H.F. 2803
(Greiling)

S.F. xxxx

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	MnSCU-IRAP/TRA
Relevant Provisions of Law:	Special legislation
General Nature of Proposal:	Retirement coverage transfer/service credit purchase
Date of Summary:	March 2, 2008

Specific Proposed Changes

- MnSCU faculty member who contends no retirement coverage election notification was ever provided or election made seeks authority to switch from default MnSCU-IRAP coverage to TRA.

Policy Issues Raised by the Proposed Legislation

1. Appropriateness of special coverage change election.
2. Compliance with Commission service credit purchase policy.
3. Service credit purchase payment and required MnSCU obligation.
4. Precedents.
5. Continued appropriateness of MnSCU-IRAP as default provision.
6. Continued appropriateness of MnSCU faculty retirement coverage exclusions.

Potential Amendment

H2803-1A, requested by MnSCU, resets the start date for the service credit purchase.

State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director LAM

RE: H.F. 2803 (Greiling); S.F. xxxx: TRA; Service Credit Purchase for MnSCU Employment Covered by IRAP by Default

DATE: March 2, 2008

Summary of H.F. 2803 (Greiling); S.F. xxxx

H.F. 2803 (Greiling); S.F. xxxx permits Deborah Mosby to elect prospective and retroactive (to January 2004) retirement coverage by the Teachers Retirement Association (TRA) for Minnesota State Colleges and Universities System (MnSCU) faculty employment with the transfer of past MnSCU Individual Retirement Account Plan (MnSCU-IRAP) member contributions and investment returns to TRA, plus her payment of any shortage compared to the TRA required member contributions on MnSCU faculty compensation. After the transfer of the balance of the MnSCU-IRAP account, representing the employer contributions and investment performance, any shortfall amount compared to the full actuarial value prior service credit purchase payment requirement under Minnesota Statutes, Section 356.551, must be paid by MnSCU. The special retirement election option for Ms. Mosby would expire on January 1, 2009.

Public Pension Problem of Deborah Mosby

Deborah Mosby is a 53-year-old faculty member at Metropolitan State University, one of the Minnesota State Colleges and Universities System (MnSCU) campuses, after having also previously been a faculty member at the Minneapolis Community and Technical College, who has coverage by the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) for prior public employment, who would prefer to have coverage by the Teachers Retirement Association (TRA) as a MnSCU faculty member, but who has retirement coverage instead by the Minnesota State Colleges and Universities System Individual Retirement Account Plan (MnSCU-IRAP) due to the operation in late 2004 of a default coverage provision, when she first became a quarter-time faculty member. Ms. Mosby indicates that she was initially employed as a faculty member in January 2004, at the Metropolitan State University, became a quarter-time faculty member in August 2004, could have elected TRA coverage at that time under Minnesota Statutes, Section 354B.21, Subdivision 2, was apparently not notified by MnSCU of her retirement coverage election option in August 2004, and was covered by the defined contribution-type retirement plan, MnSCU-IRAP, under Minnesota Statutes, Section 354B.21, Subdivision 3. Ms. Mosby believes she should now be able to elect TRA coverage, retroactive to the start of her MnSCU employment, rather than MnSCU-IRAP, because of MnSCU's failure to ever obtain an affirmative IRAP retirement coverage election from her and MnSCU's failure to appropriately notify her of her retirement coverage election opportunity when she attained the quarter-time employment status in mid-2004 or late-2004.

Requested MnSCU Amendment

Amendment H2803-1A, prepared based on a February 21, 2008, request from the Minnesota State Colleges and Universities System (MnSCU), corrects the date on which Deborah Mosby was employed at the minimum of 25 percent of full time that entitles MnSCU faculty to have retirement coverage by the MnSCU Individual Retirement Account Plan (MnSCU-IRAP) or by one of the defined benefit teacher retirement plans and resets the date on which her service credit purchase would begin as August 27, 2005, rather than January 12, 2004, or approximately 18 months shorter a service credit purchase than the proposed legislation would permit.

Background Information on the MnSCU Individual Retirement Account Plan

Relevant background information on the Higher Education Individual Retirement Account Plan (MnSCU-IRAP) is set forth in Attachment A.

