



S.F. 889
(Betzold)

H.F. xxxx

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): MSRS-Unclassified and MSRS-General
Relevant Provisions of Law: Minnesota Statutes, Chapters 352 and 352D
General Nature of Proposal: MSRS-Unclassified default coverage and transfer rights modifications
Date of Summary: July 2, 2009

Specific Proposed Change(s)

- For employees first hired after June 30, 2009, who under existing law would be covered by MSRS-Unclassified unless they elect MSRS-General, the default coverage will be MSRS-General with an option to transfer to MSRS-Unclassified within the first three years
- For employees first hired after June 30, 2009, the right to transfer from MSRS-Unclassified to MSRS-General after ten years of covered MSRS service is removed
- Any right to retain MSRS-Unclassified Program coverage upon moving to an unclassified position not included in the plan is restricted to those hired before July 1, 2009
- For transfers from MSRS-General to MSRS-Unclassified, prior employer and employee contributions will transfer with six percent interest rather than 8.5 percent
- The cap on MSRS-Unclassified administrative fees is removed

Policy Issues Raised by the Proposed Legislation

1. Revised transfer of assets interest procedures, harm to existing employees.
2. Wage impacts on employers of Unclassified Program employees.
3. Implications of removing the ten-year transfer right.
4. Negligible impact of current system.
5. Lack of transfer rights in other defined contribution plans.
6. Lack of effective dates; appropriate effective dates.
7. Unclear implication of start of coverage provision.
8. Drafting issue, Section 3.
9. Inconsistencies between S.F. 889/H.F. xxxx and S.F. 1180/H.F. 1174.

Potential Amendments

- S0889-1A reinstates the definition of "general fund" with technical revisions and adds as a new subdivision a definition of "general employees retirement plan."
- S0889-2A creates consistent use of an 8.5 percent interest on transfers rather than 6.5 percent.
- S0889-3A continues the use of an 8.5 percent annual interest on transfers for employees first hired prior to the effective date in situations where 8.5 percent interest is permitted under existing law.
- S0889-4A adds June 30, 2010, effective dates to the bill sections, and uses that same date within the sections whenever authority is to differ between existing employees and new employees.
- S0889-5A removes the "start of coverage" provision starting on line 9.34.
- S0889-6A, an alternative to Amendment S0889-5A, would repeal the "start of coverage" provision.
- S0889-7A deletes Section 11, the MSRS-Unclassified investment option provision, and Section 13, the MSRS-Unclassified administrative fees provision.
- S0889-8A, an alternative to Amendment S0889-7A, replaces Sections 11 and 13 with the language found in the delete-everything amendment to S.F. 1180 (Betzold); H.F. 1774 (Nelson) (S1180-1A). The Commission would need to insert effective dates on lines 1.33 and 2.7 of the amendment.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director *EB*
RE: S.F. 889 (Betzold); H.F. xxxx: MSRS-General, MSRS-Unclassified: Changes in Default Plan Coverage for New Employees; Elimination of Ten-Year Plan Transfer Right for New Plan Members; Reduction of Interest Rate on Transfers; Elimination of Maximum Plan Administration Fees
DATE: July 2, 2009

Summary of S.F. 889 (Betzold); H.F. xxxx

S.F. 889 (Betzold); H.F. xxxx makes certain administrative changes and includes the following substantive changes:

- For employees first hired after June 30, 2009, who under existing law would be covered by the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) unless they elect the MSRS General State Employees Retirement Plan (MSRS-General), the default coverage will be MSRS-General with an option to transfer to MSRS-Unclassified within the first three years;
- For employees first hired after June 30, 2009, the right to transfer from MSRS-Unclassified to MSRS-General after ten years of covered MSRS service is removed;
- Any right to retain MSRS-Unclassified Program coverage upon moving to an unclassified position not included in the plan is restricted to those hired before July 1, 2009;
- For transfers from MSRS-General to MSRS-Unclassified, prior employer and employee contributions will transfer with six percent interest rather than 8.5 percent; and
- The cap on MSRS-Unclassified administrative fees (one-tenth of one percent of account assets) is removed.

