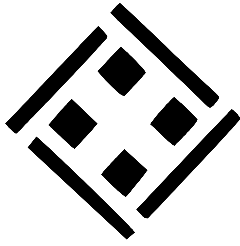

February 15, 2002

Restructuring of the Minnesota Teacher Retirement Plans

Submitted in accordance with the 2001 Omnibus Bill,
Laws of 2001, First Special Session, Chapter 10, Section 20,
Implementation Plan; Aggregation of Teacher Retirement Plans

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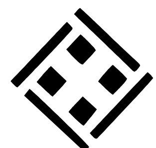

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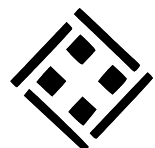


Executive Summary

The 2001 Legislature enacted a provision of law requiring the directors of the four public school teacher retirement funds that exist in the State of Minnesota to prepare and submit to the Legislature a report on the possible restructuring of the Minnesota teacher retirement plans. According to the provision, the four directors must:

1. Prepare a report detailing the steps necessary to create a single, restructured teachers retirement plan;
2. Establish and consult with a Task Force of representatives of both the affected employing units and pension plan members;
3. Include in the report proposed legislation, a detailed schedule and a timetable for completion;
4. File the report by February 15, 2002, to the Legislature.

The report is divided into four sections.

Section I provides background information including the study charge, the advisory Task Force, the process followed, historical information of the funds, and a list and summary of the reference materials used in preparing the report.

Key to the process was the understanding that the resulting proposal would be for a new restructured teachers retirement plan, and not simply an administrative consolidation of the four plans into one of the existing plans. Inherent in the proposal is the fact that the teacher members and the employers of the four existing plans must see tangible benefits resulting from the adoption of a new structure, governance and benefit package.

Section II focuses on tenets of the restructured plan that have been agreed upon by the four directors and the members of the Task Force. Of primary importance is the agreement that the structure of the restructured plan would be a nonprofit corporation with assets held in trust for the exclusive benefit of its members. The new plan will be designed according to the model outlined in the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) promulgated by the Uniform Law Commissioners in 1997, which gives full and exclusive authority and responsibility to its Board of Trustees. While agreement could not be reached on exact Permanent Board of Trustee composition, it was agreed that there would be a need for a Transition Board prior to the election and/or appointment of the Permanent Board.

Using the UMPERSA structure, the trustees of the restructured plan would have full, exclusive authority to establish an administrative budget, obtain services, and procure goods and property. The state would retain its authority to establish benefit levels and make other amendments to the plan. Membership in the restructured plan would follow the same criteria as currently exists, with the exception that Basic Plan members (non-Social Security) of the Minneapolis and St. Paul TRFAs would remain with their respective funds as closed funds.

Financing considerations will be a major issue in restructuring. Some recommendations are presented.

Analysis of current benefit provisions demonstrates that the benefits provided at the time of retirement are among the poorest in the nation, while the post-retirement adjustments are extremely generous. Proposed are significant improvements to the initial benefits provisions that would be partially funded by adopting a more traditional COLA provision.

Current retirees would not be impacted by the new benefit provisions. TRA retirees, as well as the coordinated retirees of the first class city funds, would receive their benefits from the Minnesota Post Retirement Investment Fund (Post Fund) according to existing provisions. St. Paul and Minneapolis TRFA Basic Plan retirees would elect to either remain with their existing fund or begin receiving benefits from the Post Fund. In addition, special consideration is made to preserve the existing Old Plan benefit provisions for a limited number of active Duluth TRFA members.

Full accountability, oversight and disclosure mechanisms as recommended by the UMPERSA model will be incorporated into the new plan.

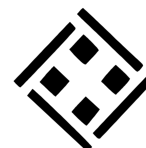
A tax-sheltered 403(b) retirement savings plan and supplemental medical programs will be administered internally by the new plan.

Section III includes issues that have been discussed, but not resolved, and issues remaining to be addressed. Included are the topics of investment authority, board structures, and timelines.

Section IV discusses the process for dissolution or merger of the first class city funds as nonprofit corporations and proposed legislation.

Section I: Background

1. Study Charge
2. Introduction
3. Organization of Report
4. Study Process
5. Historical Background
6. Review of Literature



Section I: Background

Chapter 1: Study Charge

The 2001 Legislature enacted a provision of law requiring the directors of the four teacher retirement funds in the State of Minnesota to prepare and submit to the Legislature a report on the possible restructuring of the Minnesota teachers retirement plans. This report is to be submitted to the Legislature by February 15, 2002.

The language contained in the 2001 Omnibus Bill, Laws of 2001, First Special Session, Chapter 10, Section 20 is as follows:

Sec. 20. [IMPLEMENTATION PLAN; AGGREGATION OF TEACHER RETIREMENT PLANS.]

(a) The executive director of the teachers retirement association, the secretary of the Duluth teachers retirement fund association, the executive director of the Minneapolis teachers retirement fund association, and the secretary of the St. Paul teachers retirement fund association jointly shall prepare a report detailing the steps that would be necessary to create a restructured teacher retirement plan if the legislature subsequently determines that this restructuring would be in the best interests of the state, its taxpayers, and the public education community.

(b) In preparing the report, the pension plan administrators must establish and consult with a task force. The task force must consist of representatives of the affected employing units and representatives of the collective bargaining organizations representing members of the affected pension plans.

(c) The report must include the draft proposed legislation that would be required to create a restructured teacher retirement plan as well as a detailed schedule and timetable of the completion steps for the creation of a restructured teacher retirement plan.

(d) The report must be filed by February 15, 2002, with the chair of the legislative commission on pensions and retirement, the chair of the senate committee on state and local government operations, and the chair of the house committee on government operations and veterans affairs policy.

Chapter 2: Introduction

The four teacher pension fund directors who are members of the Study Committee preparing this report are:

J. Michael Stoffel, Executive Secretary
Duluth Teachers' Retirement Fund Association (DTRFA)

Karen Kilberg, Executive Director
Minneapolis Teachers' Retirement Fund Association (MTRFA)

Gary Austin, Executive Director
Minnesota Teachers Retirement Association (TRA)

Eugene R. Waschbusch, Secretary/Treasurer
St. Paul Teachers' Retirement Fund Association (SPTRFA)

The directors worked with a consulting Task Force consisting of individuals who either a) represented the various bargaining groups representing the active teacher members of the four teacher retirement funds, or b) represented the interests of the employers of the four teacher retirement funds. The members of the Task Force are listed below:

Restructuring Advisory Task Force

Carol Ackerson	TRA Member Representative
Greg Burns	Education Minnesota
Mary Glass-LeBlanc	Duluth School Board
Ian Keith	St. Paul Federation of Teachers
Bob Lowe	Minnesota School Boards Association
Louise Sundin	Minneapolis Federation of Teachers
Ross Taylor	Minneapolis School Board
Mary Thornton-Phillips	St. Paul School Board
Pam Wheelock	Minnesota Department of Finance
Mike Zwak	Duluth Federation of Teachers

The fund directors wish to thank the members of the Task Force for their willingness to serve and for their assistance in sharing their ideas and concerns on behalf of the groups they represent.

Chapter 3:

Organization of Report

This report is divided into four sections. Section I is titled *Background*, and is included to familiarize the reader with historical information about the four existing teacher retirement fund associations, and with information on modern pension administration and previous studies, which became the rationale used in developing the proposals in this report.

Section II is titled *Agreed Upon Tenets for a Restructured Minnesota Teachers Retirement System*. This section details the structure, benefits and oversight that have been agreed to by the four directors and the members of the Task Force. It is intended by the writers that the information contained in this section will be complete, compelling and justify the inclusion of the topic in the proposal.

Section III is titled *Issues Remaining to be Resolved/Addressed*. The topics listed in this section have been researched, analyzed and discussed by the authors and the Task Force. Research and discussion will continue, with the expectation of a solution and agreement. In addition, there are important issues that have not been addressed.

Section IV is titled *Steps to Restructuring*. This section is a description of the implementation steps that are necessary to accomplish the restructuring of the Minnesota Teacher Retirement Plans. Included is proposed legislation to continue the study process.

Chapter 4: Study Process

Early in the year 2000, the directors of the four Minnesota Teacher Retirement Plans held a series of meetings with representatives of Education Minnesota to see if there was any benefit to the public school teachers in the State of Minnesota in aggregating the four existing teacher retirement plans into one. The primary thought that was requisite to engaging in these discussions was that the resulting proposal would be a new "restructured" plan, not simply an administrative consolidation of the four plans into one of the existing plans. The chief concern of an administrative consolidation is that this could create actual or de-facto subgroups, an idea that is opposed by the directors and the Task Force as discussed later.

Inherent in the proposal contained in this report is the fact that the teacher members and the employers of the four existing plans must see reasons for and tangible benefits resulting from the adoption of a new structure, governance and benefit package.

Another key item in the discussions and agreements was that this proposal should be considered as a package. The various tenets are not to be thought of as separate issues, some of which could be selected and others rejected and discarded. The package of agreed upon items is the result of such discussion and negotiation and represents a consensus of the affected groups.

There is much information that must be understood by the readers of this report and the policymakers that will be acting on it. Understanding this essential information will aid the reader in gaining the desired perspective of the four directors and the boards they represent. One fundamental piece of information is an understanding of the current and historical benefit and financing structure of the four teacher retirement plans. Please see Chapter 5 and *Appendix A* for a comparison of the structure of the four teacher retirement plans and historical funding information.

In the initial stages of this study, the four directors and the Task Force brought forth a multitude of topics and issues. As these issues were discussed and research was completed, the concept of creating a system that employed the *Best Practices of Pension Management* became of paramount importance.

A partial listing of topics and issues that have been proposed and will be addressed in depth later in this report because they meet the best practices test is as follows:

- Legal Form of Restructured Plan
- Board/Governance
- Authority/Fiduciary Duties
- Membership
- Benefits
- Modification of Post-Retirement Adjustments
- Contributions
- Liabilities
- Oversight
- Benefit Guarantee
- Basic Plan Members (members not covered by Social Security)
- Ancillary Benefits (creation of a supplemental tax-sheltered 403(b) plan, post-retirement medical savings plan, and/or Medicare supplemental plan)

During the process of developing this report, the directors of the teacher retirement funds met 13 times throughout the year. Meetings were held at each of the retirement fund offices. These meetings were held to develop the restructuring plan, prepare for presentations to the Task Force, and to assemble this report.

The Task Force met three different times. In the first meeting, the directors described the direction of the restructuring plan that they had envisioned. The second meeting of the Task Force was held one month following that first meeting. The second meeting was designed to allow Task Force members to react to the information they heard at the first meeting, and to provide feedback to the directors that they may have obtained from their constituent groups. During the second meeting, the directors also presented more details about parts of the restructuring plan that had been developed since the first meeting. The third meeting of the Task Force was to allow members the opportunity to provide the directors with comments about a draft of this report that had been provided to them in advance.

Chapter 5:

Historical Background

The directors of the four teacher retirement plans are including a chapter on the history of funding and benefits in each of the respective plans. It is hoped that this information will help provide an understanding of the current status of each of the plans.

The Duluth Teachers' Retirement Fund Association Story

The Duluth Teachers' Retirement Fund Association (DTRFA) began in 1910 as a nonprofit organization for the public school teachers in the City of Duluth. Initially, and up to 1975, the employer contributions were financed by local property taxes, levied by the City of Duluth. The Trustees of the fund had authority to set member contribution rates, based upon actuarial recommendations. The Trustees also had authority to set employer contribution rates, subject to local budgetary controls and approvals passed by the Duluth City Council.

The fund was put on an actuarial reserve basis in 1919. By 1965, the fund attained a 100 percent funding level, and since then has remained relatively strong.

Duluth became coordinated with the Social Security system in 1957 following a member referendum. Since that date there have been no Basic members in the Duluth plan. At the time of the conversion to a coordinated system, the employee contribution rate was set at 4.5 percent.

In 1975, legislation took away the authority for the City of Duluth to levy the employer contributions. These contributions became the obligation of the State of Minnesota. At that time the employer contribution rate was 5.5 percent.

An important difference in employer contribution rates among the three first class city teacher retirement funds occurred in 1979. The Duluth employer contribution rate for all its coordinated members was set at 5.79 percent. In the St. Paul and Minneapolis teacher funds the employer contribution rate for coordinated members was 4.5 percent, and was not increased until some time later. The employer contribution rate for Duluth remains at 5.79 percent today.

In 1995, the employee contribution rate was increased from 4.5 percent to 5.5 percent to provide additional funding for the benefit improvements passed into law that year.

Following legislation passed in 1997, the DTRFA began to receive an additional $486,000 in annual state aid payments as part of a package of benefit improvements and funding. Contingent upon a clarification of state statute, it appears that state aid payments will be permanently discontinued in 2002.

The Minneapolis Teachers' Retirement Fund Association Story

The Minneapolis Teachers' Retirement Fund Association (MMTRFA) was established in 1909 with permissive language in Minnesota Statutes. From the time of its establishment until 1975, the City of Minneapolis was the employer of record for the MTRFA. During that time the MTRFA would certify annually to the city the amount of the required employer contributions. Because of levy limits, the city did not always provide the MTRFA with the amount certified and an unfunded liability began to accrue.

By 1974, the city was contributing enough to put the MTRFA on a fully funded track for the statutory amortization date of 1997 and the funding ratio was 57 percent. In 1975, the state passed new laws that changed the employer from the city to the State of Minnesota. The accrued unfunded liability of over $76 million owed by the City of Minneapolis was never addressed. There was an increase in benefits at the same time and even though the employer contribution stayed the same and the employer supplemental contribution decreased, the employee contribution increased from 6.5 percent to 8.5 percent. Later adjustments were made in the employer contributions but they still were not sufficient to eliminate the funding deficiency.

In 1978, the Coordinated Plan was established, which meant that any new teacher hired became a member of that plan instead of the old basic plan. It also meant that, unlike TRA or Duluth, when a teacher retired the fund lost the employer supplemental contribution it had been receiving to help pay off the unfunded liability. It took until 1993 to restore the employer supplemental contribution, but instead of being based on the funding needs of the MTRFA, it was based on the amount that TRA employers were paying. At the time TRA was over 82 percent funded with a 0.41 percent deficiency and the MTRFA was about 54 percent funded with a 11.57 percent deficiency.

When the employer of record was changed in 1986 to the school district, the unfunded accrued liability had ballooned to over $267 million. Again, the accrued unfunded liability was never addressed. The funding ratio was 50.81 percent but mainly because the amortization date had been moved in 1979 to 2009 and the earnings assumption was changed in 1983 from 5 percent to 8 percent. (This change alone brought the funding level from 38.2 percent in 1983 to 45.3 percent in 1984.)

During the decade of the 90s, the City of Minneapolis, the Minneapolis school district, the state and the members of the fund all participated in providing additional support for the funding of the MTRFA. The schedule below shows the impact of this legislation:

1993 Funding				**1996 Funding***			**1997 Funding**	
Calendar Year	**City**	**School District**	**State**	**Calendar Year**	**City**	**School District**	**Ended June 30**	**State**
1994 and thereafter	$1,250,000	$1,250,000	$2,500,000	1998	$ 250,000	$ 250,000	1998	$17,954,000
				1999	400,000	400,000	1999 and thereafter	12,954,000
				2000	550,000	550,000		
				2001	700,000	700,000		
				2002	850,000	850,000		
				2003 and thereafter	1,000,000	1,000,000		

**The 1996 funding legislation also provided for reallocation of amortization state aid to the MTRFA. The amount of this funding for the MTRFA started at $1,084,189 in MTRFA fiscal year 1996 and has increased to $1,740,029 in MTRFA fiscal year 2001.*

Besides these additional contributions the members of the fund are now assessed administrative expenses if the cost of operating the MTRFA exceeds that of the TRA. Furthermore, retirees have their post-retirement adjustments decreased by the contribution deficiency.

In 1997 when a formula increase was granted to coordinated members along with all other public employees, the cost of this increase was paid for solely by the members. MTRFA members pay 5.5 percent for normal costs while the employer pays 4.5 percent. (It should be noted that TRA coordinated members pay 5.0 percent for slightly better benefits.)

The MTRFA is certainly grateful for the additional support that has been granted during the 1990s, but unfortunately these contributions still fall short of what is needed to put the MTRFA

on a fully funded track. According to the LCPR actuary, the funding deficiency has increased to -2.73 percent in 2001 from a sufficiency of 0.38 percent in 1997 and the funded ratio has decreased from 67.38 percent in 1999 to 65.95 percent in 2001. In the 2001 valuation the LCPR actuary lists the following as reasons why the MTRFA is in a dangerous funding position:

1. The current statutory rates are less that those that should be required.
2. Current amortization is a fixed date and that means there are higher requirements to pay the bill on time.
3. The supplemental contributions of 1993, 1996, 1997 are fixed amounts and subsequently would be a smaller percentage of payroll in years ahead.
4. The MTRFA post-retirement COLA has a built-in bias for loss to the plan.

Not listed but also a contributing factor is higher than expected number of retirements, which have increased the liabilities.

