H.F. 1953
(Kahn)

S.F. 2154
(Olson, M.)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	IRAP and TRA
Relevant Provisions of Law:	Minnesota Statutes, Section 354B.21, Subdivision 2
General Nature of Proposal:	Transfer of membership by certain MnSCU faculty members
Date of Summary:	April 4, 2008

Specific Proposed Changes

The proposed legislation adds an additional retirement coverage election opportunity for MnSCU faculty members at the time tenure is achieved, with a full actuarial value service credit purchase in TRA if defined benefit plan coverage is elected.

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of permitting second chance retirement coverage election by MnSCU faculty members.
2. Appropriateness in light of uncertainties about tenure and related concerns.
3. High potential cost of full actuarial value service credit purchases.
4. Appropriateness of changing retirement benefit plan default.

Potential Amendments

H1953-1A (substantive) changes MnSCU faculty member retirement coverage default options if no formal election is made to TRA rather than MnSCU-IRAP.

H1953-2A (technical) eliminates obsolete language, updates language and clarifies the full actuarial value purchase payment option with the appropriate statutory citation.

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director LAM

RE: H.F. 1953 (Kahn); S.F. 2154 (Olson, M.): IRAP and TRA; Transfer of Membership by Certain MnSCU Faculty Members

DATE: May 9, 2007

Summary of H.F. 1953 (Kahn); S.F. 2154 (Olson, M.)

H.F. 1953 (Kahn); S.F. 2154 (Olson, M.) amends Minnesota Statutes, Section 354B.21, Subdivision 2, a provision of the Individual Retirement Account Plan of the Minnesota State Colleges and Universities System (MnSCU-IRAP) permitting MnSCU faculty members to elect prospective retirement coverage by the Teachers Retirement Association (TRA) within one year of starting employment, by permitting MnSCU faculty members to elect TRA coverage within one year of achieving tenure and requiring those faculty members to purchase service credit at the full actuarial value purchase price.

Background Information on the Individual Retirement Account Plan

Background information on the Higher Education Individual Retirement Account Plan is set forth in Attachment A.

Discussion and Analysis

H.F. 1953 (Kahn); S.F. 2154 (Olson, M.) adds a second opportunity for a faculty member employed by the Minnesota State Colleges and Universities System (MnSCU) to change from retirement coverage by the Individual Retirement Account Plan (IRAP) to retirement coverage by the Teachers Retirement Association (TRA) within one year of the date on which the faulty member achieves tenure. The selection of TRA coverage also must include the purchase of prior MnSCU faculty employment at the full actuarial value purchase payment amount.

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

1. Appropriateness of Permitting Second Chance Retirement Coverage Election by MnSCU Faculty Members. The policy issue is the appropriateness of permitting faculty members and other administrative personnel of the Minnesota State Colleges and Universities System (MnSCU) an additional opportunity to elect retirement coverage for their MnSCU employment. In Minnesota public employment, public retirement plan coverage is generally mandatory and public employees generally do not have any options in their retirement coverage. Most Minnesota public employees are covered by defined benefit plan retirement programs, which are particularly well suited for career employees. Minnesota public employees with a choice between defined benefit plan coverage and defined contribution plan coverage, which is well suited for shorter duration employees, are limited to MnSCU faculty members and some administrative personnel and to state employees employed by the Legislature, constitutional officers, and agency, department, division, and bureau heads and their deputies. For MnSCU faculty members and affected administrative personnel, the choice of retirement coverage is between the Higher Education Individual Retirement Account Plan (IRAP), a defined contribution plan, or the Teachers Retirement Association (TRA) defined benefit plan, with the choice to be made within one year of initial employment. For affected state employees, the choice of retirement coverage is between the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), a defined contribution plan, or the MSRS General State Employees Retirement Plan (MSRS-General), a defined benefit plan, with the election to be made within one year of initial eligibility for MSRS-Unclassified coverage and with an option to transfer to MSRS-General upon the person attaining ten years of state employment before the termination of state employment. The argument made in summary fashion by the Inter Faculty Organization (IFO), the collective bargaining representatives of state university faculty, on its website, is that a second chance election upon acquiring tenure allows faculty members the best opportunity to determine the retirement coverage with the best fit in their circumstance. While the faculty member's career is potentially more certain at that point, it is unclear that the faculty member is actually in a better position to predict the future and to make a second irrevocable election about retirement coverage at this time. Even if the faculty member is in a better position to make a final

choice, that situation means that the applicable defined benefit retirement plan will bear a significant "selection against the fund" risk by gaining risk pool members who deviate significantly from the average plan membership.

