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

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.

In February, 1978, the Internal Revenue Service promulgated proposed regulations that would have prevented deferred compensation plans for state and local government employees, in part, because of the virtually unlimited potential as to amount for deferrals to deferred compensation plans. The Congress reversed the Internal Revenue Service in the Revenue Act of 1978 by enacting Internal Revenue Code Section 457, which authorizes state and local government employee deferred compensation plans, but which places specific limitations on the amounts available for deferral.

In 1980, the State Board of Investment implemented the 1977 State Deferred Compensation Program legislation and formally requested insurance company annuity option proposals. After analysis by a consultant and review by the Board, the State Board of Investment selected a proposal submitted by the Great-West Life Assurance Company, marketed by National Benefits, Inc., and a proposal submitted by the Minnesota Mutual Life Insurance Company and the Northwestern National Life Insurance Company, marketed by the Ochs Agency. Also in 1980 (Laws 1980, Chapter 607), the Minnesota Supplemental Retirement Fund was renamed the Minnesota Supplemental Investment Fund.

d. State Deferred Compensation Program Employer Contribution Match Feature. From 1977 to 1987, the State Deferred Compensation Program was amended periodically, but the amendments had little substantive importance. In 1988, the Program was modified to include a matching employer contribution in addition to the member's deferred compensation amount. The matching employer contribution, authorized under Minnesota Statutes, Section 356.24, was required to be made to the State Deferred Compensation Program, was required to be provided for in either a personnel plan or a collective bargaining agreement, was required to be a dollar for dollar match, and was limited to $2,000 per year per employee. While not restricted in use to fund retiree health insurance premiums, the employer matching contribution authorization was part of a broader legislative enactment pertaining to retiree health benefits, and the conferees on Laws 1988, Chapter 605, discussed the potential for the savings promoted by the employer matching contribution authorization to be used in part to defray post-retirement health insurance premium costs.

e. Tax-Sheltered Annuities with Employer Matching Contribution Feature. In 1992 (Laws 1992, Chapter 487, Section 4), similar authority for an employer matching contribution feature for teacher tax-sheltered annuity insurance contracts under federal Internal Revenue Code, Section 403(b), was established. The applicable tax-sheltered annuity insurance contracts are those issued by one of up to ten qualified insurance companies licensed to do business in this state, engaged in the life insurance or annuity business, determined by the Commerce Commissioner to be among the top two rating categories of a national insurance rating entity, and selected by the Minnesota State Board of Investment as providing competitive options and investment returns. Eight qualified insurance companies were designated by the State Board of Investment. The eight insurance companies are Aetna; Great West; IDS; Metropolitan; Minnesota Mutual; Nationwide; United Investors; and VALIC.

Internal Revenue Code Section 403(b) tax sheltered annuity plans are vehicles for teachers, church workers, and certain other personnel of charitable institutions, to save on a tax deferred basis. These plans are not any public employee's primary retirement coverage; rather they act to supplement the primary plan. This permits eligible employees to have some individual control over their eventual retirement income. Internal Revenue Code Section 403(b) investments are generally referred to as tax-sheltered annuities, although Internal Revenue Code Section 403(b) appears to permit investments in mutual funds in addition to annuities, providing the mutual fund investments are held by a custodian and contributions and disbursements are made only as permitted under Internal Revenue Code Section 403(b). Generally, the maximum permitted employee contribution to Internal Revenue Code Section 403 (b) plans in a year is 20 percent of salary or $9,500, which ever is less. Taxes are due when the money is withdrawn. Withdrawals may begin as early as age 59 and one half and must begin by age 70 and one half. The purpose of these age restrictions is to help ensure that the account is used for retirement purposes rather than intergenerational transfers.

f. 1997 Deferred Compensation Program Amendments. Laws 1997, Chapter 241, Article 3, Sections 1, 2, and 3, modified the investment options available to be provided by the State Deferred Compensation Program and changed the legal status of the program in conformity with a recently enacted federal law, the Small Business Protection Act/Minimum Wage Bill. The investment options and investment providers to the state deferred compensation plan were expanded to include mutual fund companies, investments managed by registered investment providers, and investments managed by banks and bank holding companies deferred compensation accounts also will be required to be held in trust. The authority of the State Board of Investment was expanded to solicit bids to include the expanded group of providers.

