Code, Section 403(b), investments are generally referred to as tax-sheltered annuities.

Also, in 1988 (Laws 1988, Chapter 709, Article 11), with the creation of the State University System/Community College System Individual Retirement Account Plan (IRAP), an exception for the IRAP Plan was added to Minnesota Statutes, Section 356.24. In 1989 (Laws 1989, Chapter 319, Article 12, Section 3), employer contributions to the Higher Education Supplemental Retirement Plan, established in 1965, were exempted from the application of the supplemental pension plan restriction of Minnesota Statutes, Section 356.24.

In 2001, two additional exceptions were added to the supplemental retirement plan restriction of Minnesota Statutes, Section 356.24. The exceptions are for employer contributions to a supplemental plan or governmental trust established for post-retirement health care expenses under the federal Internal Revenue Code as set in the employer's personnel policy or set by a collective bargaining agreement and for employer contributions up to \$2,000 annually to the Laborer's National Industrial Pension Fund as set in a collective bargaining agreement. In 2002 (Laws 2002, Chapter 392, Article 10, Section 1), additional exceptions for the Plumbers and Pipefitters National Pension Fund and for the International Union of Operating Engineers Pension Fund were added to the supplemental retirement plan restriction of Minnesota Statutes, Section 356.24, with a \$2,000 annual maximum on the employer contributions to each of the two new supplemental retirement plans. Also in 2002 (Laws 2002, Chapter 392, Article 10, Section 1), an exception was added for a supplemental plan operated under the federal Internal Revenue Code that is wholly and solely funded by the accumulated amounts to the employee's credit under sick leave, vacation leave, or severance pay programs. In 2003 (First Special Session Laws 2003, Chapter 7, Section 1), the exceptions for the Plumbers and Pipefitters National Pension Fund was broadened to include alternatively a plumbers and pipefitters local pension fund.

Discussion and Analysis

S.F. 1741 (Betzold); H.F. 1934 (Wardlow) clarifies the 2002 supplemental retirement plan exception for accumulated severance pay, sick pay, or vacation pay transfers to a tax qualified supplemental plan by specifying that the exception applies to transfers of amounts accumulated as of the public employee's retirement or termination from active service.

The proposed legislation raises several pension and related public policy issues that may merit discussion and consideration by the Commission, as follows:

1. Need for the Clarification and Appropriateness of the Clarification. The policy issue is the need for and the appropriateness of the proposed clarification. When the 2002 exception for accumulated severance pay, sick leave pay, or vacation pay-based supplemental retirement plans was added, the assumption undoubtedly was that the supplemental plans related to end-of-working career accumulations, not annual or periodic accumulations. Education Minnesota, which was active in seeking the 2002 addition, reports that some vendors of supplemental plans have been promoting as authorized supplemental plans investment vehicles based on periodic or annual transfers of these amounts. Since some vendors are potentially or actually misconstruing the statute, if the unstated assumption in 2002 was for end-of-employment transfers rather than periodic transfers during employment, as the Commission staff believes, the proposed legislation would be appropriate. The Commission may wish to take testimony from Education Minnesota and other interested parties about the proposed legislation.
2. Appropriate Effective Date for Proposed Legislation. The policy issue is the appropriate date for the proposed legislation to be effective. If the proposed legislation is simply stating in words an unexpressed assumption about the 2002 supplemental plan exception, then the proposed immediate effective date is appropriate. If there are contrary contentions about whether the proposed legislation is a change or a clarification, the Commission may need to take testimony from the Minnesota School Boards Association and other employer representatives about the timing of securing compliance with the proposed legislation.

3. Potential Need for Supplemental Plan Reporting. The policy issue arising out of the proposed legislation is the large picture question of whether the Commission, the Legislature, and the public have enough information about the establishment and operation of supplemental retirement plans. Currently, there is no comprehensive reporting about supplemental retirement plans by employing units, although the annual financial reporting of each employing units should include or refer to any applicable supplemental plans. As a consequence, the Commission staff has no significant information on the number of supplemental plans, the number of employing units served by supplemental plans, the number of public employees covered by supplemental plans, the amount of money contributed to supplemental plans annually, or the current amount of assets accumulated in supplemental plans. This lack of information makes consideration of potential additions to or modifications in Minnesota Statutes, Section 356.24, more difficult.