



TO: Members of the Legislative Commission on Pensions and Retirement  
FROM: Lawrence A. Martin, Executive Director  
RE: Review of the Retirement Plan Design Study  
DATE: September 15, 2011

### Introduction

As a potential item of assistance to the Legislative Commission on Pensions and Retirement in its consideration of the document, the Commission staff has reviewed and analyzed the Retirement Plan Design Study prepared by David Bergstrom, Laurie Hacking, and Mary Vanek.

### Legislative Mandate for a Retirement Plan Design Study

Laws 2010, Chapter 359, Article 1, Section 86, mandated a study of retirement benefit plan design options, providing the following:

**Sec. 86. DEFINED CONTRIBUTION PLAN STUDY.**

The executive directors of the Minnesota State Retirement System, the Public Employees Retirement Association, and the Teachers Retirement Association shall jointly conduct a study of defined benefit, defined contribution, and other alternative retirement plans for Minnesota public employees. The study must include analysis of the feasibility, sustainability, financial impacts, and other design considerations of these retirement plans. The report must be provided no later than June 1, 2011, to the chair, the vice-chair, and the executive director of the Legislative Commission on Pensions and Retirement.

The mandated study language ultimately enacted was an action of the 2010 Omnibus Retirement Bill conference committee, chaired by Senator Don Betzold, and was a substitution suggested by or on behalf of the statewide retirement plan administrators to replace a study provision that was added to the House version of the 2010 Omnibus Retirement Bill as a House floor amendment. The replaced House floor amendment relating to a retirement plan design study provided for the following:

**"Sec. 85. DEFINED CONTRIBUTION PLAN STUDY.**

A study group consisting of representatives from the various state pension plans shall be convened by the Legislative Commission on Pensions and Retirement to study the amount of time and the manner in which the various state pension plans may be transferred from defined benefit plans to defined contribution plans. Administrative support for the study group shall be provided by the Legislative Commission on Pensions and Retirement and the various state pension plans. The report will be provided no later than January 15, 2011, to the chair and ranking minority caucus member of the senate State and Local Government Operations and Oversight Committee and the chair and ranking minority caucus member of the house State and Local Government Operations Reform, Technology and Elections Committee."

### Brief Summary of the Retirement Plan Design Study

The report contains an executive summary, cost findings, plan design comparison findings, study recommendations, and an introduction setting forth the study purpose and scope, discusses pensions and retirement security, presents basic information on the statewide retirement systems and the State Board of Investment, presents proponent and opponent views of retirement plan designs for defined benefit plans, defined contribution plans, and hybrid retirement plans, includes an actuarial consulting firm cash flow analysis of substituting a particular defined contribution retirement plan for the three largest current defined benefit retirement plans for new hires after July 1, 2010, discusses unique considerations with respect to public safety employees, and presents a list of references for the study. Also included in the report are stakeholder comments from the Minnesota Taxpayers Association, the Minnesota Free Market Institute, the Minnesota Nurses Association, an individual teacher, an individual registered nurse, the Minnesota Retired State Employees Association, Inc., Ehrentreich LDI Consulting & Research, LLC, and an individual retired actuary/teacher.

The executive summary sets forth the study purpose, the presentation of proponent and opponent views of defined benefit, defined contribution, and hybrid retirement plan designs, indicates the study contents in addition to reviewing benefit plan options as providing basic data on the three largest retirement plans and

information about the State Board of Investment, indicates that Minnesota is disciplined and proactive in addressing retirement issues, and indicates that a retirement crisis for public pensions, private pensions, and personal retirement savings looms.

Key findings are presented that a shift from defined benefit retirement coverage to defined contribution retirement coverage for new hires would cause high transition costs, lower mid-term costs, and higher long-term costs, a pattern of transition costs similar to those experienced in other states, and would require the institution of a more conservative investment strategy.

