



TO: Members of the Legislative Commission on Pensions and Retirement
 FROM: Lawrence A. Martin, Executive Director
 RE: H.F. 3029 (Hilstrom); S.F. 2759 (Betzold): Various Employers; Alternative Employer-Funded Deferred Compensation Plans
 DATE: March 14, 2008

Summary of H.F. 3029 (Hilstrom); S.F. 2759 (Betzold)

H.F. 3029 (Hilstrom); S.F. 2759 (Betzold) amends Minnesota Statutes, Section 356.24, Subdivision 1, the general restriction on state agencies and local governments contributing to supplemental pension plans or deferred compensation plans and the 12 exceptions to that restriction, by increasing the maximum matching employer contribution to a deferred compensation program from \$2,000 annually to one-half of available elective deferral permitted under the federal Internal Revenue Code and expands the eligible deferred compensation programs from the Minnesota State Deferred Compensation Program to any deferred compensation plan available under the federal Internal Revenue Code Section 457.

Background Information on Relevant Topics

Information related to the relevant topics is contained in the following attachments:

- Attachment A sets forth background information on the Minnesota State Deferred Compensation Program.
- Attachment B sets forth information on the statutory restrictions on supplemental pension plan coverage.
- Attachment C sets forth information on Internal Revenue Code Section 457 Deferred Compensation Plans.

Discussion and Analysis

H.F. 3029 (Hilstrom); S.F. 2759 (Betzold) modifies a current exception to the general prohibition on employer-funded supplemental retirement plans and deferred compensation plans by increasing the annual maximum on the employer matching contribution from \$2,000 annually currently to \$7,700 under age 50, \$10,250 over age 49, and \$15,500 during the catch-up period of the three years before the unreduced normal retirement age and by allowing employer-matching contributions to any deferred compensation plan.

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

1. Appropriateness Given the Unclear Need for the Increase in the Employer Matching Contribution Maximum. The policy issue is the appropriateness of the 387.5 percent increase (787.5 percent increase with catch-up amount) in the maximum employer matching contribution amount without some documentation of a policy need to substantially increase the maximum match. It is difficult to identify what would constitute a persuasive policy argument that the increase is needed based on the legislative history and legislative intent for the program. The Minnesota Deferred Compensation Program was established in 1971 for state employees, without any employer match, as a mechanism for employees with some disposable income to save to augment their retirement benefits. The program was extended beyond state employees to all Minnesota public employees in 1975 to permit all public employees to utilize that retirement savings plan option. The employer matching contribution authority was added in 1988, implementing a collective bargaining agreement between Special School District No. 1, Minneapolis, and the Minneapolis Teachers Federation, with the employer match intended to inspire greater utilization of the savings program. The current \$2,000 employer deferred compensation matching contribution maximum is not an insignificant contribution level, even though it has not changed in amount for over 20 years. The following indicates, for the three largest statewide retirement plans as of June 30, 2007, the average age, average length of service credit, average salary, and the percentage of average salary that the \$2,000 maximum constitutes:

Statewide Retirement Plan	Average Age	Average Length of Service Credit	Average Salary	Current Maximum % of Current Average Salary
MSRS-General	46.2 years	12.4 years	\$46,337	4.32%
PERA-General	46.2 years	10.1 years	\$33,905	5.90%
TRA	43.3 years	11.7 years	\$49,095	4.07%

The current \$2,000 employer deferred compensation matching contribution maximum is less generous for more highly compensated employees, but still is of value for the highest compensated tier of public employees. The following indicates, for the grouping of at least 30 participants with the highest average compensation as of June 30, 2007, for the three largest statewide retirement plans, the age range, service range, average salary, and the percentage of that average salary that the \$2,000 maximum constitutes:

Statewide Retirement Plan	Age Range	Length of Service Credit Range	Average Salary	Current Maximum % of Current Cohort Average Salary
MSRS-General	ages 65-69	35-39 years	\$65,324	3.06%
PERA-General	ages 55-59	over 30 years	\$60,118	3.33%
TRA	ages 65-69	35-39 years	\$95,702	2.09%

Unless there is some reason to believe that there is under-utilization of the retirement savings program by the higher-compensated compared to the lower-compensated, a sizeable increase in the maximum will unlikely increase program participation. The proponents should be accorded an opportunity to make their best policy argument for the need to increase the maximum.

