



**H.F. 3874**  
(Anzelc)

**S.F. 3548**  
(Tomassoni)

**Executive Summary of Commission Staff Materials**

*Affected Pension Plan(s):* Various Public Employees and Employers  
*Relevant Provisions of Law:* Minnesota Statutes, Section 356.24, Subdivision 1  
*General Nature of Proposal:* Permits alternative deferred compensation programs as supplemental retirement plans  
*Date of Summary:* March 26, 2008

**Specific Proposed Changes**

- The bill increases the maximum matching employer contribution to a deferred compensation program from \$2,000 annually to \$5,000 annually 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.

**Policy Issues Raised by the Proposed Legislation**

1. Appropriateness given the unclear need for the increase in the employer matching contribution maximum.
2. Appropriateness given the unclear need for an expansion in the deferred compensation vendors permitted to receive employer matching contributions.
3. Appropriateness of matching contribution increase given the apparent lack of utilization of the employer match authority among public employers.
4. Appropriateness of increased matching amount when few employers offer the current matching maximum.
5. Appropriateness of vendor expansion if based on business relationships rather than employee demand.

**Potential Amendments**

H3874-1A eliminates the increase in the employer matching contribution maximum.

H3874-2A substitutes employer matching contribution maximum increase to \$2,700.

H3874-3A substitutes employer matching contribution maximum increase to \$2,086 in 2008 and indexed to the Consumer Price Index thereafter, up to \$5,000.

H3874-4A substitutes employer matching contribution maximum increase to an unspecified figure when 90 percent of public employers provide an employer deferred compensation matching contribution.

H3874-5A substitutes employer matching contribution maximum increase to an unspecified figure when 90 percent of public employers provide an employer matching deferred compensation contribution of at least \$1,900.

H3874-6A eliminates the deferred compensation program vendor expansion.



TO: Members of the Legislative Commission on Pensions and Retirement  
 FROM: Lawrence A. Martin, Executive Director *LAM*  
 RE: H.F. 3874 (Anzelc); S.F. 3548 (Tomassoni): Various Employers; Alternative Employer-Funded Deferred Compensation Plans and Matching Contributions Increase  
 DATE: March 26, 2008

Summary of H.F. 3874 (Anzelc); S.F. 3548 (Tomassoni)

H.F. 3874 (Anzelc); S.F. 3548 (Tomassoni) 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 \$5,000 annually 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. 3874 (Anzelc); S.F. 3548 (Tomassoni) 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 \$5,000 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 250 percent increase 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:

<u>Statewide Retirement Plan</u>	<u>Average Age</u>	<u>Average Length of Service Credit</u>	<u>Average Salary</u>	<u>Current Maximum % of Current Average Salary</u>
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:

<u>Statewide Retirement Plan</u>	<u>Age Range</u>	<u>Length of Service Credit Range</u>	<u>Average Salary</u>	<u>Current Maximum % of Current Cohort Average Salary</u>
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 concerned about the appropriateness of any increase in the maximum employer matching contribution, Amendment H3874-1A 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 a likely optimal choice. The proponents should be invited to indicate the policy advantages that they believe would result from an unlimited expansion of the authority of deferred compensation program vendors 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 the proponents of the proposed legislation should be requested to provide that information on utilization if it is important to the Commission’s consideration.

4. Appropriateness of Increased Matching Amount When Few Employers Offer the Current Matching Maximum. The policy issue, related to 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 access to 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 that will be available only to a small proportion of public employees, there are a number of potential alternative increases that the Commission may wish to consider, as follows:

Amendment H3874-2A 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 H3874-3A 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, but not to exceed \$5,000.

Amendment H3874-4A 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 H3874-5A 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. Appropriateness of Proposed Deferred Compensation Plan Vendor 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 H3874-6A eliminates the proposed vendor expansion language in the bill.



## 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.