For a more detailed look at the funded ratios and contribution rates, please see *Appendix A*.

The St. Paul Teachers' Retirement Fund Association Story

The St. Paul Teachers' Retirement Fund Association (SPTRFA) began in 1909 as a nonprofit public employee retirement plan for the public school teachers located in the corporate limits of the City of St. Paul. The plan operated on a "pay as you go" basis from inception to 1955. "Pay as you go" means that employees were required to contribute a percentage of pay to the fund and the fund used the employee contributions to pay current retiree benefits with little or no chance to build a reserve. SPTRFA did not receive any employer contributions from the City of St. Paul or from the State of Minnesota until 1955. At that time the SPTRFA fund reserves were under $300,000, which was about six months annuitant payroll.

The funding ratio of SPTRFA in 1955 was about zero. The Legislature began to require contributions from the employer at that time. This requirement began the progress toward fiscal solvency. Steady progress was made so that by 1974 SPTRFA had assets of over $40,000,000 and had a funding ratio of

36.1 percent. In 1974, the total contributions to SPTRFA from all sources was 21.5 percent of payroll. This amount was needed to correct the past underfunding by the employer (city and state).

Starting in 1975 there was a series of changes in the contribution rates and responsibilities. In 1975, the State of Minnesota assumed the responsibility for the employer contributions to the teacher plans. The problem that occurred was that the state reduced the employer contribution by over 2 percent of payroll, causing a funding deficiency.

In 1978, the funding problems got worse because the Legislature required all new members of SPTRFA become members of a newly created coordinated plan. A significant problem that accompanied the creation of this new coordinated plan was that the Legislature discontinued the employer additional contribution on behalf of the coordinated plan members that SPTRFA had been receiving on behalf of its Basic Plan members to make up for past omitted contributions. St. Paul and Minneapolis coordinated plans were the only plans that were not given an additional employer contribution for coordinated plan members to reduce the unfunded liability.

The total contributions to SPTRFA continued to decline until 1991 when the total contributions were 15.44 percent. During this period, SPTRFA was not provided with the necessary assets that could have been used to help solve its funding problems. In 1992, the first step was made to solve the SPTRFA funding problem when the Legislature began requiring the employer to make an employer additional contribution for the coordinated plan. The inception of this employer additional contribution and legislation in 1996 and 1997 put SPTRFA on track to meet the full funding target date of 2020.

The Teachers Retirement Association of Minnesota Story

The precursor to the current Teachers Retirement Association of Minnesota (TRA) fund was established in 1915. The 1915 Fund, also referred to as the Pioneer Teachers Retirement Fund, was liquidated during the Great Depression.

The current statewide TRA was established in 1931. Initially, teachers could elect exemption from membership until they were age 25. Members made contributions as a percentage of their salary

into a sort of savings account with no state matching until the members retired and purchased a retirement annuity in this defined contribution (DC) plan.

In 1957, membership in TRA became mandatory and the state began partially matching member contributions on a current basis.

In 1959, election of Social Security coverage became available to all members and new hires were automatically members of the coordinated system with Social Security coverage. In addition to matching employee contributions, the state began making supplemental employer contributions of 1 percent in recognition of past service liabilities.

In 1969, in response to woefully inadequate defined contribution benefits, members were given the option to elect a defined benefit plan (Career-Average Formula), a variable annuity defined contribution plan, or remain in their improved money purchase defined contribution plan. Employee and employer contribution rates were increased and the state increased its supplemental contributions to 2 percent.

In 1973, the benefit formula was changed from a Career Average to a High-5 formula plan, a major benefit improvement. At that time, the funding ratio of assets to liabilities was only 50 percent, so employer supplemental contributions were increased once again to 2.5 percent. In 1979, the supplemental contributions were increased to 3.05 percent.

In 1984, as the funding ratio continued to flounder at less than 60 percent, the employer supplemental contributions were increased for the last time to 4.48 percent. The increased contributions and favorable investment returns allowed the TRA funding progress to steadily improve and permitted the reduction of the employer supplemental rate to 3.64 percent in 1991.

With adequate employee and employer contributions and strong investment returns, TRA became financially healthy during the 1990s. In 1997, as part of the Pension Benefit Uniformity package, TRA employer contributions were reduced by 1.5 percent from 8.14 percent to 6.64 percent (5 percent matching and 1.64 percent supplemental). This reduction resulted in a savings of approximately $37.5 million annually. From this savings, $22 million was redirected to PERA to respond to their funding deficiency, $12.9 million went in direct state aid to Minneapolis

Teachers' Retirement Fund, $2.8 million to the St. Paul Teachers' Retirement Fund, and $500,000 to the Duluth Teachers' Retirement Fund to solve their respective funding problems.

In 1998, as a result of achieving 100 percent funding status, the remaining TRA employer supplemental contribution of 1.64 percent was eliminated, reducing the total contribution rates to the current level of 10 percent overall – 5 percent employee and 5 percent employer. The 5 percent employer contribution is its lowest rate since 1969 and the 10 percent total contribution rate is the lowest since 1973.

Currently, the July 1, 2001, actuarial valuation indicates that TRA has a funding ratio of 105.8 percent and a contribution sufficiency of 2.15 percent.

Chapter 6:

Review of Literature

The recommendations of the fund directors and the "steps that would be necessary" to accomplish the creation of a new restructured teachers retirement plan are the result of extensive research and review of the following:

(1) Previous studies of consolidation of the Minnesota Teacher Plans, the most thorough of which was the 1993 study conducted by the Minnesota Department of Finance and reported to the Legislature (April 1994).

(2) Work that has been done in the area of public employee pension structure and administration. The most notable recent study is the report prepared by The National Conference of Commissioners on Uniform State Law entitled *Uniform Management of Public Employee Retirement Systems Act (UMPERSA)*.

(3) Features of the leading public employee retirement systems in the nation as presented in the National Education Association (NEA) report *Characteristics of 100 Large Public Pension Plans* (September 2000).

(4) Information included in the report *Is Your Pension Protected?* (2000) published by the National Retired Teachers Association (NRTA).

(5) A report prepared by the NRTA entitled *FIGHTING INFLATION: How Does Your COLA Compare?* (2000). This document allowed the authors and Task Force to compare and contrast the post-retirement adjustments used by other teacher retirement plans.

(6) *Public Pension Plans, The State Regulatory Framework (3rd Edition, 1998),* published by the National Council on Teacher Retirement (NCTR), which gave information on the "best practices" of pension plans.

(7) The study titled *Preservation of Defined Benefit Plans* (Cynthia L. Moore, NCTR, 1996) researched the idea of creating a defined benefit plan vs a defined contribution plan.

(8) The Government Finance Officers Association (GFOA) publication, *Recommended Practices for State and Local Governments* (May 2001), provided additional "best practices" information to the study group.

(9) The document prepared by Minnesota Legislative Commission on Pensions and Retirement (LCPR), entitled *Principles of Pension Policy,* was reviewed.

(10) The *2000 Survey of State and Local Government Employee Retirement Systems,* prepared by the GFOA Research Center for members of The Public Pension Coordinating Council. This document presents the results of a survey of 246 public employee retirement systems representing 371 retirement plans. These plans covered 85 percent of the 12.8 million active plan members reported by the U.S. Bureau of the Census.

As the authors have stated before, the guideline that was used by the study group throughout this study on restructuring of the Minnesota Teacher Retirement Plans was that the plan created by the Study Group, in consultation with the Task Force, incorporate the best practices of pension plan structure and administration as described in the above-referenced documents.

The following are brief summaries of some of the above-referenced materials. More comprehensive information is included in Appendix B and C of this report.

Minnesota Department of Finance Consolidation Study

The 1993 Minnesota Department of Finance Consolidation study proposed and analyzed 14 different ways of consolidating two or more of the four teacher plans and in some cases the Minneapolis Employees Retirement Fund (MERF). The scenarios studied ranged from a simple consolidation of the administrative functions of MTRFA and MERF to a complete consolidation of all the teacher plans into the existing TRA plan.

After extensive study and after obtaining the actuarial cost impacts of each of the scenarios evaluated, the Minnesota Department of Finance study came to a number of conclusions indicating that the cost of consolidation was very high, the process and issues complex, and savings of administrative costs minimal. Some of the conclusions in the report are:

"Consolidation or phase-out of first class city pension funds appears to be very costly under each scenario evaluated. These options are also more controversial, long-term and complex to implement than others considered."

"Administrative costs are not significant in terms of overall funding requirements. Under virtually every option we studied, administrative savings were assumed liberally, but were never sufficient to offset much larger adverse actuarial impacts of consolidation options..."

"Where plans are consolidated or phased-out, issues to be resolved are many and complex, particularly as regards to elections of benefits, asset transfer ratios, along with establishing base pensions, and financing post-retirement increases."

The Executive Summary of this report is included as *Appendix B*.

National Conference of Commissioners on Uniform State Laws (NCCUSL), Uniform Management of Public Employee Retirement Systems Act (UMPERSA)

UMPERSA is the result of much study on the "best practices" of pension plan design, superior plan administration and statutory authority by the National Conference of Commissioners on Uniform State Laws. A summary of the key elements of UMPERSA follows.

Organization of the NCCUSL

The National Conference of Commissioners on Uniform State Laws (NCCUSL) was organized in 1892. Its mission is to work for the uniformity of state laws. It is a nonprofit unincorporated association, comprised of commissioners on uniform laws from each state, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands. All of the more than 300 uniform law commissioners are required to be members of the bar. While some commissioners serve as state legislators, most are practitioners, judges and law professors. They serve for specific terms, and receive no salaries or fees for their work with the Conference.

The state uniform law commissioners come together as the National Conference for one purpose – to study and review the law of the states to determine which areas of law should be uniform. The commissioners promote the principle of uniformity by drafting and proposing specific statutes in areas of the law where uniformity between the states is desirable. It must be emphasized that the Conference can only propose – no uniform law is effective until a state Legislature adopts it.

Among the projects by the NCCUSL are the Uniform Commercial Code, Interstate Family Support Act, Limited Liability Company Act, Limited Partnership Act, and the Probate Code.

Uniform Management of Public Employee Retirement Systems Act

In 1997, the Uniform Law Commissioners promulgated the Uniform Management of Public Employee Retirement Systems Act (see *Appendix C*). The Act is the first uniform law that applies to the more than one trillion dollars in assets held in state and local retirement systems. UMPERSA was developed to remedy a deficiency identified by the Uniform Law Commissioners: A mixture of state law governs these systems, unlike private retirement systems which are governed primarily by a common federal law, the Employee Retirement Income Security Act (ERISA). State laws vary considerably, and in some cases have not kept up with modern investment practices. Hence the Commissioners saw the need for an act that would modernize, clarify, and make uniform the rules governing the management of public retirement systems.

The Act is designed to replace laws that inhibit or, in a number of States, even prevent use of modern investment practices. In the long run, these outmoded laws result in billions of dollars of lost opportunities for investment income. The lost income could be used to increase pension benefits, lower contribution rates, or some combination thereof. The immediate beneficiaries would be the system's participants and beneficiaries, but the ultimate beneficiary would be the State's taxpayers. Taxpayers could offer employees either a better pension for the same cost or the same pension for a lower cost.

In broad terms, UMPERSA protects participants and beneficiaries of public retirement systems in two ways. First, the Act articulates the fiduciary obligations of trustees and others with discretionary authority over various aspects of a retirement system and ensures that trustees have sufficient authority to fulfill their obligations (Sections 4 through 10). Second, the Act facilitates effective monitoring of retirement systems by requiring regular and significant disclosure of the financial and actuarial status of the system, both to participants and beneficiaries directly and to the public (Sections 12 through 18).

Considered in more detail, the Act's regulation of the management of public employee retirement systems can be divided into six categories:

1. The Act requires that all retirement system assets be held in trust (Section 4);
2. The Act ensures that the trustee has exclusive authority over those assets (Section 4), and sufficient control over the organization to manage the assets efficiently and effectively (Sections 5 and 6);
3. The Act articulates the duties of trustees and others with discretionary authority over the operation and administration of a retirement system or the management of its assets (Sections 6 through 10);
4. To facilitate effective monitoring of retirement systems, the Act imposes significant disclosure requirements. The Act clarifies the application of state open record and open meetings laws to retirement systems (Section 12) and requires systems to publish various types of reports (Sections 13 through 18). The reports must be distributed widely and be made available to the public (Sections 13 through 15);
5. The Act has provisions to permit effective enforcement (Sections 11, 19, and 20);
6. Finally, the Act prohibits the assignment or alienation of benefits, unless the Legislature expressly decides that assignment or alienation is appropriate and consistent with the underlying policy of protecting retirement benefits (Section 21).

The enactment of UMPERSA establishes the independence of a retirement system from its sponsoring employer. Independence places a legal wall between the governor and Legislature and the retirement system by putting system assets in trust and making trustees loyal exclusively to the interests of participants and beneficiaries. These actions help curtail politically motivated reversions. The Act provides the retirement system trustees with the necessary independence and institutional resources necessary to manage retirement system assets in accordance with modern investment practices. It minimizes political influence over systems and facilitates effective monitoring of trustees by

requiring significant openness in the operation of retirement systems. UMPERSA therefore meets standards of loyalty to participants and beneficiaries, openness and accountability.

The UMPERSA model provides for improved investment returns for public employee retirement systems. It guarantees important information to public employers, trustees and participants about the administration of these systems. It provides clear liability and enforcement rules. State and local governments, trustees and fiduciaries, participants and the taxpayer, who must pay for financial deficiencies in such systems, all stand to gain from the adoption of the model public employee retirement system outlined in UMPERSA. Throughout this report, we will reference sections of UMPERSA as a guide to what is proposed in the restructured teachers retirement plan for the educators of the State of Minnesota.

Characteristics of 100 Large Pension Plans

(September 2000)

This document is the product of the National Education Association Survey of the 100 largest state and local public teacher retirement plans in the nation. It compares and ranks the various governance, benefit and funding mechanisms existing in the majority of public employee pension plans that have teachers as members. This study covers approximately 11.3 million active members and 4.5 million retired members of the 100 plans. Some of the major topics of this study are:

1. Retirement Eligibility
2. Cost of Living Adjustments (COLAs) and Taxes
3. Employer/Employee Contributions
4. Investment Allocations and Rates of Return
5. Actuarial Methods and Funding
6. Board of Trustee Membership

Based on the information in this report, the Study Group worked to incorporate benefits and governance structures that would place the teachers in the State of Minnesota in the top half of the teacher plans studied. The State of Minnesota would benefit by having a superior pension plan through the ability to attract and retain the best teachers and educational administrators in the nation.

Is Your Pension Protected? A Compilation of Constitutional Pension Protections for Public Educators *(2000)*

This is a publication produced by the National Retired Teachers Association (NRTA), a division of AARP, and the NRTA Round Table. The NRTA consists of members from 50 states and 2,700 city and local retired educators' associations.

The publication is a compilation of constitutional pension protections in 50 states, concentrating on educators' retirement funds. It provides a summary of the constitutional pension protections found in various states which include such things as: funding requirements, assets for retirement purposes only, no diversion of assets, board of trustees governance, guaranteed right to a benefit, investment authority, and separate trust funds. It makes additional recommendations about other protections that could be enacted.

Many of the constitutional guarantees found in other states are considered to be essential protections for all pension funds. The study group realizes that it is extremely difficult to change a state's constitution but many changes could be made through statute changes. Some of the protections found in this publication have been incorporated into the recommendations in this report, not only because they are currently missing in our constitutional protections, but because they are also a part of the best practices recommended by UMPERSA.

Fighting Inflation: How Does Your COLA Compare?

(2nd edition: copyright 2000 by AARP)

This publication was prepared by the National Retired Teachers Association (NRTA), a division of the American Association of Retired Persons (AARP). The publication is a compilation of cost of living adjustment (COLAs) laws and policies in the 50 states and the District of Columbia, specifically focusing on the state retirement plans that provide benefits to retired educators.

Inflation can severely reduce the purchasing power of retiree pensions. The document provides an overview by state of how and when COLAs are paid. It also reviews approaches that state governments use to fund COLAs.

The views expressed in this document are for information, debate and discussion and do not necessarily represent formal policies of the NRTA.

Preservation of Defined Benefit Plans

(NCTR, Third Edition, 1998)

This publication was prepared by Cynthia L. Moore, who is General Counsel to the National Council on Teacher Retirement (NCTR). The publication provides a comparative analysis of the qualities and deficiencies of defined benefit and defined contribution retirement plans.

The four fund directors felt that a brief discussion of the advantages of defined benefit over defined contribution retirement plans for public employees is a necessary part of this report so that the reader will know that this important topic was addressed.

Defined benefit plans are commonly used by large corporate employers and by the majority of public employers in the United States. These plans provide a more complete retirement program than defined contribution plans as illustrated in the following points.

