State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

H.F. 1954
(Kahn)

S.F. 2152
(Olson, M.)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	MnSCU/Minnesota Office of Higher Education Office employees
Relevant Provisions of Law:	Minnesota Statutes, Section 136F.45, Subdivision 1
General Nature of Proposal:	Adds Roth IRAs as authorized investment products
Date of Summary:	April 30, 2007

Specific Proposed Changes

- Permits purchase of Roth IRAs as individual thrift plan investment products.

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of adding Roth accounts to the current traditional individual retirement savings program.
2. Extent of MnSCU system/MnSCU employee support.
3. Likely additional cost of adding Roth accounts and the likely additional participant charges.
4. Appropriateness of extending Roth account authority to comparable public employee retirement authority statutes.

Potential Amendments

H1954-1A (substantive) adds comparable language to other individual thrift plan authorization provisions.

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: H.F. 1954 (Kahn); S.F. 2152 (Olson, M.): MnSCU; Roth Accounts as Thrift/ Savings Option

DATE: April 26, 2007

Summary of H.F. 1954 (Kahn); S.F. 2152 (Olson, M.)

H.F. 1954 (Kahn); S.F. 2152 (Olson, M.) amends Minnesota Statutes, Section 136F.45, Subdivision 1, permitting the board of trustees of the Minnesota State Colleges and Universities System (MnSCU) to purchase through salary reduction federal Internal Revenue Code Section 403(b)(7) individual custodial accounts for MnSCU employees and for Minnesota Office of Higher Education employees, by additionally authorizing after December 31, 2007, Roth 403(b) accounts and by allowing for an employee charge for program expenses if the board cannot negotiate a fee rebate from investment product providers.

Background Information

A. Supplemental Retirement Savings Opportunities for Public Employees. Background information on the supplemental retirement savings opportunities for public employees is set forth in Attachment A.

B. Roth Individual Retirement Accounts, Roth 401(k) Accounts, and Roth 403(b) Accounts. Background information on Roth individual retirement accounts, Roth 401(k) accounts, and Roth 403(b) accounts is set forth in Attachment B.

Discussion and Analysis

H.F. 1954 (Kahn); S.F. 2152 (Olson, M.) adds Roth individual retirement accounts to the authority for the board of trustees of the Minnesota State Colleges and Universities System (MnSCU) to purchase retirement savings products on behalf of MnSCU employees.

The proposed legislation raises several pension and related public policy issues for potential Commission consideration and discussion, which are as follows:

1. Appropriateness of Adding Roth Accounts to the Current Traditional Individual Retirement Savings Program. The policy issue is the appropriateness of MnSCU utilizing Roth accounts in addition to the traditional individual retirement savings programs it currently offers. MnSCU, like other Minnesota public employers, offers traditional tax-sheltered annuities and related types of personal employer-assisted savings products to its employees, and by additional statutory authority, to employees of the Minnesota Office of Higher Education. Roth-type investment products have been permitted by a federal law in addition to these traditional products since January 1, 2006. A Roth 403(b) account provides some advantages over the traditional tax-deferred savings vehicles and suffers from some disadvantages also. The advantages may or may not be sufficient to justify the administrative effort to implement them. The requested Roth 403(b) account product expansion will, of course, be favored by investment marketers, who have a financial interest to market additional personal investment products.

2. Extent of MnSCU System/MnSCU Employee Support. The policy issue is the extent of support by the administration of MnSCU if the proponents of the proposed legislation are the representatives of MnSCU employee groups or the extent of support by MnSCU employee groups if the proponent is the MnSCU administration. The source of the proposed legislation is unclear on its face, but may not be advisable if the MnSCU administration and MnSCU employee groups are not actively supportive.

3. Likely Additional Cost of Adding Roth Accounts and the Likely Additional Participant Charges. The policy issue is the appropriateness of the proposed legislation if there is likely to be an additional cost of adding the Roth accounts and if there is likely to be additional participant charges. The 1998 omnibus retirement bill became the subject of a somewhat contentious conference between House and Senate Retirement Commission members based on the issue of a MnSCU proposed limit on MnSCU tax-sheltered annuity vendors and of fees from the tax-sheltered annuity program charged back to MnSCU employees. The questions of any additional costs and any additional employee fees should be addressed by the proponents of the bill to clarify the issue for the Commission.

4. Appropriateness of Extending Roth Account Authority to Comparable Public Employee Retirement Authority Statutes. The policy issue is the appropriateness of adding the same Roth account authority to the various other statutes authorizing public employees to engage in personal tax-deferred retirement savings. If the Roth account extension makes sense for and is appropriate for MnSCU employees, it is likely also appropriate for other public employees and making the extension of the authority now rather than piecemeal over time may save on future legislative effort.