2. Appropriateness in Light of Uncertainties about Tenure and Related Concerns. The policy issue is the appropriateness of triggering a second chance benefit plan coverage election on acquiring tenure when tenure acquisition is variable as to the length of prior employment and when there are other potential timing difficulties. Attached are excerpts from the current Inter Faculty Organization (IFO)-Minnesota State Colleges and Universities System (MnSCU) contract relating to tenure, which appears to indicate that the probationary period before gaining tenure can range from one year to five years. The tenure periods and tenure requirements for other faculty and related employee bargaining units may be similar, although the Commission staff has not attempted to compile a comparison of each. Although achievement of tenure might indicate that the MnSCU faculty member or comparable employee has a clearer picture of the person's long-term career track, it is not necessarily a significantly better time to make the selection and the variability of pre-tenure probationary periods will raise concerns about the capability of MnSCU or the Teachers Retirement Association (TRA) to provide appropriate counseling. Additional testimony from MnSCU and from MnSCU employee representatives may be necessary to determine whether a grant of tenure is as opportune a time for making this second chance irrevocable benefit coverage election as the IFO contends.

3. High Potential Cost of Full Actuarial Value Service Credit Purchases. The policy issue is the appropriateness of implementing a system of benefit plan elections that will produce regular periodic prior service credit purchases with a sizable full actuarial value purchase payment price. Because service credit purchases alter the risk pool after the fact and permit individuals to select from options to their benefit and with a potential liability increase to the retirement plan, the normal contribution structure of the retirement plan is not an adequate way to fund these purchases and the Commission has resolved over the past 30 years that service credit purchases are to be funded with a full actuarial value payment based on the benefit obtained by the purchase. The full actuarial value prior service credit purchase payment amount is frequently a very large dollar amount, likely greater than the IRAP account balance amassed during the pre-tenure grant period. The large service credit purchase payment required will likely limit the actual utilization of the second chance election by MnSCU faculty and will likely disappoint a number of potential purchasers, who may then complain to their local legislators and seek personal special legislation, likely unsuccessfully. If the Inter Faculty Organization (IFO), the Minnesota State Colleges and Universities System (MnSCU), or other MnSCU bargaining representatives could provide information on the average age at which new faculty members are hired, the average length of time that new faculty serve on probation before gaining tenure, and the average salary at the grant of tenure, the Teachers Retirement Association (TRA) could provide a sense of the average full actuarial value service credit purchase payment amount, which could provide guidance to the Commission on this policy issue.

4. Appropriateness of Changing Retirement Benefit Plan Default. The policy issue is whether the actual or perceived problem that gave rise to the proposed legislation would be better resolved by changing the default retirement coverage for newly employed Minnesota State Colleges and Universities System (MnSCU) faculty and comparable staff from the Higher Education Individual Retirement Account Plan (IRAP) to the Teachers Retirement Association (TRA). If new MnSCU faculty believe that they would be better off with defined benefit plan retirement coverage rather than defined contribution plan retirement coverage and if most MnSCU faculty members achieve tenure, reducing the chief advantage they may find in IRAP coverage, then TRA would be the better default coverage option. It is less financially problematic to transfer past contributions out of a defined benefit plan for deposit into a defined contribution plan than it is to utilize full actuarial value prior service credit purchases to convert past defined contribution retirement coverage into defined benefit retirement coverage.

   If this change of the default option appears to the Commission to be an appropriate way to address the perceived or actual problem giving rise to this proposed second chance election legislation, **Amendment H1953-1A** would change the default from IRAP to TRA.