Normal Retirement. In a defined benefit plan the employee earns a fixed benefit based on a formula. The benefit is easily determined if the employee's final average salary and years of service are known. In a defined contribution plan no guarantee of a specific retirement benefit is given. The benefit is based on the account value at the time of retirement. Thus after experiencing market fluctuations, employees in defined contribution plans may well have a tendency to "bail out" of the workforce just when there is a shortage of employees. The shortage of employees often occurs when the economy is good, markets are high and the defined contribution portfolios are at relative peaks. It is at this time that defined contribution portfolios of members who leave employment are rich.

Disability Retirement. Defined benefit plans are designed to share risk, so disability coverage could easily be built into the total retirement program. In a defined contribution plan risk cannot be shared.

Death Benefits. A defined benefit plan can provide a fixed formula death benefit. The death benefit can pay to a survivor some minimum amount even if the deceased member's earned benefit was small. In a defined contribution plan, the death benefit depends solely on the account balance. No minimum benefit can be established.

COLAs. Defined benefit plans can provide for post-retirement increases or COLAs. These increases are frequently tied to the Consumer Price Index (CPI), which measures the cost of living. A COLA provides retirees with a means of protecting their retirement benefits against the adverse effects of inflation. Most defined contribution plans do not provide COLAs because it is difficult to incorporate the funding necessary to pay for them.

Benefit Increases. A well funded, mature defined benefit plan can pay for benefit increases through favorable actuarial or investment experience. The only way to increase benefits under a defined contribution plan is to increase account balances. Account balances can only be increased by raising employee/ employer contributions or by increasing investment performance.

Portability. Defined benefit plans provide for portability by allowing vested members to purchase service in the current plan for service in another plan for which they do not have a future pension benefit. In addition, most defined benefit plans allow a former member to withdraw the employee contributions (and in some cases a part of the employer) plus interest. In defined contribution plans the member can take their account balance with them when they leave service.

It is for these reasons that the proposed restructured plan is a defined benefit plan.

2000 Survey of State and Local Government Employee Retirement Systems

(Published by the Public Pension Coordinating Council: April 2000)

The Public Pension Coordinating Council (PPCC) consists of representatives from four national organizations. The four organizations are:

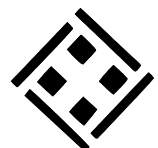
- Government Finance Officers Association (GFOA)
- National Association of State Retirement Administrators (NASRA)
- National Conference on Public Employee Retirement Systems (NCPERS)
- National Council on Teachers Retirement (NCTR)

This report presents a summary statistical analysis of state and local government employee retirement systems surveyed by the PPCC during the summer of 1999. It provides in-depth information about the current practices of public employee retirement systems regarding administration, membership, benefits, contributions, funding, investments and reporting.

This survey has been conducted for a number of years and is likely to be updated again during 2002.

Section II: Agreed Upon Tenets for a Restructured Minnesota Teachers Retirement System

7. Structure of Plan
8. Governing Board
9. Authority and Fiduciary Responsibilities of the Trustees
10. Accountability, Oversight and Disclosure
11. Plan Membership
12. Plan Benefits
13. Current Benefit Recipients
14. Duluth Old Plan
15. Minneapolis and St. Paul Basic Plan
16. Contributions and Liabilities
17. Financing
18. Ancillary Benefits



Section II: Agreed Upon Tenets for a Restructured Minnesota Teachers Retirement System

Chapter 7: Structure of Plan

The Study Committee and the Task Force reviewed two alternative structure options that are commonly employed in the design of a public employee retirement plan. Those two choices are: a) a state agency, or b) a nonprofit corporation.

Each of these two options is currently being used by various public employee pension plans throughout the USA. The structure of the new fund is crucial because it would provide the mechanism with which all other issues would be implemented.

Proposal and Rationale

Structure: Nonprofit corporation with assets held in trust for the exclusive benefit of its members.

Background

Since their inception, after permissive language in 1909 allowed their creation, the three first class city teacher funds have existed as nonprofit corporations. Their boards of trustees under prudent investor standards invest the assets of the corporations. Their members are covered under the protections granted to them under MN Statutes, Chapter 317A (MN Nonprofit Corporation Act) including the right to vote on any changes to the corporation (see Chapter 24, Implementation Phase: Merger, Consolidation, Dissolution Laws Affecting Nonprofit Corporations).

The state teachers' fund, created in 1931, is a governmental agency. MN Statute 354.10 states that the assets of the TRA belong to the State of Minnesota until they are paid to the pension plan member and Chapter 11A states the assets of the agency are invested by the State Board of Investment under the guidance of the constitutional officers of the State of Minnesota. These laws do not recognize the difference of the retirement systems from other state agencies. The pension system has a more singular responsibility than do other state entities since its duties and responsibilities require acting in the best interests of plan members. "Specifically, the obligation of the trustees is to act

solely on behalf of the retirees who are currently receiving benefits and the active members who will receive benefits in the future." *Day v. New Hampshire Retirement System*, 635 A.2d 493, 496-97 (NH, 1997). State officials have a much broader mandate. Their duty is to all citizens.

Additionally, MN Statutes 356A.04 states that Minnesota public pension plan trustees' fiduciary duties are to their members, the State of Minnesota, and its taxpayers. This creates a real conflict of interest for the fiduciaries of the pension funds and would not be acceptable under ERISA and is not acceptable under the federal *exclusive benefit* rule found in the Internal Revenue Code 401(a). This rule applies to retirement system trustees and requires a duty of loyalty to the members only. If a retirement system fails to comply with this rule, serious tax consequences could follow.

Unlike Minnesota, many states currently have constitutional protections for their pension benefits and assets. These constitutional protections include such things as funding requirements, assets used for retirement purposes only, no diversion of assets, board of trustees' governance, guaranteed right to a benefit, investment authority, and separate trust funds. The following statewide teacher pension funds are independent organizations: Colorado, Georgia, Illinois, Louisiana, Missouri, New York, Ohio, and Utah. (See *Is Your Pension Protected?* in Chapter 6.)

Since Minnesota pension funds are without any constitutional protections and because current state law seems to be contrary to federal exclusive benefit rules, adopting the "best practices" provisions of UMPERSA would address these issues.

Rationale

Restructuring the new pension plan in the form of a nonprofit corporation would be in keeping with the recommendation of UMPERSA, Section 4, that states: "except as otherwise provided in subsection (b), all assets of a retirement system are held in trust. The trustee has the exclusive authority, subject to this (ACT), to invest and manage those assets."

It would also implement Section 7 of UMPERSA regarding General Fiduciary Duties thus satisfying the exclusive benefit rule. This section states: "A trustee or other fiduciary shall discharge duties with respect to a retirement system: 1) solely in the interest of the participants and beneficiaries... ."

In order to carry out the duties specified in UMPERSA Sections 4 and 7, Section 5 of UMPERSA relating to the powers of the trustees would also be incorporated into the restructured teachers retirement plan. This section is crucial since it allows trustees to carry out their fiduciary duties.

The restructured plan would treat all members the same. Currently, there are differences in benefits not only between members of the same fund but also members of the TRA and first class city funds. Furthermore, some members are paying more than others for the same benefits and some members are paying for benefits they do not have. The restructured plan would treat all members equally in terms of benefits and contribution rates. All assets and liabilities would be pooled into one fund and the funding level would be the same for all members.

This structure as an independent entity does not mean that the state has given up its authority to establish benefit levels and make other amendments to the plan. The Legislature would retain this authority subject to any contractual rights previously promised to plan participants. In addition, taxpayers would have a continuing interest in the management of the retirement system. Citizens would benefit from a well-run and soundly invested retirement system because it would be less expensive to operate and would help in attracting and retaining teachers of excellence.

Chapter 8: Governing Board

An important component of the restructured teachers retirement plan is the composition and authority of the fiduciaries of the plan, the Board of Trustees. The next chapter of this report will expand on the authority and fiduciary responsibilities of the trustees and the rationale for such authority.

This chapter will examine the rationale for inclusion of the various classifications of members of the Board of Trustees. It is important for the reader to note that we will be discussing two distinct boards of trustees, as the authors concluded that the transition from four separate teacher plans to one statewide restructured teachers retirement plan would need a Transition Board for a period prior to the election and/or appointment of the Permanent Board.

A report prepared by the GFOA Research Center for the members of The Public Pension Coordinating Council, entitled *2000 Survey of State and Local Government Employee Retirement Systems,* stated that for most retirement systems, overall management is the responsibility of the system's retirement board or Board of Trustees, which is made up of individuals who are either appointed to their positions, elected by system members, or otherwise designated to serve. This survey, which contained the responses of 246 public employee retirement systems representing 371 retirement plans, goes on to state that the number of retirement board members ranged from four to twenty-six members. The average board size was 8.1 members, however, systems covering teachers tended to have somewhat larger boards, averaging 9.7 members per system.

A typical Permanent Board composition would be a nine-member board composed of a majority of active teachers who are elected by the members of the system, retiree representation, appointed members usually from the state administration, and from a school board association.

In Minnesota, the size and composition of the respective teacher fund boards is as follows:

Duluth TRFA	St. Paul TRFA	Minneapolis TRFA	Minnesota TRA
9 trustees	**10 trustees**	**7 trustees**	**8 trustees**
7 elected members	9 elected members	6 elected members	5 elected members
1 school board member	1 school board member	1 school board member	3 ex-officio:
1 superintendent or designee			Comm. of Finance
			Comm. of CFL
			MN School Board Assn.

The composition of the Permanent Board structure is further discussed in Chapter 19.

The composition of a Transition Board would be different and usually comprised of a larger number of members. The Transition Board would usually be appointed from various groups such as active teacher trustee(s) from each of the four boards involved in the restructuring and employer trustees from the various existing teacher retirement boards. The period of existence of the Transition Board would be until the full board could assume the operation of the restructured teachers retirement plan. The composition of the Transition Board is further discussed in Chapter 19.

Chapter 9:

Authority and Fiduciary Responsibilities of the Trustees

The trustees of the restructured teachers retirement plan would have full, exclusive authority for the following areas:

1) **To establish an administrative budget** sufficient to perform the trustee's duties and, as appropriate and reasonable, draw upon assets of the retirement system to fund the budget;

2) **To obtain by employment or to contract the services necessary** to exercise the trustee's powers and perform the trustee's duties, including actuarial, auditing, custodial, investment, and legal services; and

3) **To procure and dispose of goods and property necessar**y to exercise the trustee's powers and perform the trustee's duties.

In exercising authority, the trustees must carry out their fiduciary duties, but would not be subject to civil service, personnel, procurement, or similar general laws relating to other state agencies and other state employees.

According to Section 7 of UMPERSA, the authority conferred upon the trustees is intended to ensure that retirement system trustees have a level of independence sufficient to permit them to perform their duties and to do so effectively and efficiently. Trustees are different from other agents of the state, or other state employees, because trustees are subject to an extensive and stringent set of fiduciary obligations to retirement system participants and beneficiaries. These obligations both require and justify some level of trustee independence.

Independence is required because it permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations. In the absence of independence, trustees may be forced to decide between fulfilling their fiduciary obligations to participants and beneficiaries or complying with the directions of others who are responding to a more wide-ranging, possibly conflicting set of interests. In this sense, the independence given to the trustees is an important corollary of the fiduciary obligations that they have.

The fiduciary obligations of trustees also justify the level of independence. Trustees are not independent without constraint; instead, they must comply with their fiduciary obligations when exercising judgment. The trustees are endowed with more independence than other agents of the state or other state

employees, but in exercising that independence the trustees are subject to a more extensive and stringent set of fiduciary obligations than those other individuals.

Trustee independence aligns well with the interests and prerogatives of the Legislature. First, the Legislature has a strong interest in effective and efficient management of public retirement systems. Mismanagement presents obvious political hazards and, in the long run, may result in lower benefits, higher contribution levels, or both. The trustee is already under a fiduciary duty to act effectively and efficiently; this section removes constraints that may interfere with the fulfillment of that duty. Second, the Legislature is interested in protecting its legitimate prerogatives. For example, it creates retirement programs, establishes benefit levels, and determines funding methods. Trustee independence does not infringe on those prerogatives. The trustee's independence is confined to the trustee's legitimate role of managing the operation, administration, and assets of a retirement system.

Item #1, authority to establish a budget, indicates that the trustees must have authority, within the confines of fiduciary duties, to draw on retirement system assets to fund the administrative budget and to accomplish the purposes of the trust.

Item #2, authority to employ or contract for services, is intended to provide the trustees of the restructured teachers retirement plan with broad authority over personnel matters. The intent is to free the trustee from restrictive civil service requirements, to shield the trustee against interference by others who do not share the trustee's fiduciary obligations, and to protect the trustee against representation by those with potentially conflicting interests.

Additionally, Item #2 authorizes the trustee to obtain actuarial and other services. The actuary retained by the trustees would be responsible to perform the official annual actuarial valuations, conduct periodic experience studies, and would make recommendations as to the appropriate funding level, and the use of appropriate actuarial assumptions of the retirement plan. Trustees would have full, exclusive authority to set the actuarial assumptions. The actuary obtained by the trustees might not be the only actuarial firm in place. State law could allow the Legislature or another oversight body to retain an actuary for additional oversight, and to review the work of the actuary

retained by the trustees. According to the *2000 Survey of State and Local Government Employer Retirement Systems,* published by the GFOA Research Center, of the 246 state and local retirement systems across the country that responded to the survey, 218 systems, almost 90 percent, indicated that the retirement system trustees have authority to set the actuarial assumptions.

Item #3, authority to procure and dispose of goods and property is intended to provide the trustees with broad authority over procurement matters. Under this arrangement, trustee decisions on procurement matters must comply with his/her fiduciary responsibilities, rather than with the requirements of state procurement laws.

Finally, the authors believe there is a need for some mechanism whereby recommendations from the plan actuary to change contribution rates could be addressed and adjudicated on a timely basis. This is particularly critical when the recommendations are made as a result of analysis by the actuary of current and future demographics of the plan membership, or as a result of conclusions reached after conducting an experience study, projection valuation, or other actuarial analysis.

The intent of this chapter is to assert that trustees must have independence. Trustees must be subject to certain fiduciary duties, but should not be subject to obligations imposed by general civil service, personnel, or procurement laws of a state or political subdivision. Nevertheless, other general laws such as conflict of interest, code of ethics rules, and other requirements in nonprofit law would continue to apply to the trustees.

Chapter 10:

Accountability, Oversight and Disclosure

Accountability

A trustee or other fiduciary will be held personally liable to the members and beneficiaries of the plan for any breach of fiduciary duty. This liability applies to any fiduciary breach whether "knowing and willful" or non-knowing or non-willful that results in a non-recoverable loss to the system. This liability cannot be limited by any agreement. This accountability is recommended by UMPERSA.

Oversight

Oversight is a critical component of the restructured educators pension plan. We believe that many of the current oversight mechanisms currently in place are necessary under the restructured teachers retirement plan. The oversight mechanisms currently in place would continue:

1. Annual financial and compliance audit by the Office of the State Auditor;
2. Investment performance monitoring by the Office of the State Auditor;
3. Reporting to, and oversight, by the Legislature.

Disclosure

Disclosure is also an important feature of the restructured teachers retirement plan. The following items would be important disclosure features of the plan:

1. **Open public meetings and records**. Currently, each of the separate teacher retirement fund Boards are required to follow the open meeting law requirements contained in MN Statutes, Chapter 13D. This would continue under a restructured educators' plan. However, it is suggested in UMPERSA that the Board of Trustees, having authority to invest or manage assets of a retirement system, may deliberate about, or make tentative or final decisions on, investments or other financial matters in executive session if disclosure of the deliberations or decisions jeopardizes the ability to implement a decision or to achieve investment objectives. Additionally, a record of a retirement system that discloses deliberations about, or a tentative or final decision on, investments or other financial

matters is not a public record under the State Open Records Law to the extent and so long as its disclosure jeopardizes the ability to implement an investment decision or program or to achieve investment objectives.

2. **Disclosure to the Public**

   a. The administrator of the restructured educators' retirement plan would prepare the following for distribution to the employer units and to the public:

      i. Summary plan description of each retirement plan it administers. Basically, this is a description of the retirement program and its benefits. It must be written in a manner understood by the average participant and be accurate and sufficiently comprehensive to reasonably inform the participants and beneficiaries of their rights and obligations under the retirement program. It must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

      ii. A summary description of any material changes or modifications to the terms of the retirement program, or to the summary plan description.

      iii. An annual disclosure of financial and actuarial status. This is a compilation of a great deal of information about the retirement system and program, its financial position, and, for defined benefit plans, its actuarial position. It does not need to be distributed to each participant and beneficiary. Instead, it has a very limited required distribution intended to make the report widely available to interested parties at modest cost to the retirement system.

      iv. A summary annual financial report. This is a summary of the annual disclosure of financial and actuarial status. It must contain certain key financial information and, for defined benefit plans, key actuarial information. The summary annual report must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

b. The administrator shall make available for public examination in the principle office of the administrator and at each of the employer units in order to make information reasonably available to the members:

   i. the governing law of the retirement program and system;

   ii. the most recent summary plan description;

   iii. summary descriptions of any material changes or modifications to the terms of the retirement program, or to the summary plan description;

   iv. the most recent annual disclosure of financial and actuarial status;

   v. the most recent comprehensive annual financial report.