g. General Comparisons between Internal Revenue Code Section 403(b) and Internal Revenue Code Section 457 Plans. Internal Revenue Code Section 403(b) tax sheltered annuity plans are similar to Internal Revenue Code Section 457 deferred compensation plans in their basic effect to encourage saving by delaying taxes. The tax deferral is achieved, however, differs under the two plan types. Under an Internal Revenue Code Section 403(b) plan, the tax is declared, under law, to be deferred. In contrast, Internal Revenue Code Section 457 deferred compensation plans achieve tax deferral by removing constructive receipt of the deferred income. The deferred income is deemed to be retained by the employer. Since the income is not received by the state employee, no tax is currently due on the deferred amounts or on any investment gain on the deferred amounts.

The maximum deferral amounts, the ability to borrow from the account, and other features differ between the two plan types. The maximum deferral amounts under Internal Revenue Code Section 457 plans are less than the amounts that can be set aside under Internal Revenue Code Section 403(b) plans. Internal Revenue Code Section 403 (b) plans also have more lenient provision on permissible withdrawals prior to retirement, and the state employee is permitted to borrow from the account. Borrowing from an Internal Revenue Code Section 457 plan account is not permitted. For these reasons, although teachers have access to both types of plans, they tend to prefer Internal Revenue Code Section 403(b) plans over Internal Revenue Code Section 457 plans. Public employees other than teachers and other school district employees are not eligible for Internal Revenue Code Section 403(b) plans, but are restricted to Internal Revenue Code Section 457 plans.

Attachment B

Background Information on Supplemental and Local Pension Plan Restrictions

Minnesota Statutes, Section 356.24, when initially enacted in 1971 (Laws 1971, Chapter 222, Section 1), was intended to end a growing 1960s 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 geographically 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 retirement 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 statewide general employee retirement plan benefit increases occurred in 1980, 1989, 1992, and 1997.

A number of exceptions to the restriction on supplemental employer-funded pension plans have been enacted. Beyond the pre-1971 grandfathered supplemental pension plans, the 1971 legislation also excluded from its application group health, hospital, disability, or death benefits.

In 1980 (Laws 1980, Chapter 600, Section 7), an exception was added for severance pay plans authorized under Minnesota Statutes, Section 465.72.

In 1988 (Laws 1988, Chapter 605, Section 9), the State Deferred Compensation Program was modified to include a matching employer contribution in addition to the member's deferred compensation amount. 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. 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, functions to encourage additional saving for retirement, supplementing income during retirement from the primary public pension plan, Social Security, or other income sources. The State Deferred Compensation Program was established in 1971, by Extra Session Laws 1971, Chapter 32, Section 19. The matching employer contribution to the State Deferred Compensation Plan, authorized under Minnesota Statutes, Section 356.24, under the 1988 legislation was required to be made solely to the State Deferred Compensation Program, was required to be provided for in either a personnel plan or a collective bargaining agreement, was required to be a dollar for dollar match, and was limited to $2,000 per year per employee. While not restricted in use to fund retiree health insurance premiums, the employer matching contribution authorization was part of a broader legislative enactment pertaining to retiree health benefits, and the conferees on Laws 1988, Chapter 605, discussed the potential for the savings promoted by the employer matching contribution authorization to be used in part to defray post-retirement health insurance premium costs.

In 1992 (Laws 1992, Chapter 487, Section 4), similar authority for an employer matching contribution feature for teacher tax-sheltered annuity insurance contracts under federal Internal Revenue Code, Section 403(b), was established by adding an additional exception to Minnesota Statutes, Section 356.24. The applicable tax-sheltered annuity insurance contracts are those issued by one of up to ten qualified insurance companies licensed to do business in this state, engaged in the life insurance or annuity business, determined by the Commerce Commissioner to be among the top two rating categories of a national insurance rating entity, and selected by the Minnesota State Board of Investment as providing competitive options and investment returns. Internal Revenue Code, Section 403(b), tax-sheltered annuity plans are vehicles for teachers, church workers, and certain other personnel of charitable institutions, to save on a tax deferred basis. These plans are not any public employee's primary retirement coverage; rather they act to supplement the primary plan. This permits eligible employees to have some individual control over their eventual retirement income. Internal Revenue Code, Section 403(b), investments are generally referred to as tax-sheltered annuities.

