



**H.F. 2170**  
(Kahn)

**S.F. 2153**  
(Olson, M.)

### **Executive Summary of Commission Staff Materials**

*Affected Pension Plan(s):* MnSCU IRAP and Supplemental Plan  
*Relevant Provisions of Law:* Minnesota Statutes,  
*General Nature of Proposal:* MnSCU IRAP and Supplemental Plan limit on administrative expenses and required unclaimed account procedures  
*Date of Summary:* April 4, 2008

### **Specific Proposed Changes**

The proposed legislation defines unclaimed MnSCU-IRAP accounts, limits the amount that can be expended for MnSCU-IRAP administrative expenses, and establishes a procedure for abandoned MnSCU-IRAP monies.

### **Policy Issues Raised by the Proposed Legislation**

1. Adequacy of the proposed unclaimed plan account amounts definition.
2. Appropriateness of proposed cap on administrative expenses.
3. Unclear rationale for the cap given the current "reasonable and necessary" expense standard.
4. Unclear positive function of the IRA-SRP Advisory Committee and annual detailed administrative expense report.
5. Appropriateness of funding administrative expenses from abandoned accounts.
6. Adequacy of the process for recovering abandoned amounts.

### **Potential Amendments**

- H2170-1A refines the unclaimed MnSCU-IRAP account definition to cover the specific instances that give rise to abandoned accounts.
- H2170-2A clarifies the abandonment standard for unclaimed MnSCU-IRAP accounts by adding a specific Internal Revenue Code citation.
- H2170-3A adds minimum time period elapse requirement for abandoned MnSCU-IRAP accounts, replicating the five-year abandonment period applicable to the MSRS-Unclassified Program.
- H2170-4A Revises proposed change allowing abandoned MnSCU-IRAP accounts to be used to offset administrative expenses.



TO: Members of the Legislative Commission on Pensions and Retirement  
FROM: Lawrence A. Martin, Executive Director *JAM*  
RE: H.F. 2170 (Kahn); S.F. 2153 (Olson, M.): MnSCU IRAP and Supplemental Plan Limit on Administrative Expenses and Required Unclaimed Account Procedures  
DATE: May 11, 2007

Summary of H.F. 2170 (Kahn); S.F. 2153 (Olson, M.)

H.F. 2170 (Kahn); S.F. 2153 (Olson, M.) amends portions of Minnesota Statutes, Chapters 354B and 354C, the statutory chapters governing the Individual Retirement Account Plan (IRAP) applicable to various Minnesota State Colleges and Universities System (MnSCU) faculty members and the Higher Education Supplemental Retirement Plan, by defining the term "unclaimed plan account amounts" for both plans (Sections 1 and 5), by setting an annual limit on administrative expenses for both plans (Sections 2 and 4), and by establishing a procedure for the disposition of abandoned public pension plan amounts (Section 3).

Background Materials

Background information applicable to the broad subject matter of the proposed legislation is attached:

1. Attachment A contains background information on the Higher Education Individual Retirement Account Plan (IRAP).
2. Attachment B contains background information on the Higher Education Supplemental Retirement Plan (SRP).

Discussion and Analysis

H.F. 2170 (Kahn); S.F. 2153 (Olson, M.) sets a cap on the administrative expense of the Higher Education Individual Retirement Account Plan (IRAP) and the Higher Education Supplemental Retirement Plan and establishes a procedure for disposing of unclaimed IRAP or Supplemental Retirement Plan (SRP) accounts to offset plan administrative expenses.

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

1. Adequacy of the Proposed Unclaimed Plan Account Amounts Definition. The policy issue is the adequacy of the proposed definition of unclaimed plan account amounts. The proposed legislation defines the term as the distributable accounts of a plan participant that the plan administrator is unable to locate under the due diligence requirements of the Internal Revenue Service (IRS). The meaning of the word "distributable" is not readily discernible, unless it means the account of a Higher Education Individual Retirement Account Plan (IRAP) participant who has terminated Minnesota State Colleges and Universities System (MnSCU) employment or who has died, the two occurrences that give rise to the payment of benefits from either plan. If it does mean those two occurrences and only those two occurrences, the definition could be better rendered by specifically referencing those two circumstances rather than the less clear "distributable" reference. **Amendment H2170-1A** attempts to rework the definition to specify those two circumstances.