Section-by-Section Summary of S.F. 889 (Betzold); H.F. xxxx

- Section 1. The MSRS-General included employee provision (M.S., Sec. 352.01, Subd. 2a) is amended to include members who transfer from MSRS-Unclassified to MSRS-General, and individuals covered by MSRS-General who have not exercised any existing right to transfer to MSRS-Unclassified. *(1.8-3.2)*
- Section 2. The MSRS-General excluded employee provision (M.S., Sec. 352.01, Subd. 2b) is amended to exclude employees who transfer to MSRS-Unclassified. *(3.3-5.33)*
- Section 3. The MSRS-Unclassified general fund definition is revised to a general employees retirement plan definition, meaning the MSRS-General plan under Chapter 352. *(5.34-6.3)*
- Section 4. The MSRS-Unclassified coverage provision (M.S., Section 352D.02, Subd. 2) is revised by changing the default coverage to be MSRS-General rather than MSRS-Unclassified for unclassified employees first hired after June 30, 2009. *(6.4-8.4)*
- Section 5. An MSRS-Unclassified transfer of contribution provision (M.S., Section 352D.02, Subd. 1c) is revised by correcting the name of the General Plan. *(8.5-8.10)*
- Section 6. An MSRS-Unclassified election of participation provision is revised by removing authority for those first hired after June 30, 2009, to continue MSRS-Unclassified coverage if the person moves to an unclassified position not normally covered by the program; and by specifying that for post-June 30, 2009, hires the default coverage is MSRS-General, with a right to elect MSRS-Unclassified within the first three years of service. If MSRS-Unclassified is elected, the employee and employer contributions will transfer to MSRS-Unclassified with six percent interest. *(8.11-8.34)*
- Section 7. An MSRS-Unclassified coverage-upon-employment-change provision which permits certain individuals in MSRS-Unclassified to remain in the program if the position held is deleted from coverage is revised to apply only to those in the program before July 1, 2009. *(9.1-9.11)*
- Section 8. The MSRS-Unclassified provision permitting transfer from MSRS-Unclassified to MSRS-General after ten years of covered service (M.S., Sec. 352D.02, Subd. 3), is amended by restricting this treatment to those hired before July 1, 2009. *(9.12-9.33)*

- Section 9. An MSRS-Unclassified coverage start provision which specifies that when a person elects MSRS-Unclassified, all contributions from the time first eligible to make an election shall be covered by the plan, is restricted to those first hired before July 1, 2009. (9.34-10.3)
- Section 10. The MSRS-Unclassified provision covering the treatment of assets transferred to MSRS-Unclassified is revised by requiring the transfers to include six percent interest rather than 8.5 percent interest. (10.4-10.13)
- Section 11. An MSRS-Unclassified investment option provision (M.S., Section 352D.04, Subd. 1) is amended by permitting individuals to specify the desired investment vehicles in a manner provided by the executive director, rather than on a provided form, and by eliminating references to guaranteed investment contracts. (10.14-11.6)
- Section 12. The MSRS-Unclassified repayment of refund provision, (M.S., Section 352D.05, Subd. 4) is amended by correcting the reference to MSRS-General. (11.7-11.18)
- Section 13. The MSRS-Unclassified administrative fees provision is revised by removing the cap on the fees. (11.19-11.25)

Relevant Background Information

- **Attachment A** contains background information on the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified).

Discussion and Analysis

S.F. 889 (Betzold); H.F. xxxx revises the default coverage for employees first hired after June 30, 2009, who under existing law would be covered by MSRS-Unclassified unless they elect MSRS-General to default to MSRS-General coverage with an option to transfer to MSRS-Unclassified within the first three years; removes the right to transfer from MSRS-Unclassified to MSRS-General after ten years of covered MSRS service for employees first hired after June 30, 2009; restricts any right to retain MSRS-Unclassified Program coverage upon moving to an unclassified position not included in the plan to those hired before July 1, 2009; revises the interest rate for prior employer and employee contribution transfers from MSRS-General to MSRS-Unclassified to six percent interest rather than 8.5 percent; and removes the cap on MSRS-Unclassified administrative fees.

The bill raises the following pension or related public policy issues:

1. Revised Transfer of Assets Interest Procedures, Harm to Existing Employees. The general issue is the shift in policy represented by revised interest procedures for transferring assets to MSRS-Unclassified. Under Section 10 (*lines 10.4 to 10.13*), amounts transferred to MSRS-Unclassified will transfer with six percent interest rather than interest at the pre-retirement interest rate assumption (8.5 percent). This change is not limited to new hires, so it will harm existing employees. A related concern is that this change reflects a policy shift from treating these transfers as to effort to keep the individual whole (by transferring the full 8.5 percent annual investment earnings presumed to have been earned by the pension fund which held those assets), to treating these like a refund with only six percent interest. Current interest treatment within this chapter and bill are inconsistent (compare Section 5 on page 8 which currently pays 8.5 percent interest to Section 9 which is a similar transfer provision but which under current law allows only six percent interest). In attempting to create more consistent treatment, MSRS wants to settle on six percent interest. The Commission may wish to have the MSRS Executive Director discuss the reasoning behind these proposed changes. If the Commission is comfortable with the general direction of this change, the Commission may wish to consider whether to have this new policy apply only to new hires or to all employees. As drafted, it applies to all. The application to existing employees may create legal challenges.
2. Wage Impacts on Employers of Unclassified Program Employees. The reduced interest rate on transfers (six percent rather than 8.5 percent) may make state employees currently covered by MSRS-General less willing to take employment as legislative staff, or any other position for which MSRS-Unclassified coverage is offered. If employees view this change as harmful, higher wages will be required to get existing employees or new hires to take these positions.
3. Implications of Removing the Ten-Year Transfer Right. A significant policy change presented by this bill is the removal of authority (in Section 8) to transfer from MSRS-Unclassified to MSRS-General after ten or more years of covered MSRS service for any employee first hired after June 30, 2009.