Discussion and Analysis

H.F. 2803 (Greiling); S.F. xxxx allows a Minnesota State Colleges and Universities System (MnSCU) faculty member, Deborah Mosby, who was apparently not notified in a timely fashion of an opportunity to elect defined benefit plan retirement coverage by the Teachers Retirement Association (TRA) in 2004, and consequently has defined contribution plan retirement coverage by the Higher Education Individual Retirement Account Plan (MnSCU-IRAP) by virtue of a statutory default provision, to now elect TRA coverage for past and prospective service, with an equivalent to a prior service credit purchase that includes a mandatory employer contribution of any full actuarial value payment shortfall.

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

1. Appropriateness of Special Retirement Coverage Change Election. The policy issue is the appropriateness of permitting Deborah Mosby, a Minnesota State Colleges and Universities System (MnSCU) faculty member covered by the Higher Education Individual Retirement Account Plan (MnSCU-IRAP) since august 2004, to now elect Teachers Retirement Association (TRA) coverage for both future and past MnSCU faculty employment. The proposed special retirement coverage change election is essentially a deadline extension or waiver, for which the Commission has a policy principle. That Commission policy principle, approved by the Commission in 1996, provides:

   II.C.11. Deadline Extensions and Waivers

   > Deadline extensions or waivers should be permitted only if, on a case-by-case basis, it is determined that there is a sufficient equitable basis for the extension or waiver, the extension or waiver does not involve broader applicability than the pension plan members making the request, and that the extension or waiver is unlikely to constitute an inappropriate precedent for the future.

   Thus, Commission recommendation of the election option should depend on the equities of the situation. Ms. Mosby indicates that she never affirmatively elected MnSCU-IRAP coverage and was not informed of her opportunity to elect TRA coverage when she shifted to quarter time and first became eligible for retirement coverage as a part-time MnSCU faculty member, which she believes occurred in mid- or late-2004. If Ms. Mosby was not ever provided any notice of a retirement coverage option in 2004, this is not a second chance request, which would be a potentially adverse consideration, but is the correction of an employer error. Ms. Mosby, with prior Minnesota defined benefit plan teacher retirement coverage and apparently unlikely to enter the national higher education employment market, would have been best served by electing TRA coverage in 2004 (Ms. Mosby's date) or August 27, 2005 (MnSCU's date). Because her MnSCU-IRAP coverage did not begin until 2004, after the last investment market bubble deflated, this request is not likely to have been prompted by investment market reversals, which also would be an adverse equitable consideration. Unless MnSCU has records that prove or suggest compellingly that a retirement coverage notice was provided to Ms. Mosby in 2004 or 2005, the equities appear to run with her and against MnSCU.

2. Appropriateness of Past Service Credit Acquisition. The policy issue is the appropriateness of special legislation allowing a public employee to acquire defined benefit plan service credit for prior public employment for which Ms. Mosby did receive retirement coverage. The request is essentially a prior service credit purchase, which, in Commission practice since 1999, has generally been permitted if the purchase is made with a full actuarial value payment and does not violate equitable notions. The past service credit is accompanied by a full actuarial value funding requirement, in conformity with Commission policy. The equitable considerations were discussed with respect to the first policy issue and, unless other relevant information is forwarded by MnSCU, appear to favor Ms. Mosby.

3. Cost of the Service Credit Payment and the Mandatory MnSCU Payment. The policy issue is the potential large cost of the service credit purchase and the proposed allocation of most of the additional funding requirement to MnSCU. No estimate of the full actuarial value payment requirement for this purchase has been assembled, since the estimate is dependent on records that are not available to the Commission staff or to TRA, and involve mostly part-time employment, but the purchase cost would be significant. The proposed purchase also places the largest funding burden on MnSCU as the employer, based on the apparent failure of MnSCU to provide adequate notice of a prior retirement coverage election opportunity in 2004 or 2005. The Commission in recent years has frequently placed the largest portion of the service credit purchase payment burden on employers who caused a loss of service credit.

4. Precedent. The policy issue is the extent to which identical or similar previously enacted special legislation exists that could be argued as potentially binding in this instance and the extent to which any Commission or legislative action with respect to the proposal could create an arguable binding precedent for future similar or identical requests. Two recent special laws could be viewed as precedents with respect to this request:

- In 2003 (First Special Session Laws 2003, Chapter 12, Article 15, Section 1), a long-term K-12 teacher with prior TRA coverage who was hired as a farm business management instructor by Riverland Community College and who missed the deadline to elect to continue TRA coverage was permitted a deadline extension, without any indicated error by MnSCU and without any additional financial obligation placed on MnSCU.