Also, in 1988 (Laws 1988, Chapter 709, Article 11), with the creation of the State University System/ Community College System Individual Retirement Account Plan (IRAP), an exception for the IRAP Plan was added to Minnesota Statutes, Section 356.24. In 1989 (Laws 1989, Chapter 319, Article 12, Section 3), employer contributions to the Higher Education Supplemental Retirement Plan, established in 1965, were exempted from the application of the supplemental pension plan restriction of Minnesota Statutes, Section 356.24.

In 2001, two additional exceptions were added to the supplemental retirement plan restriction of Minnesota Statutes, Section 356.24. The exceptions are for employer contributions to a supplemental plan or governmental trust established for post-retirement health care expenses under the federal Internal Revenue Code as set in the employer's personnel policy or set by a collective bargaining agreement and for employer contributions up to $2,000 annually to the Laborer's National Industrial Pension Fund as set in a collective bargaining agreement.

In 2002 (Laws 2002, Chapter 392, Article 10, Section 1), additional exceptions for the Plumbers and Pipefitters National Pension Fund and for the International Union of Operating Engineers Pension Fund were added to the supplemental retirement plan restriction of Minnesota Statutes, Section 356.24, with a $2,000 annual maximum on the employer contributions to each of the two new supplemental retirement plans.

In 2003 (First Special Session Laws 2003, Chapter 7, Section 1), the exceptions for the Plumbers and Pipefitters National Pension Fund was broadened to include alternatively a plumbers and pipefitters local pension fund.

In 2006 (Laws 2006, Chapter 271, Article 3, Section 40), city managers excluded from coverage by the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) were specifically included in the State Deferred Compensation Program matching employer contribution authority and use of the State Deferred Compensation Program in lieu of Social Security coverage for volunteer firefighters was specifically prohibited. Both 2006 changes were recommended by the League of Minnesota Cities.

Attachment C

Background Information on Internal Revenue Code Section 457 Deferred Compensation Plans

a. In General. State and local government deferred compensation plans are tax deferred plans that are available to state and local public employees. These plans are voluntary, supplemental, long-term retirement programs that give employees of states, counties, cities, towns and special purpose local governments an opportunity to defer receipt of income until retirement or termination of employment. Employees they reduce their current taxable income and receive that income and investment earnings on it at a later date when the income may be taxed at a lower rate.

b. Pre-Section-457 Deferred Compensation Authority and Arrangements. The concept of public deferred compensation plans initially developed from Private Letter Rulings of the Internal Revenue Service (IRS) for individual private sector deferred compensation plans. The primary ruling was IRS ruling 60-31, applying the doctrine of "constructive receipt" to five specific deferred compensation arrangements. Under the Internal Revenue Code and Regulations, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitation or restriction.

Deferred compensation arrangements based on the absence of constructive receipt had been utilized by a narrow range of private sector individuals because the arrangement involved the retention of ownership of the amount of compensation by the business, subject to its creditors. Applications of deferred compensation arrangements for the public sector began developing in the late 1960's. A government unit in Utah was the first public jurisdiction to activate a deferred compensation plan in 1968. By 1977, 22 states and a limited number of city and county governments had activated plans, including the State of Minnesota in 1971 (Extra Session Laws 1971, Chapter 32, Section 19). By mid-1977, the IRS issued a moratorium of approval of new plans and placed limits on existing plans.

A group of public and private sector organizations combined efforts to counter the moratorium by seeking Congressional legislation that would codify public sector deferred compensation. A bi-partisan bill was introduced early in the 1978 Congressional session. The U.S. Conference of Mayors, National Association of Counties, National Governors Association, National League of Cities, International City Mangers Association, National Conference of State Legislators, Council of State Governments, Government Finance Officers Association, and the Assembly of Governmental Employees all provided major support for the legislation. The legislation was passed and signed into law, effective January 1, 1979 (P.L. 95-600, Section 131), as Section 457 of the Internal Revenue Code; introduced and passed in the same year, a rare accomplishment for legislation affecting taxes or benefits, much less both. A parallel provision addressed the concept for the private sector as Internal Revenue Code, Section 401(k).