The right provided to existing employees under current law has considerable value. It permits individuals to select, late in their careers as retirement is approaching, between the MSRS-General defined benefit plan and MSRS-Unclassified, a defined contribution plan. With MSRS-Unclassified, the value is determined by the sum of the employee and employer contributions made to the plan plus the investment earnings. With MSRS-General, the benefit will be determined solely by the individual's high-five average salary, the accrual rate or rates used by the plan, and the years of covered service. It is reasonable that an employee would initially select MSRS-Unclassified coverage when he or she is hired. If the markets have provided normal or above average returns and the individual has invested reasonably and with discipline, the Unclassified Program account value may be worth more than the value of the MSRS-General benefit. If not, then it is economically rational for the individual to transfer to MSRS-General late in his or her career.

MSRS Executive Director David Bergstrom has on several past occasions mentioned that this provision in MSRS-Unclassified law creates adverse selection against MSRS-General, and that at some point MSRS would request legislation to remove the ten-year transfer authority, either for all employees including existing employees, or for new hires. The current bill is that legislative effort, aimed at removing the authority for new hires. Mr. Bergstrom's concern is that individuals use this transfer right only when the value of their MSRS-Unclassified account is worth less than the value of the MSRS-General benefit, which creates a loss for MSRS-General and increases the MSRS-General plan cost above what it would otherwise be. One can argue that it is unfair that MSRS-General Plan members and the employing units should have to cover this liability being imposed by those who transfer from MSRS-Unclassified. However, a counter argument is that there is no net impact on state government employers as a whole and possibly not on employees either. The additional amounts paid by employing units through additional employer contributions to MSRS-General to cover the value of this transfer right is equal to the added salaries or other benefits that would otherwise have to be offered to new employees covered by MSRS-Unclassified to compensation for this lost right. Similarly, there may be no real negative impact on all or most employees who are paying employee contributions to MSRS-General. Employees care about the amount of their take-home pay. Salary and benefits are collectively bargained or are tied, formally or informally, to collectively bargained salary and benefits. To the extent that the MSRS-Unclassified transfer right adds incrementally to the MSRS-General employee contribution requirement, that same amount is added to the wages which the employing units must offer to settle the contracts. Thus, there may be no real harm to MSRS-General employing units and employees, only the perception of harm.

4. Negligible Impact of Current System. Even if one were to accept an argument that the current system creates harm to MSRS-General, the harm seems too minimal to warrant any legislative action. Information from the most recent MSRS-General actuarial valuation suggests that the contingent liabilities created by the MSRS-Unclassified ten-year transfer right is an amount equal to about one-tenth of one percent of MSRS-General total liabilities. In recent years, MSRS has included a special exhibit in the MSRS-General actuarial report noting the Unclassified Program contingent liabilities imposed on MSRS-General. Attached to this memo are the applicable pages from the 2006, 2007, and 2008 MSRS-General actuarial valuations. For these three years there is some contingent liability which could be imposed on MSRS-General, but the estimated amount vary considerably from year to year, and is impossible to predict contingent liability amounts with any certainty going forward. There is contingent liability if the aggregate value of all MSRS-Unclassified accounts is less than the value of the MSRS-General benefits individuals could receive. If the aggregate value of all MSRS-Unclassified accounts is equal to the value of the MSRS-General benefits there is no contingent liability. The contingent liability estimates vary depending upon investment results. Strong investment years will considerably increase the value of MSRS-Unclassified accounts which will lessen or could even eliminate any contingent liabilities. The attached information for 2006 through 2008 indicates a computed contingent liability in 2006 of \$18.6 million, while the 2007 estimate was much higher at \$64.8 million, and the 2008 estimate fell to \$10.3 million. Going forward, all that is clear is that the contingent liability results will be variable and could be negligible or non-existent if there is a strong economic recovery. In any event, these contingent liabilities are negligible compared to MSRS-General total liabilities. According to the 2008 actuarial valuation, the MSRS-General total liability was \$9.994 billion. The 2008 contingent liability of \$10.3 million is one tenth of one percent (0.1 percent) of the total liability amount.
5. Lack of Transfer Rights in Other Defined Contribution Plans. An argument for eliminating the ten-year transfer right is that this benefit is unique to the MSRS-Unclassified Program. In enacting newer other defined contribution plans, notable the Higher Education Individual Retirement Account Plan (IRAP), and the IRAP for the Historical Society, Arts Board, and Humanities Commission, the Legislature chose not to include a ten-year transfer right. The existence of a transfer right in MSRS-

Unclassified may not represent the best policy, and it may at some point encourage representatives of the IRAP plans to try to establish a transfer right into a defined benefit plan. This has been an issue for Higher Education IRAP. Whenever markets fall, various individuals express a desire to revise general law, or to have special law legislation, allowing them to becoming a Teachers Retirement Association (TRA) member.

