



Delete-Everything Amendment S1180-1A to
S.F. 1180 **H.F. 1774**
(Betzold) (Nelson)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): MSRS Deferred Compensation and MSRS-Unclassified
Relevant Provisions of Law: Minnesota Statutes, Chapters 352 and 352D
General Nature of Proposal: Changes to MSRS Deferred Compensation Plan and the MSRS-Unclassified Program
Date of Summary: July 1, 2009

Specific Proposed Change(s)

Delete-Everything Amendment S1180-1A requires employing units to transmit to the MSRS Deferred Compensation Plan third party administrator the information deemed necessary by the MSRS executive director; requires employers to provide identification information and financial information to a third party administrator for MSRS-Unclassified to allow daily rather than monthly valuation of the accounts; revises MSRS-Unclassified provisions to permit an annuity to accrue the day after submitting an application or the day after termination, whichever is later, rather than at the beginning of the next month; and removes the cap on MSRS-Unclassified administrative fees.

Policy Issues Raised by the Proposed Legislation

1. Sufficient need for the change.
2. Data privacy and identity theft concern due to increased use of outside record keepers.
3. Removal of cap on MSRS-Unclassified administrative fees.
4. Appropriate effective dates given that the bill did not pass during the 2009 Legislative Session.

Potential Amendments

Administrative Fee Amendments:

S1180-2A retains the cap on administrative fees remains as stated in existing law (10/100 of one percent of account assets attributable to contributions made on or after July 1, 1992, and any related investment gain) by removing this section from the delete-everything amendment.

S1180-3A, an alternative to S1180-2A, leaves a cap in place but revises the cap from 10/100 of one percent of applicable assets to an amount to be specified by the Commission.

Effective Date Amendments:

S1180-4A would make the provisions effective July 1, 2010, rather than July 1, 2009.

S1180-5A, an alternative to S1180-4A, makes the provisions effective retroactively from July 1, 2009.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Ed Burek, Deputy Director
RE: Delete-Everything Amendment S1180-1A to S.F. 1180 (Betzold); H.F. 1774 (Nelson); MSRS Deferred Compensation Plan and Unclassified Program; Changing to Daily Valuation of Accounts; Using Third-Party Administrator; Revising Annuity Accrual Dates
DATE: July 1, 2009

Introduction

Minnesota State Retirement System Executive Director Dave Bergstrom requested that when S.F. 1180 (Betzold); H.F. 1774 (Nelson) is heard by the Legislative Commission on Pensions and Retirement, that it be heard in the form of Delete-Everything Amendment S1180-1A.

Summary of Delete-Everything Amendment S1180-1A to S.F. 1180 (Betzold); H.F. 1774 (Nelson)

Delete-Everything Amendment S1180-1A requires employing units to transmit to the Minnesota State Retirement System (MSRS) Deferred Compensation Plan third party administrator the information deemed necessary by the MSRS executive director; requires employers to provide identification information and financial information to a third party administrator for the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) to allow daily rather than monthly valuation of the accounts; revises MSRS-Unclassified provisions to permit an annuity to accrue the day after submitting an application or the day after termination, whichever is later, rather than at the beginning of the next month; and removes the cap on MSRS-Unclassified administrative fees.

Section-By-Section Summary of Delete-Everything Amendment S1180-1A

1. Section 1 amends Minnesota Statutes, Section 352.965, Subdivision 6, the deferred compensation plan administrative expense provision, by requiring employers to supply necessary personal and financial data to the third party administrator on plan participants, and by clarifying that the third party administrator must comply with data privacy requirements (1.3-1.28).
2. Section 2 amends Minnesota Statutes, Section 352D.015, Subdivision 9, the definition of "value" in MSRS-Unclassified, by specifying that value means the account's market value at the end of the day, rather than value at the end of the month following receipt of an annuity (1.29-1.34).
3. Section 3 amends Minnesota Statutes, Section 352D.02, an MSRS-Unclassified coverage provision, by adding a subdivision requiring employers to provide personal and financial data to an outside record keeper selected by MSRS. The record keeper must comply with data privacy procedures (2.1-2.10).
4. Section 4 amends Minnesota Statutes, Section 352D.04, Subdivision 1, an MSRS-Unclassified investment option provision, by clarifying the provision and by making language changes consistent with the change from monthly to daily pricing, and by permitting changes in the funds used to invest an account to be made electronically rather than in writing (2.11-3.7).
5. Section 5 amends Minnesota Statutes, Section 352D.05, Subdivision 3, an asset withdrawal provision, to be consistent with daily rather than monthly valuation of accounts (3.8-3.17).
6. Section 6 amends Section 352D.06, Subdivision 3, the MSRS-Unclassified retirement accrual date provision, to permit an annuity to accrue the day after receipt of a valid application or the day following termination of employment, whichever is later, rather than at the start of the next full month (3.27).
7. Section 7 amends Minnesota Statutes, Section 352D.065, Subdivision 3, the MSRS-Unclassified disability accrual date provision, to have disability annuities accrue the day after receipt of a valid application or the day following termination of employment, whichever is later, rather than at the start of the next full month (3.28-4.3).
8. Section 8 amends Minnesota Statutes, Section 352D.09, Subdivision 3, the MSRS-Unclassified prospectus provision, by requiring the executive director to make the MSRS-Unclassified investment

prospectus available by electronic means, and by permitting individuals to request hard copies, rather than by requiring distribution of a prospectus to each participant (4.4- 4.11).