   Amendment H1954-1A adds the Roth account authority to the relevant additional personal retirement savings statutes.

Attachment A

Background Information on Supplemental Retirement Savings Opportunities for Public Employees

Personal Retirement Savings Opportunities in General

Although the retirement coverage for most public employees in Minnesota is provided through defined benefit plan coverage and is supported by employer contributions, there are opportunities for public employees to engage in additional retirement savings, either on an employee-financed basis wholly or on a partially employee-financed and partially employer-financed basis.

Employee-Financed Retirement Savings Authority

All or virtually all Minnesota public employees are authorized to utilize an employee-funded retirement thrift or savings program.

Under Minnesota Statutes, Section 123B.02, Subdivision 15, added in 1961 (Laws 1961, Chapter 225), school district employees can request the school board to purchase an individual annuity contract under federal Internal Revenue Code Section 403(b) or an equivalent federal income tax law provision from payroll allocations. The savings authority must be extended in a nondiscriminatory manner. Once purchased, the annuity contract will be owned by the school district employee.

Minnesota Statutes, Section 354A.021, Subdivision 5, permits any of the first class city teacher retirement fund associations to establish a tax-sheltered annuity program and fund under federal Internal Revenue Code Section 403(b). The Duluth Teachers Retirement Fund Association (DTRFA), primarily covering teachers employed by Independent School District No. 709, Duluth, was the only teacher retirement fund association that implemented the authority.

Under Minnesota Statutes, Section 136F.45, at the request of an employee, the board of trustees Minnesota State Colleges and Universities System (MnSCU) may purchase an individual custodial account under federal Internal Revenue Code Section 403(b)(7) from a Minnesota-licensed company, funded by deductions from the employee's compensation. The MnSCU board is authorized to limit the number of tax-sheltered annuity vendors for which it would transmit employee contributions, but is required to include lower expense and no-load mutual funds and equivalent products. Fees to operate the MnSCU tax-sheltered savings program are to be shared and the MnSCU board is authorized to negotiate with investment vendors.

Under Minnesota Statutes, Section 352.96 (enacted as Extra Session Laws 1971, Chapter 32, Section 19), State employees, political subdivision employees, and any employees covered by a Minnesota statewide or local retirement plan are permitted to participate in the Minnesota State Deferred Compensation Program, a federal Internal Revenue Code Section 457 tax-deferred savings program. The program is administered by the State Board of Investment with respect to investment options under the program and by the executive director of the Minnesota State Retirement System (MSRS) with respect to recordkeeping and other program elements.

Under Minnesota Statutes, Section 471.615, officers or employees of cities, towns, counties, school districts, public authorities, special districts, other political subdivisions, or the State of Minnesota may request their employer to negotiate for and purchase individual annuity contracts under federal Internal Revenue Code Section 403(b) or equivalent tax law provisions from a Minnesota-licensed company, with the deduction of the contract premium from compensation.

Partially Employer-Financed Retirement Savings Authority

As an exception to the general restriction on employer-financed supplemental retirement plans, Minnesota Statutes, Section 356.24, enacted in 1971 (Laws 1971, Chapter 222), a matching employer contribution to the Minnesota State Deferred Compensation Program or to a tax-sheltered annuity contract was authorized. Minnesota Statutes, Section 356.24, Subdivision 1, Paragraph (a), Clause (5), initially added by Laws 1988, Chapter 605, Section 9, permits a matching employer contribution, with a dollar-for-dollar match of employee contributions, generally subject to a $2,000 annual limit, if provided for in the personnel policy of the employing unit or in a collective bargaining agreement.

Attachment B

Background Information on Roth Individual Retirement Accounts and Related Investment Opportunities

In General

A Roth IRA is an individual retirement account (IRA) that is allowed under federal tax laws. It was named for its chief legislative sponsor, U.S. Senator William V. Roth Jr. of Delaware.

The Roth IRA provides no deduction for contributions, but instead provides a benefit that isn't available for any other form of retirement savings. If you meet certain requirements, all earnings are tax free when you or your beneficiaries withdraw them. Other benefits include avoiding the early distribution penalty on certain withdrawals, and eliminating the need to take minimum distributions after age 70½.