3. **Disclosure to Participants and Beneficiaries**

   a. The administrator shall furnish to each participant and beneficiary who is receiving benefits the following:

      i. A copy of the most recent summary plan description, and any summary description of changes or modifications to the plan within three months after a person becomes a contributing member, or within three months after a person first receives benefits;

      ii. A summary description of any changes or modifications to the plan within seven months after the fiscal year end in which a modification or change has been made;

      iii. A copy of an updated summary plan description that integrates all modifications to the plan at intervals not to exceed five years;

      iv. A summary annual report within seven months after the end of each fiscal year.

   b. The administrator shall provide to each participant a statement containing information that estimates projected benefits reasonably, to the extent the information is regularly maintained by the retirement system.

4. **Reports to the Legislature**

The following reports would be provided to the Legislature as they are prepared by the trustees of the restructured teachers retirement plan:

a. Annual actuarial valuation. This is a measure of the actuarial condition of the retirement plan. It would be prepared by a qualified actuarial firm retained by the trustees of the plan.

b. Comprehensive annual financial report. This is a compilation of a great deal of information about the retirement system and program, its financial position, and its actuarial position. It does not need to be distributed to each participant and beneficiary. Instead, it has a very limited required distribution intended to make the report widely available to interested parties at modest cost to the retirement system. A summary of the annual report must be distributed to participants and beneficiaries receiving benefits, and be made available to the public. The report must contain the financial statements and notes in conformity with generally accepted accounting principles. The principal current articulation of those principles is Governmental Accounting Standards Board Statement No. 25, which requires two financial statements (a statement of plan net assets and a statement of changes in net plan assets) and accompanying notes. Governmental Accounting Standards Board Statement No. 25 also addresses a multitude of other issues that must be addressed in preparing the financial statements and notes.

c. Periodic Experience Study Reports. These reports analyze the actual experience of the plan compared to the actuarial assumptions currently in place.

d. Other actuarial reports and analysis such as projection valuations, etc.

Chapter 11:

Plan Membership

Except for the Basic Plan members of Minneapolis and St. Paul teacher retirement fund associations (see Chapter 15), membership in the restructured plan would retain the same criteria as is currently provided in statute for the existing teacher funds. For each fund, "teacher" is defined in statute. Any service performed by any person within this definition would be considered covered service. Licensure granted by the Minnesota Board of Teaching or by the Minnesota Department of Children, Families and Learning is required to qualify as a "teacher" within the definition. Teaching service performed for "for-profit" employers would not be covered by the restructured plan.

Chapter 12: Plan Benefits

A very significant aspect of developing a restructured plan is improving the structure of the benefit provisions included in the plan. In this Chapter, analysis is first presented of the existing benefit provisions, which is followed by the proposed improvements to the benefit structure for those who are not retired at the time the new restructured plan begins.

Determining a Retirement Benefit

The four teacher retirement plans are defined benefit plans. Defined benefit plans provide a guaranteed and predictable pension benefit that generally would be a percentage of the teaching salary at the time of retirement. The amount of retirement benefit would be determined by three primary variables: 1) the final average salary (FAS); 2) years of credited service; 3) age at retirement. By inserting these variables into the benefit formula, precise amount of benefits could be calculated quite easily.

Again, the benefit formula is comprised of three basic components:

1) **Final Average Salary** (FAS) – the number of years of salaries that are averaged to determine the base salary for benefit calculation.
2) **Formula Multiplier** – the percentage of the FAS that is awarded for each year of credited service
3) **Normal Retirement Age** – the age, service, or combination of age and service at which a member could receive an unreduced pension benefit.

By using these components to determine a benefit, the formula multiplier is applied to each year of service to determine what percentage of the FAS would be included in the benefit. If the retiree has reached the minimum normal retirement age, this percentage of the FAS would be the annual base benefit. If the retiree has not yet reached normal retirement age, early retirement reduction factors would be applied to discount the benefit.

Evaluating Minnesota's Current Benefit Provisions

The value or determination of the three components of a benefit formula vary greatly among public pension plans throughout the nation and consequently, the amount of pension benefits varies greatly for retirees that have similar experience with respect to salary, service, and age at retirement. In comparing the three

formula components used by the Minnesota Teachers Retirement Association (TRA) in determining initial benefits for its retirees to the formula components used by the similar statewide teacher retirement systems throughout the nation, TRA comes up very low in all three comparisons. Not surprisingly, a comparison of contribution rates indicates that Minnesota's contributions, in particular its employer contributions, are considerably lower than the national average.

This comparison is based on information provided in the publication *Characteristics of 100 Large Public Pension Plans* published by the National Education Association in September 2000, which is summarized in *Attachment A* on page 46. Comparison in this report is made to the 33 statewide teacher retirement systems that have benefit structures similar to Minnesota TRA. States not included in the comparison are non-Social Security states for pension purposes and, consequently, have significantly greater public pension benefits.

Formula Multiplier Comparison – The formula multiplier is the percentage factor that is applied to each year of creditable service to determine what overall percentage of the FAS would be included in the initial pension benefit. Of the three formula components, the value of the formula multiplier generally has the greatest impact in determining a retiree pension benefit. In comparing the factors used in the 34 states, the multipliers range from a low of 1.5 percent per year to a high of 2.35 percent per year. The table in *Attachment A* ranks the states according to the value of their respective formula multiplier. Half (17) of the states have multipliers that are 2.0 percent or higher and the average of all states was slightly over 1.88 percent. In Minnesota, members hired before 1989 have a two-tier benefit calculation provision in which the retiree can use whichever method generates the greatest benefits. Members retiring after age 62 generally get a larger benefit under Tier II which has a formula multiplier of 1.7 percent for each year of service. Most TRA retirees, however, utilize the Tier I calculation method because it is associated with the Rule of 90 early retirement provision. Under Tier I, the formula multiplier is a very low 1.2 percent for the first 10 years and 1.7 percent for each year thereafter. For a 30-year teacher, the formula multiplier for a Tier I retiree averages only 1.53 percent per year – only Michigan has a lower factor of 1.5 percent per year.

Final Average Salary (FAS) Comparison – There is considerable variance in the 34 systems in how many years of salary are to be averaged in determining the FAS for benefit calculation. Minnesota is one of six states that averages the highest five years of salary to determine FAS. Three years of salary is by far the most common and is used in 24 states. The other four states use either two, three and one-half, or four years in their FAS. No systems use more than five years. Logically, averaging three years would generate a larger FAS than averaging five years, and a larger FAS would generate a larger, initial benefit if we assume the other two components are equal.

Normal Retirement Age/Service Comparison – Normal retirement age/service is the established minimum age and/or service criteria a member must obtain to be able to retire and not be subject to early retirement penalties. Normal retirement age is the earliest age a member having the minimum amount of service required for vesting can qualify for an unreduced retirement benefit. In addition, nearly all funds have a service related "early retirement" provision that permits a member to retire before the normal retirement age if they obtain a certain number of years of service or reach an age and service combination. For example, several systems allow unreduced pension benefits after 30 years of service regardless of age, whereas other systems have a combination of age plus service (e.g., Rule of 90) to determine their early retirement provision. These provisions are listed in the fifth column of *Attachment A*.

In Minnesota, teachers hired before 1989, can retire with an unreduced retirement benefit at age 65 or when their age plus service totals 90, whichever is earlier. For teachers hired after 1989, the normal retirement age is 66 with no early retirement provision. No other state in the nation requires its members to go beyond age 65 to receive an unreduced pension benefit. In fact, only 13 of the 34 states have age 65 as normal retirement age. In other states, 6 have age 62, 13 have age 60, one has age 58, and one has age 55. In addition, most states have a service-related early retirement provision that is considerably more liberal than the TRA Rule of 90. In 16 states, 30 years of service would allow retirement at any age with no reduction. Another eight have age and service combinations that are less than Rule of 90 (e.g., Rule of 80, 85, 88, etc.). Only Idaho with its age 65 normal and

Rule of 90 appears to be as conservative as Minnesota's pre-1989 provision with this component. Certainly, no other funds have anything as stringent as the age 66 normal retirement with no early retirement provisions that is currently available for our members hired after July 1, 1989.

Contribution Rate Comparison

As indicated on the two right columns of *Attachment A*, employee and employer contributions vary greatly among similar statewide teacher retirement systems. Minnesota's TRA contribution rates are currently 5 percent each for employee and employer. While the 5 percent employee contribution is only slightly less than the average of 5.29 percent, the 5 percent employer contribution is considerably less than the average employer contribution rate of 7.96 percent. While Minnesota's contribution rates are already very low, it is particularly disturbing to hear there is consideration to reduce them further, rather than improve the initial benefit provisions.

Evaluation Summary

In summary, based on the comparison of the three component parts of pension benefits, Minnesota has the poorest overall initial benefit provisions of any similar statewide teacher retirement system. Only Michigan has a slightly lower formula multiplier (1.5 percent), but they use a High-3 final average salary and have a normal retirement age of 60 with ten years of service or any age with 30 years of service.

Evaluating Minnesota's Current Post-Retirement Adjustment Provision

In contrast to having the poorest initial retirement benefit provisions in the nation, Minnesota has one of the most generous cost-of-living adjustment provisions for member benefits after retirement.

Minnesota is quite unique in that it has pension assets divided between two funds – one for its active members and a second for its retired members. Only the Wisconsin Retirement System has a similar arrangement. The active member fund is comprised of employee and employer contributions plus investment earnings that have accumulated during the years prior to retirement.

When a member retires, the assets necessary to fully fund the member's retirement benefits throughout a normal lifetime are transferred from the active member fund to the retiree fund, which is called the Minnesota Post Retirement Investment Fund (Post Fund). Assets are transferred with the assumption that the Post Fund will earn 6 percent annually on these assets.

Minnesota COLA provisions have two components: an inflation guarantee up to 2.5 percent maximum and an investment component based on earnings in excess of the combined assumed rate of 6 percent and the inflation component (2.5 percent maximum). There is no maximum to the Minnesota COLA. Essentially, all Post Fund investment earnings in excess of the 6 percent assumed earnings are distributed to retirees in the form of annual post-retirement adjustments or COLAs.

When the current COLA formula was established in 1992, it was anticipated that favorable investment experience would generate annual adjustments that would be approximately equal to the CPI rate of inflation so that retirement benefits could retain purchasing power – increases generally in the 2 to 4 percent range each year. It was never anticipated that there would be year after year of the very high investment earnings that were experienced in the 90s. With these much higher than expected investment earnings, the TRA annual adjustment COLAs averaged 9.3 percent for 1997-2001 – four times the average CPI inflation rate of 2.42 percent. Longer term, since 1981 TRA COLAs have averaged 7.0 percent – nearly double the CPI average of 3.52 percent (see *Attachment C*, page 48).

While this evaluation compares the COLA of TRA to other statewide teacher retirement systems, it is important to note that the COLAs provided by the Minneapolis, St. Paul, and Duluth Teacher Retirement Fund Associations have been extremely generous in recent years as demonstrated by the graph in *Attachment D* on page 49.

Only Wisconsin among the other statewide teacher retirement systems in the nation provides automatic COLA increases that are even close to the generous level provided by Minnesota TRA. According to the publication *Fighting Inflation: How Does Your COLA Compare?* printed by AARP in 2000 (see *Attachment B* on

page 47), 37 statewide teacher retirement systems provide an automatic COLA for their retirees each year. Other states provide increases to retirees on an ad hoc basis.

Of these 37 states providing automatic increases, the COLAs in:

- 9 states provide fixed percentage increases each year ranging from 1.5 to 3.1 percent
- 16 states equal CPI with maximums ranging from 2 to 5 percent per year
- 3 states equal the CPI only if there are excess earnings. Maximums range from 3 to 6 percent
- 4 states are a percentage of CPI with maximums averaging from 4 to 5 percent
- 1 state provides CPI plus excess earnings with an overall maximum of 5 percent

Wisconsin provides increases or decreases based solely on excess earnings above its earnings rate of 5 percent and has no maximum. Like Minnesota, Wisconsin awarded very generous increases throughout the 90s, but Wisconsin retirees received substantial decreases in their benefits for the year 2000. Minnesota's benefits are never reduced.

There are two fundamental problems with providing these unlimited and very generous post-retirement increases.

First, these generous increases do not come without a cost and part of that cost is lower initial benefits. Funding retirement benefits using low post-retirement earnings assumptions (6 percent in MN, and 5 percent in Wisconsin) provides a nice built-in cushion for providing post-retirement increases because investment earnings are generally expected to be higher than that – in the 10 percent range long-term. However, funding benefits using lower earnings assumptions is much more expensive than if higher earnings assumptions are used. If funding the benefits is more expensive, the way to keep the overall cost at a reasonable level is by providing lower benefits at the time of retirement. This is one of the reasons Minnesota has the lowest initial retirement benefits in the nation and Wisconsin ranks only slightly better – 32 out of 34 similar statewide teacher plans.

A second problem, distributing all excess earnings with no maximum cap, creates extreme volatility in the increases from year to year. A defined benefit plan generates a guaranteed and predictable initial pension benefit and its post-retirement COLAs should also be somewhat consistent and predictable for retirement planning purposes. Retirees should not have to be concerned with the investment performance of pension fund assets during their retirement years.

While nobody could have predicted the unbelievable rise in the investment market during the 1990s, the huge increases generated by the much higher than anticipated investment earnings resulted in a huge windfall for members who retired before or during this time period. Members retiring in 1996 received cumulative increases in their benefits of over 59 percent during the five years following their retirement. By contrast, a member retiring today, after the dramatic downturn of the markets, likely would receive much smaller increases compounding to less than 20 percent during the five years following retirement. This extreme disparity due to the investment market was not anticipated in Minnesota's post-retirement increases and should not exist in any defined benefit pension plan.

Proposed Improvements to Initial Benefit Provisions

In restructuring our current pension provisions, it is desirable to bring both the initial benefits and the COLA provisions from the current respective extremes when compared to peer pension plans to a more traditional middle-of-the-road defined benefit plan. We propose making significant improvements to the initial benefit provisions that would be funded particularly by adopting a less expensive but more typical COLA provision.

While there are numerous ways that pension plans could be altered to provide various desired outcomes, we are proposing three substantive changes that would bring our plan benefits more closely into the mainstream of benefits that other pension plans are providing today. These three improvements are:

- Increasing the formula multiplier to 2 percent per year for all years of service,
- Using the highest three years instead of the highest five years in determining the final average salary,
- Making a normal retirement age of 65 and the Rule of 90 early retirement provision available to all members.

Two Percent Formula Multiplier

Increasing the formula multiplier to 2 percent for all years of service brings our plan into the mainstream for this very important component of the benefit formula. As previously indicated, half (17 out of 34) of the similar statewide teacher retirement systems have formula multipliers that are 2 percent or greater.

High-3 Years for Final Average Salary

Using three years instead of five years for determining the final average salary upon which the retirement benefit would be based would provide a modest benefit improvement for most new retirees. Over 70 percent (24 out of 34) of the similar statewide funds use three years while only five other states use five years in their final average salary determination. No fund uses more than five years.

Age-65 Normal Retirement Age and Rule of 90 applicable to all members

This improvement is primarily a fairness and equity provision that would not have a significant impact on retirements for nearly 20 years. This provision extends to teachers hired after July 1, 1989, the same benefit provision that their teacher counterparts who were first hired before that date currently enjoy. All teachers make the same contributions and should be entitled to the same level of benefits.

Young teachers first hired after 1989, would not meet the service requirements for Rule of 90 for several years but it is important that they have a target date that they can strive for as an incentive in their long range planning. Currently, post-1989 hires have no early retirement target incentive and must wait until age 66 to retire with an unreduced benefit. No other state in the nation has such a stringent requirement for its teachers.

Extending these retirement provisions to members regardless of when they were hired is an equity issue. It does not alter the fact that Minnesota's age 65 normal retirement age and Rule of 90 provisions remain about the most conservative with respect to this component of the benefit formula when compared to other similar statewide plans. In light of the current teacher shortage, we are not proposing liberalized age/service requirements for anyone retiring in the immediate future.

Improvement Summary

Despite retaining the conservative age/service requirements for unreduced benefits, the increase in the formula multiplier to 2 percent per year and to a high three years in determining final average salary are two very significant improvements that would move Minnesota much closer to the middle of comparable pension funds in its benefit provisions instead of being last.

Proposed Changes to the Post-Retirement COLA for Current Active Members

By providing a more traditional automatic COLA mechanism for new retirees instead of the current generous but expensive provisions, significant cost savings could be incurred that would partially fund the improvements proposed for initial benefits. Current retirees will retain the current post-retirement adjustment mechanism.

The most significant cost savings would be generated by increasing the post-retirement earnings assumption from its current 6 percent to 7 ½ percent. Assuming 7 ½ percent future investment earnings on retiree assets means that fewer dollars need to be reserved at the time of retirement to pay benefits over a retiree's lifetime.

