Restructuring of the Minnesota Teacher Retirement Plans

February 15, 2002 - Report Summary

The Study

During 2001 and early 2002, the directors of the four Minnesota teacher retirement funds conducted a study to restructure the teacher retirement system in the state. Their report was presented to the Legislature on February 15, 2002, and contains significant and fundamental changes to the current pension system. Extensive research and analysis was conducted of other comparable teacher pension funds in the country, and of current literature and industry practices recommended by national organizations. This research became the basis for the proposal. The research provides evidence that the Minnesota teacher pension plans currently have the poorest initial retirement benefits when compared to similar teacher pension plans in the nation. The research also shows the Minnesota plans have the potential to pay very generous post-retirement adjustments to the retirees, and have relatively low employee and employer contribution rates. The report outlines the problems with the current post-retirement adjustment mechanisms, and the conflicts of interest issues of the fiduciaries under certain administrative structures. The objective of the directors was to propose a system that is more mainstream, and one that employs the "best practices" of public pension plan management in terms of benefits and administration.

Analysis of the issues that need to be addressed in restructuring a retirement system are presented in two sections of the report: 1) agreed upon tenets; 2) issues remaining to be resolved/addressed.

Agreed Upon Tenets for a Restructured Teacher Retirement System

A. **Administrative Structure.** *The underlying objective is to fully empower the trustees of the restructured plan with the authority they need to carry out their fiduciary duties. Proper accountability, oversight, and disclosure are also critical components of the restructured plan.*

1. **Non-Profit Corporation.** The organization would be a nonprofit corporation, with assets held in trust for the exclusive benefit of members.
2. **Governing Board.** A transition board of trustees would be in place during the transition period. After a period of time, a permanent board of trustees would be in place comprised of a majority of active members, along with retiree and employer representation.
3. **Board Authority.** The trustees would have exclusive and independent authority to establish a budget; to obtain any services necessary by employment or contract; and to procure and dispose of any necessary goods and property. This authority would not be restricted by civil service, personnel, procurement, or other similar laws.
4. **Actuarial Matters.** The trustees would have exclusive and independent authority to retain the actuary to prepare annual actuarial valuations and experience studies, to recommend appropriate funding levels, and to recommend appropriate actuarial assumptions. The trustees would have exclusive authority to set the actuarial assumptions necessary to administer the plan.
5. **Legislature's Authority.** The Legislature would retain the authority to create retirement programs, establish benefit levels, and determine funding methods.
6. **Accountability.** Trustees of the plan will be personally liable to the members and beneficiaries of the plan for any breach of fiduciary duty, whether the breach is knowing and willful, or non-knowing and non-willful.
7. **Oversight.** Oversight mechanisms currently in place would continue: the State Auditor would conduct annual financial and compliance audits, and report on investment performance; reporting to and oversight by the Legislature would continue.
8. **Disclosure.** Meetings of the trustees would be conducted under open meeting laws. There would be appropriate levels of disclosure to members and beneficiaries, to the Legislature, and to the public.

B. **Plan Benefits**. *The objective is to provide benefits that are more mainstream, attractive, and competitive compared to other similar teacher pension plans in the country. A higher retirement formula is traded for lower annual post-retirement adjustments. Only the currently active members would be eligible for the new level of benefits and post-retirement adjustments.*

1. **Greater Initial Retirement Benefits**. Initial retirement benefits would be increased by changing three major components of the formula:
    - a formula multiplier of 2 percent for all years of allowable service credit;
    - a high-3 average salary instead of a high-5;
    - make the rule of 90 and a normal retirement age of 65 available to all members.
2. **Lower Post-Retirement Adjustments**. Annual adjustments to retiree pensions would be lowered and capped. There would be a guaranteed annual increase of 1 percent, and an additional percentage increase to match the increase in the consumer price index to the extent that the investment earnings of the fund exceeded the actuarial assumption. There would be a cap of 4 percent on the total post-retirement increase in any one year.
3. **Current Benefit Recipients**. Current coordinated retirees of the State TRA, Duluth, Minneapolis, and St. Paul teacher retirement plans would all be paid from the MN Post Retirement Fund and would make a one-time election to retain the post-retirement adjustment guarantee that they currently have or select the increase provisions of the MN Post Retirement Fund. Retired basic plan members of the Minneapolis and St. Paul teacher plans would choose to participate in the MN Post Retirement Fund or remain with their existing plan.
4. Active basic plan members of the Minneapolis and St. Paul teacher retirement plans would remain with their current plans.

C. **Contributions, Liabilities, and Financing**. *The report acknowledges that it is common practice in public pension plans to split the normal cost of plan benefits between the employee and the employer. It is also noted that unfunded liabilities are usually the obligation of the employer.*

1. **Fundamental Principles**. Three fundamental principles were agreed to:
    - there will be no sub-groups or sub-accounts in the restructured plan;
    - surplus assets at the time of the restructuring will be reserved for the exclusive benefit of members and beneficiaries of that specific plan;
    - after restructuring, all members will have the same benefits, pay the same contribution rate, and belong to the same plan.
2. **Sources of Financing**. There are three sources of funding. The report indicates how each of the three sources below could be tapped to finance the benefits and costs of administering the restructured plan:
    - employee and employer contributions;
    - investment earnings;
    - contributions from the state or other sources.

Issues Remaining to be Resolved/ Addressed

Several issues remain to be addressed and resolved in order to complete the design of the restructured teacher retirement plan. Before consensus can be reached, additional research and discussion is necessary.

Major issues discussed and left unresolved include:

- who would have authority to invest plan assets – the trustees, or a state investment board;
- composition of the transition board and the permanent board of trustees;
- timeline for the proposed restructuring process.

Not discussed were such issues as:

- Should there be auxiliary offices (e.g., Duluth)?
- What would happen to current staff members and how would they be protected?
- How would years of service be reconciled?
- How would assets be transferred, at what valuation?
- Should there be a supplementary add-on plan to bring retired teachers back into teaching to help with the teacher shortage issue?
- If a plan has surplus assets at the time of the restructuring, how would those surplus assets be preserved for the exclusive benefit of the members of the plan?

Steps to Restructuring

Because the first class city teacher retirement funds are organized under the MN Nonprofit Corporation Act, the members of those plans would ratify by a majority vote of the membership any plan to dissolve, merge, or consolidate the current retirement plan associations.