Advantages and Disadvantages of Roth IRAs

Advantages of a Roth IRA:

- At any time, the Roth IRA owner may withdraw up to the total of contributions.
- If there is money in the Roth IRA due to conversion from a traditional IRA, the Roth IRA owner may withdraw up to the total of the converted amount, as long as the five-year "seasoning" period has passed on the converted funds.
- Withdrawals of more than the total of Roth IRA contributions plus seasoned traditional IRA conversions are considered withdrawals of earnings, and are subject to tax and penalty if they are not qualified.
- Earnings withdrawals become automatically qualified in the tax year in which the participant reaches age 59.5 or becomes disabled, so long as the account was established for five or more years.
- Up to $10,000 in earnings withdrawals are considered qualified if the money is used to acquire a principal residence by the IRA owner, their spouse, or their lineal ancestors and descendants.
- If a Roth IRA owner dies, if the spouse is the sole beneficiary of that Roth IRA and if the spouse also owns a Roth IRA, the surviving spouse may combine the two Roth IRAs into a single account without penalty.
- Perhaps the greatest advantage of the Roth IRA is its lack of forced distributions based on age at age 70½ or later.

Disadvantages of a Roth IRA:

- The main disadvantage of a Roth IRA is that contributions are not tax deductible.
- There are heavy penalties for early withdrawals of earnings of a Roth IRA.
- The perceived tax benefit may never be realized if the participant does not live to retirement or much beyond.

Roth IRA Eligibility: Income Limits

Congress has limited who can contribute to a Roth IRA, based upon income. The ranges, for 2007, are:

- Single filers: Up to $99,000 (to qualify for a full contribution); $99,000-$114,000 (to be eligible for a partial contribution).
- Joint filers: Up to $156,000 (to qualify for a full contribution); $156,000-$166,000 (to be eligible for a partial contribution).

Roth Accounts in Addition to Roth IRAs

In addition to Roth IRAs, there are Roth 401(k) and Roth 403(b) accounts. A Roth 401(k) or Roth 403(b) account is not a new type of plan. A designated Roth account is a separate account under a section 401(k) plan or section 403(b) plan to which designated Roth contributions are made, and for which separate accounting of contributions, gains, and losses is maintained. This separate accounting requirement applies at the time the designated Roth contribution is contributed to the plan and must continue to apply until the designated Roth account is completely distributed.

Designated Roth contributions are a new type of contribution that can be accepted by new or existing 401(k) or 403(b) plans. This feature is permitted under a Code section added by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), effective for years beginning on or after January 1, 2006. If a plan adopts this feature, employees can designate some or all of their elective contributions as designated Roth contributions, (which are included in gross income) rather than traditional, pretax elective contributions. So, starting in 2006, elective contributions come in two types: traditional, pretax elective contributions (elective contributions are also referred to as elective deferrals) and designated Roth contributions. A designated Roth contribution is an elective deferral to a section 401(k) or 403(b) plan that has been designated irrevocably by an employee as not excludable from the employee's gross income and to be deposited into a designated Roth account under the plan.

The rules regarding frequency of elections apply in the same manner to both pretax elective contributions and designated Roth contributions and must be specified under the plan. The employer can make matching contributions on designated Roth contributions. However, only an employee's designated Roth contributions can be allocated to designated Roth accounts. The matching contributions made on account of designated Roth contributions must be allocated to a pretax account, just as matching contributions on traditional pretax elective contributions are.

Designated Roth contributions must be kept completely separate from previous and current 401(k) or 403(b) pretax elective contributions. A separate account must be established for each participant making designated Roth contributions.

Roth accounts are subject to a seasoning requirement, which means that they must be established for a five-taxable-year period.

The plan administrator or other responsible party with respect to a plan with a designated Roth account is responsible for keeping track of the five-taxable-year period for each employee and the amount of designated Roth contributions made on behalf of the employee. An employee has no reporting obligation with respect to designated Roth contributions under a section 401(k) or 403(b) plan.

Roth contributions are treated the same as pretax elective contributions when performing annual nondiscrimination testing.

.... moves to amend H.F. No. 1954; S.F. No. 2152, as follows:

Page 1, after line 5, insert:

"Section 1. Minnesota Statutes 2006, section 123B.02, subdivision 15, is amended to read:

Subd. 15. **Annuity contract; payroll allocation.** (a) At the request of an employee and as part of the employee's compensation arrangement, the board may purchase an individual annuity contract for an employee for retirement or other purposes and may make payroll allocations in accordance with such arrangement for the purpose of paying the entire premium due and to become due under such contract. The allocation must be made in a manner which will qualify the annuity premiums, or a portion thereof, for the benefit afforded under section 403(b) of the current Federal Internal Revenue Code or any equivalent provision of subsequent federal income tax law. The employee shall own such contract and the employee's rights under the contract shall be nonforfeitable except for failure to pay premiums. Section 122A.40 shall not be applicable hereto and the board shall have no liability thereunder because of its purchase of any individual annuity contracts. This statute shall be applied in a nondiscriminatory manner to employees of the school district.