9. Section 9 amends Minnesota Statutes, Section 352D.09, Subdivision 7, the MSRS-Unclassified administrative fees provision, by removing the cap on administrative fees (4.12-4.18).

Relevant Background Information

- **Attachment A** contains background information on the MSRS Unclassified Program.
- **Attachment B** contains background information on the MSRS Deferred Compensation Plan.

Discussion and Analysis

Delete-Everything Amendment S1180-1A requires employing units to transmit to the MSRS Deferred Compensation Plan third party administrator the information deemed necessary by the MSRS executive director; requires employers to provide identification information and financial information to a third party administrator for the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) to allow daily rather than monthly valuation of the accounts; revises MSRS-Unclassified provisions to permit an annuity to accrue the day after submitting an application or the day after termination, whichever is later, rather than at the beginning of the next month; and removes the cap on MSRS-Unclassified administrative fees.

The delete-everything amendment raises pension or related public policy issues for Commission consideration and potential discussion, as follows:

1. Sufficient Need for the Change. The issue is whether there is sufficient need for the primary changes covered by the delete-everything amendment, the move from monthly to daily pricing of accounts and the corresponding changes in annuity accrual dates, permitting an annuity to accrue on the day after receipt of a valid application and after termination of service has occurred, rather than at the start of the next month. These changes should reduce uncertainty to MSRS-Unclassified members who choose to draw an annuity from the Unclassified Program. In the very volatile markets recently encountered, large changes in account value can occur during a month. Permitting an annuity based on the account value a day after all requirements to receive an annuity have been satisfied, rather than delaying the valuation of the account for several weeks, as can occur under existing law, will add more certainty to the process. The MSRS executive director has also indicated his intention of doing away with the current practice of placing contributions received during any given month in a holding account, to be transmitted at the beginning of the next month into the investment vehicles which the member has specified. This is currently required because the price of a share of the given investment vehicle is not known until the start of the next month. Instead, contributions can be immediately transferred upon receipt to the investment vehicles specified by the individual. Over time, this should add to the investment gains in the account, creating a higher asset value.
2. Possible Concerns About the Increased Use of Outside Record Keepers. The Commission may wish to request testimony from Mr. Bergstrom to ensure the Commission is comfortable with the increased reliance on outside record keepers, particularly with the MSRS-Unclassified Program. MSRS contends that it is necessary to utilize outside record keepers to be able to price the accounts on a daily basis. A drawback is that the more parties with access to the data, the greater the risk that an unauthorized party might access the data, creating data privacy and possible identity theft concerns. The delete-everything amendment does require any third party administrator to treat the data as required by data privacy laws.
3. Removal of Cap on MSRS-Unclassified Administrative Fees. The policy issue is the removal of the cap on MSRS-Unclassified administrative fees, currently capped at 10/100 of one percent of assets attributable to contributions made on or after July 1, 1992, and any related investment gain. MSRS contends that although the fees may go up compared to existing law, the members will actually receive a net gain after the increased investment returns due to eliminating the use of holding accounts is factored in. The Commission may wish to ensure it is comfortable with the proposed removal of the cap.
4. Appropriate Effective Date. The bill was introduced in 2009 using July 1, 2009, effective dates, and the delete-everything amendment contains the same effective dates. Because the bills was not heard by the Commission in during the 2009 Legislative Session, it may be appropriate to use July 1, 2010, effective dates, or to revise the language to clarify that the provisions are effective retroactively from July 1, 2009.

Potential Amendments for Commission Consideration

- S1180-2A can be used if the Commission is uncomfortable removing the cap on administrative fees. The amendment would ensure the cap remains as stated in existing law (10/100 of one percent of account assets attributable to contributions made on or after July 1, 1992, and any related investment gain) by removing this section from the delete-everything amendment.
- S1180-3A, an alternative to S1180-2A, leaves a cap in place but revises the cap from 10/100 of one percent of applicable assets to an amount to be specified by the Commission.
- S1180-4A would make the provisions effective July 1, 2010, rather than July 1, 2009.
- S1180-5A, an alternative to S1180-4A, makes the provisions effective retroactively from July 1, 2009.

Attachment A

Background Information on the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified)

The Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) was established in 1971 (Laws 1971, Chapter 604), and is governed by Minnesota Statutes, Chapter 352D.

- a. Establishment and Membership. MSRS-Unclassified is a defined contribution plan established by Minnesota Statutes, Chapter 352D. It covers a number of state employees or officers in the unclassified service of the state on a mandatory or optional basis.