c. Internal Revenue Code Section 457. Internal Revenue Code Section 457 allows deferrals in eligible deferred compensation plans and set limits on the amount that can be deferred. A qualified deferred compensation plan is a plan established by an eligible employer, which are states, subdivisions of states, instrumentalities or political subdivisions of states, or, after 1986, any entity other than a governmental unit that is exempt from federal income taxes, including charitable organizations, religious organizations, educational organizations, private hospitals, private foundations, labor unions, trade associations, fraternal orders, and farmers cooperatives. The amount deferred annually by an employee for an eligible plan cannot exceed the lesser of 100 percent of the employee's compensation or an applicable dollar amount, which was $7,500 for many years and has recently increased to $11,000 for 2002, $12,000 for 2003, $13,000 for 2004, $14,000 for 2005, $15,000 for 2006, $15,500 for 2007, $15,500 for 2008, and increased by annual cost-of-living adjustments after 2008 if the employee was under age 50. Greater limits apply if the employee is age 50 or older in order to catch up on retirement savings.

Amounts available for distributions under a section 457(b) plan generally cannot be made available to participants or beneficiaries earlier than the occurrence of specified events, namely, severance from employment, attainment of age 70½ while still employed, or the occurrence of an unforeseeable emergency creating a financial hardship. Amounts distributed to participants who have not attained age 59½ are not subject to the 10% premature distribution penalty applicable to Individual Retirement Accounts and to Internal Revenue Code, Section 401(k) plans.

Governmental deferred compensation plans must hold all assets of the plan and all income on those assets are in trust for the exclusive benefit of participants and their beneficiaries.

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, reinstate the stricken language and delete the new language

Page 2, line 6, delete the new language

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, delete the new language and insert "$2,700"

Page 2, line 6, delete "elective deferral permitted" and delete ", under the Internal Revenue Code"

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, delete the new language and insert "$5,000"

Page 2, line 6, delete "elective deferral permitted" and delete ", under the Internal Revenue Code"

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, delete the new language and insert "$2,086"

Page 2, line 6, delete "elective deferral permitted" and delete ", under the Internal Revenue Code" and insert "in calendar year 2008 and $2,086 increased by the same percentage that the Consumer Price Index for all urban consumers published by the Bureau of Labor Statistics, increased between January 2008 and the most recent January for calendar years after 2008"

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, reinstate the stricken "$2,000" and delete the new language and insert "or 5.10 percent of covered salary as defined by the applicable public retirement plan, whichever is greater,"

Page 2, line 6, delete "elective deferral permitted" and delete ", under the Internal Revenue Code"

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, reinstate the stricken "$2,000" and delete the new language

Page 2, line 6, delete "elective deferral permitted" and delete ", under the Internal Revenue Code" and insert "or, if at least 90 percent of all governmental subdivisions as defined in section 353.01, subdivision 6, are obligated by collective bargaining agreement or personnel policy to provide an employer matching contribution under this clause, $..... per year per employee"

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 5, reinstate the stricken "$2,000" and delete the new language

Page 2, line 6, delete "elective deferral permitted" and delete ", under the Internal Revenue Code" and insert "or, if at least 90 percent of all governmental subdivisions as defined in section 353.01, subdivision 6, are obligated by collective bargaining agreement or personnel policy to provide an employer matching contribution under this clause of at least $1,900 per year per employee, $..... per year per employee"

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 6, after "permitted" insert "for a person under age 49"

1.1 ..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

1.2 Page 2, line 7, reinstate the stricken language

1.3 Page 2, line 11, delete "or"

1.4 Page 2, delete lines 12 and 13

..... moves to amend H.F. No. 3029; S.F. No. 2759, as follows:

Page 2, line 20, strike "$2,700 a" and insert "one-half of the available elective deferral permitted under the Internal Revenue Code per"

Page 2, line 29, strike "$5,000" and insert "one-half of the available elective deferral permitted under the Internal Revenue Code per"

Page 2, line 35, strike "$5,000" and insert "one-half of the available elective deferral permitted under the Internal Revenue Code per"

Page 3, line 4, strike "$5,000" and insert "one-half of the available elective deferral permitted under the Internal Revenue Code per"

Page 3, line 11, strike "$5,000" and insert "one-half of the available elective deferral permitted under the Internal Revenue Code per"

State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-FIFTH
SESSION

HOUSE FILE NO. 3029

February 18, 2008
Authored by Hilstrom
The bill was read for the first time and referred to the Committee on Governmental Operations, Reform, Technology and Elections

A bill for an act

relating to retirement; allowing employers to offer alternative deferred compensation plans; amending Minnesota Statutes 2006, section 356.24, subdivision 1.