(b) After January 1, 2008, a school board may make available to employees eligible to participate in the plan authorized by 403(b) a designated Roth 403(b) account option, as authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001."

Page 2, after line 6, insert:

"Sec. 3. Minnesota Statutes 2006, section 354A.021, subdivision 5, is amended to read:

Subd. 5. **Tax sheltered annuity program and fund.** (a) A teachers retirement fund association may establish a tax sheltered annuity program and fund meeting the requirements of section 403(b) of the Internal Revenue Code of 1986, as amended, which must include all assets which were acquired for the specific purpose of being credited to the program and fund and to which must be credited all employee contributions and employer contributions, if negotiated under a collective bargaining agreement, designated for this purpose and all interest income attributable to the assets of the program and fund.

(b) After January 1, 2008, a teachers retirement fund association may make available to teachers eligible to participate in the plan authorized by 403(b) a designated Roth 403(b) account option, as authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001.

Sec. 4. Minnesota Statutes 2006, section 471.615, is amended to read:

471.615 INDIVIDUAL ANNUITY FOR PUBLIC OFFICER, EMPLOYEE.

(a) At the request of an officer or employee and as part of a compensation arrangement, the governing body of any city, town, county, school district, public corporation, public authority, special district or other political subdivision, or the commissioner of administration of the state of Minnesota may negotiate and purchase an individual annuity contract from a company licensed to do business in the state of Minnesota for an officer or employee for retirement or other purposes and may make payroll allocations in accordance with such arrangement for the purpose of paying the entire premium due or to become due under such contract. The allocation shall be made in a manner which will qualify the annuity premiums, or a portion thereof, for the benefit afforded under Section 403(b) of the current Federal Internal Revenue Code or any equivalent provisions of subsequent federal income tax law. The officer or employee shall own such contract and have rights thereunder that shall be nonforfeitable except for failure to pay premiums. This section shall be applied in a nondiscriminatory manner to officers and employees of the political subdivisions herein named.

(b) The governing body or the commissioner, whichever applies, after January 1, 2008, may make available to employees eligible to participate in the plan authorized by 403(b) a designated Roth 403(b) account option, as authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001."

Renumber the sections in sequence and correct the internal references

Amend the title accordingly

This Document can be made available in alternative formats upon request

State of Minnesota

HOUSE OF REPRESENTATIVES

EIGHTY-FIFTH SESSION

HOUSE FILE NO. 1954

March 12, 2007
Authored by Kahn; Murphy, M.; Haws; Moe and Seifert
The bill was read for the first time and referred to the Committee on Governmental Operations, Reform, Technology and Elections

A bill for an act

relating to retirement; amending Minnesota State Colleges and Universities annuity provisions; allowing participation in a Roth account option; amending Minnesota Statutes 2006, section 136F.45, subdivision 1.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

Section 1. Minnesota Statutes 2006, section 136F.45, subdivision 1, is amended to read:

Subdivision 1. **Purchase.** (a) At the request of an employee, the board may negotiate and purchase an individual custodial account under section 403(b)(7) of the Internal Revenue Code, for an employee for retirement or other purposes from a company licensed to do business in Minnesota, and may allocate a portion of the compensation otherwise payable to the employee as salary for the purpose of paying the entire contribution due or to become due under the account. The allocation shall be made in a manner that will qualify the custodial account contributions, or portions thereof, for the benefit afforded under section 403(b)(7) of the current federal Internal Revenue Code or any equivalent provision of subsequent federal income tax law. The employee shall own the account and the employee's rights thereunder shall be nonforfeitable except for failure to pay contributions.

(b) At its discretion, and in the same manner provided in paragraph (a), the board may negotiate and purchase individual custodial accounts under section 403(b)(7) of the Internal Revenue Code, for employees of the Minnesota Office of Higher Education as defined in section 136A.03. Participation under this paragraph must be in accordance with any applicable federal law.

<u>(c) Beginning January 1, 2008, the board shall make available to employees eligible to participate in the plan authorized by 403(b)(7) a designated Roth 403(b) account option,</u>

as authorized by the Economic Growth and Tax Relief Reconciliation Act of 2001. To the extent that offering a designated Roth 403(b) account option increases the total necessary and reasonable expenses of the program and if the board is unable to negotiate a rebate of fees from the mutual fund or equivalent investment product providers, the board may charge the participants utilizing designated Roth 403(b) account option a fee to cover those expenses.