Increasing the post-retirement earnings assumption by 1 ½ percent means that the current inflation component guarantee would be reduced from the current 2 ½ percent maximum to a flat 1 percent guarantee regardless of inflation. With the 7 ½ percent assumption plus 1 percent guarantee, the assets would have to earn 8 ½ percent to cover this cost. With the current asset mix utilized by the investment policy of the State Board of Investment, earnings are generally expected to average closer to 10 percent over time. This anticipates excess earnings to provide post-retirement adjustments beyond the 1 percent guarantee.

All investment earnings in excess of the required 8 ½ percent would be used to increase the total COLA amount up to CPI with the COLA capped at 4 percent per year. Earnings in excess of that necessary to pay for the COLA would be carried forward and accumulated in an "excess earnings account" which could be available for funding future COLAs. This account could incur a negative balance in the event there were not enough earnings to cover the 1 percent guarantee.

In similar fashion to accumulating excess earnings for future COLAs, excess CPI would accumulate during years when the funds were not available to pay COLAs equal to the CPI or in years when the CPI exceeds the 4 percent maximum.

With this COLA structure, new retirees would automatically receive annual increases ranging from 1 percent to 4 percent with anticipation of averaging about 2 ½ percent. Although this percentage is considerably less than recent retirees have enjoyed, it is higher than increases provided by most private sector pension funds, and similar to the provisions of most statewide teacher retirement systems.

Comparing Minnesota TRA with All Similar Statewide Teachers Retirement Systems

(Non-Social Security States Excluded)

Rank	State	Formula Multiplier	Final Avg Salary	Normal Retirement Age/Service	Contributions Employee	Contributions Employer
1	New Mexico	2.35	High-5	65/5, A25, R75	7.60	8.65
2	Texas	2.20	3	65/5, R80	6.40	6.00
3	Rhode Island	2.20	3	60/10, A28	9.50	12.01
4	Arkansas	2.12	3	60/5, A28	6.00	12.00
6	Arizona	2.10	3	65/A, 62/10, R80	2.66	2.66
6	Alabama	2.01	3	60/10, A25	5.00	5.96
7	Georgia	2.00	2	60/10, A30	5.00	11.29
8	New York	2.00	3	62/10, 55/30	3.00	1.42
9	Oklahoma	2.00	3	62/10, R90	7.00	9.80
10	Pennsylvania	2.00	3	62/1, 60/30, A35	6.25	1.94
11	Utah	2.00	3	65/4, A30	0.00	13.69
12	Wyoming	2.00	3	60/4, R85	5.57	5.68
13	Iowa	2.00	3	65/A, 62/20, R88	3.70	5.75
14	Hawaii	2.00	3	55/5	7.80	9.69
15	Idaho	2.00	3.5	65/5, R90	5.85	9.77
16	Washington	2.00	5	60/5, 55/25, A30	3.01	7.10
17	West Virginia	2.00	5	60/5, 55/30, A35	6.00	17.95
18	Nebraska	1.90	3	65/5, R85	7.25	7.32
19	North Dakota	1.88	3	65/3, R85	7.75	7.75
20	Mississippi	1.88	4	60/4, A25	7.25	9.75
21	South Carolina	1.82	3	65/A, A30	6.00	7.70
22	Maryland	1.80	3	60/A, A30	7.00	10.95
23	North Carolina	1.80	4	65/5, 60/25, A30	6.00	8.83
24	Delaware	1.80	5	62/5, 60/15, A30	3.00	9.52
25	Kansas	1.75	3	65/A, 62/10, R85	4.00	4.19
26	**Minnesota — Level**	**1.70**	**5**	**65/3**	**5.00**	**5.00**
27	Florida	1.68	5	62/10, A30	0.00	9.21
28	Vermont	1.67	3	62/5, A30	3.40	4.96
29	New Hampshire	1.67	3	60/A	5.00	4.11
30	Montana	1.67	3	60/5, A25	7.15	7.58
31	New Jersey	1.67	3	60/A	4.50	5.44
32	Oregon	1.67	3	58/A, A30	6.00	12.25
33	Wisconsin	1.60	3	65/A, 57/30	6.20	6.10
34	**Minnesota — Step (R90)***	**1.53**	**5**	**65/3, 62/30, R90**	**5.00**	**5.00**
35	Michigan	1.50	3	60/10, A30	4.30	11.66
	AVERAGE	**1.884**	**3.44**		**5.29**	**7.96**

***Step Formula** = 1.2% for first 10 years, 1.7% thereafter; for 30 years of service, multiplier averages 1.53% per year

A = Any Example: A30 = any age with 30 years of service; 65/A = 65 years of age with any service

R = Rule of Example: R 80 = Rule of 80

Sources: Characteristics of 100 Large Public Pension Plans, NEA (Sept 2000)

Statewide Teacher Retirement Systems COLA Comparison

States*	Type of COLA	Benefit**		Min %	Max %
AL	Ad Hoc				
AZ	Automatic	Lesser of CPI or excess earnings		0	3
AR	“	3% *simple*		3	3
CA	“	2% *simple*		2	2
CO	“	CPI		0	3.5
CT	“	CPI based on excess earnings account		0	6
DE	Ad Hoc	2%		2	2
DC	Automatic	CPI		0	3
FL	“	3%		3	3
GA	At board discretion	CPI every 6 months		0	1.5
HI	Automatic	2.5% *simple*		2.5	2.5
ID	“	Portion of CPI based 100% funding		1	6
IL	“	3%		3	3
IN	Ad Hoc				
KS	“				
KY	Automatic	1.5% plus 1.5% ad hoc		1.5	3
LA	“	CPI		0	2
ME	“	CPI		0	4
MD	“	CPI		0	3
MA	Legislative approval	CPI on first $12,000		0	3
MN	Automatic	CPI up to 2.5% plus excess earnings		0	No max
MS	“	Formula?			
MO	At board discretion	CPI	75% career maximum	0	5
MT	Automatic	1.5%		1.5	1.5
NE	“	CPI		0	2
NV	“	CPI		0	5
NH	Recommended by actuary	CPI plus excess earnings account		1	5
NJ	Automatic	60% of CPI *simple*		0	No max
NM	“	50% of CPI, 100% if CPI less than 2%		0	4
NY	Ad Hoc				
NC	“				
ND	“				
OH	Automatic	CPI	Accumulates excess CPI	0	3
OK	Ad Hoc				
OR	Automatic	CPI	Accumulates excess CPI	0	2
PA	Ad Hoc				
RI	Automatic	3%		3	3
SC	“	CPI		0	4
SD	“	3.1%		3.1	3.1
TN	“	CPI		0	3
TX	Ad Hoc				
UT	Automatic	CPI *simple*	Accumulates excess CPI	0	4
VT	“	50% CPI beginning at age 62		0	5
VA	“	CPI up to 3%, plus 50% of CPI between 3% and 7%		0	4.5
WA	“	CPI		0	3
WV	Ad Hoc				
WI	Recommended by actuary	Based on excess earnings		0	No max
WY	Automatic	CPI	Accumulates excess CPI	0	2.5

* Alaska, Iowa and Michigan are not included in this chart because they have more than one type of COLA.

** All benefits compounded unless designated as simple.

Source: “Fighting Inflation: How Does Your COLA Compare?” AARP 2000.

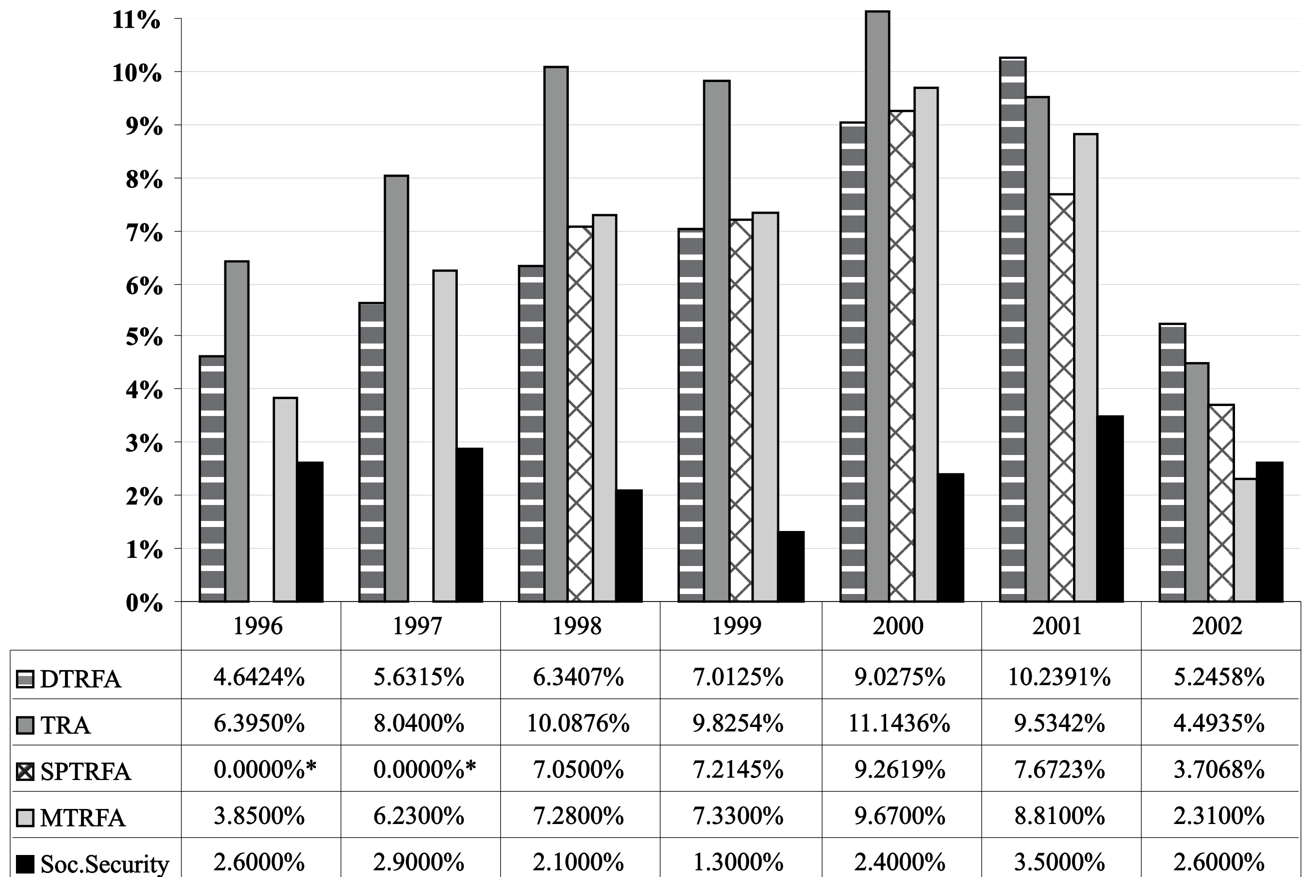
Note: Minneapolis, St. Paul and Duluth TRFA COLA: 2% plus excess earnings, 2% minimum, no maximum

Minnesota Post Retirement Investment Fund (MPRIF) Increases
vs
CPI Increases

Assuming 1980 monthly benefit of $1000

	MPRIF				CPI			
January 1	*Annual Increase*	*Benefit Amount*	*Cumulative Increase*	*Average Increase since 1980*	*Annual Increase*	*Benefit Amount*	*Cumulative Increase*	*Average Increase since 1980*
1981	3.2090%	$1,032.09	3.209%	3.209%	8.9%	$1,089.00	8.900%	8.90%
1982	7.4360%	$1,108.84	10.884%	5.323%	3.8%	$1,130.38	13.038%	6.35%
1983	6.8530%	$1,184.82	18.482%	5.833%	3.8%	$1,173.34	17.334%	5.50%
1984	7.4990%	$1,273.67	27.367%	6.249%	3.9%	$1,219.10	21.910%	5.10%
1985	6.9050%	$1,361.62	36.162%	6.380%	3.8%	$1,265.42	26.542%	4.84%
1986	7.8840%	$1,468.97	46.897%	6.631%	1.1%	$1,279.34	27.934%	4.22%
1987	9.7920%	$1,612.81	61.281%	7.083%	4.4%	$1,335.63	33.563%	4.24%
1988	8.0540%	$1,742.71	74.271%	7.204%	4.4%	$1,394.40	39.440%	4.26%
1989	6.9180%	$1,863.27	86.327%	7.172%	4.6%	$1,458.54	45.854%	4.30%
1990	4.0400%	$1,938.55	93.855%	6.859%	6.1%	$1,547.51	54.751%	4.48%
1991	5.1000%	$2,037.41	103.741%	6.699%	3.1%	$1,595.49	59.549%	4.35%
1992	4.2950%	$2,124.92	112.492%	6.499%	2.9%	$1,641.76	64.176%	4.23%
1993	4.5530%	$2,221.67	122.167%	6.349%	2.7%	$1,686.08	68.608%	4.12%
1994	6.0170%	$2,355.35	135.535%	6.325%	2.8%	$1,733.29	73.329%	4.02%
1995	3.9850%	$2,449.21	144.921%	6.169%	2.4%	$1,774.89	77.489%	3.91%
1996	6.3954%	$2,605.84	160.584%	6.183%	3.1%	$1,829.92	82.992%	3.86%
1997	8.0395%	$2,815.34	181.534%	6.293%	2.8%	$1,881.15	88.115%	3.80%
1998	10.0876%	$3,099.34	209.934%	6.503%	2.1%	$1,920.66	92.066%	3.71%
1999	9.8254%	$3,403.86	240.386%	6.678%	1.5%	$1,949.47	94.947%	3.59%
2000	11.1436%	$3,783.17	278.317%	6.902%	1.9%	$1,986.51	98.651%	3.51%
2001	9.5342%	$4,143.87	314.387%	7.027%	3.8%	$2,061.99	106.199%	3.52%
2002								
2003								

Annual Pension Increases of Minnesota's Teacher Retirement Plans



	1996	1997	1998	1999	2000	2001	2002
DTRFA	4.6424%	5.6315%	6.3407%	7.0125%	9.0275%	10.2391%	5.2458%
TRA	6.3950%	8.0400%	10.0876%	9.8254%	11.1436%	9.5342%	4.4935%
SPTRFA	0.0000%*	0.0000%*	7.0500%	7.2145%	9.2619%	7.6723%	3.7068%
MTRFA	3.8500%	6.2300%	7.2800%	7.3300%	9.6700%	8.8100%	2.3100%
Soc.Security	2.6000%	2.9000%	2.1000%	1.3000%	2.4000%	3.5000%	2.6000%

Adjustment Date = January 1

*St. Paul percentage COLA did not begin until 1998.

Chapter 13:

Current Benefit Recipients

The proposed pension benefit restructuring would apply only to future retirees and would not affect current benefit recipients. All current TRA benefit recipients would continue to be paid from the Minnesota Post Retirement Investment Fund (Post Fund) and have the same post-retirement adjustment formula that is currently in place.

Coordinated member benefit recipients from Duluth, Minneapolis and St. Paul would have their benefits paid from the Post Fund. For determining their post-retirement adjustments from the Post Fund those benefit recipients would make a one-time election to retain their 2 percent guarantee or receive the CPI adjustment up to a 2 ½ percent maximum that the other benefit recipients would receive.

Assets necessary to fully fund these benefit payments would be transferred to the Post Fund at a required amount determined by the actuary for the Legislative Commission on Pensions and Retirement (LCPR), to be sufficient to keep the Post Fund whole with no adverse impact on existing participants. Transfer of funds to the Post Fund from the first class city plan would be made at the funding ratio of the plan at the time of transfer. The difference between the required amount and the amount transferred from the first class city plan would be paid from other funding sources to be determined.

As outlined in Chapter 15, basic member benefit recipients from Minneapolis and St. Paul would make a one-time election to transfer to the Post Fund or remain with their existing plan.

Chapter 14:

Duluth Old Plan

Members of the Duluth Teachers' Retirement Fund Association hired prior to July 1, 1981, currently have rights and benefits in the DTRFA Old Plan. Contribution rates for Old Plan members are the same (5.5 percent) as "new law" members. However, the retirement benefits in the Old Plan are significantly different than the benefits for employees hired after June 30, 1981. The Old Plan has a normal retirement age of 60. It also has the Rule of 90, and a 3 percent per year reduction for members who retire prior to normal retirement age. The formula multiplier, currently 1.45 percent, is modest compared to the New Law plans. There are also some advantages in the leave of absence provisions in the DTRFA Old Plan. The members who utilize and benefit from the Old Plan are those who retire at an earlier age and retire with fewer years of service credit. On June 30, 2001, there were 309 active DTRFA members that were covered by the Old Plan, 31 survivors, and 474 retired members collecting benefits under the Old Plan.

Under the restructured teachers retirement plan, it is envisioned that the DTRFA members who are covered by the Old Plan would belong to the restructured plan, but would retain current rights and benefits. Active DTRFA members who were covered by the Old Plan would contribute to the restructured plan, would be voting members of the restructured plan, would have the same rights and benefits as all other members of the restructured plan, but would retain the rights and benefits of the DTRFA Old Plan. At time of retirement, DTRFA Old Plan members would have the same optional benefit choices and post-retirement adjustment options as all other members that come into the restructured plan from the various teacher retirement plans.

