



H.F. 4109
(Murphy, M., by req.)

S.F. xxxx
(_____)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): IRAP/Teacher Plans
Relevant Provisions of Law: Minnesota Statutes, Section 354B.21
General Nature of Proposal: Permitting certain higher education IRAP members to elect defined benefit plan coverage
Date of Summary: March 27, 2008

Specific Proposed Changes

Permits any higher education Individual Retirement Account Plan (IRAP) member with past service in TRA or a first class city teacher plan to elect to transfer prospective coverage to the applicable defined benefit teacher plan and permits purchase of past service at full actuarial value using assets of the IRAP account.

Policy Issues Raised by the Proposed Legislation

1. Lack of justification for proposed change in coverage; appropriateness of permitting election following weak investment markets.
2. Lack of election for other IRAP members; likely request to expand this treatment.
3. Harm to defined benefit plans through adverse selection.
4. Appropriateness of permitting revision of irrevocable election.
5. Additional administrative burden on defined benefit plans to provide counseling and to compute full actuarial value service credit purchase amounts.

Potential Amendments

None.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Edward Burek, Deputy Director *EB*
RE: H.F. 4109 (Murphy, M., by request); S.F. xxxx: IRAP/Teacher Plans;
Permitting Certain Higher Education IRAP Members to Elect Defined Benefit
Plan Coverage
DATE: March 26, 2008

Summary of H.F. 4109 (Murphy, M., by request); S.F. xxxx

H.F. 4109 (Murphy, M., by request); S.F. xxxx amends Minnesota Statutes, Section 354B.21, which governs pension coverage elections by Minnesota State Colleges and Universities System (MnSCU) employees, by making the following changes:

1. Second Chance Election of Future Retirement Coverage. Any member of the Higher Education Individual Retirement Account Plan (IRAP) who had previous coverage by the Teachers Retirement Association (TRA) or a first class city teacher plan (the Duluth Teachers Retirement Fund Association (DTRFA), the Minneapolis Teachers Retirement Fund Association (MTRFA), or the St. Paul Teachers Retirement Fund Association (SPTRFA)) will have a second chance referendum prior to June 30, 2009, allowing them to terminate IRAP coverage and become an active member of the defined benefit teacher plan which previously provided coverage (TRA would provide coverage for the prior MTRFA members because the MTRFA was merged into TRA).
2. Purchase of Prior Plan Service Credit Gap. MnSCU employees who elect to switch prospective coverage to a defined benefit plan as specified above are permitted to purchase service credit in the defined benefit plan for the period now covered by IRAP within one year following the election under paragraph #1 above, at full actuarial value. The individuals would be authorized to cover the purchase using assets from the MnSCU/IRAP account, the Supplemental Retirement Plan (SRP), or other pretax investment accounts.

Background Information on the Higher Education Individual Retirement Account Plan and the Higher Education Supplemental Retirement Plan

MnSCU's IRAP plan stems from the late 1980s, when state university and state college teachers and related employees sought coverage by a defined contribution plan rather than the Teachers Retirement Association (TRA). IRAP was established in 1988 (Laws 1988, Chapter 709, Article 11) as a late addition to the conference committee report on the omnibus pension bill of that session. The IRAP plan, coded as Minnesota Statutes, Chapter 354B, 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 administrator personnel at MnSCU who wanted defined contribution rather than defined benefit plan coverage. The Higher Education IRAP plan does not cover faculty or administrators at the University of Minnesota.

Pension plans are classified either as defined benefit plans or defined contribution plans. Defined benefit plans establish a procedure or method (usually a formula) under which retirement annuities and benefits are calculated and are predeterminable, leaving the pension plan contribution requirement a variable to be assessed periodically through the preparation of an actuarial valuation. Defined contribution plans establish a pension plan contribution requirement, leaving the calculation of an eventual retirement annuity or benefit to occur at the conclusion of the member's working career, based on the intangibles of investment income, age at retirement, and expected mortality.

The argument made by initial proponents of a defined contribution plan for higher education faculty and administrators is that higher education faculty, as a group, are highly job-mobile in a national market. If the individual changes employment to another college in another state, the individual retains the full value of the IRAP account, and that account continues to grow in value over time due to the continuing investment earnings on the account. A defined benefit plan, in contrast, favors individuals who provide long service for a single employer or at least within the same multi-employer retirement system. Under a

defined benefit plan, an individual who leaves the plan after a few years may take a refund of the employee contribution plus six percent interest, but that does not include the employer contributions made on behalf of that employee, and the remainder of the investment growth on the account. A defined benefit plan, like TRA or one of the first class city teacher plans, may be a better choice for higher education faculty members who, through personal choice or lack of opportunity, are less mobile, 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 prior to hire or due to their past higher education service benefit plan coverage.