Key findings are presented relative to the plan design comparison, focusing on less predictable employer costs for defined benefit plans, greater risks of inadequate retirement income from defined contribution plans, greater defined contribution plan participant investment control, lower defined benefit plan investment costs, greater defined contribution plan popularity with younger, mobile employees, greater defined benefit plan popularity with participants aware of investment risks, long-term defined contribution plan government cost reductions once higher short-term transition costs have been borne, lower defined benefit plan costs than defined contribution plan costs for the same level of benefits paid, greater economic downturn flexibility for defined contribution plans, and mitigated, but not eliminated, liability and longevity risks from hybrid plans.

The study recommendations were for a careful analysis of the transitional financial impacts of a plan design change, which should include the identification of future revenues to offset future costs, consideration of the negative future investment return offset with a plan design change, and an analysis of the benefit adequacy and state and local economy separate from a plan design change

#### Identification of Topics to be Addressed in the Report

The legislation mandating the retirement benefit plan design study indicated that the report was to include the following:

- study of defined benefit retirement plan designs
- study of defined contribution retirement plan designs
- study of other alternative retirement plan designs
- analysis of the feasibility of various retirement plan designs
- analysis of the sustainability of various retirement plan designs
- analysis of the financial impacts of various retirement plan designs
- analysis of other design considerations of various retirement plan designs

The study approach summary presented to the Commission on July 8, 2010, indicated the following about the approach that the study would take:

- Study will identify retirement plan design options and describe their advantages/disadvantages. The study will not make recommendations.
- Retirement systems will conduct study and rely on actuarial firms for special cost analyses. Actuarial analyses will be prepared for three major plans (MSRS General, PERA General, TRA). Actuarial studies will be conducted by Mercer (systems' actuary) with results reviewed for reasonableness by Milliman (LCPR actuary).
- Input and comments will be solicited from stakeholder groups and other interested parties. The draft outline of the study will be circulated for feedback from stakeholder groups.

The study outline presented to the Commission on July 8, 2010, indicated that the report was to include the following:

- I. Executive Summary
- II. Introduction
  - Purpose of study, approach
  - Legislative mandate
  - Methodology used, actuarial analysis, process for involving stakeholder groups
- III. Description of 3 Systems (MSRS, PERA, TRA)
  - Benefit Structure
  - Key Member Demographics
  - Current actuarial status/costs (based FY210 valuations)
  - Investment Program and Historical Returns
- IV. Identify Main Retirement Plan Options
  - DB
  - DC
  - Hybrid DB/DC
  - Cash Balance

- V. Describe Advantages/Disadvantages of Each Option based on criteria such as:
  - Cost predictability
  - Financial Impact – include projections under different economic scenarios
  - Income Security/Adequacy
  - Risk – investment, longevity
  - Investment Performance
  - Portability
  - Recruitment/Retention
  - Generational considerations
  - Additional categories?
- VI. Public Safety Plans – unique considerations
- VII. Public Written Comments
- VIII. Appendix (may include links to studies or websites)
  - Trends Among Other State Retirement Systems
  - Trends in Private Sector
  - Retirement income security studies
  - Economic impact study
  - Other background?

### Topics Clearly Addressed by the Report

1. The report provides a description of a contention that there may be a looming retirement crisis based on inadequate household retirement income, inadequate retirement resources, potential increases in taxpayer funded public assistance costs, and national polling results indicating a public perception that retirement reforms are needed.
2. It provides summary demographic age and service information, retirement plan benefit information, contribution rate history, and retirement plan funded ratio history for the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), and the Teachers Retirement Association (TRA).
3. It also provides a summary of the financial sustainability article of the 2010 Omnibus Retirement Bill.
4. It provides information on the geographic distribution of the three retirement system benefit recipients and their annual benefit amounts in Minnesota.
5. It provides summary information on the structure, fiduciary standard, authorized investments, investment policies and objectives, asset allocation, investment management structure, and investment performance of the Minnesota State Board of Investment.
6. The report defines and summarizes proponent views and opponent views for defined benefit retirement plans and defined contribution retirement plans. It summarizes proponent views and opponent views for hybrid retirement plans.
7. The report provides a projection of annual required contributions for the three largest Minnesota statewide retirement plans under the current defined benefit retirement plan structures and under a transition to a defined contribution retirement plan structure for two or more decades out from 2010 using an 8.5% interest rate actuarial assumption and using a 7.0% interest rate actuarial assumption.
8. It summarizes the unique considerations in considering a retirement benefit plan change for public safety employees.
9. It also provides a list of 90 references related to retirement benefit coverage.