DTRFA members who have already retired with benefits from the Old Plan and survivors receiving Old Plan benefits would continue to receive those same benefits, but they would be paid and their accounts would be administered by the restructured teachers retirement plan.

Chapter 15:

Minneapolis and St. Paul Basic Plan

Prior to July 1, 1978, both Minneapolis Teachers' Retirement Fund Association (MTRFA) and St. Paul Teachers' Retirement Fund Association (SPTRFA) had plans that were not associated with Social Security. Duluth Teachers' Retirement Fund Association members are all coordinated with Social Security and TRA members currently are almost all coordinated with Social Security.

These plans, known as Basic Member Plans, are not only non-Social Security plans but also have different benefit structures than the Coordinated plans of the first class cities and the state TRA. (See *Appendix A*, *Funding History of the Teacher Pension Plans*.) Additionally, most of the retirees in the MTRFA and the SPTRFA are basic plan members.

Since these members do not have similar benefits to the coordinated members and since they exist under the Articles and Bylaws of their associations, these members would remain as closed funds in keeping with the Study Committee premise that there would be no sub-funds in the restructured teachers retirement plan. This has been done several times before in Minneapolis with the Minneapolis Employees' Retirement Fund Association and the Minneapolis Police Relief Association.

New benefit provisions for Minneapolis and St. Paul Basics: Active Members

1. 2.8 percent formula for all years of service up to a maximum of 100 percent. (The change in the COLA could provide funding for a higher formula.)
2. High three average salary.
3. Post-retirement adjustment would be changed to a guaranteed 1 percent plus additional adjustment, up to inflation.
4. Optional annuity provisions would be available to those who elect survivor benefits.

If active members choose to retain the old post-retirement adjustment, they could do so but they would then keep their current benefit provisions.

Retirees

There would be a one-time election by retirees to either keep their current post-retirement formula or move into the current TRA Post Fund. If the retiree elects to move into the TRA Post Fund, a transfer of funds would be made into the Post Fund at the funding ratio of the plan they transferred from. Additional funding would be needed to transfer current retirees into the state Post Fund. If there were actuarial losses, these would not come from the old basic plan.

Chapter 16:

Contributions and Liabilities

The split of the contributions between plan members and the employers in public employee retirement plans has been established in the guiding principles of the Legislative Commission on Pensions and Retirement (LCPR). That split has been determined to be an equal sharing of the "normal cost" by the employee and employer.

This concept of sharing the normal cost is present in public employee retirement plans. In most retirement plans in private industry, the employer pays the entire cost of providing a retirement plan to the employees. The prevailing thought in the private sector is that an employer-provided pension is a benefit like employer-provided insurance. Benefits are provided to attract and retain qualified employees.

It is common in most pension plans that the employer is responsible for any unfunded liabilities that exist. The primary reason for the employer or the state to bear the responsibility to pay for any existing unfunded liability is that past history has shown a pattern of inadequate or no funding at various times in the past. This is especially true in the case of the Minneapolis and St. Paul plans. (See Chapter 5 and *Appendix A, Funding History of the Teacher Pension Plans*.)

Generally accepted accounting principles in the public sector require that any unfunded actuarial liability be amortized over a period not to exceed 30 years (Statement No. 5 of the Governmental Accounting Standards Board, paragraph 36f, and 144).

Chapter 17: Financing

Financing the proposed Restructured Teacher Retirement System has demanded much discussion and caused the teacher fund directors to be as creative as possible while remaining within the bounds of sound pension principles.

Some of the major tenets agreed to by the authors are critical to keep in mind in thinking about the financing for the restructured teachers retirement plan. Those tenets include:

- In the restructured plan, there would be no subgroups or sub-accounts;
- At the time of restructuring, surplus assets in any plan would be reserved for the exclusive benefit of the members of that specific plan;
- After the restructuring is implemented, all members of the new plan would be treated the same, have the same benefits, pay the same contribution rates, and belong to one plan.

It is obvious that the only sources for financing the benefit package that is proposed in this paper are the same ones that have been present in the current retirement plans namely: 1) employee and employer contributions, 2) investment returns, and 3) additional contributions from the State of Minnesota or from some other source.

Employee and employer contributions could each be raised to meet the increased costs of an improved benefit package. Employers should contribute at least 50 percent of the normal cost of the plan. In addition when new benefits are adopted, a part of the increased liability that is greater than the normal cost increase could be amortized over a 30-year period.

Investment income could be used to help pay for the increased cost of an improved benefit package. It must be kept in mind that a key actuarial assumption of the plan is that the investments will be earning 8.5 percent return each and every year. In years when the return on investments exceeds this assumed earnings rate, the excess could be used to reduce the cost of the benefit package.

Additional, immediate contributions from some source would be needed to make up for the differences in the unfunded liabilities of the plans that are being aggregated, and for the increase in unfunded liabilities that would occur when plans with different funding ratios are aggregated into the new restructured plan.

Currently, the TRA and the DTRFA are over 100 percent funded, and the SPTRFA and the MTRFA are underfunded. By restructuring and aggregating the plans into one common pool, there must be a contribution on behalf of the underfunded plans to bring them up to a 100 percent funding ratio. If none of the funds are fully funded at the time of restructuring, then the additional contribution must be sufficient to bring each of the underfunded plans to the level of the plan with the highest funding ratio. Without this contribution, the members of the plans that were better funded at the time of restructuring would, in essence, be forced to contribute towards the unfunded liability of plans that were underfunded at the time of the restructuring.

There is also a need for an immediate infusion of funds when any of the current retirees from the first class city teacher retirement plans are transferred into the Minnesota Post Retirement Investment Fund (MPRIF). The MPRIF is required to be 100 percent funded. Since the interest earning assumption in the MPRIF is more conservative (6.0 percent) than in the first class city teacher retirement funds (6.5 percent), the amount of required reserves for current retirees that must be transferred to the MPRIF are higher than currently valued by the first class city teacher retirement funds. Compounding this problem again is the fact that each of the funds that would be aggregated has a different funding ratio. Retirees that would be transferred to the MPRIF from a plan that is less than 100 percent funded would not have a full reserve amount available for transfer. The amount of reserves required to be transferred to the MPRIF from an underfunded plan would be reduced by the funding ratio of the original plan. The deficiency of the required transfer amount would require an immediate infusion of funds from an alternate funding source in order to make the transfer and keep the MPRIF whole.

A final major cost consideration is the funding that is necessary to pay for the retirements of the Basic Plan members that would be remaining in the Minneapolis and St. Paul Teacher Retirement plans. Without an immediate infusion of money or a schedule to fully fund these plans by the target date of 2020, there would be a funding crisis that is estimated to reach over 100 million dollars per year in the not too distant future. In these two plans, the

actual division of assets between active and retired members, and between coordinated and basic members, continues to be a significant issue that needs resolution.

One option to provide the immediate infusion of money to address the problems outlined above is to imitate other state and local sponsors of public employee pension funds and issue bonds. Bonds would provide the needed immediate infusion of cash to the restructured teachers retirement plan and allow the State of Minnesota to pay off these bonds over a period of time. At times when interest rates on new bond issuances are relatively low, as they currently are, there may be attractive interest rate arbitrage opportunities that could make this a viable option.

There are additional changes that could be employed to mitigate the contribution requirements of the restructured plan. A notable change would be to reset the target date to achieve full funding to a date 30 years from the effective date of the restructuring. This would provide additional time to retire the unfunded liability of the plan, and would work well if bonds were issued. Also, at the time of the restructuring, if the market value of assets is greater than the actuarial value of assets, that higher value could be captured since each of the four existing plans would be legally closed and a new restructured plan would come into existence. Assets would transfer to the new restructured plan at full market value. Finally, changes already described to the post-retirement adjustment calculation in the restructured plan would act to reduce contribution requirements. All of these changes, depending on the timing of the restructuring, could lessen the cost of the restructuring by lowering the contribution requirements of the restructured plan.

In discussions about financing, the question arises as to the use of surplus assets that might exist in any of the teacher retirement plans at the time of restructuring, and if those assets could be used to help finance the obligations of the plans that are not as well funded. In all the literature that was reviewed, and in current federal law and state statute, it is clear that the assets of one system may not be used to solve the funding needs of another system even if the systems are consolidating. Based on current federal and state law the notion of the exclusive benefit applies to the assets that are held in trust by each of the systems.

Chapter 18: Ancillary Benefits

There are two ancillary benefits that are important to be administered internally for the active and retired members of the restructured plan:

1. Tax-sheltered 403(b) retirement savings plan; and
2. Supplemental medical programs.

Tax-Sheltered 403(b) Retirement Savings Plan

Most members currently indicate that they are not and do not care to become expert in matters concerning pensions, investments, taxes, economics, etc. Most also indicate they believe a defined benefit plan is most appropriate as their basic, fundamental retirement plan. They like the availability of a tax-sheltered defined contribution option to supplement their pension. For educators of public schools, this is available through vehicles such as 457 deferred compensation, tax sheltered 403(b) accounts, and various types of individual retirement accounts (IRA) and tax-sheltered annuities. All of these investment products are offered through private for-profit investment firms and insurance companies, except that deferred compensation, which is also available through the Minnesota State Retirement System. Most financial planners indicate that the most attractive options for public school educators to save for their retirement on a tax-deferred basis is through 1) tax-sheltered 403(b) accounts, 2) 457 deferred compensation, and 3) Roth IRAs.

Under the restructured teachers retirement plan, there would be a tax-sheltered 403(b) plan, administered by trustees of the plan. There are a number of advantages to having such a plan:

1. The infrastructure would be in place to efficiently implement such a plan. The basic retirement plan employs professional and high quality investment managers and a custodial bank. The investment of assets in the tax-sheltered 403(b) plan could flow to all or a combination of the existing investment firms already employed to manage the assets of the restructured teachers retirement plan. Separate custodial bank accounts could easily be opened at the existing bank for each of the investment managers participating in the tax-sheltered 403(b) program. Staff of the restructured plan would be

available to counsel members, and to prepare and distribute quarterly statements (unless it is determined that a third-party administrator would create even more efficiencies).

2. Members would receive professional, independent, and objective financial planning advice from staff concerning the advantages and operations of a tax sheltered 403(b) account. Other vendors are obviously very good at providing advice, but they are also motivated by profit. Staff at the restructured teachers retirement plan would have the interest of the members as their sole focus. Members looking for a trustworthy, independent source for objective financial planning information could rely on the staff to provide such a service.

3. Members would have one organization available to them to serve all their retirement planning needs. It is very effective to conduct retirement planning and to counsel members by first covering their basic pension benefit, and then expand to cover the tax-sheltered options as a way to supplement their pensions. Members would obviously have the ability to take advantage of the benefits and services offered through their own financial planners and advisors, or the Minnesota Deferred Compensation Program. However, those options involve taking an additional step, an additional contact to resolve issues, answer questions, etc.

4. An array of appropriate investment options could be offered to members. Investment options with varying degrees of risk and return potential would be made available to members to allow them to make their asset allocation determinations. There is a plethora of anecdotal information and regular stories in the press about investment advisors who have lead their clients into inappropriate investment vehicles, and advisors who developed inappropriate asset allocation plans for their clients. The likelihood of this occurring with a tax-sheltered 403(b) plan administered by the restructured teachers retirement plan is diminished due to the controls that would be in place over the basic pension plan operation. Selection of the investment firms would be conducted after

extensive due diligence and deliberation by the trustees of the restructured plan. A highly trained and professional staff would be in place. Oversight mechanisms would be present. Although the specific asset allocation determination would be left to the individual member, they would receive professional, objective information from the staff of the restructured plan to help them make those determinations.

5. Due to the significant economy of scale advantage, this service would be available to members at a greatly discounted fee compared to what is available at private investment firms in the open market.

Supplemental Medical Programs

Many school districts throughout the state either provide some monetary help to their retired employees or allow those employees to continue to belong to their group insurance plans until they reach the age for Medicare. However, many retirees find themselves paying extremely high costs for things like prescription drugs that Medicare does not cover or they take out individual supplemental policies at high costs.

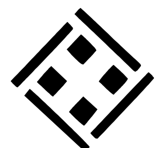
The State of Minnesota has passed legislation that allows the establishment of post-retirement medical reimbursement. This is an excellent step toward helping retired employees cope with the cost of medical expenses. In conjunction with this, the restructured teachers retirement plan would sponsor Medicare supplemental insurance. The restructured plan has no costs associated with this nor does it have any liabilities. It simply provides the means by which retirees can purchase group supplemental health insurance.

If teachers have the means through a pre-retirement medical savings plan to set money aside before retirement for medical expenses and then have an opportunity to purchase affordable group medical insurance after retirement without costing the state any additional money, these public employees would certainly benefit.

Section III: Issues Remaining to be Resolved/Addressed

19. Issues Remaining to be Resolved

20. Issues Remaining to be Addressed



Chapter 19: Issues Remaining to be Resolved

Investment Authority

A major issue discussed at length and yet to be resolved is who would have investment authority and responsibility for the assets of the fund. Should the Permanent Board of the restructured teachers retirement plan have authority and responsibility for investing the assets of the fund or should investment authority reside with the State Board of Investment (SBI)?

The investment management of pension trust fund assets is a vital source of long-term funding stability for public employee pensions. As the world of investment opportunities becomes more complex, sound investment policies and professional expertise are essential to achieve return objectives. The net assets of the four teacher retirement systems as of July 1, 2001, are:

TRA	$	15,092	million
Duluth	$	266	million
Minneapolis	$	1,062	million
Saint Paul	$	824	million

The investment management authority and practices of the four teacher retirement associations are very dissimilar. Since its formation in 1931, the assets of TRA are invested under the authority of the State Board of Investment (SBI). The SBI is established in the Minnesota Constitution, Article 11, Section 8, to manage the investing of all state funds. The duties and powers of the SBI are specified in MN Statutes, Section 11A.04. The SBI sets major investment policies, contracts with qualified private money management firms, and employs an Executive Director and staff to oversee these activities.

In contrast, boards of the three first class city retirement systems are charged with investment under their articles of incorporation and bylaws, and the authority of MN Statutes. Similar to the SBI role, the boards themselves set investment policies and asset allocation targets, contract with money management firms, and regularly review performance of investment activity.

While the duties and powers of a sound investment strategy have been established through both theory and practice, the main questions this report leaves unanswered is: Which entity is charged with the legal responsibility to perform these duties?

Structure of Permanent Board

In Chapter 8, considerable discussion is made regarding the size and composition of the Board of Trustees that would govern the restructured teachers retirement plan for years to come. Board composition was reviewed both at the national level, as well as comparison of the current board structures of the four Minnesota teacher plans. Consensus on the structure of the Permanent Board is yet to be achieved.

Structure of Transition Board

As discussed in Chapter 8, a key component to the restructured teachers retirement plan would be a Transition Board that must be in place as the restructured plan is being implemented, and prior to the election and appointment of the Permanent Board.

Although there was considerable discussion among the fund directors regarding the composition of the Transition Board, no consensus was reached as to its exact structure. There are, however, a number of consensus items regarding the ultimate structure of the board, including:

- A Transition Board should be slightly larger (11-13 members) than the Permanent Board;
- Member representation from each of the four systems should be included;
- Retirees should be represented;
- Employer representation should be included;

Active and retiree member representatives would be appointed by the respective boards of the four funds.

Discussion will continue toward reaching a consensus on this sensitive issue.

Proposed Timeline

Included in the legislative mandate for preparing this restructuring report is the requirement that the report include a detailed schedule and timeline. There was much discussion on what should be an appropriate timeline, but consensus could not be reached by the directors.

Chapter 20:

Issues Remaining to be Addressed

Although much time and effort was put into this report, there were not only issues that were discussed and unresolved but also issues that the authors did not have an opportunity to sufficiently address. These issues appear in list form below. Some of these issues are local and administrative in nature (e.g., how would current employees in each fund be protected?) and other issues are more global (e.g., what could be added to the fund to retain teachers?).

It is the consensus of the authors that these issues must be addressed before the final legislative restructuring could take place.

Issues remaining to be addressed:

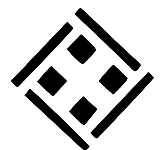
- Should there be auxiliary offices (e.g., Duluth)?
- Could calendar and fiscal years of service be merged?
- Should definition of salary be modified (e.g., coaches' bill, statewide median salary)?
- What would happen to current staff members and how would they be protected?
- How would current boards be held harmless in a restructuring?
- How would assets be transferred, at what valuation?
- Does the restructured plan need a new IRS qualification?
- What would be the process for dissolving the current nonprofit corporations?
- How would current benefits be protected?
- Should there be a supplementary add-on plan to bring retired teachers back into teaching to help with the teacher shortage issue?
- Should there be disability options or should current provisions be modified?
- What could be offered for phased retirement?
- If a plan is underfunded, how would the assets be divided between active and retiree members?
- 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?

Other issues may be added as discussions continue.

