Background Information on MnSCU-IRAP Plan and Supplemental Retirement Plan; Prior Requests to Change Coverage Election

The Minnesota State Colleges and Universities System (MnSCU) Individual Retirement Account Plan (IRAP) plan stems from the late 1980s, when state university and state college teachers and related employees sought coverage by a defined contribution plan rather than the Teachers Retirement Association (TRA). IRAP was established in 1988 (Laws 1988, Ch. 709, Art. 11) as a late addition to the conference committee report on the omnibus pension bill of that session. The IRAP plan, coded as Minnesota Statutes, Chapter 354B, was not implemented until mid-1989 due to problems in ensuring proper Social Security coverage. The plan was expanded to include technical college managerial employees in 1993 and technical college faculty in 1994. The Higher Education IRAP plan covers faculty members and upper level administrator personnel at MnSCU who wanted defined contribution rather than defined benefit plan coverage. The Higher Education IRAP plan does not cover faculty or administrators at the University of Minnesota.

Pension plans are classified either as defined benefit plans or defined contribution plans. Defined benefit plans establish a procedure or method (usually a formula) under which retirement annuities and benefits are calculated and are pre-determinable, leaving the pension plan contribution requirement a variable to be assessed periodically through the preparation of an actuarial valuation. Defined contribution plans establish a pension plan contribution requirement, leaving the calculation of an eventual retirement annuity or benefit to occur at the conclusion of the member's working career, based on the intangibles of investment income, age at retirement, and expected mortality.

The argument made by initial proponents of a defined contribution plan for higher education faculty and administrators is that higher education faculty, as a group, are highly job-mobile in a national market. If the individual changes employment to another college in another state, the individual retains the full value of the IRAP account, and that account continues to grow in value over time due to the continuing investment earnings on the account. A defined benefit plan, in contrast, favors individuals who provide long service for a single employer or at least within the same multi-employer retirement system. Under a defined benefit plan, an individual who leaves the plan after a few years may take a refund of the employee contribution plus interest at a rate specified in statute, but that does not include the employer contributions made on behalf of that employee, and the remainder of the investment growth on the account. A defined benefit plan, like TRA or one of the first class city teacher plans, may be a better choice for higher education faculty members who, through personal choice or lack of opportunity, are less mobile, particularly as these individuals become long-term employees. A defined benefit plan may also be best for higher education faculty members who have considerable prior TRA or first class city teacher plan covered service prior to hire or due to their past higher education service benefit plan coverage.

When the Higher Education IRAP plan was initially implemented, IRAP coverage was mandatory for new hires without prior covered service, while employees in eligible positions who had prior TRA service were given an option to elect IRAP rather than continuation of defined benefit coverage. Election rights and election procedures were frequently revised over the years. At the current time, all MnSCU employees have the coverage which they freely elected. Currently, new IRAP members are permitted to elect TRA coverage during the first year of employment. IRAP is the default coverage if TRA is not elected. Elections are irrevocable. (Also, in 2009 a provision was enacted permitting MnSCU faculty members with IRAP coverage to elect to transfer to TRA within one year after achieving tenure. If the newly tenured faculty member elects TRA, that person must also purchase past service credit in TRA at full actuarial value. The provision expires on June 30, 2014.)

The MnSCU higher education faculty is also covered by a plan called the Higher Education Supplemental Retirement Plan, which is also a defined contribution plan. Higher education faculty and administrators are covered by the Supplemental Retirement Plan whether the individual is a TRA member or an IRAP member. The Supplemental Retirement Plan was created in 1967. At that time, TRA provided the primary coverage for higher education faculty and the Supplemental Retirement Plan was created to address deficiency in the benefits provided by TRA. Those deficiencies in TRA benefits were addressed decades ago when TRA moved to using the high-five average salary to compute benefits, and benefits were further enhanced in more recent years. The problem that the Supplemental Retirement Plan was intended to address has been eliminated. Given that elimination, the purpose for continuing the Supplemental Retirement Plan currently is unclear.

Prior Requests to Change the Coverage Election

Over the years there have been various requests to allow at least some MnSCU members to reverse the irrevocable plan coverage elections. Some of these requests have been for single individuals, others for classes of individuals, such as a 2004 bill, H.F. 286 (Huntley): IRAP/Teacher Plans: Technical College Benefit Coverage Re-Election and Combined Service Annuity Inclusion. In 2002, bill drafts were made for a technical college teacher who contended that he should be permitted to reverse his election of IRAP rather than defined benefit plan coverage because he had received inadequate advice prior to making the election and the time permitted for making an election was too short. In 2004 this request was broadened under H.F. 286 (Huntley) to include all technical college teachers who elected IRAP under the elections that occurred when the technical colleges were merged into MnSCU in 1995. These 2004 or earlier bills were not heard. A hearing request for H.F. 286 in 2004 was withdrawn by the author.

The requested second chance election in the 2004 bill likely stemmed from arguments made a few years earlier by the technical college teacher who requested another election. The contention was that technical college teachers, following the merger of the technical colleges into the MnSCU system, were given too short a time period to make the retirement coverage elections, and that retirement coverage information provided to the technical college teachers was so considerable that it constituted an overload. The merger of technical college teachers into MnSCU and the requirement that technical college teachers elect between their prior retirement plan coverage and IRAP was provided for in 1994 (Laws 1994, Ch. 508, Art. 1, Sec. 11; Laws 1994, Ch. 532, Art. 5, Sec. 1, Subd. 2). The provisions were enacted on April 22, 1994, and May 2, 1994, respectively, and became effective 14 or 15 months later, on July 1, 1995. Thus, the process of formalizing the retirement coverage elections should have been no surprise for MnSCU, the four affected teacher retirement plans, the various teacher bargaining units, and technical college teachers.