The definition sets the standard of abandonment based on the due diligence requirements of the IRS, although it is unclear what those IRS due diligence requirements are and the appropriateness of tying this regulatory provision to a federal provision that is not clearly established by legislative enactment, rulemaking process, or other known impartial procedure. The Commission staff attempted to identify what constitutes the federal IRS due diligence requirements in this regard and could not identify any specific regulation. If the proponents of this abandonment standard have a particular provision of the Internal Revenue Code or Internal Revenue Regulations in mind, it would be better legislative policymaking to cite the code provision or the regulation. Also, since the IRS exists primarily as a revenue raising agency rather than as a dispassionate policymaker, citing a current known standard rather than automatically utilizing a standard that could change over time for federal revenue raising reasons is also better policymaking. **Amendment H2170-2A** attempts to clarify the abandonment standard.

Finally, there is no specific time period that must elapse before an account is considered to be abandoned. In a comparable situation, the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), a defined contribution plan, Minnesota Statutes, Section 352D.09, Subdivision 5, requires that five years elapse since the termination of active employment or the participant reaches age 70, whichever is later, or that ten years elapse since the participant's death. While the abandonment provision may be prompted by a desire to cover a current plan administration cost problem with a different funding source than member changes and to immediately capture some available revenue amounts, some balance against undue haste would appear to be appropriate and some argument of a different standard than is applicable in a comparable situation should be reviewed. **Amendment H2170-3A** replicates the timeframes for abandonment applicable to the MSRS-Unclassified Program.

2. Appropriateness of Proposed Cap on Administrative Expenses. The policy issue is the appropriateness of the proposed annual maximum amount of administrative expenses for the Higher Education Individual Retirement Account Plan (IRAP) or the Higher Education Supplemental Retirement Plan (SRP). The proposed annual cap is set at an amount to be determined by multiplying the number of participants by \$20. Although the Minnesota State Colleges and Universities System (MnSCU) website does not provide specific information on the number of faculty members and other IRAP or SRP eligible personnel, it does indicate that the system employs 18,000 faculty and other staff. If half of that number is assumed to be covered by the two plans, the maximum budget for each plan would be \$180,000 annually. The amount proposed for a cap is not indexed, so if the maximum is close to the current administrative expense or is actually smaller than the current administrative expense, the cap will become outdated initially or in short order and would require frequent revisiting by the Legislature over time.
3. Unclear Rationale for the Cap Given the Current "Reasonable and Necessary" Expense Standard. The policy issue is the appropriateness of the proposed administrative expense maximum in light of the current statutory constraint on administrative expenses, which require that expenses be both necessary and reasonable. The initial 1988 Individual Retirement Account Plan (IRAP) law (Laws 1988, Chapter 709, Article 11) had no provision for administrative expenses and, presumably, the administrative expenses of the early plan were borne by the State University Board and the Community College Board. Administrative expenses of IRAP were first addressed in 1993 (Laws 1993, Chapter 239, Article 2, Section 5), when those expenses were made the obligation of plan participants, with the expenses of IRAP investments in the Minnesota Supplemental Investment Fund handled under the general Minnesota Supplemental Investment Fund law and with the expenses of IRAP investments in outside vendors limited to two percent of the total contribution. In 1995 (Laws 1995, Chapter 141, Article 4, Section 13), IRAP was recodified and the pre-1995 administrative expenses provision was retained with the single addition of the requirement that the expenses be necessary and reasonable. Presumably, if all administrative expenses meet the "necessary" and the "reasonable" tests, there should be little dispute over those expenses and those disputes should be quickly resolved, but that apparently has not been the case. Representatives from the Minnesota State Colleges and Universities System (MnSCU) and from MnSCU faculty groups should be requested to testify why the "necessary" and "reasonable" standard for administrative expenses has not resolved disputes over administrative expenses.
4. Unclear Positive Function of the IRA-SRP Advisory Committee and Annual Detailed Administrative Expense Report. The policy issue is the appropriateness of the proposed cap on administrative expenses in light of the existence of a participant advisory committee for the Individual Retirement Account Plan (IRAP) and the Supplemental Retirement Plan (SRP) and the requirement that the Minnesota State Colleges and Universities System (MnSCU) Board of Trustees annually submit a detailed administrative expense report to the advisory committee. The IRAP-SRP advisory committee was created in 1997 (Laws 1997, chapter 241, Article 3, Section 7), and appears to have been an attempt to resolve outstanding disputes between the various collective bargaining representatives of plan participants and MnSCU, including administration and administrative expense issues. The detailed administrative expense report requirement was also added in 1997 (Laws 1997, Chapter 241, Article 3, Section 8). Notwithstanding these structural attempts to resolve apparent disputes over IRAP and SRP administrative expenses, there is interest in further constraints on IRAP and SRP administrative expenses, presumably by participant participants, and some additional testimony about any disputes and about the rationale for the proposed corrective provisions should be heard.
5. Appropriateness of Funding Administrative Expenses from Abandoned Accounts. The policy issue is the appropriateness of funding administrative expenses of two retirement plans, the Individual Retirement Account Plan (IRAP) and the Supplemental Retirement Plan (SRP), from the proceeds of