If the Commission is not concerned that any increase in the maximum employer matching contribution is appropriate, Amendment H3029-1A removes the maximum increase portion of the proposed legislation.

2. Appropriateness Given the Unclear Need for an Expansion in the Deferred Compensation Vendors Permitted to Receive Employer Matching Contributions. The policy issue is the appropriateness of extending the authority to receive employer matching contributions from the Minnesota Deferred Compensation Program to any deferred compensation program without some demonstration of a policy need for that substantial expansion. When the Minnesota Deferred Compensation Program was singled out for the receipt of the employer matching contribution because it utilized the Minnesota State Retirement System, the Minnesota Supplemental Investment Fund, and the State Board of Investment, which were dedicated to the retirement savings function without any need to produce profit margins. With the considerable reduction of the role played by the Minnesota Supplemental Investment Fund and the State Board of Investment in recent years, the favorable comparability of administrative and investment expenses of the Minnesota Deferred Compensation Program over other potential vendors is less clear than it was previously, but centralizing the employer match to one vendor not prompted by market share and profit margins and capable of gaining full advantage of economies of scale still makes the Minnesota Deferred Compensation Program an optimal choice. The proponents should be invited to indicate the policy advantages that they believe would result from an unlimited expansion of the authority to receive employer matching deferred compensation program contributions.

3. Appropriateness of Matching Contribution Increase Given the Apparent Lack of Utilization of the Employer Match Authority Among Public Employers. The policy issue is the appropriateness of the expansion of the employer matching deferred compensation program contribution amount, to the benefit of those public employees with employers that have implemented the authority and have the economic ability to utilize the additional amount, when it is not clear that a large percentage of Minnesota public employers have implemented the authority at all. The reason for the Legislature enacting Minnesota Statutes, Section 356.24, in 1971 was to preclude the phenomenon that was growing during the 1960s of some advantaged public employers creating supplemental pension plans and gaining a greater competitive advantage in recruiting and retaining employees without insuring adequate retirement coverage for public employees broadly. The authorization of employer-matching contributions in 1988 allowed public employers to create moderately generous supplemental plans, but the maximum matching amount was set not to allow those supplemental arrangements to overshadow the generally applicable public employee pension coverage. If the utilization of any employer deferred compensation program match is not widespread, as was the case several years ago when the Commission last took testimony on the topic, enhancing the program for the “have” public employers and public employees without regard to the “have-not” public employers and public employees adds to disparities rather than encouraging a reformulation of the benefit baseline. The Commission staff has no comprehensive studies about the extent of utilization of the employer matching contribution authority statewide, but has communicated to representatives of the proponents of the proposed legislation that information on utilization may be important to the Commission’s consideration of the proposal.

4. Appropriateness of Increased Matching Amount When Few Employers Offer the Current Matching Maximum. The policy issue, an extension of policy issue #3, is the appropriateness of the proposed increase in the maximum employer matching deferred compensation contribution amount when it appears that few public employing units currently provide for the \$2,000 annual maximum and that even fewer employing units apparently actually make contributions at that level. While there is no comprehensive information available on the employer matching deferred compensation contribution practices, anecdotal information suggests that few Minnesota public employers provide for the full current maximum. If few employers actually provide for the current maximum and if the maximum is only provided for a portion of that employer's total workforce, the need for an increase in the maximum is not clear. The proponents of the proposal could be required to provide available information on the number of employers currently providing a \$2,000 employer deferred compensation matching contribution, the total number of those governmental employers' workforces covered by the match at that level, and the total number of public employees actually utilizing the full \$2,000 employer match. If those groupings are very small in number, the proposed increase seems less appropriate as a matter of public policy. If the Commission is troubled by the substantial proposed increase in the maximum employer matching deferred compensation contributions, there are a number of potential alternative increases that the Commission may wish to consider, as follows:

Amendment H3029-2A increases the employer maximum matching contribution amount from \$2,000 to \$2,700, the comparable amount applicable to employees of the Minnesota State Colleges and Universities System (MnSCU) who are covered by the Minnesota Deferred Compensation Program and the 1967 Higher Education Supplemental Retirement Plan.