6. Lack of Effective Dates; Appropriate Effective Dates. The bill lacks effective dates. Presumably, effective date provisions should be added, but a further question is what those dates should be. The bill was drafted assuming it would be acted upon by the 2009 Legislature and that the termination of transfer authority for employees hired after June 30, 2009, would not harm anyone currently employed. This avoids the implications of negatively impacting the pension provisions applicable to existing current employees. If the Commission wishes to take action on this bill, it may wish to consider using a June 30, 2010, effective date for the provisions and change the internal references to be consistent with this new date.
7. Unclear Implication of Start of Coverage Provision. The issue is the unclear implications of the state-of-coverage provision found on lines 9.34 to 10.3. As drafted, only for persons hired before July 1, 2009, will past contributions transfer to MSRS-Unclassified upon electing coverage by that program. But this contradicts new language appearing on lines 8.24 to 8.34 for post June 30, 2009, hires. The Commission may wish to consider leaving existing law unchanged by dropping this provision from the bill, or consider repealing it. It does not seem necessary since the needed transfer procedure is stated elsewhere.
8. Drafting Issue, Section 3. Section 3 is an attempt to change the MSRS-Unclassified chapter definition of General Fund into a General Employees Retirement Plan definition. However, the term “general fund” is used in Chapter 352D and transforming the definition will leave that term undefined. It may be better to leave a general fund definition in place and to create a new separate definition of general employees retirement plan.
9. Inconsistencies Between Bills. The issue is inconsistent revisions to the same provisions of statute appearing in this bill and in another bill on the agenda, S.F. 1180 (Betzold); H.F. 1774 (Nelson): Revisions to the State Deferred Compensation Program and MSRS-Unclassified, in the form of Delete-Everything Amendment S1180-1A. Sections 11 and 13 in the current bill also appear in the delete-everything amendment to S.F. 1180/H.F. 1774, but the language is different. Mr. Bergstrom has indicated that he is comfortable with the drafting of S1180-1A. Therefore, if the Commission recommends S1180-1A to pass, it may wish to delete sections 11 and 13 from the current bill. If the Commission does not choose to use S1180-1A, it may wish to replace sections 11 and 13 in the current bill with language for those sections lifted from S1180-1A.

Potential Amendments for Commission Consideration

- S0889-1A reinstates the definition of “general fund” with technical revisions and adds as a new subdivision a definition of “general employees retirement plan.”
- S0889-2A creates consistent use of an 8.5 percent interest on transfers permitted under the bill rather than 6.5 percent.
- S0889-3A continues the use of an 8.5 percent annual interest on transfers for employees first hired prior to the effective date in situations where 8.5 percent interest is permitted under existing law.
- S0889-4A adds June 30, 2010, effective dates to the bill sections, and uses that same date within the sections whenever authority is to differ between existing employees and new employees. If the Commission wishes to use a year other than 2010, a verbal amendment could be used to replace “2010” wherever it appears with a different date.
- S0889-5A removes the “start of coverage” provision starting on line 9.34 of the bill if the Commission concludes that section is unnecessary. The provision conflicts with other treatment specified in the bill and could be deleted without harm.
- S0889-6A, an alternative to Amendment S0889-5A, would repeal the “start of coverage” provision. This can be justified because the provision appears to be unnecessary and duplicative since transfer provisions are specified elsewhere in the bill and in existing law.

- S0889-7A deletes Section 11, the MSRS-Unclassified investment option provision, and Section 13, the MSRS-Unclassified administrative fees provision. The Commission may wish to use this amendment if it concludes that the changes proposed in these sections should not occur, or if the Commission has already addressed these sections by adopting delete-everything amendment S1180-1A to S.F. 1180 (Betzold); H.F. 1774 (Nelson), Revisions to the State Deferred Compensation Plan and MSRS Unclassified, which also revises these provisions.
- S0889-8A, an alternative to Amendment S0889-7A, could be used if the Commission does not adopt the delete-everything amendment to S.F. 1180 (Betzold); H.F. 1774 (Nelson) (S1180-1A), but the Commission prefers the language for these two sections found in that delete-everything amendment rather than the language for those sections found in the current bill. This amendment duplicates the language for these two sections from Delete-Everything Amendment S1180-1A. The Commission would need to insert an effective date on lines 1.33 and 2.7 of the amendment.