- In 2006 (Laws 2006, Chapter 271, Article 14, Section 8), a long-term community college faculty member with prior TRA coverage who had newly been made eligible for MnSCU-IRAP coverage, but was documented as not having been provided notice of the retirement coverage election before the deadline ran and the default coverage election provision implemented, was allowed to elect prospective TRA coverage and to obtain prior TRA coverage in a full actuarial value service credit purchase to the extent of her IRAP account balance, without any additional financial obligation placed on MnSCU.

From the two prior special laws, there is precedent for extending the retirement coverage deadline for TRA elections by MnSCU faculty, either based on the individual's error or a MnSCU notice failure, and there is precedent for allowing past TRA service credit to be purchased in either case. Imposing additional financial obligations on MnSCU arising from any MnSCU error remains a potentially unresolved question, although the Commission staff recalls that MnSCU strenuously objected to any financial participation in connection with the 2006 special legislation because of its fears of setting a precedent for other MnSCU faculty coverage errors. If this proposed legislation would be recommended by the Commission and enacted, it would continue the precedent of allowing election deadline extensions and, if it obligated MnSCU to bear some or all of the cost of any error, would set a new precedent.

5. <u>Appropriateness of Current MnSCU-IRAP Coverage Default Provision</u>. A policy issue implicitly raised by the proposed legislation, but beyond the individual circumstance addressed in the draft potential legislation, is the issue of the appropriateness of continuing to default to defined contribution plan coverage in the form of the Higher Education Individual Retirement Account Plan (MnSCU-IRAP) for newly employed or newly retirement-coverage-eligible Minnesota State Colleges and Universities System (MnSCU) faculty members. There are probably two reasons for the current default, although the precise reason for the current statutory provision is difficult to document. The likely reasons are that defined contribution plan coverage has been viewed as the most likely desired plan coverage by the MnSCU administration, MnSCU faculty members, or both, and that the default replicates the only other situation where there is a choice between defined contribution plan coverage and defined benefit plan coverage, which is the situation of legislative employees, constitutional officer employees, and state agency department and division heads with alternative coverage by the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) or by the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), the default defined contribution plan option. For State University faculty, the original proponents of MnSCU-IRAP, a certain proportion of faculty members are either in a national employment market or may be in a national employment market, where defined contribution plan coverage provides portability that a defined benefit plan does not. For other MnSCU faculty, national employment portability concerns may be less clear or less widespread, raising the question of whether the default election provision should be different for different MnSCU faculty groups or should be revised generally. If the default had been different in 2004 or 2005, Ms. Mosby would not have needed to seek special legislation.

6. <u>Appropriateness of the Current Exclusion from Retirement Coverage for Under Quarter Time MnSCU Faculty</u>. The policy issue implicitly raised by the proposed legislation is whether or not it still is appropriate to exclude from retirement coverage Minnesota State Colleges and Universities System (MnSCU) faculty members who are employed less than full time. If Ms. Mosby had been provided with retirement coverage and a choice between options from her initial date of substantial MnSCU employment, the opportunity for MnSCU to fail to provide a timely notice of eligibility and the coverage option would be reduced or eliminated and the retirement plan choice would occur when many other employment benefit elections also take place. While larger than Ms. Mosby's specific situation, the current MnSCU practice of excluding minimally employed faculty from retirement coverage eligibility does cause a loss of retirement coverage for some individuals and creates an opportunity for administrative errors in notification. With only two significant exceptions, which are the MnSCU part-time faculty and minimally compensated local government employees otherwise eligible for coverage by the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), Minnesota follows the practice in its retirement plans of providing retirement coverage from the initial date of employment on. MnSCU excludes faculty members

employed at less than quarter time and PERA-General excludes employees with compensation continually and exclusively under $400 per month. Both retirement coverage exemptions undoubtedly were enacted for economic reasons, saving employer retirement contributions for significant part-time employee populations. The practice of excluding certain employee groups, in addition to permitting or even encouraging administrative errors, also deprives the defined benefit retirement plan involved of additional potential turnover gains that could bolster the retirement plan funding.

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.