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 continuation of defined benefit coverage. Election rights and election procedures were frequently revised over the years. In 1994, the current procedure was established, which permits individuals with prior defined benefit plan coverage to continue that coverage or elect IRAP, and permits new hires to choose between IRAP and the defined benefit plan that would otherwise provide the coverage. The election is irrevocable, and under current law the election must occur within one year of commencing covered employment. Individuals hired prior to 1994 who did not have an opportunity to elect the coverage of their choice were given an election. At the current time, all MnSCU employees have the coverage which they freely elected.

The MnSCU higher education faculty is also covered by a plan called the Higher Education Supplemental Retirement Plan (SRP), which is also a defined contribution plan. Higher education faculty and administrators are covered by the SRP whether the individual is a TRA member or an IRAP member. The SRP was created in 1967. At that time, TRA provided the primary coverage for higher education faculty and the SRP was created to address deficiency in the benefits provided by TRA. Those deficiencies in TRA benefits were addressed decades ago when TRA moved to using the high-five average salary to compute benefits, and benefits were further enhanced in more recent years. The problem that the SRP was intended to address has been eliminated. Given that elimination, the purpose for continuing the SRP currently is unclear.

Prior Requests to Change the Coverage Election

In the years since 1994, there have been various requests to allow at least some MnSCU members to reverse the irrevocable plan coverage election. Some of these requests have been for single individuals, others for classes of individuals, such as a 2004 bill, H.F. 286 (Huntley): IRAP/Teacher Plans: Technical College Benefit Coverage Re-Election and Combined Service Annuity Inclusion. In 2002, bill drafts were made for a technical college teacher, Patrick Carey, who contended that he should be permitted to reverse his election of IRAP rather than defined benefit plan coverage because he had received inadequate advice prior to making the election and the time permitted for making an election was too short. In 2004 this request was broadened under H.F. 286 (Huntley) to include all technical college teachers who elected IRAP under the elections that occurred when the technical colleges were merged into MnSCU in 1995. These 2004 or earlier bills were not heard. A hearing request for H.F. 286 in 2004 was withdrawn by the author.

The requested second chance election in the 2004 bill likely stemmed from arguments made a few years earlier by Mr. Carey, the technical college teacher who requested another election. The contention was that technical college teachers, following the merger of the technical colleges into the MnSCU system, were given too short a time period to make the retirement coverage elections and that retirement coverage information provided to the technical college teachers was so considerable that it constituted an overload. The merger of technical college teachers into MnSCU and the requirement that technical college teachers elect between their prior retirement plan coverage and IRAP was provided for in 1994 (Laws 1994, Chapter 508, Article 1, Section 11, and Laws 1994, Chapter 532, Article 5, Section 1, Subdivision 2). The provisions were enacted on April 22, 1994, and May 2, 1994, respectively, and became effective 14 or 15 months later, on July 1, 1995. Thus, the process of formalizing the retirement coverage elections should have been no surprise for MnSCU, the four affected teacher retirement plans, the various teacher bargaining units, and technical college teachers. In 1995 (Laws 1995, Chapter 141, Article 4, Section 9), the actual retirement coverage election period was lengthened from 60 days to 90 days, in response to MnSCU and MnSCU employee bargaining representative requests. Thus, the chronology of the applicable legislation suggests that the technical college teacher transfer to MnSCU and their election of benefit coverage had a very long lead time during which the affected individuals could prepare for this retirement coverage election, and the Legislature specifically addressed the request for additional time to make the election. With more than a year of advance notice and with the choice being a simple one of the selection of defined benefit plan coverage or of defined contribution plan coverage, technical college

faculty members should have been well positioned to comprehend the choice that they were requested to make in 1995.

The only request for special consideration involving IRAP/defined benefit teacher plan elections which has been enacted occurred in Laws 2006, Chapter 271, Article 14, Section 8. The source bill was S.F. 2248 (Skoglund); S.F. 2462 (Wagenius). This involved a North Hennepin Community College employee who should have been given an opportunity to choose TRA coverage rather than continuing in IRAP during elections authorized in 1994. The campus notified individuals of the election by certified mail, and a review of records at the college indicated that the college failed to include this eligible individual in the mailing. The 2006 language permitted the individual to elect prospective TRA coverage, with additional authority to use the IRAP account or any other sources permitted by law to purchase service credit in TRA at full actuarial value back to the date of the 1994-1995 election.