canceling abandoned accounts. Although no information on the number of abandoned accounts or the amount of assets attributable to abandoned accounts is included on the Minnesota State Colleges and Universities System (MnSCU) website, the State University Inter Faculty Organization (IFO) website indicates that the total for abandoned IRAP and SRP accounts is \$1.25 million. Before committing to funding some or all of the administrative expenses of the two plans, it would be appropriate for the Commission to ascertain the number of “abandoned” accounts, the duration of the perceived “abandonment,” the amount of assets in “abandoned” accounts, and the pattern or frequency of account “abandonments.” If the number of abandoned accounts is large, but the length of time over which the account has been determined to be abandoned is short and there is some significant potential for an eventual demand for reinstatement of the account, the use of abandoned accounts to fund ongoing expenses may be budgetarily difficult and inappropriate as a matter of policy. While the IFO assertion that abandoned accounts within the Teachers Retirement Association (TRA), the Minnesota State Retirement System (MSRS), and the Public Employees Retirement Association (PERA) do cancel back to the retirement fund is true, the actual disposition of abandoned TRA, MSRS, or PERA accounts is different than the disposition proposed here because of the nature of the plans. TRA, MSRS, and PERA are defined benefit plans, where any canceled account is credited to a self-insured fund, rather than to the actual disbursements proposed in the legislation. If the Commission believes that the proposed use of abandoned IRAP and SRP accounts to defray IRAP and SRP administrative expenses, **Amendment H2170-4A** would eliminate the abandoned account portion of the proposed legislation.

6. Adequacy of the Process for Recovering Abandoned Amounts. The policy issue is the adequacy of the process in the proposed legislation for recovering amounts canceled from abandoned accounts that are reclaimed by the participant or by the participant’s beneficiary or estate. The proposed legislation provides for the restoration of a canceled account if a claimant establishes a valid claim, with recovery of the canceled amount, but without post-cancellation interest or investment earnings, and requires the Minnesota State Colleges and Universities System (MnSCU) Board to insure that the reserve account for abandoned accounts have sufficient amounts to restore canceled accounts and requires the Board to fund restorations from other MnSCU revenue sources in the event that there is a shortfall resulting from the restoration. The cancellation of abandoned accounts is triggered after six months have elapsed since the plan administrator first attempts to locate the former member, which is a very rapid timeframe for cancellation compared to other retirement plan provisions and is likely to overstate cancellations and require restorations on a predictably chaotic schedule. If the time period of inactivity after an account appears to go unclaimed is accurately identified, the potential restoration problem may be minimized. **Amendment H2170-3A**, discussed as part of policy issue number 1, would increase the time period to elapse.

## 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 predeterminable 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 predeterminable, 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.

