September 15, 1999
Room 5 State Office Building

8th Meeting

LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

MINUTES

Representative Harry Mares called the meeting to order at 10:15 A.M. He noted that the Commission did not yet have a quorum.

Commission members present at this meeting:
Representatives Philip Krinkie, Harry Mares, Mary Murphy, and Stephen Wenzel
Senators Don Betzold, Dean Johnson, Lawrence Pogemiller, and LeRoy Stumpf

Agenda Items Discussed

3. **Mandated Commission Interim Project: Appropriate Means For Partially Employer-funded Tax-sheltered Savings Opportunities For Educational Employees (Second Consideration)** Edward Burek, LCPR Deputy Executive Director, reviewed the staff memo on the issue and stated that this mandated study does not specify a due date nor require a report to the Legislature. The law does require the Commission to study the single provider option as well as an option to allow the program to continue with an unrestricted number of vendors. He stated that this memo dealt with the single provider option. The next memo on this topic will deal with allowing an unrestricted number of vendors. Mr. Burek stated that his memo on the single provider option summarizes the 1997 State Board of Investment report which recommended the single provider option. He also referred members to the attachments, the SBI report, which included an example of the maximum exclusion allowance calculation worksheet provided by the Copeland Companies, and IRS publication 571, which included a worksheet for school districts to use to calculate the maximum exclusion allowance. These attachments show the complexity of administering the 403(b) program. Mr. Burek noted that the SBI report characterized the K-12 403(b) market as fragmented and inefficient. He referred members to Table 1 in the staff memo which indicated that some of the investment products offered to teachers include very high fees and charges. The table indicated the range of fees charged by insurance companies compared to the fees charged by no-load mutual funds. Table 2 indicated the effect on an investment of $2,000 over a 25 and a 30 year period. He stated that $2,000 invested at no cost, gaining 10% annually, would grow to $34,899 after 30 years; with a .5% fee, it would grow to $30,441 after 30 years; and with a 2.75% fee, it would grow to only $16,329 after 30 years, which is less than half of the value if no fee was charged.

Mr. Burek noted that the SBI report discussed the IRS audit of various school districts because of the maximum exclusion allowance calculations. The audit resulted in some school districts being required to pay back taxes because of exceeding the maximum exclusion allowance. As a result of the IRS audits, school districts became apprehensive about administering these 403(b) plans and were encouraged to use a billing trust program identified as ESI.

SBI's report recommended establishing a centralized 403(b) State plan administration. SBI outlined features for State administration but did not make a recommendation as to SBI's ongoing review role or who the centralized administrator would be. The SBI report also identified other options which SBI reviewed and concluded were inferior to the SBI recommended single provider program. SBI did not state whether the single provider option would replace all other providers or compete with them.

Howard Bicker, SBI Director, provided a brief overview of the 1997 SBI report. He testified that teachers are getting inconsistent, poor quality information. He testified that the program is costly and burdensome for school districts and rigid and inflexible for teachers. He further testified that the single administrator should be either MSRS or TRA and should be modeled after the State Deferred Compensation Plan.

Rep. Mares stated that currently the State administers the 457 Deferred Compensation Plan but is not involved with the 403(b) program. Mr. Bicker agreed. Rep. Mares asked if SBI's recommendation would eliminate the eight insurance companies participation? Mr. Bicker responded that it would depend on what the Legislature passed. He testified that an SBI program could be just another option and the insurance companies could continue to be available. The recommendation envisioned a statewide program that would utilize various educational facilities to provide ongoing, consistent information to teachers given by educational people rather than commissioned sales people. Rep. Mares asked how SBI's cost could be lower than what is available through the free enterprise system's many options? Mr. Bicker responded that insurance companies have administrative costs, investment management costs, and surrender charges which average around 2%. If the State chose to have a plan like this, SBI could negotiate a contract with individual mutual funds to have administrative fees ranging from three or four hundredths of a percent for an index fund to possibly one percent for an aggressive international fund. In addition to contracted fees, SBI would also need approximately one half percent for administrative expenses to pay for the educational force and for the third party record keeper to calculate the maximum exclusion allowance. That would bring the average cost of a statewide plan to a high of one and one half percent compared to the 2% average cost for insurance companies.

Sen. Stumpf stated that the goal is lower cost and better information. Which approach would Mr. Bicker recommend to achieve that goal, more SBI control or increasing the number of vendors and mutual funds to compete with SBI? Mr. Bicker responded that insurance companies compete to gain access to the teacher but do not provide comparisons with other companies or compete among themselves to reduce their costs. Increasing the number of vendors, in reality, only increases the number of people trying to reach the teacher.

Rep. Mares asked how many representatives go around the State to provide information on the Deferred Compensation Plan? Rep. Mares also questioned why Dakota County does not use the State Deferred Compensation Plan? Mr. Bicker responded that approximately twelve people travel around the State providing informational sessions to public employees. He also noted that the contract required them to cover the entire State. With regard to Rep. Mares question about Dakota County, Mr. Bicker responded that Dakota County chooses to have its own 457 plan. He stated that SBI's 457 plan fees are lower and the plan offers greater flexibility than the Dakota County plan because SBI has much greater purchasing power.

Rep. Krinkie asked why not have SBI educate teachers without administering the plan? Mr. Bicker responded that using that method would add another layer of costs to the current program rather than reduce costs.

Sen. Stumpf asked if there was an error on page 11 of the SBI report where it stated that the insurance company's commission is 55% of the first year's premium on a whole life policy? Mr. Bicker responded that the SBI report was correct.

Rep. Mares asked if it was correct that when the number of providers were reduced for MNSCU employees, participation dropped by 40%? Mr. Bicker responded that if an employee was already making 403(b) contributions through a particular vendor, they would not be required to stop making those contributions but would have an alternative.