Technical Amendment

Amendment H1953-2A eliminates some obsolete portions of the current provision, updates the language style and usage of the provisions, and clarifies the full actuarial value service credit purchase payment amount by adding the appropriate statutory citation.

Attachment A

Background Information on the Higher Education Individual Retirement Account Plan (IRAP)

1. Difference Between Defined Contribution Retirement Plans and Defined Benefit Retirement Plans

   There are two major factors in designing retirement plans and attempting to fix or make pre-determinable one or the other factors constitutes the difference between defined contribution retirement plans and defined benefit retirement plans. When one factor is fixed or made pre-determinable, the other factor is automatically made variable. The factors are the level of the benefits and the level of contributions.

   In a defined contribution retirement plan, the level of contributions or the amount of member and/or employer funding are specified or fixed in some manner, making the level of eventual benefits and/or their duration the variable factor. Most commonly, in a defined contribution plan, the funding of the plan is specified as a percentage of the covered payroll of plan members. Those contributions, allocated to individual accounts and frequently invested based on individual selection, along with any investment return obtained, constitute the benefit available to the plan member upon termination of employment or retirement. Most commonly, the individual account balance is payable in a lump sum upon the termination of plan coverage or is available to be transferred to an insurance company for the purchase of a retirement annuity. Some retirement plans that generally are classified as defined contribution plans permit the individual account balance amount to be converted into a retirement annuity within the retirement plan at a specified rate, although the assumption of that retirement annuity mortality risk actually defines the post-retirement benefit amount and subjects the retirement plan to potential future mortality and investment return experience losses and a chance for an unfunded actuarial accrued liability, akin to a defined benefit plan.

   In a defined benefit retirement plan, the level of benefits at the time of retirement or after retirement are specified or fixed in some manner, making the level of contributions or the amount of funding from period to period the variable factor. Most commonly, in a defined benefit plan, the retirement benefit is specified as a percentage of the final salary or of the final average salary per year of credited service rendered. Thus, the plan tracks and awards allowable service credit and salary credit and amasses a liability for the service and salary credit rendered to date that requires the periodic calculation and assessment by an actuary. The resulting actuarial valuation report both assesses the amount of actuarial accrued liability that the retirement plan has amassed to date and the amount of total contributions needed for the future plan year or plan years. Most commonly, in defined benefit plans, any lump sum amount is limited to a pre-retirement employment termination member contribution refund, with the regular retirement benefit only payable as a retirement annuity. Generally, a regular retirement annuity has optional equivalent value forms that open for election by the plan member. Retirement plans that are defined benefit plans can take on defined contribution retirement plan aspects, such as determining post-retirement adjustment amounts from the amount of investment gain in whole or in part generated by the plan.

2. Contrasting Development of Defined Contribution Plans Between The Private Sector And The Public Sector

   In the private sector as a whole, defined contribution plans are very prevalent, while in the public sector as a whole, defined benefit plans predominate. However, many of those private sector defined contribution plans have been established and are maintained by sole proprietor businesses or similar small employers. Among industrial employers in the private sector and other large employers, defined benefit plans are more prevalent. Public sector pension plans, which are typically very large membership single employer or multiple employer pension plans, tend to follow the private sector industrial model in utilizing defined benefit pension plans. In the private sector, defined contribution plans, in the form of Internal Revenue Code Section 401(k) plans are relatively common and generally function as supplemental thrift or savings plans. In the public sector, supplemental defined contribution pension plans also occur frequently. Primary coverage private sector pension plans, either defined benefit plans or defined contribution plans, are most commonly funded by the employing unit, while primary coverage public sector pension plans are most commonly funded by a combination of member and employer contributions. Supplementary pension plans, both private sector and public sector, are almost always funded by member contributions and frequently include some employer funding.