### Topics Insufficiently Addressed by the Report

1. Executive Summary.
  - The presentation of findings was heavily weighted to the question of defined benefit retirement plan coverage or defined contribution retirement plan coverage without a comparable set of findings for hybrid retirement plans (*see Report page 3*).
  - The determination of what constituted the criteria for the inclusion of a finding as a key finding in this section is unclear.
  - The inclusion of recommendations, although more process-oriented than substantive, was contrary to the approach outlined for the Commission in July 2010, and the recommendations appear protective of defined benefit retirement plans rather than being more balanced (*see Report page 4*).

## 2. Introduction.

- Although the outline presented to the Commission in July 2010 indicated that the study methodology would be presented in this section, methodology was not discussed. Mercer generally presented its methodology for its open group retirement plan required contribution projections, but indicated no explicit assumption about the future retirement plan membership size it assumed in its open group cash flow analysis (*see Report pages 86-87*).
- Although the Mercer analysis provides some general impact assessment from a closed retirement plan with a reduced interest rate assumption, the analysis does not include any general impact assessment from a variation of the chosen replacement defined contribution plan that either allowed optional, rather than mandatory, member contributions or that utilized an employer contribution rate that is lower than the member contribution rate, both features which are apparently common in private sector defined contribution retirement plans and which may be of interest to replacement defined contribution plan proponents in the Legislature.

## 3. Pension and Retirement Security.

- The assertion of a looming retirement crisis omitted any discussion as part of a crisis the limited financial capacity of the public sector to meet current and future retirement plan costs, especially in adverse investment market cycles, and overemphasizes, by comparison, benefit adequacy and benefit size over any other criterion for what constitutes a looming crisis (*see Report pages 9-13*).
- The retirement adequacy information presented used a replacement of the pre-retirement income level at retirement measure, rather than other measures of retirement adequacy at retirement or other measures of retirement adequacy throughout retirement (*see Report pages 8-9*).
- The retirement adequacy goal discussion only indicates adequacy for the age 60-62 category, without addressing whether or not that is an appropriate retirement age to be used in defining benefit adequacy goals (*see Report pages 8-9*).
- Retirement benefit adequacy is inherently a defined benefit retirement plan-leaning consideration, but it is not necessarily a more valued public policy goal and consideration than public sector fiscal frugality or than the replication of private sector compensation and benefit practices in the public sector. Neither of those potential alternative policy goals was discussed as an analysis consideration in the report.
- This portion of the report, presented as background or context information and not as proponent or opponent statements, also draws heavily on a publication of the National Institute on Retirement Security, which is a four-year-old nonprofit corporation that was founded by three other organizations, the Council of Institutional Investors (of which two-thirds of the membership were either union affiliated or public sector defined benefit-public sector retirement plan affiliated), the National Association of State Retirement Administrators, and the National Council on Teacher Retirement, suggesting that the organization and its analysis may have a defined benefit preference or bias (*see Report page 12*).

## 4. Statewide Retirement Plan Information

- The summaries of the MSRS-General, PERA-General, and TRA benefit plans did not clearly identify the full set of components typically contained by defined benefit plans, such as disability coverage, survivor coverage, past service credit purchases, refunds, and refund repayments, making comparisons with the totality of a typical defined contribution retirement plan or a typical hybrid retirement plan difficult (*see Report pages 17, 21, and 25*).
- The three statewide retirement plan comparisons also omit any information on or the extent of utilization of the current elective supplemental defined contribution coverage of Minnesota public employees through a deferred compensation plan or a tax-sheltered annuity plan with a matching employer contribution, which may be an important consideration with respect to hybrid retirement plan options.
- The retirement contribution histories for the three retirement plans omits any indication of a comparison of the total contribution rates with the total actuarial requirement rates, since past total contribution rates have not always been well-correlated with the total actuarial requirements (*see Report pages 18, 22, and 26*).
- The summary of the State Board of Investment approaches and results does not include any information on recent State Board of Investment asset class portfolio forward-looking economic modeling results, which reportedly were made available to the three retirement system boards and were apparently the basis for those boards declining to ratify Mercer's recommendation to change to an 8.0% interest rate actuarial assumption. If that State Board of Investment analysis was so persuasive for the three boards to decide to retain the current 8.5% interest rate assumption, it may also have a bearing on Commission deliberations on the future of Minnesota public sector retirement coverage (*see Report pages 39-47*).