Russ Stanton, a representative of MNSCU faculty members, testified that before a centralized administration was created for the MNSCU plan, 4,500 members participated and afterwards only 2,500 members participated. He also noted that participation numbers are now increasing.

4. **Mandated Commission Interim Project: Comparability of Public Sector and Private Sector Employee Pension and Other Post Retirement Benefits (Second Consideration)**

Lawrence A. Martin, LCPR Executive Director, referred members to the staff memo and noted that this is a mandated study with a report due January 15, 2000. He noted that at the last meeting the Commission chose to combine two of the four options provided in that staff memo. The combination included a review of the available literature and published comparisons of the benefit practices of the public and private sector. The other part of the combination included a comparison of hypothetical benefit amounts for various public and private sector pension plans. He noted that this memo provided some information with regard to the literature review and a draft letter requesting hypothetical benefit calculations that is proposed to be sent to 24 employing units who are members of the Minnesota Business Partnership. He requested that to add balance to the larger business bias of the Minnesota Business Partnership list, members may want to suggest one or more of their main street businesses that may be appropriate to include in this study. Mr. Martin also noted that Rep. Krinkie suggested asking any third party pension plan administrators that could be identified to provide hypothetical benefit calculations. To that end, a draft letter to third party plan administrators was added to member's packets. He referred members to page five of the staff memo for trends he has identified from his initial review of the materials assembled and he reviewed the 11 preliminary findings. He concluded by noting that when the hypothetical benefit calculations come in, he will be able to flesh out and finalize the report.

Rep. Krinkie questioned why, in the second table on page six of the memo under defined benefit plans, the benefits paid out are significantly higher than the contributions paid in? Mr. Martin responded that defined benefit plans are funded in large measure by investment gains over time and are primarily paid out in monthly annuities rather than in lump sums and that accounts for the benefits being higher than the contributions. Rep. Krinkie stated that he believes that this study will permit the Legislature to get a better idea of where the State of Minnesota fits as far as pension benefits are concerned.

Rep. Wenzel questioned if public sector employers are choosing defined contribution plans more frequently now because they are cheaper for taxpayers than defined benefit plans? Mr. Martin stated that the perception is that defined contribution plans are cheaper and they can be if the defined benefit plans compared to them are greatly underfunded. Mr. Martin stated that defined benefit plans tend to benefit older, long service employees and not all employees fit that demographic. Defined contribution plans provide benefits to all participants and may actually be more expensive. He noted that MSRS has an employer contribution of 4% which is about the equivalent of providing an employee with a two week vacation. It would be difficult to find a defined contribution plan with an employer contribution cheaper than that.

Rep. Wenzel questioned whether the study would compare Minnesota to its neighboring states? Mr. Martin stated that comparison was not included in the mandated study but could be included if members wished to see that information.

1. **Approval of Minutes of the Commission Meeting of July 29, 1999**
Sen. Betzold moved approval of the meeting minutes for the July 29, 1999, meeting. **MOTION PREVAILED.**

2. **Revision of Commission Rules: Quorum and Recommendation of Proposed Legislation Requirements**
Mr. Martin referred members to the second paragraph of Rule 5.0 and noted that when Commission membership was increased to 12, this rule was changed to reflect the increase. He recommended that since the Commission membership law was amended to decrease the membership to ten last Session, it would be appropriate to change the quorum from seven to six members and change the requirement for legislative action from four members to three members from the House and three members from the Senate.

Sen. Stumpf moved approval of the recommended Commission Rule changes. **MOTION PREVAILED.**

Mr. Martin noted that Rule 8.0 requires approval by four members from each body to change the rules. He did not recommend changing that rule.

Sen. Pogemiller questioned whether Rule 9.0, which was noted in the footnote at the bottom of the page, should be considered for reinstatement. The rule required pension bills to be introduced on a timely basis to be considered by the Commission. Discussion followed and it was agreed that Rep. Mares would send a letter to all members noting that this will be a short session and requesting that all major pension bills be offered early to permit appropriate time for consideration.

5. **Commission Interim Topic: Volunteer Firefighters; Various Changes to the Volunteer Firefighter Laws (Second Consideration)**
Rep. Mares noted that volunteer firefighter representatives had come to him with this bill and it was his intention to have it reviewed by a Subcommittee of the Pension Commission. He asked members to let him know if they were willing to serve on the Subcommittee.

Mr. Martin referred members to the staff memo and attachments. He noted that the packet included a staff memo (dated August 26, 1999), a delete everything amendment (LCPR99-253) (which implemented the changes proposed by MARAC), Attachment A (which provided background information on volunteer firefighters and information on volunteer firefighter benefits), Appendix B (basic liability, asset, and funding ratio information), Appendix C (contribution percentages and source information), Appendix D (investment dollar-weighted performance and asset mix information), and finally, two letters from MARAC that led to the drafting of the delete everything amendment. Mr. Martin referred members to page four of the staff memo and began to summarize the 15 changes included in the delete everything amendment. He stated that this will provide the basis of the Subcommittee's deliberations. He noted that the balance of the memo dealt with the policy issues raised by the proposed changes.

Nyle Zikmund, representing MARAC, testified that these issues have been raised by MARAC members over the last several years. He noted that he has already been involved in discussions with both the League of Minnesota Cities and mutual fund insurers.

Rep. Mares again requested that members interested in serving on the Subcommittee contact him or Commission staff.

Rep. Murphy asked for an update on the building for the three statewide funds but the representatives of those funds had already left the meeting. Rep. Mares stated that he would add an update on the building process as an agenda item on the next agenda.

The meeting adjourned at 12:15 P.M.

Jean Liebgott

Jean Liebgott, Secretary