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

Section 1. Minnesota Statutes 2006, section 356.24, subdivision 1, is amended to read:

Subdivision 1. **Restriction; exceptions.** (a) It is unlawful for a school district or other governmental subdivision or state agency to levy taxes for, or to contribute public funds to a supplemental pension or deferred compensation plan that is established, maintained, and operated in addition to a primary pension program for the benefit of the governmental subdivision employees other than:

(1) to a supplemental pension plan that was established, maintained, and operated before May 6, 1971;

(2) to a plan that provides solely for group health, hospital, disability, or death benefits;

(3) to the individual retirement account plan established by chapter 354B;

(4) to a plan that provides solely for severance pay under section 465.72 to a retiring or terminating employee;

(5) for employees other than personnel employed by the Board of Trustees of the Minnesota State Colleges and Universities and covered under the Higher Education Supplemental Retirement Plan under chapter 354C, but including city managers covered by an alternative retirement arrangement under section 353.028, subdivision 3, paragraph (a), or by the defined contribution plan of the Public Employees Retirement Association under section 353.028, subdivision 3, paragraph (b), if the supplemental plan coverage is

provided for in a personnel policy of the public employer or in the collective bargaining agreement between the public employer and the exclusive representative of public employees in an appropriate unit or in the individual employment contract between a city and a city manager, in an amount matching employee contributions on a dollar for dollar basis, but not to exceed an employer contribution of ~~$2,000 a~~ one-half of the available elective deferral permitted per year per employee, under the Internal Revenue Code:

(i) to the state of Minnesota deferred compensation plan under section 352.96; ~~or~~

(ii) in payment of the applicable portion of the contribution made to any investment eligible under section 403(b) of the Internal Revenue Code, if the employing unit has complied with any applicable pension plan provisions of the Internal Revenue Code with respect to the tax-sheltered annuity program during the preceding calendar year; or

(iii) any other deferred compensation plan offered by the employer under section 457 of the Internal Revenue Code;

(6) for personnel employed by the Board of Trustees of the Minnesota State Colleges and Universities and not covered by clause (5), to the supplemental retirement plan under chapter 354C, if the supplemental plan coverage is provided for in a personnel policy or in the collective bargaining agreement of the public employer with the exclusive representative of the covered employees in an appropriate unit, in an amount matching employee contributions on a dollar for dollar basis, but not to exceed an employer contribution of $2,700 a year for each employee;

(7) to a supplemental plan or to a governmental trust to save for postretirement health care expenses qualified for tax-preferred treatment under the Internal Revenue Code, if the supplemental plan coverage is provided for in a personnel policy or in the collective bargaining agreement of a public employer with the exclusive representative of the covered employees in an appropriate unit;

(8) to the laborers national industrial pension fund or to a laborers local pension fund for the employees of a governmental subdivision who are covered by a collective bargaining agreement that provides for coverage by that fund and that sets forth a fund contribution rate, but not to exceed an employer contribution of $5,000 per year per employee;

(9) to the plumbers and pipefitters national pension fund or to a plumbers and pipefitters local pension fund for the employees of a governmental subdivision who are covered by a collective bargaining agreement that provides for coverage by that fund and that sets forth a fund contribution rate, but not to exceed an employer contribution of $5,000 per year per employee;

(10) to the international union of operating engineers pension fund for the employees of a governmental subdivision who are covered by a collective bargaining agreement that provides for coverage by that fund and that sets forth a fund contribution rate, but not to exceed an employer contribution of $5,000 per year per employee;

(11) to a supplemental plan organized and operated under the federal Internal Revenue Code, as amended, that is wholly and solely funded by the employee's accumulated sick leave, accumulated vacation leave, and accumulated severance pay; or

(12) to the International Association of Machinists national pension fund for the employees of a governmental subdivision who are covered by a collective bargaining agreement that provides for coverage by that fund and that sets forth a fund contribution rate, but not to exceed an employer contribution of $5,000 per year per employee.

(b) No governmental subdivision may make a contribution to a deferred compensation plan operating under section 457 of the Internal Revenue Code for volunteer or emergency on-call firefighters in lieu of providing retirement coverage under the federal old age, survivors, and disability insurance program.