In 1995 (Laws 1995, Ch. 141, Art. 4, Sec. 9), the actual retirement coverage election period was lengthened from 60 days to 90 days, in response to MnSCU and MnSCU employee bargaining representative requests. Thus, the chronology of the applicable legislation suggests that the technical college teacher transfer to MnSCU and their election of benefit coverage had a very long lead time during which the affected individuals could prepare for this retirement coverage election, and the Legislature specifically addressed the request for additional time to make the election. With more than a year of advance notice and with the choice being a simple one of the selection of defined benefit plan coverage or of defined contribution plan coverage, technical college faculty members should have been well positioned to comprehend the choice that they were requested to make in 1995.

Only three requests, all fairly recent, for special consideration involving IRAP/defined benefit teacher plan elections have been enacted. The justification for the first two provisions appears to be harm done to the employee due to employer error. The first occurred in 2006 (under Laws 2006, Ch. 271, Art. 14, Sec. 8. The source bill was S.F. 2248 (Skoglund); S.F. 2462 (Wagenius)). This involved a North Hennepin Community College employee who should have been given an opportunity to choose TRA coverage rather than continuing in IRAP during elections authorized in 1994. The campus notified individuals of the election by certified mail, but a review of records at the college indicated that the college failed to include this eligible individual in the mailing. The 2006 language permitted the individual to elect prospective TRA coverage, with additional authority to use the IRAP account or any other sources permitted by law to purchase service credit in TRA at full actuarial value back to the date of the 1994-1995 election. A second case occurred in 2008. (It passed as Laws 2008, Ch. 349, Art. 16, Sec. 4. The source bill was H.F. 2803 (Greiling); S.F. 3618 (Marty).) This involved an employee initially excluded from coverage because the initial employment was part-time. The person, first employed in excess of 25% time in 2005 and who became a full-time faculty member in 2007, was covered by IRAP because of a MnSCU failure to inform the individual of retirement coverage options. Under the legislation the individual was permitted to transfer coverage to TRA. To obtain past service credit in TRA, the person's IRAP account was transferred to TRA, and MnSCU was required to pay to TRA any difference between that amount and the full actuarial value of the service credit.

A third special law provision passed in 2010, but the policy justification for that provision is not clear. S.F. 2633 (Sparks); H.F. 2550 (Poppe) was heard by the Commission on February 16, 2010. The situation involved a MnSCU employee, not a faculty member, who had been covered by MSRS-General for many years. The person's MnSCU position was upgraded or reclassified, and due to that upgrade the person was no longer eligible to continue in MSRS-General coverage. Instead, the coverage available to the person was default coverage by IRAP or an election of TRA. Given the past coverage (over 20 years) by MSRS-General, and also some brief prior employment that had been covered by PERA-General, it was clearly in the best interest of the person to elect TRA coverage. This would have permitted the person to use the combined service annuity provision to create defined benefit plan coverage for a long career, and also to permit the person to repay refunds to PERA-General and to MSRS-General for brief periods of uncovered service. However, the person failed to elect TRA, and so the default IRAP coverage applied.

There was no indication of employer error or harm, and representatives from MnSCU, TRA, and an employee union argued against the bill. The Commission, acting as a subcommittee due to lack of a full quorum, took a vote on whether to recommend the bill for inclusion in the Commission's omnibus bill, and the bill failed. However, language similar to the original bill was added to the Commission's omnibus bill in House Government Operations, and was eventually enacted.

The reluctance of the Legislature to reopen IRAP/TRA coverage elections except under extraordinary circumstances reflects concerns about plan cost and other policy matters. Retirement coverage elections are major decisions which should be made by the individual after careful study of the implications. Once an election is made, it cannot be undone without imposing costs and/or shifting risks to other parties. For these reasons, the applicable coverage provisions in current law specify that these elections are irrevocable. Allowing individuals to shift to TRA or first class city teacher plans, in some cases many years after employment commenced, creates adverse selection. Adding very young employees to defined benefit plans is likely to lower plan normal cost. Adding older employees has the opposite effect. The typical new MnSCU employee is likely to be older than a typical K-12 teacher. Allowing MnSCU employees to shift to TRA or a first class city teacher plan after years or even decades of MnSCU service, as is permitted under this draft language, would raise the defined benefit pension plan's normal cost. Also, the individuals who shift to these plans are a self-selected group. They will shift to these plans because they intend to remain in covered service and retire from the plan. (An individual who intends to leave MnSCU employment and move to other college teaching employment in another state would presumably want to remain with IRAP coverage, because the full value of the IRAP account would remain with the individual.) The turnover assumptions (probabilities of leaving covered employment at each age prior to retirement) used by the actuaries in determining defined benefit plan cost is violated, again serving to drive up the true cost of the plan.

The investment markets at a given point in time also create interest in switching to defined benefit coverage. In years when the markets are providing extraordinary returns there is little interest in shifting to defined benefit plans, because individuals are convinced they can do better investing their account than if they would if they had a defined benefit pension plan providing a benefit specified based upon age, high-five salary, and years of service. In bad investment times, individuals with defined contribution coverage are far more likely to seek a switch in coverage because the value of an individual's account will have minimal growth or may fall in value. Allowing a switch to a defined benefit plan moves all investment risk to the plan. However, individuals and retirement funds are investing in the same markets. When the markets provide individuals with weak positive or even negative returns, pension fund investment returns will also be weak, well below the 8.5% long-term return needed by the pension fund.