3. Higher Education Individual Retirement Account Plan (IRAP)

Public pension coverage for public university and public college faculty and upper level administrators frequently follow the private and nonprofit sector practice of utilizing defined contribution plan coverage, frequently through the use of the Teachers Insurance and Annuity Association-College Retirement Equity Fund (TIAA-CREF). The coverage generally either is exclusive defined contribution plan coverage or is the inclusion of defined contribution plan coverage as an elective alternative to the defined benefit plan coverage otherwise applicable to governmental employees at that level.

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 (Laws 1988, Chapter 709, Article 11), 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.

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 (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 1968. 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 use of 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.

The Minnesota State University System and the Minnesota State Community College System shifted to defined contribution plan coverage as an option in the form of the Individual Retirement Account Plan (IRAP) in the late 1980s. Technical College faculty members were added to IRAP in the mid-1990s, when IRAP was also shifted from being the exclusive type of pension benefit coverage for new hires to an option as an alternative to defined benefit plan coverage by the statewide Teachers Retirement Association (TRA) or by one of the first class city teacher retirement fund associations. The creation of IRAP was as a result of active lobbying by the union representatives of State University and State Community College faculty members. Coverage by IRAP is the primary retirement vehicle for teaching personnel employed by the Minnesota State Colleges and Universities (MnSCU), which is the successor to the three prior higher education systems.

Excerpts of the

IFO
Inter Faculty Organization

2005-2007 Master Contract

between the

Minnesota State College and University
Board of Trustees
and the
Inter Faculty Organization

October, 2005

Minnesota State Colleges and Universities
Office of the Chancellor
Labor Relations Division
30 7th Street East, Suite 350
St. Paul, Minnesota 55101

ARTICLE 21
Appointment of Faculty

Section A. Notice of any vacancies

Section B. Appointment Date.

Section C. Information.

Section D. Initial Assignment to Rank. Qualifications for initial assignment to faculty rank are to be as follows:

Professor: Earned doctorate or other appropriate degree, plus ten (10) years of collegiate-level teaching or related experience.

Associate Professor: Earned doctorate or other appropriate degree, plus seven (7) years of collegiate-level teaching or related experience.

Assistant Professor: Earned doctorate or other appropriate degree.

Instructor: Appropriate preparation.

Normally, no faculty member may be assigned to a rank more than one (1) level below that for which he/she is qualified. In each instance, the President shall establish what constitutes appropriate experience and appropriate degrees for the purpose of assignment to rank.

Section E. Appointment. Appointments shall be one of the following seven (7) types:

Subd. 1. Fixed-Term Appointments.

Subd. 2. Non-Tenure Track Appointments.

Subd. 3. Adjunct Appointments.

Subd. 4. Community Faculty Appointments. See Article 10, Section J.

Subd. 5. Athletic Appointments. See Article 10, Section G.

Subd. 6. Probationary Appointments.

a. Definition. A probationary appointment is for a stated term and is designed to lead to tenure. During such term the appointee is being evaluated in accordance with Article 22 for purposes of determining whether an appointment with tenure shall be offered in accordance with Article 25 not later than the end of the stated term. Probationary appointments may be for one (1) year or other stated periods and may be terminated prior to the end of the stated term subject to the conditions in Articles 24 and 25.

b. Length. The total period of probationary service prior to the acquisition of tenure shall not be less than one (1) year in the university and shall not exceed five (5) years of full-time equivalent service. For those persons who, because of prior part-time service, reach four (4) FTE years of service during the academic year, the probationary period shall end at completion of that academic year.

c. Computation. The probationary period shall include all tenured, probationary, non-tenure track, except as provided in Subd. 6.b., and fixed-term employment served within the previous twelve (12) years in the faculty member's university together with such previous higher education service in other institutions up to a maximum of four (4) years if approved in writing by the President at the time of initial employment. If the service which will be counted is from a higher education institution outside the Minnesota state universities, the prospective faculty member will be advised of his/her right to have a probationary period of five (5) years in length, and that accepting a shortened probationary period at the time of hire is a waiver of that right. Faculty members accepting shortened probationary periods shall sign a waiver of the right to the full five (5) years. Where a shortened probationary period is accepted, notice of such acceptance shall be conveyed to the department and to