## 5. Retirement Plan Designs.

- In the presentation of the defined benefit retirement plan proponent arguments, a majority of assertions (24 of 43) have a citation to a third-party source, but in the presentation of the defined benefit retirement plan opponent arguments, only 10% (two of 20) opponent view assertions have indicated third-party sources. Similarly, of the defined contribution retirement plan proponent arguments, only five of 21 assertions have a citation to a third party, while 24 of 27 defined contribution retirement plan opponent assertions have a specified third-party source. Also, hybrid retirement plan proponent assertions have an indicated third-party source in only four of 30 instances, while 30 of 44 hybrid retirement plan opponent assertions have third-party sources indicated. Presumably, all of the proponent and opponent assertions for the three categories of retirement plan designs could be sourced to one or more third-party sources with diligent research. The striking difference on the number of indicated third-party sources provides an impression that favors one category of retirement plans and disfavors the other two categories of retirement plans (*see Report pages 50-80*).
- Also, the proponent and opponent assertions in each category of retirement plan are not clearly weighted in any fashion in the analysis, meaning that each assertion could be viewed by a report reader as having equal merit with every other assertion and that defined benefit retirement plans, with 43 positive and 20 negative assertions, should be favored over defined contribution retirement plans, with 21 positive and 27 negative assertions, and over hybrid retirement plans, with 30 positive and 44 negative assertions (*see Report pages 50-80*).
- The hybrid retirement plan presentation provided a very limited description of a blended defined benefit/defined contribution plan, without providing any sense of the components of a stripped-down defined benefit retirement plan in Minnesota beyond a changed benefit accrual rate, does not provide an easily understood definition of a target benefit plan, and lumped all of the proponent and opponent assertions for the four described hybrid retirement plans together, blurring the analysis (*see Report pages 50-80*).
- A transition from a defined benefit retirement plan beyond the set date phase-out for new hires costed out by Mercer is not considered or addressed and its absence does not provide assistance to policymakers for other possible transitions, such as a mandatory transfer of all non-vested plan members or as the authorization of an elective transfer by existing plan members with some accompanying asset transfer.
- The appropriate retirement plan design for judges, who could represent a special case akin to public safety employees, is not addressed in the report.
- In the public safety employee unique consideration discussion, no third-party sources are indicated for any of the analysis, even for identified experiences in other states, such as the Anchorage, Alaska, public safety retirement coverage changes.

## Additional Specific Critiques

### 1. Pensions & Retirement Security.

- The report cites a Boston College Center for Retirement Research study that reveals a \$6.6 trillion retirement income deficit without specifying how the figure was calculated, and, because the author of the study was not cited and neither Boston College nor the Center for Retirement Research was separately indicated in the bibliography, it is very difficult to identify and consult the actual study (*see Report page 7*).
- The report attributes a study on insufficient retirement resources and an 85% post-retirement income replacement rate for adequacy to the Wall Street Journal, but the Wall Street Journal simply reported the two points, which appear to be more appropriately attributed to the Federal Reserve and to the Center for Retirement Research at Boston College upon an actual review of the cited article (*see Report pages 8-9*).
- The study's indicated response to outside criticism of its use of an 85% replacement rate for adequacy appears both overly defensive and overly argumentative (*see Report page 9*).
- The report is incorrect on its identification of the history of Georgia State University and AON Consulting in replacement rate studies, with Georgia State University involved in those studies for 30 years and with AON Consulting involved in those studies for 20 years only based on a Commission staff Internet search (*see Report page 9*).
- In a comparison drawn from a compensation study done by the Minnesota Taxpayers Association, the report inaccurately labels the comparison as a "compensation comparison" when the comparison is actually a retirement benefit comparison (*see Report page 13*).