The reluctance of the Legislature to reopen IRAP/TRA coverage elections except under extraordinary circumstances reflects concerns about plan cost and other policy matters. Retirement coverage elections are major decisions which should be made by the individual after careful study of the implications. Once an election is made, it cannot be undone without imposing costs and/or shifting risks to other parties. For these reasons, the applicable coverage provisions in current law specify that these elections are irrevocable. Allowing individuals to shift to TRA or first class city teacher plans, in some cases many years after employment commenced, creates adverse selection. Adding very young employees to defined benefit plans is likely to lower plan normal cost. Adding older employees has the opposite effect. The typical new MnSCU employee is likely to be older than a typical K-12 teacher. Allowing MnSCU employees to shift to TRA or a first class city teacher plan after years or even decades of MnSCU service, as is permitted under this draft language, would raise the defined benefit pension plan's normal cost. Also, the individuals who shift to these plans are a self-selected group. They will shift to these plans because they intend to remain in covered service and retire from the plan. (An individual who intends to leave MnSCU employment and move to other college teaching employment in another state would presumably want to remain with IRAP coverage, because the full value of the IRAP account would remain with the individual.) The turnover assumptions (probabilities of leaving covered employment at each age prior to retirement) used by the actuaries in determining defined benefit plan cost is violated, again serving to drive up the true cost of the plan.

The investment markets at a given point in time also create interest in switching to defined benefit coverage. In years when the markets are providing extraordinary returns there is little interest in shifting to defined benefit plans, because individuals are convinced they can do better investing their account than if they would if they had a defined benefit pension plan providing a benefit specified based upon age, high-five salary, and years of service. In bad investment times, individuals with defined contribution coverage are far more likely to seek a switch in coverage because the value of an individual's account will have minimal growth or may fall in value. Allowing a switch to a defined benefit plan moves all investment risk to the plan. However, individuals and retirement funds are investing in the same markets. When the markets provide individuals with weak positive or even negative returns, pension fund investment returns will also be weak, well below the 8.5 percent long-term return needed by the pension fund. In the last several months, investment returns have been very poor. Earlier in the calendar year it looked like the domestic stock market would provide double-digit returns. This was derailed by the weak housing sector and the fallout from high-risk mortgage loans. The outlook for economic growth in 2008 is now very poor, and the investment markets may not begin to recover until late 2008 or into 2009.

Discussion and Analysis

H.F. 4109 (Murphy, M., by request); S.F. xxxx would allow any member of the Higher Education Individual Retirement Account Plan (IRAP) who previously had coverage by Teachers Retirement Association (TRA) or a first class city teacher plan to have a one-time referendum to elect the prior defined benefit plan rather than continuing IRAP coverage and to purchase past service credit in the applicable defined benefit plan, at full actuarial value, for the period of time currently covered by the IRAP.

The bill raises a number of pension and related public policy issues for potential Commission consideration, as follows:

1. Lack of Justification for Change. The policy issue is the apparent lack of justification for the proposed change. Prior requests for permitting new elections of retirement coverage by subgroups of MnSCU employees were based on claims that single individuals (or certain groups of MnSCU employees, such as the technical college teachers who were merged into MnSCU in 1994-95) were not given sufficient

time or sufficient counseling to properly consider the implications of the retirement coverage choices. With the exception of the one MnSCU employee covered by the 2006 special legislation, no claim seemed sufficiently compelling to legislators to warrant a legislative hearing.

The current proposal is more global than any previous request. It would permit reelections by any MnSCU employee who elected IRAP, whether they were first hired decades ago or are very recent hires, and regardless of whether they are employed at an institution that was a university, college, or a technical college. The only restriction in the language is that the individual, at some prior point in their career, had TRA or first class city teacher plan coverage. This defines the group which, given perfect hindsight, may be most advantaged by being permitted to have another chance to elect defined benefit plan coverage. But the value of that advantage must be weighed by an equal cost that would be imposed on the defined benefit plans. Presumably, there would need to be some compelling claim of harm done by other parties to these MnSCU employees, but it is difficult to envision any claim of harm that could apply to so large and diverse a group.