Amendment H3029-3A increases the employer maximum matching contribution amount from \$2,000 to \$5,000, the comparable amount applicable to certain trade union pension plans operating as supplemental retirement plans.

Amendment H3029-4A increases the employer maximum matching contribution amount from \$2,000 to \$2,086 for 2008 reflecting the 4.28 cost of living (Consumer Price Index) increase from January 2007 to January 2008 and increases the amount in the future by the percentage increase in the Consumer Price Index – All Urban Consumers, from January 1, 2007, to the most recent January, rounded to the nearest full dollar amount.

Amendment H3029-5A increases the employer maximum matching contribution amount from \$2,000 to 5.10 percent of covered pay, the average of the average percentages for the three major plans that \$2,000 represents currently, but not to exceed one-half of maximum elective deferral amount under federal tax law.

Amendment H3029-6A increases the employer maximum matching contribution amount from \$2,000 to a yet-to-be specified figure if 90 percent of all Minnesota public employers provide an employer-matching contribution to their employees as certified by the executive director of the Minnesota State Retirement System (MSRS).

Amendment H3029-7A increases the employer maximum matching contribution amount from \$2,000 to a yet-to-be specified figure if 90 percent of all Minnesota public employers provide an employer match of at least \$1,900 as certified by the MSRS executive director.

5. Administrative Problems in Implementing and Potential Confusion in Understanding Variable Maximums Based Wholly or Partially on Age. The policy issue arises from setting the maximum employer deferred compensation matching contribution based on the amounts of deferral permitted by the federal tax code, currently set at three different levels (\$7,700 under age 50, \$10,250 over age 49, and \$15,500 during the three-year period immediately prior to the full unreduced normal retirement age), where there will be administrative problems for the employing units in attempting to program payroll systems to implement and where there will be communication problems for employers and employees in conveying and understanding the multiple limits. If the increased limits are only intended to actually apply to a narrow slice of the total public employee workforce, this will reduce both the implementation and communications problems, but that narrowness of potential application emphasizes the policy issues outlined in points #1, 3, and 4.

If the Commission desires to reduce the complexity of the proposed maximum, Amendment H3029-8A would set the maximum matching amount at one-half of the smallest and most commonly available amount, the under-age-50 amount, or \$7,750 currently.

6. Appropriateness of Proposed Deferred Compensation Plan Vendors Expansion if Based on Employer Relationships Rather than Employee Demand. The policy issue is the appropriateness of the proposed expansion of the deferred compensation program vendors able to accept an employer matching contribution from the Minnesota Deferred Compensation Program, administered by the Minnesota State Retirement System (MSRS), to all potential deferred compensation plan vendors if that expansion is motivated by financial or other relationships between potential vendors and employing units rather than by responses to employee preferences or demands. Groups of governmental employers may have relationships with vendors, including deferred compensation plan vendors, and the proposal for allowing employer matching contributions to be invested through vendors other than the Minnesota Deferred Compensation Program may be a function of those relationships rather than documented inadequacies of the Minnesota Deferred Compensation Program, competitive administrative or investment fee or service advantages of other vendors, or deferred compensation participant preferences. The Association of Minnesota Counties endorses Nationwide Retirement Solutions, Inc., as a deferred compensation vendor. The League of Minnesota Cities favorably cites the International City/County Management Association Retirement Trust and Nationwide, as deferred compensation vendors. The Minnesota Inter-County Association identifies by name ICMA, Nationwide, and AIG as deferred compensation vendors.

If alternative vendors to the Minnesota Deferred Compensation Program exist that provide lower administrative and investment costs and better service and response to participants, expansion to more competitive vendors would be appropriate from a policy standpoint, but if competitive advantages to participants are not documented, the proposal may not be appropriate. Amendment H3029-9A eliminates the proposed vendor expansion language in the bill.