## 2. Pension Plan Information.

- The report entitles a portion of its section on Minnesota public pensions in perspective “Prompt, proactive action taken in 2010 and in previous decades,” which briefly introduces the 2010 financial sustainability legislation, but does not actually discuss previous decades (*see Report page 28*).
- Under a comparable section title on page 32, some discussion of pre-2010 benefit reforms is presented, but distorts some of the cited legislative changes (such as the omission of the fact that the cited 1989 legislation actually first added the Rule of 90 early subsidized normal retirement age for MSRS-General and TRA members as of that date) and omits inconsistent retirement plan-supported legislation (such as the 1993 repeal of the provision that would have eliminated the Rule of 90 if the provision was used to too great an extent (*see Report page 32*)).
- In comparing member and employer contribution rates between Minnesota and nationally, potentially arguing that Minnesota retirement plans are economical, the comparison does not disclose that the total contribution rates in most Minnesota retirement plans are deficient when compared to the calculated total actuarial requirements (*see Report page 34*).
- The citation to a Deloitte publication, “Deloitte, International Foundation of Employee Benefit Plans, 2009, 401(k) Benchmarking Survey,” in this section of the report differs in the text when compared to the apparent citation in the references, “Deloitte. (2009). Annual 401(k) Survey: Retirement Readiness,” although both seem to describe the same source of information (*compare Report page 35 with Report page 104*).
- The report suggests that Minnesota public pension benefit levels are modest or relatively modest, without providing any source or measure of what the criteria is that constitutes modest or relatively modest benefit levels (*see Report page 36*).
- The graphic and chart in the report presents information on the benefit recipients of three retirement funds, but does not clarify whether the figures are only for the three largest statewide retirement plans (MSRS-General, PERA-General, and TRA) or whether the figures are for all of the retirement plans administered by MSRS, PERA, and TRA (*see Report pages 37-38*).

## 3. Retirement Plan Designs.

- An analysis point on the cost of defined benefit plan coverage cites “a recent study” and also cites a GAO study, without making it clear whether the two references relate to the same study (*see Report page 57*).
- Another analysis point on the cost of defined benefit plans combines information related to Minnesota with an unclear sourcing and then cites a study by Alicia Munnell on member contribution increases and retiree benefit reductions which is not included in the listed references and which was published after the publication date of the report (*see Report pages 51 and 106*).
- Recruitment and retention as an analysis point was raised as a proponent point for defined benefit plans, as an opponent point for defined contribution plans, and for both proponent and opponent points for hybrid plans and omitted as an opponent point for defined benefit plans and as a proponent point for defined contribution plans, even though Minnesota has experience in creating defined contribution plans for employee groups opposing defined benefit plan coverage and favoring defined contribution plan coverage in the creation of the MSRS Unclassified State Employees Retirement Program, the PERA Defined Contribution Retirement Plan, and the Minnesota State Colleges and Universities System Individual Retirement Account Plan (*see Report pages 54, 66, 75, and 79*).
- The results on the administrative and investment costs of defined contribution plans as twice as high as defined benefit plans does not indicate whether the comparison was adjusted for the same plan size, since many defined benefit plans have large memberships and many defined contribution plans have very small memberships (*see Report page 63*).
- An analysis point opposing defined contribution plans on transition costs indicates that the actuarial results prepared by Mercer were similar to other studies in other states, without citing a specific source for the point, and also cites a Standard and Poor’s source that is available only by subscription and thus is generally unavailable (*see Report page 64*).
- The report provides no private sector or public sector examples of target benefit plans, cash balance plans, and hybrid floor plans, limiting the report’s value to policymakers who may desire to explore those options (*see Report pages 72 and 81-82*).

## 4. Mercer Analysis.

- The placement of the 14-page presentation of an actuarial analysis and implications after the hybrid benefit plan section and before the section discussing unique considerations for public safety plans, rather than as an appendix item or an additional inclusion item representing stakeholder comments, is confusing and risks obscuring that public safety employee analysis.