The following positions are members of the program on a mandatory basis:

1. the governor, the lieutenant governor, the secretary of state, the state auditor, and the attorney general;
2. legislators first elected after June 30, 1997; and
3. judges, for service in excess of 24 years (Minnesota Statutes, Section 490.121, Subdivision 22).

The following group was permitted to choose between the Legislators Plan and the MSRS-Unclassified Plan:

1. legislators first elected before July 1, 1997.

The remaining positions have the option to elect to be members of the program rather than being a member of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General):

1. an employee of the State Board of Investment;
2. the head of a department, division, or agency created by statute in the unclassified service;
3. a permanent, full-time unclassified employee of the legislature or a commission or an agency of the legislature;
4. the regional administrator or executive director of the Metropolitan Council, general counsel, division directors, operations managers, and other positions as designated by the council;
5. the executive director, associate executive director of the Higher Education Services Office in the unclassified service;
6. the clerk of the Appellate Court;
7. the chief executive officers of correctional facilities, hospitals, and nursing homes;
8. an employee of the state ceremonial house;
9. an employee of the Minnesota Educational Computing Corporation;
10. an employee of the World Trade Center board;
11. an employee of the State Lottery board;
12. an employee of Minnesota Technology Incorporated;
13. Minnesota State Colleges and Universities System (MnSCU) employees employed by the former state university system or community college system before May 1, 1995, or other MnSCU unclassified administrators in service before July 1, 1995, who elected MSRS-Unclassified coverage.

- b. Plan Governance and Administration. An 11-member board, the Minnesota State Retirement System (MSRS) Board of Directors is chaired by a board member and performs the policymaking function of the MSRS-Unclassified Plan. The MSRS administrative staff and the Minnesota State Board of Investment carry out the general administration of the MSRS-Unclassified Plan. The MSRS staff executes the recordkeeping and the communication functions of the plan. The State Board of Investment and its staff perform the investment function of the plan.

- c. Contribution Rates and Collection. The contribution rate to the MSRS-Unclassified Program for an employee is four percent of gross salary, except for the long-service judges covered by the program, where the member contribution is eight percent of salary. In addition, the employer must contribute six percent of the employee gross salary, except for the long-service judges covered by the program, where there is no employer contribution to the MSRS-Unclassified Plan. Both contributions, which are not taxable, are collected at payday every two weeks and credited to the employee's account

each month. The contributions generally are collected electronically by MSRS. An 8.5 percent fee applies for late collection or payment.

- d. Administrative Expenses. All administrative and investment expenses are borne by participants, who are charged 0.08 percent of total program assets a year for the plan administrative expenses, compared to the 0.22 percent of covered pay for MSRS-General.
- e. Plan Investments. The plan investments are directed individually by each participant, who makes the actual choice in the composition of investment securities in the person's own account. Under Minnesota Statutes, Section 11A.17, the investments are shares in one or a combination of the income share account, the growth share account, the international share account, the money market account, the bond market account, the fixed interest account and the common stock index account. The contributions are invested within the month they are received. Actual investments are done through outside vendors who enter into competitively bid contracts with the State Board of Investment for five years. The contracts are reviewed periodically by the State Board of Investment.
- f. Plan Communication, New Member Processing, and Benefit Counseling. MSRS provides information to plan members through newsletters, a quarterly benefit statement, a plan handbook, and financial reports each year. MSRS also presents to every new member a welcome letter, forms for membership, and the plan handbook. Finally, for an employee approaching retirement, MSRS provides an estimate of the person's benefit, and the tax impact on the benefit if the participant either opts for a lump sum payment or an annuity. An annuity may be purchased at age 55 or older.
- g. Option to Switch to Defined Benefit Plan Coverage. Under Minnesota Statutes, Section 352D.02, Subdivision 3, a participant in the MSRS-Unclassified Program with at least ten years of state service is permitted up to one month following termination of employment to elect to transfer coverage to MSRS-General, a defined benefit plan governed by Minnesota Statutes, Chapter 352. The MSRS-General retirement annuity is 1.7 percent of a member's highest five successive years average salary per year of covered service, payable in full at age 65 and reduced actuarially if the annuity commenced before age 65, with the earliest reduced benefit retirement age of 55.
- h. Actuarial Impact. The option to transfer coverage from MSRS-Unclassified to defined benefit plan coverage by MSRS-General has an actuarial cost for MSRS-General. The July 1, 2004, MSRS-General actuarial valuation was the first which calculated the actuarial liability for the active members of MSRS-Unclassified under the MSRS-Unclassified Program asset value or the present value of the MSRS-General benefit, whichever is greater. As of July 1, 2008, the MSRS-General transfer provision creates a \$10.3 million unfunded actuarial accrued liability in MSRS-General. The normal cost under the MSRS-General defined benefit plan for the MSRS-Unclassified active participants was 10.15 percent of covered pay, compared to the normal cost for MSRS-General active members of 7.8 percent of covered pay.

Attachment B

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