Section IV: Steps to Restructuring

21. Implementation Process

22. Authorizing Legislation



Chapter 21:

Implementation Process

One of the critical issues involved in the restructuring deals with how to go from the current four teacher plans into one restructured teachers retirement plan. Since the three first class city funds were incorporated under Chapter 317A, which is the Minnesota Nonprofit Corporation Act, their dissolution or merger would have to be done in accordance with that chapter. This is especially important to the current trustees of the teacher plans, since they must be held harmless if restructuring occurs.

One of provisions of Chapter 317A has been discussed in detail by the authors and that is the provision that provides for a vote by the members. Each of the first class city teacher funds would have to ratify the dissolution or merger of their old plans to the new restructured teachers retirement plan. This ratification process has been incorporated into the proposed timeline for restructuring.

Since the TRA is currently a governmental agency, it is not anticipated that its membership would vote on the restructured plan.

The authors anticipate that the employers would want to ratify the restructured plan since they are responsible for any liabilities created by the restructured teachers retirement plan. A more detailed discussion of the actual implementation steps has not taken place.

Below is a summary of some key citations from Chapter 317A, which should serve as a further guideline to restructuring as it affects the first class city funds as nonprofit corporations.

Merger, Consolidation, Dissolution Laws Affecting Minnesota Nonprofit Corporations

Organizational Background. Minneapolis, St. Paul and Duluth teachers' retirement funds were originally created under MN Laws 1909, Chapter 343, which authorized their formation.

The 1909 enabling act has been amended several times. The establishment provision found in MN Statutes, Section 354A.021, subd. 2, of that section further provides that teachers' retirement fund associations in cities of the first class "shall be organized and governed pursuant to this chapter and Chapter 317A," which is the Minnesota Nonprofit Corporation Act.

Merger, Consolidation. MN Statutes, Sections 317A.601 through 317A.671, govern merger, consolidation and transfer of assets of a nonprofit corporation.

A. Two or more corporations may merge or consolidate, resulting in a single corporation. Section 317A.601, subd. 1.

B. A plan of merger or consolidation must be approved by each constituent corporation. Section 317A.613, subd. 1.

   1. When a constituent corporation has members with voting rights, the plan of merger or consolidation must be submitted to a vote of the members with voting rights, and unless the articles of incorporation require a greater vote, the plan of merger or consolidation must be approved by a majority of the members who vote. Section 317A.613, subd. 2.

Effect on Corporation

1. In the case of a merger, one of the constituent corporations is the surviving corporation. In the case of a consolidation, the surviving corporation is a new corporation. Section 317A.641, subd. 2(1).
2. The agreement of merger or consolidation may provide for the continued existence of a constituent corporation in the merged corporation for purposes declared in the agreement. Section 317A.641, subd. 2(3).
3. The surviving or new corporation has all the rights, privileges, immunities, powers and franchises of each constituent corporation. Section 317A. 641, subd. 2(4) and (5).
4. All real or personal property, debts and interests belonging to each constituent corporation are transferred to the single corporation without further act or deed. Section 317A.641, subd. 2(6).
5. Debts and liabilities of each constituent corporation become the debts and liabilities of the single corporation, as if the single corporation had contracted them. Section 317A.641, subd. 2(9).

6. The rights of creditors or liens upon the property of a constituent corporation are not impaired by the merger or consolidation, but the liens are limited to the property upon which there were liens immediately before the merger or consolidation. Section 317A.641, subd. 2(12).

Effect on Fiduciary Capacity. Under Section 317A.641, subd. 3(b), the single corporation is the successor of the constituent corporations in fiduciary capacities in which a constituent corporation was acting at the time of the merger or consolidation "and is liable to the beneficiaries as fully as if the constituent corporation had continued its separate corporate existence."

Assets not to be Diverted. Under Section 317A.671, when a corporation dissolves, merges or consolidates, assets of the corporation or a constituent corporation "may not be diverted from uses and purposes for which the assets have been received and held, or from the uses and purpose expressed or intended by the original donor."

Dissolution. MN Statutes, Sections 317A.701 through 317A.791, govern dissolution of nonprofit corporations. Dissolution is not discussed in detail here. It is noted that if the corporation has members with voting rights, a proposed dissolution must be submitted for approval at a meeting of such members. Section 317A.721.

Chapter 22:

Authorizing Legislation

BE IT ENACTED BY THE LEGISLATURE
OF THE STATE OF MINNESOTA:

CONTINUING STUDY FOR CREATION OF A
RESTRUCTURED MINNESOTA
TEACHERS RETIREMENT PLAN

Section 1. [PURPOSE AND INTENT.]

The executive director of the teachers retirement association, the executive secretary of the Duluth teachers retirement fund association, the executive director of the Minneapolis teachers retirement fund association, and the executive director of the St. Paul teachers retirement fund association shall continue the process of establishing a nonprofit corporation that will provide retirement, survivor, disability benefits and ancillary benefits to eligible public school teachers in the state of Minnesota. This nonprofit corporation shall be the successor to the current teacher retirement funds that exist in the state of Minnesota and shall be created to accomplish the tenets that have been proposed in the report titled “Restructuring of the Minnesota Teacher Retirement Plans.”

Section 2. [SCOPE.]

The directors shall be charged with the following duties:

1. Continue to consult with a task force consisting of representatives of the affected employing units and representatives of the collective bargaining groups representing members of the affected pension plans.

2. Prepare and propose a timeline for the accomplishment of the necessary steps to establish the new restructured teacher retirement fund association after the enactment of permissive legislation.

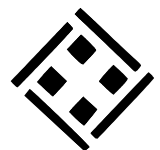
3. Prepare a draft of proposed legislation that would be required to accomplish the establishment of a restructured teacher retirement fund association.

Section 3. [DURATION.]

The directors shall present to the chair of the Legislative Commission on Pensions and Retirement the final draft of the proposed legislation that would be required to establish a restructured teacher retirement fund association, no later than January 15, 2003.

Appendix A

- Analysis of Minnesota Small Systems and Minnesota TRA Pension Funds
- Funding History of the Teacher Pension Plans



Analysis of Minnesota Small Systems and Minnesota TRA Pension Funds

(as of June 30, 2001)

	Duluth TRA	St. Paul TRA	Minneapolis TRA	Minnesota TRA
Total Net Assets (in millions)[1]	$ 266.7	$ 824.2	$ 1,062.0	$ 15,092.0
Annual Covered Payroll (in millions)	$ 50.4	$ 199.0	$ 267.9	$ 2,812.0
Annuity Payroll (in millions)	$ 14.3	$ 53.3	$ 110.0	$ 861.7
Administrative Expenses	$419,807	$ 444,000	$ 627,000	$13,077,718
Administrative Expenses as a % of Payroll	0.79%	0.22%	0.26%	0.46%
Funding Ratio	107.6%	81.9%	65.95%	105.8%
Contribution Sufficiency/(Deficiency)	4.71%	1.26%	(2.73%)	2.15%
Total Active Members	1,427	4,671	5,813	71,097
Old Plan (Duluth)	309	NA	NA	
Basic Plan (Minneapolis/St. Paul)	NA	575	614	
Coordinated Plan	1,118	4,096	5,199	
Inactive Members	828	2,248	3,052	27,801
Retired Members/Survivors	1,058	2,050	3,444	33,757
Retired	992	1,807	3,161	31,169
Survivors/Disabilitants	66	243	283	2,588
Contribution Rates				
Employee	5.50%	5.50% *C*	5.50% *C*	5.00%
Employer	5.79%	8.34% *C*	8.14% *C*	5.00%
Annual Employer Additional Contribution[2]	$ NA	$ 4,577,000	$ 21,244,000 [3]	$ NA
State		$ 3,777,000	$ 17,194,000 [3]	
School District		$ 800,000	$ 2,025,000 [3]	
City			$ 2,025,000 [3]	
Board Structure	**9 trustees** 7 elected members 1 school bd member 1 superintendent or designee	**10 trustees** 9 elected members 1 school bd appointed	**7 trustees** 6 elected members 1 school bd appointed	**8 trustees** 5 elected members 3 ex-officio - Comm. of Finance - Comm. of CFL - MN School Bd Assn

[1]Defined Benefit Plan Assets

[2]Result of Legislature in 1993, 1996 and 1997; see history of funding for detailed information

[3]2002 maximum per statute

C = Coordinated Plan

Historical Contribution Rates and Funding*

	2000	1998	1997	1995	1994	1990	1984	1983	1979	1978	1974	1973
Duluth												
Employee	5.50%	5.50%	5.50%	5.50%	4.50%	4.50%	4.50%	4.50%	4.00%	4.00%	4.00%	4.00%
Employer**	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	5.79%	6.50%	5.00%	5.00%
Additional	0.92%	1.01%	1.01%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	12.21%	12.30%	12.30%	11.29%	10.29%	10.29%	10.29%	10.29%	9.79%	10.50%	9.00%	9.00%
Total Required	8.51%	10.24%	12.87%	13.23%	10.36%	10.70%	13.26%	13.82%	10.08%	10.72%	9.50%	10.27%
Sufficiency/(Deficiency)	3.70%	2.06%	-0.57%	-1.94%	-0.07%	-0.41%	-2.97%	-3.53%	-0.29%	-0.22%	-0.50%	-1.27%
Funding Ratio	103.77%	95.13%	85.97%	82.12%	97.50%	93.61%	65.40%	67.40%	79.70%	79.70%	88.70%	92.30%
St. Paul												
Employee	6.05%	6.21%	6.38%	5.99%	6.15%	6.50%	7.05%	7.19%	7.52%	7.63%	8.00%	7.00%
Employer**	9.07%	9.26%	9.40%	9.54%	8.94%	9.14%	10.42%	10.74%	11.51%	12.63%	13.50%	12.00%
Additional	2.17%	2.12%	3.46%	0.34%	0.36%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	17.29%	17.59%	19.24%	15.87%	15.45%	15.64%	17.47%	17.93%	19.03%	20.26%	21.50%	19.00%
Total Required	16.57%	18.82%	18.45%	17.96%	18.63%	18.86%	16.25%	26.44%	26.12%	25.69%	24.17%	21.62%
Sufficiency/(Deficiency)	0.72%	-1.23%	0.79%	-2.09%	-3.18%	-3.22%	1.22%	-8.51%	-7.08%	-5.42%	-2.67%	-2.62%
Funding Ratio	80.32%	72.55%	69.11%	70.41%	68.28%	63.68%	55.20%	46.30%	40.70%	39.30%	36.10%	34.20%
Minneapolis												
Employee	6.10%	6.44%	6.63%	6.33%	6.25%	7.10%	8.02%	8.11%	8.40%	8.50%	6.50%	6.50%
Employer**	8.95%	9.34%	9.53%	9.80%	9.89%	10.26%	12.29%	12.48%	13.14%	13.35%	15.89%	14.65%
Additional	8.20%	9.61%	12.45%	2.87%	3.02%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	23.25%	25.39%	28.61%	19.00%	19.16%	17.36%	20.31%	20.59%	21.54%	21.85%	22.39%	21.15%
Total Required	25.25%	25.80%	28.23%	25.18%	25.03%	30.40%	34.45%	41.13%	35.59%	32.64%	21.57%	21.43%
Sufficiency/(Deficiency)	-2.00%	-0.41%	0.38%	-6.18%	-5.87%	-13.04%	-14.14%	-20.54%	-14.05%	-10.79%	0.82%	-0.28%
Funding Ratio	66.54%	63.91%	57.37%	56.44%	55.86%	49.96%	45.30%	38.20%	41.20%	42.40%	57.00%	56.90%
Minnesota TRA												
Employee	5.00%	5.00%	5.00%	6.51%	6.51%	4.58%	4.71%	4.73%	4.30%	4.32%	4.40%	4.45%
Employer**	5.00%	5.00%	6.64%	8.15%	8.15%	8.22%	9.19%	7.78%	7.30%	7.32%	5.90%	5.90%
Additional	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total Contribution	10.00%	10.00%	11.64%	14.66%	14.66%	12.80%	13.90%	12.51%	11.60%	11.64%	10.30%	10.35%
Total Required	7.92%	9.82%	9.85%	14.30%	14.73%	13.11%	14.55%	18.63%	17.15%	15.14%	15.63%	14.12%
Sufficiency/(Deficiency)	2.10%	0.20%	1.79%	0.36%	-0.07%	-0.31%	-0.65%	-6.12%	-5.55%	-3.50%	-5.33%	-3.77%
Funding Ratio	105.21%	105.70%	101.30%	85.91%	83.51%	77.60%	59.60%	57.10%	51.20%	54.30%	50.00%	53.40%

* Historical contribution rates as determined by annual actuarial valuations or LCPR summaries.

** Employer contributions include employer supplemental

Notes:

1998 TRA over 100% funded; employer supplemental contribution eliminated (reduction of 1.64%)

1997 TRA employer supplemental contribution lowered by 1.5%. These contributions were dedicated annually to the following:
Duluth $486,000, St. Paul $2,827,000, Minneapolis $12,954,000, PERA $15,885,000

1990 TRA employer supplemental reduced by 0.84%

1984 TRA receives additional supplemental contribution from state 1.49%

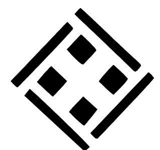
1978 New Coordinated plan begins for Minneapolis & St. Paul (Duluth in 1981). Employer supplemental eliminated for St. Paul & Minneapolis Coordinated.

View additional funding information in Chapter 5.

Appendix B

First Class City Teacher Retirement Funds
Phase-Out Consolidation Options:

Technical Advisory Group
Report to the Legislative Commission on
Pensions & Retirement (March 16, 1994)



Summary of Findings

Purpose and Scope

This report is provided by the Technical Advisory Group as part of a study mandated by the 1993 Legislature to examine phase-out or consolidation options for the First Class City teacher retirement funds. We identify and analyze an array of fourteen distinct options relating to alternative plan structures, fund consolidations, management and financing arrangements, including the *status quo* as both an option and a baseline against which to assess others.

No recommendation is made in this report. The Technical Advisory Group intends simply to provide policymakers with the most thorough and objective information that can be obtained on the options identified as worthy of consideration. What follows is an attempt to synthesize the best empirical information and professional assessments of these options attainable given the time and resources available.

Fourteen options were identified and selected for assessment ranging from maintaining the current plan, funding and management arrangements, to total and immediate consolidation of the four teacher retirement plans in the state. Between these extremes lie twelve alternatives on a continuum of progressively more fundamental and sweeping plan/funding modifications. This report evaluates, along with fund elimination options, proposals that address concerns about cost effective administration and investment management, along with alternative funding scenarios driven partly by bonding opportunities to arbitrage downward the projected unfunded liabilities of several plans: An approach that could have significant positive impacts on the funding status of the Minneapolis and St. Paul funds in particular.

We break the options into 3 (overlapping) categories:

1) Administrative Efficiency Opportunities

2) Funding Change Opportunities

3) Actual Plan/Fund Modification Opportunities

Current Status

The "Current Status" section of the report lays out the situation faced by the teacher funds as a whole and separately. The major point to be drawn from our appraisal of the situation is

that Minnesota teacher retirement liabilities are, on the whole, very well funded. Ninety percent of the active teacher fund members are in adequately funded plans. There are serious ongoing deficiencies, however, in two local plans, Minneapolis ($9,813,284 per year) and St. Paul ($4,333,485 per year), in which approximately 10% of the active teachers and administrators participate. This point is worth emphasizing: If policymakers believe that funding is the primary issue of concern regarding teacher funds in the state, then the response should be focused as closely as possible on the genuine locus of the funding problem. It may be the case that consolidation of poorly funded plans with well-funded plans could expand the scope of the problem, rather than containing and resolving the issue of central concern.

Benefits do not appear to be the driving force behind the current funding problems. One summary way to compare benefits is to look at the **normal cost of retirements**. From this perspective, current benefits among the various plans are quite similar in terms of *total* cost. There are significant differences among the plans in terms of *specific* benefits, but from a total cost perspective there do not appear to be large, overall benefit disparities.

There are significant differences among the funds in terms of administrative costs, both as a percentage of payroll, and in terms of annual expenditures distributed by plan membership. Administrative costs range from 0.83% of annual payroll (Duluth) to 0.15% (TRA). This can be accounted for partly by economies of scale, but also appears to be driven by different division between internal/external service provision. In addition, fixed costs in the smaller plans have a smaller base against which to be distributed, and therefore, would, under any level of efficiency in operations from a variable cost perspective, probably always be higher.

Certainly, opportunities for long-run economies in administration exist. The issue for policymakers, however, is whether the potential savings are worth the transition costs, or possible member service and policy implications of any administrative consolidation.

Analysis of Options

Consolidation or phase-out of First Class City pension funds appears to be very costly under each scenario evaluated. These options are also more controversial, long-term and complex to implement than others considered.

Aside from the many policy considerations presented to policymakers by the options evaluated, there seem to be very few opportunities for actual plan or fund *consolidation* that do not also imply significant actuarial costs. Unless some of these issues can be resolved through legislation on plan consolidation provisions, it does not appear that reducing the number of funds creates economies in strict cost/benefit terms to the state or the employing jurisdictions. Some other superseding policy objective would be required to justify the fiscal impacts presented here. Issues that deal with some of these other dimensions are more

thoroughly addressed in the following section of the report.

