SF 1910 (Frentz): Minnesota State Higher Education Individual Retirement Account Plan; Increasing the employer contribution rate

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Introduction

Affected Plan: Minnesota State Higher Education Individual Retirement Account Plan (IRAP)

Laws Amended: Minnesota Statutes, section 354B.23, subdivision 3

Brief Description: The bill phases in an increase in the employer contribution rate for the IRAP from the current 6% to 8.75% by 2027

Attachments: Amendment Hxxxx.S1910-1A (corrects error; adds appropriation)
Amendment Hxxxx.S1910-2A (shortens phase-in; adds appropriation)

Background

The IRAP is a defined contribution plan that covers employees of the Minnesota State Colleges and Universities (MN State). MN State currently contributes an employer contribution equal to 6% of each employee's pay to an account established in the IRAP for the employee. Each employee currently contributes a percentage of pay that is equal to the percentage of pay contributed by members of the Teachers Retirement Association (TRA). That percentage is currently 7.5% and is scheduled to increase to 7.75% on July 1, 2023.

The employee contribution rate was increased in 2019 from 4.5% of pay to 7.5% of pay, to match the employee contribution rate for TRA. The change in the employee contribution rate in 2019 was driven by the discovery that federal law requires the employee contribution rates to be the same if an employee can elect to transfer from one plan to the other. Prior to the change in the contribution rate in 2019, when an employee in the IRAP elected to be covered by TRA, whether at the commencement of employment or when the employee became tenured, the employee's employee contribution rate would change from 4.5% to 7.5%. With the change in 2019, when an employee elects to transfer coverage from the IRAP to TRA, the employee contribution rate remains constant at 7.5%.

The employer contribution rate for the IRAP has been at 6% since 1995. The employer contribution rate for TRA is currently 8.55% and is scheduled to increase to 8.75% on July 1, 2023. Federal law does not similarly require the employer contribution rate to the IRAP to match the employer contribution rate for

TRA even though employees can elect to transfer from the IRAP to TRA. For employees of MN State who have transferred to TRA coverage or TRA coverage is the default coverage, MN State is required to contribute at a rate that is higher than the rate of its contribution to the IRAP. Currently, MN State makes an employer contribution of 8.55% to TRA, as compared to a 6% employer contribution to the IRAP.

Summary of SF 1910

The bill is one section and an effective date. Section 1 amends section 354B.23, subdivision 3, to increase the current employer rate of 6% in .55% increments over the next 5 years, until the rate reaches 8.75% on July 1, 2027. The bill is effective the day following final enactment. When the rate reaches 8.75%, it will equal the rate of the employer contribution MN State is required to make to TRA for its employees in TRA.

Cost to MN State. The increase in the employer contribution rate will increase the annual cost of the IRAP to MN State, which is not funded in the bill. As calculated by MN State, the annual additional costs are the following:

Cost of Proposed Increase in IRAP Employer Contributions from 6.00% to 8.75%

	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	
Employer Contribution	6.00%	6.55%	7.10%	7.65%	8.20%	8.75%	8.75%	
Proposed Change	0.00%	0.55%	0.55%	0.55%	0.55%	0.55%	0%	
Employer Contributions	$30,933,048	$31,496,421	$32,064,096	$32,636,073	$33,212,352	$33,792,933	$34,194,778	TOTAL
Additional Cost	$0	$172,283	$348,868	$529,754	$714,943	$904,434	$915,189	$3,585,470

Amendments

Amendment 1910-1A. The -1A amendment corrects an error at line 14 of the bill by changing 7.65% to 8.2%. The amendment adds an appropriation section and the amounts to be appropriated each year are the amounts from the table above.

Amendment S1910-2A. The -2A amendment shortens the phase-in of the employer contribution increase to 2 years, to be phased-in as follows:

From July 1, 1993, to June 30, 2023: 6%
From July 1, 2023, to June 30, 2024: 7.75%
After June 30, 2024: 8.75%

Amendment -2A also adds an appropriation section and the amounts to be appropriated each year are the amounts from a table provided by MN State:

Cost of Proposed Increase in IRAP Employer Contributions from 6.00% to 8.75% over two years

	FY2023	FY2024	FY2025	
Employer Contribution	6.00%	7.75%	8.75%	
Proposed Change	0.00%	1.75%	1.00%	
Employer Contributions	$30,933,048	$31,872,311	$32,587,397	TOTAL
Additional Cost	$0	$548,172	$872,169	$1,420,341

Analysis

Employer contributions to the IRAP vs. employer contributions to TRA. The bill, as introduced, would increase the employer contributions from 6% to 8.75% in 0.55% increments, which would make MN State's contribution rate to the IRAP equal to MN State's contribution rate to TRA beginning in FY 2028. Under Amendment 2A, the rates will be equal beginning in FY 2025.

In theory, an argument could be made for making the employer contributions to the two plans equal. Why shouldn't Minnesota State have to contribute the same amount, regardless of whether the member elects to be covered by TRA rather than the IRAP?

The response would be that the two plans are different types of plans—the IRAP is a defined contribution plan and TRA is a defined benefit plan. When a dollar of employer contribution is paid into the IRAP, it is directly deposited into an account in the member's name and thus directly benefits the member. However, of the 16.82% of covered payroll that is the 2022 statutory contribution to TRA, 6.21% of payroll goes to pay off unfunded liabilities. Put another way, 37 cents of each dollar contributed to TRA is being used to pay off the unfunded liabilities that have accrued over years of contributing less than is required to fund annual accruals. In other words, the employer contribution to TRA pays for more than just a single employee's benefit.

In a defined contribution plan, the contributions are made to an employee's account and are solely for the employee's benefit. In a defined benefit plan, the contributions are commingled with all other plan assets and have no impact on the amount the employee will actually receive at retirement. In TRA's case, a portion of each employee's contribution goes to pay legacy costs, years of benefit accruals that were not covered by the annual contributions to the plan.