2. No Proposed Reelection by Defined Benefit Plan Members. The issue is why no one who elected TRA or first class city teacher plan coverage will be permitted a second election. The draft only applies to individuals who first elected IRAP coverage.
3. Pressure for Further Expansion. The issue is that if the group identified in the bill draft is permitted another election, the Legislative Commission on Pensions and Retirement and the Legislature may find it very difficult not to offer another election to all MnSCU employees. Unless some strong argument can be made in testimony before the Commission why the group identified in the bill is more deserving than other MnSCU groups, equity would suggest that the proposed treatment should be extended to all. That, however, would increase the cost impacts on the defined benefit plans.

While those with prior TRA or first class city teacher plan coverage may desire another opportunity to combine prior TRA or first class city teacher plan coverage with prospective coverage by that particular defined benefit plan, those with past coverage by other Minnesota public plans may find that opportunity equally desirable. For example, the individual covered by the 2006 special legislation had no prior TRA coverage. However, the individual did have considerable past service covered by the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) due to other public employment before becoming a MnSCU employee. By gaining TRA coverage under the election offered to the individual by the special legislation, when she retires she can use the Combined Service Annuity provision (Minnesota Statutes, Section 353.30) to combine the TRA service credit she will earn following the transfer of coverage to that plan with the PERA service credit, to create an annuity as though the entire service were covered by TRA. Thus, legislators may be concerned that any MnSCU employees with IRAP coverage who have any past service covered by any Minnesota defined benefit plan may find another election opportunity to be desirable. And if the group is expanded to that extent, the Legislature may be compelled to permit all MnSCU employees, even those with no prior coverage, to have a reelection.

4. Implications of Highly Educated Coverage Group. The Commission may wish to consider that most MnSCU employees have college degrees and many have advanced degrees. Given the educational level of this coverage group, this group should be highly capable of understanding information provided to them prior to the individual electing the form of pension coverage each has chosen.
5. Harm to Defined Benefit Plans. The issue is that reelections, if permitted, will impose costs on the defined benefit plans due to adverse selection, placing upward pressure on normal costs and amortization requirements.
6. Appropriateness of Allowing Second Chance Elections In General. The policy issue is the appropriateness of providing a second chance opportunity to elect retirement plan coverage when the initial election was provided to be a single election opportunity. Current law specifies that these elections are to be irrevocable. Retirement elections are serious decisions with serious ramifications if the choice is made haphazardly or is made incorrectly. If elections are allowed to be revisited, it is likely that the process making the initial election will be less deliberate rather than more deliberate. Second elections in retirement coverage also have the "broken egg" phenomenon, where it is very difficult to recreate or restore the status that the person would have had if the person had made the second choice initially. If the Commission is to be convinced that a second chance election is appropriate to be authorized in this instance, the Commission will need substantial testimony from affected faculty members, from the first class city teachers retirement fund associations, from TRA,

and from MnSCU about why initial elections were flawed and how the process of making the second election will be different, more informative, and more serious.

7. Appropriateness of a Second Chance Coverage Election Following Weak, Turbulent Investment Period. The policy issue is the appropriateness of providing a second chance opportunity to elect alternative retirement plan coverage following a period of troubled investment markets. In the first years of this century the stock market provided weak or negative returns. Now, after a few years of moderately good returns the markets are again troubled, by a weak housing sector and foreclosures and general problems with sub-prime loans. As a defined contribution plan, IRAP places the risk of investment performance on the individual member. In the mid 1980s through the 1990s, the investment markets were very strong and opportunities for significant investment performance were considerable. Selecting highly portable defined contribution plan retirement coverage may have looked very favorable. Now, with investment markets that are far less generous and possibly with more limited alternative employment opportunities, defined contribution retirement coverage may be less favorably viewed. Those changing circumstances, however, are unlikely to be a sufficient reason to allow for a second chance coverage election.
8. Appropriateness of the Additional Administrative Burden on the Teacher Retirement Plans and MnSCU. The policy issue is the considerable administrative burden that would be placed on MnSCU and on the teacher retirement plans by the proposed second chance retirement coverage election and by the proposed service credit purchase authorization. For thousands of individuals, it may be necessary to examine records to determine whether the individual has past defined benefit teacher plan coverage, to establish whether the individual is eligible for the election. Hundreds or thousands of individuals may request information on the cost of purchasing prior service. There may be a need for MnSCU to share salary information with the defined benefit plan administration to allow the plan to determine these purchase prices. Despite an extensive effort, some will be missed, and at future dates the Legislature will be requested to allow additional elections.