7. Spill-Over Impact on Comparable Limits. The policy issue is the effect that increase in the employer deferred compensation matching contribution maximum amount will likely have to other matching contribution maximums in the same section. Currently, the maximum employer matching contribution amount for Minnesota State Colleges and Universities System (MnSCU) employees also covered by the 1967 Higher Education Supplemental Retirement Plan is set at \$2,700 annually and the maximum employer matching contribution amount for various trade union pension plans functioning as supplemental pension coverage is set at \$5,000.

If the Commission wishes to anticipate the likely future requests to match the proposed matching contribution maximum increase for those groups, Amendment H3029-10A makes the same maximum change for each additional group.

Attachment A

Background Information on the Minnesota State Deferred Compensation Program

- a. In General. The State Deferred Compensation Program is an Internal Revenue Code Section 457 deferred compensation plan. The State Deferred Compensation Program is governed by Minnesota Statutes, Section 352.96. The State Deferred Compensation Program is the sole government sponsored retirement thrift or savings program for most public employees by virtue of a restriction on supplemental retirement plans and employer-funded deferred compensation programs under Minnesota Statutes, Section 356.24. Although the plan is administered by the Minnesota State Retirement System (MSRS), public employees throughout the state are authorized to participate. For purposes of the State Deferred Compensation Program, public employment includes volunteer firefighters. The State Deferred Compensation Program, akin to the somewhat similar Internal Revenue Code Section 403(b) plans, function to encourage additional saving for retirement, supplementing income during retirement from the primary public pension plan, Social Security, or other income sources.
- b. Historical Development of Minnesota Statutes, Section 356.24. Minnesota Statutes, Section 356.24, when initially enacted in 1971 (Laws 1971, Chapter 222, Section 1), was intended to end a growing practice in local government (primarily by school districts) of creating supplemental employer-funded pension plans beyond the regularly applicable statewide pension plan for that type of public employee. At that time, public pension benefits were considerably more modest than they are currently and some of the more affluent jurisdictions were attempting to readjust their employees' pension coverage by local action, without the approval of or notice to the Legislature. The Legislature decided that this practice was inappropriate and that the creation of additional pension plans was an unwise policy. The Legislature also apparently felt that pension benefits should be as uniform as possible throughout public employment. In 1973, the Legislature considerably improved pension benefits payable under the public employees primary pension coverage by moving from career average salary plans to pensions that were based on the average salary of the individual close to retirement. The intent at the time was to provide an adequate benefit through the primary pension plan and eliminate the need, or the ability, to create supplemental plans. Those supplemental plans that were in effect prior to 1971 were grandfathered. Substantial benefit increases occurred in 1980, 1989, 1992, and 1997.
- c. State Deferred Compensation Program. The State Deferred Compensation Program was established in 1971, by Extra Session Laws 1971, Chapter 32, Section 19. The program was established without any specific Federal Internal Revenue Code authority, initially depending instead on a federal IRS Revenue Ruling implementing the notion of the lack of actual or constructive receipt of salary when a portion of an employee's salary is deferred and the amount invested by the employer is subject to claims of the employer's general creditors.

The program initially was open only to state employees and was administered by the Minnesota State Retirement System (MSRS), with rules, regulations and procedures established by the Commissioner of Administration, and invested by the State Board of Investment in a state operated investment fund substantially similar to a mutual fund, known then as the Minnesota Supplemental Retirement Fund. The program specifically prohibited an employer contribution initially and provided that the state employee was to bear the full risk of any investment loss incurred.

In 1975 (Laws 1975, Chapter 273), the State Deferred Compensation Program was broadened in its coverage, with access to the program extended to any political subdivision employee or any public pension plan member. The applicable governing law was also moved from Minnesota Statutes 1974, Chapter 16A (governing the Department of Finance) to Minnesota Statutes, Section 352.96. The power to establish rules, regulations, and procedures for the State Deferred Compensation Program was also transferred to the Executive Director of MSRS.

In 1977 (Laws 1977, Chapter 300, Sections 1-3), the State Deferred Compensation Program was broadened in its investment options. The 1977 legislation authorized fixed and variable annuity products of insurance companies as investment options for the State Deferred Compensation Program in addition to the various investment account approaches provided through the Minnesota Supplemental Retirement Fund operated by the State Board of Investment. The insurance company products were required to be selected through open bidding procedures.