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State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-FIFTH
SESSION

HOUSE FILE NO. 4109

March 19, 2008

Authored by Murphy, M., by request,
The bill was read for the first time and referred to the Committee on Governmental Operations, Reform, Technology and Elections

1.1 A bill for an act
1.2 relating to retirement; the Minnesota State Colleges and Universities system
1.3 individual retirement account plan; permitting a revision in prior retirement
1.4 benefit coverage elections; amending Minnesota Statutes 2006, section 354B.21,
1.5 by adding a subdivision.

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

1.7 Section 1. Minnesota Statutes 2006, section 354B.21, is amended by adding a
1.8 subdivision to read:

1.9 Subd. 5a. Second chance coverage election. (a) Notwithstanding any provision
1.10 of this section to the contrary, an active member of the plan specified in this chapter
1.11 who had prior plan coverage by the Duluth Teachers Retirement Fund Association, the
1.12 St. Paul Teachers Retirement Fund Association, the Minneapolis Teachers Retirement
1.13 Fund Association, or the Teachers Retirement Association, may elect future retirement
1.14 coverage under paragraph (b) and past retirement coverage under paragraph (c) on or
1.15 before June 30, 2009.

1.16 (b) For service as a Minnesota State Colleges and Universities system employee
1.17 rendered after the end of the month in which the election under paragraph (a) is made, the
1.18 eligible person under paragraph (a) may select coverage by one of the following:

1.19 (1) the Duluth Teachers Retirement Fund Association governed under chapter 354A
1.20 if the person was an active member of that retirement plan before coverage by the plan
1.21 specified in this chapter commenced;

1.22 (2) the St. Paul Teachers Retirement Fund Association governed under chapter 354A
1.23 if the person was an active member of that retirement plan before coverage by the plan
1.24 specified in this chapter commenced; or

2.1 (3) the Teachers Retirement Association governed under chapter 354 if the person
2.2 was an active member of that retirement plan or of the Minneapolis Teachers Retirement
2.3 Fund Association before coverage by the plan specified in this chapter commenced.

2.4 (c) If a person elects alternative retirement coverage under paragraph (b), the
2.5 person also may elect to receive allowable service and covered salary credit from the
2.6 same retirement plan for any prior Minnesota State Colleges and Universities system
2.7 employment covered by the plan specified in this chapter before the date of the coverage
2.8 change under paragraph (b). If the past retirement coverage election is made, the balance
2.9 of the person's account in the individual retirement account plan must be transferred by the
2.10 Minnesota State Colleges and Universities system chancellor to the applicable retirement
2.11 plan as of the end of the month in which the election is made. The balance, if any, of the
2.12 prior service credit purchase payment under section 356.551, is payable by the person
2.13 within 30 days of the account balance transfer. If permitted under law, the person may also
2.14 use assets from the person's supplemental retirement plan under chapter 354C to make
2.15 the payment. If the payment of the balance of the prior service credit purchase amount is
2.16 not made in a timely fashion, the allowable service credit of the person must be adjusted
2.17 in proportion to the relationship that the total amount of the purchase payment amount
2.18 received bears to the total calculated prior service credit purchase payment amount, but
2.19 must not exceed the applicable period of past employment.

2.20 (d) The second chance coverage election under paragraph (b) must be made in
2.21 writing and is irrevocable. The past service credit election under paragraph (c) must be
2.22 made in writing, is irrevocable, and must be made within one year of the election under
2.23 paragraph (b), but not after the person's termination of employment by the Minnesota
2.24 State Colleges and Universities system.

2.25 (e) Elections under paragraphs (b) and (c) shall be made on forms provided by the
2.26 chief administrative officer of the Teachers Retirement Association or applicable first-class
2.27 city teacher fund association. Before October 1, 2008, the Minnesota State Colleges
2.28 and Universities system shall notify all eligible individuals under paragraph (a) of the
2.29 option to have an election under this subdivision. The chief administrative officers of the
2.30 Teachers Retirement Association, the first-class city teacher retirement fund associations,
2.31 and the Minnesota State Colleges and Universities system are jointly responsible for
2.32 providing educational materials to help members understand the consequences of revising
2.33 retirement coverage.

2.34 **EFFECTIVE DATE.** This section is effective the day following final enactment.