Consolidation or phase-out of the three first class city funds is projected to be very costly. The new first year cost ranges from $29 million for Option 8 to $65 million under Option 13. The Commission actuary did not perform the valuations necessary to derive cost figures for Option 14, but it is safe to assume that the costs for this option would certainly exceed those for Option 13.

For other options that fall generally within the "Consolidation Opportunity" category, the first year costs are larger than we anticipated. The costs are most often due to differences in the assumed rates of return on pre/post-retirement assets, funded status of the plans, and diminishing active payroll to support closed plans as they approach the amortization target date. By far the most expensive options are #12 and #13. Allowing only actives to elect current or TRA benefits and SBI post-retirement adjustments (Option #12) raises first year costs from $28.8 to $55.8 million; a difference of $27 million. Under Option #13, we extend to retirees the election on post-retirement benefits, which increases projected required contributions by $9.2 million. Primary factors driving these results are:

1) Moving members from plans that are poorly funded into well-funded plans;

2) allowing the election of SBI or 13th check post-retirement increases; and,

3) the lower assumed post-retirement rate of return for the State TRA versus local fund rates.

Changes in funding arrangements, such as issuing taxable general obligatio bonds to finance part of the unfunded liabilities of plans in need, and reallocation of current contribution amounts, present opportunities to improve the funded status of plans without additional costs to the state, employers, or employees. These benefits under these options rely more, however, on forecasted debt service costs and returns on assets.

Of the fourteen alternatives, there are only three where costs (as measured in terms of required contributions) are actually reduced - Options 2, 3, and 4.

Options #3 and #4 (affecting only MPLS-TRA and MERF) involve a "contribution lock-in, and G.O. bonding of unfunded liabilities. These are the only alternatives to current policy that the Advisory Group studied that show some promise of significantly reducing retirement obligations. Detail cash-flow projections are included in the appendix to this report which illustrate the actuarial effects under Options #3 and #4.

First-year "savings" under option #3 are estimated at $5.4 million. Savings here, is measured against the current combined total deficiency for the relevant funds. A reduction in deficiencies is defined here from an actuarial perspective as "savings." From a strict fiscal and budgetary point of view, expenditures are not really reduced under Options #3 or #4.

The next option, adds to this scenario the issuance by the school district and city, taxable general obligation bonds to offset the unfunded liabilities of the MERF and MPLS-TRA funds. The text runs to date have been for sales of $100 million each for the two funds. The spread between the rate of return on the assets obtained, and the rate of interest on the bonds creates an arbitrage opportunity. A large amount of assets are infused into the funds, and compound at a rate sufficient to double the effect of the contribution lock-in; savings are $11.5 million the first year.

The effect of all this on MPLS-TRA can be understood as a reversal of the current situation, where insufficient assets come into the fund each year, and the loss is negatively compounded by the rate of return that could have been obtained. In this case, a significant share of that contribution insufficiency is corrected, such that the deficiency for MPLS-TRA goes from 6.80% to 2.23% with the lock-in and bond sales. The funding problem for MPLS-TRA is not resolved entirely under these projections, but if recent investment performance of the two funds (well in excess of assumed returns) can be sustained for even the next few years, the effect could be even more dramatic. Certain technical problems need to be resolved before either or both of these options could be implemented, and these are discussed further in the "Option-by-Option Analysis" section of the report.

Administrative costs are not significant in terms of overall funding requirements. Under virtually every option we studied, administrative savings were assumed liberally, but were never sufficient to offset much larger adverse actuarial impacts of consolidation options. Where administrative savings were not reversed by actuarial effects, they do not appear large enough to warrant the operational disruptions and up-front costs implied.

Administrative costs simply do not amount to much in the pensions context. The estimated administrative savings in the table for Options 2-5 are based upon analyses by MERF and MPLS-TRA. The amount saved by sharing certain administrative functions and office space is approximately 5%. For Options 6 and 7, affecting only the four teacher funds, we assumed 20% savings in administration, and 10% on investment costs. These are beyond the item-by-item projections for MERF and MPLS-TRA. We felt that a significant amount should be assumed given the more similar nature of the plans being managed. For the remaining options, we assumed a 10% savings in overall administrative costs. Larger memberships and greater geographic dispersion of employers/members, the scale of operations and systems, and the complexity of administrative arrangements could render these assumptions invalid, and in fact, cause *diseconomies*.

The administrative savings under Options 2 ($300,000) are so minor that they could easily be eliminated by incorporating effects on overall fund and employer administrative costs that have *not* been included in this report. Administrative savings under Option #5 ($608,000) are dwarfed by the actuarial costs of the proposal. While significant administrative "savings" occur under Option #6 ($1,755,000) they are similarly wiped out by actuarial costs.

While members of the advisory group are by no means unanimous on this point, it appears that member services would either be enhanced or at least not substantially impaired in the long-run by most of the options we considered. Options 6 and 7, however, and perhaps 12 and 13, centralize administration of the plans, and in doing so, could limit member access to fund management and staff. Where problems such as member access, service levels, or potential technical/administrative issues appear, we have noted this in the "Option Impacts" and "Option-by-Option Analysis" sections of the report. There are significant transition issues and costs associated with consolidation of administrative functions. These are easily identified by the people who actually administer the current four funds. Putting monetary value on them, or defining timelines to implementation, are more difficult and speculative tasks.

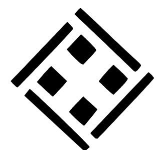
Where plans are consolidated or phased-out, issues to be resolved are many and complex, particularly as regards election of benefits, asset transfer ratios, along with establishing base pensions, and financing post-retirement increases.

For any of the actual plan/fund consolidations, a common problem exists: How does a 13th check operate if a fund is closed to new members, and active members or retirees are either re-directed to another plan or allowed to elect another's benefits? The base of contributions, asset accumulation, and thus capacity to generate excess returns available for distribution, would be considerably reduced. In a closed fund, there would be no new actives, and therefore a shrinking pool of assets against which to draw 1% for distribution. Funding the 13th check becomes difficult without some other infusion of contributions to the fund. The issue also remains as to how the 13th check, which for many older retirees is now larger than their retirement benefit, would be converted into a base pension within the Post Fund.

Wherever there are benefit changes (except for #14, the "Best of All Plans" option), there are typically *both* winners and losers. This report attempts to show which group outweighs the other for each option. Where there is expected to be a significant number of members potentially affected either way, that information is presented. While none of the options seems to imply reductions for the majority of the affected members, any occurrence of reduced benefit (i.e., transfers of member assets at less than the *pro rata* share from their current fund) could be litigated by members if the plan selection was not optional. Where there appears to be potential for litigation, we have either marked the column with a negative sign or question mark.

Appendix C

Uniform Management of Public Employee Retirement Systems Act (UMPERSA) — 1997



UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-SIXTH YEAR
IN SACRAMENTO, CALIFORNIA
JULY 25 - AUGUST 1, 1997

WITH PREFATORY NOTE AND COMMENTS

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NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

The Committee that acted for the National Conference of Commissioners on Uniform State Laws in preparing the Uniform Management of Public Employee Retirement Systems Act (1997) was as follows:

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UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

PREFATORY NOTE

State and local retirement systems currently manage in excess of $1 trillion in assets for the benefit of participants and beneficiaries. The well-known federal law regulating the management of retirement funds, the Employee Retirement Income Security Act (ERISA), does not apply to these systems. ERISA §§ 3(32), 4(b), 29 U.S.C. §§ 1002(32), 1003(b) (1994). Instead, the systems are regulated by law in each State. That law varies considerably across States and has often failed to keep pace with modern investment practices. The Management of Public Employee Retirement Systems Act (MPERS Act) will modernize, clarify, and make uniform the rules governing the management of public retirement systems.

In broad terms, the MPERS Act protects participants and beneficiaries of public retirement systems in two ways. First, the Act articulates the fiduciary obligations of trustees and others with discretionary authority over various aspects of a retirement system and ensures that trustees have sufficient authority to fulfill their obligations (Sections 4 through 10). Second, the Act facilitates effective monitoring of retirement systems by requiring regular and significant disclosure of the financial and actuarial status of the system, both to participants and beneficiaries directly and to the public (Sections 12 through 18).

Considered in more detail, the Act's regulation of the management of public employee retirement systems can be divided into six categories. First, the Act requires that all retirement system assets be held in trust (Section 4). Second, the Act ensures that the trustee has exclusive authority over those assets (Section 4) and sufficient control over the enterprise to manage the assets efficiently and effectively (Sections 5 and 6). Third, the Act articulates the duties of trustees and others with discretionary authority over the operation and administration of a retirement system or the management of its assets (Sections 6 through 10). Fourth, to facilitate effective monitoring of retirement systems, the Act imposes significant disclosure requirements. The Act clarifies the application of state open record and open meetings laws to retirement systems (Section 12) and requires systems to publish various types of reports (Sections 13 through 18). The reports must be distributed widely and be made available to the public (Sections 13 through 15). Fifth, the Act has provisions to permit effective enforcement (Sections 11, 19, and 20). Finally, the Act prohibits the assignment or alienation of benefits, unless the legislature expressly decides that assignment or alienation is appropriate and consistent with the underlying policy of protecting retirement benefits (Section 21).

A primary purpose of this Act is to facilitate the incorporation of modern investment practices into state law regulating the management of public employee retirement systems. Since the late 1960's, the investment practices of fiduciaries experienced significant change. These changes occurred under the influence of a large and broadly accepted body of empirical and theoretical knowledge about the behavior of capital markets, often described as "modern portfolio theory." The law of trust investment has been modernized to keep pace with these changes, and the National Conference has actively participated in the effort. Restatement (Third) of Trusts: Prudent Investor Rule (1992) (hereinafter "Restatement of Trusts 3d: Prudent Investor Rule"); Uniform Prudent Investor Act (1994) (hereinafter "Uniform Prudent Investor Act"); Uniform Principal and Income Act (1997).

The Act is designed to replace laws that inhibit or, in a number of States, even prevent use of modern investment practices. In the long run, these outmoded laws result in billions of dollars of lost opportunities for investment income. The lost income could be used to increase pension benefits, lower contribution rates, or some combination. The immediate beneficiaries would be the system's participants and beneficiaries, but the ultimate beneficiary would be the State's taxpayers. Taxpayers could offer employees either a better pension for the same cost or the same pension for a lower cost.

The Act facilitates the incorporation of modern investment practices, in large part, by revising and clarifying the standards of prudent retirement fund investing. Five generally accepted principles of modern fiduciary investment practice are implemented. All are found in the Restatement of Trusts 3d: Prudent Investor Rule and all derive from the Uniform Prudent Investor Act, another National Conference initiative to incorporate modern investment practices into state law:

(1) The standard of prudence is applied to any investment as part of the total portfolio, rather than to individual investments. In the retirement system setting, the term portfolio embraces the assets of each retirement program or appropriate grouping of programs. MPERS Act § 10(2).

(2) The tradeoff in all investing between risk and return is identified as the trustee's central investment consideration. MPERS Act § 10(2).

(3) All categoric restrictions on types of investments have been abrogated; the trustee can invest in anything that plays an appropriate role in achieving the risk/return objectives of the program and that meets the other requirements of prudent investing. MPERS Act § 8(a)(4).

(4) The long-familiar principle that trustees diversify their investments has been integrated into the definition of prudent investing. MPERS Act § 8(a)(2).

(5) The power of a trustee to delegate investment and management functions is affirmed, clarified, and subjected to safeguards. MPERS Act § 6.

For a discussion of these principles as they appear in the Uniform Prudent Investor Act, see John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 Iowa L. Rev. 641 (1996).

These standards of prudent investing apply to retirement system trustees. Consequently, they can only be effective in incorporating modern investment practices into the retirement system setting to the extent trustees have the independence and institutional resources necessary to comply. The Act contains provisions that protect the ability of trustees to manage retirement system assets in accordance with the prudence standards of this Act and, hence, in accordance with modern investment practices. MPERS Act §§ 4-6. At the same time, the Act facilitates effective monitoring of trustees by requiring significant openness in the operation of retirement systems. MPERS Act §§ 12-18.

UNIFORM MANAGEMENT OF PUBLIC EMPLOYEE RETIREMENT SYSTEMS ACT (1997)

SECTION 1. SHORT TITLE. This [Act] may be cited as the Uniform Management of Public Employee Retirement Systems Act.

SECTION 2. DEFINITIONS. In this [Act]:

(1) "Administrator" means a person primarily responsible for the management of a retirement system or, if no person is clearly designated, the trustee of the system who has the ultimate authority to manage the system.

(2) "Agent group of programs" means a group of retirement programs which shares administrative and investment functions but maintains a separate account for each retirement program so that assets accumulated for a particular program may be used to pay benefits only for that program's participants and beneficiaries.

(3) "Appropriate grouping of programs" means:

(A) for defined benefit plans, a cost-sharing program or an agent group of programs; and

(B) for defined contribution plans, a group of retirement programs which shares administrative and investment functions.

(4) "Beneficiary" means a person, other than the participant, who is designated by a participant or by a retirement program to receive a benefit under the program.

(5) "Code" means the federal Internal Revenue Code of 1986, as amended.

(6) "Cost-sharing program" means a retirement program for the employees of more than one public employer in which all assets accumulated for the payment of benefits may be used to pay benefits to any participants or beneficiaries of the program.

(7) "Defined benefit plan" means a retirement program other than a defined contribution plan.

(8) "Defined contribution plan" means a retirement program that provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account; any income, expenses, gains, and losses credited or charged to the account; and any forfeitures of accounts of other participants that may be allocated to the participant's account.

(9) "Employee" includes an officer of a public employer.

(10) "Fair value" means the amount that a willing buyer would pay a willing seller for an asset in a current sale, as determined in good faith by a fiduciary.

(11) "Fiduciary" means a person who:

(A) exercises any discretionary authority to manage a retirement system;

(B) exercises any authority to invest or manage assets of a system;

(C) provides investment advice for a fee or other direct or indirect compensation with respect to assets of a system or has any authority or responsibility to do so; or

(D) is a trustee or a member of a board of trustees.

(12) "Furnish" means:

(A) to deliver personally, to mail to the last known place of employment or home address of the intended recipient, or, if reasonable grounds exist to believe that the intended recipient would receive it in ordinary course, to transmit by any other usual means of communication; or

(B) to provide to the intended recipient's public employer if reasonable grounds exist to believe that the employer will make a good faith effort to deliver personally, by mail, or by other usual means of communication.

(13) "Governing law" means state and local laws establishing or authorizing the creation of a retirement program or system and the principal state and local laws and regulations governing the management of a retirement program or system or assets of either.

(14) "Guaranteed benefit policy" means an insurance policy or contract to the extent the policy or contract provides for benefits in a guaranteed amount. The term includes any surplus in a separate account, but excludes any other portion of a separate account.

(15) "Insurer" means a company, service, or organization qualified to engage in the business of insurance in this State.

(16) "Nonforfeitable benefit" means an immediate or deferred benefit that arises from a participant's service, is unconditional, and is enforceable against the retirement system.

(17) "Participant" means an individual who is or has been an employee enrolled in a retirement program and who is or may become eligible to receive, or is currently receiving, a benefit under the program, or whose beneficiaries are or may become eligible to receive a benefit. The term does not include an individual who is no longer an employee of a public employer and has not accrued any nonforfeitable benefits under the program.

(18) "Public employer" means this State or any political subdivision, or any agency or instrumentality of this State or any political subdivision, whose employees are participants in a retirement program.

(19) "Retirement program" means a program of rights and obligations which a public employer establishes or maintains and which, by its express terms or as a result of surrounding circumstances:

(A) provides retirement income to employees; or

(B) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond.

(20) "Retirement system" means an entity established or maintained by a public employer to manage one or more retirement programs, or to invest or manage the assets of one or more retirement programs. [May also list state retirement systems and statutes authorizing the formation of systems.]

(21) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(22) "Trustee" means a person who has ultimate authority to manage a retirement system or to invest or manage its assets.

Comment

The definition of "agent group of programs" in paragraph (2), together with the definitions of "appropriate grouping of programs" in paragraph (3) and "cost-sharing program" in paragraph (6), support the fiduciary requirements of Sections 8 and 9 and the reporting and disclosure requirements of Section 17. In evaluating fiduciary responsibilities and reporting obligations, the default rule is that the focus should be on each individual retirement program. A trustee, for example, should diversify the investments of each program, MPERS Act § 8(a)(2), and the annual disclosure of financial and actuarial status should identify each program. MPERS Act § 17(c)(1). Some retirement programs, however, are so interconnected that the focus appropriately should be on a grouping of programs. These definitions are used later in the Act to delineate when the default focus on individual programs is overridden and the focus should fall instead on a grouping of programs. The definitions track those established in Financial Reporting

for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, Statement of Governmental Accounting Standards No. 25, ¶¶ 15-16, 44 (Governmental Accounting Standards Board, 1994) (hereinafter "GASB Statement No. 25"), and, hence, are well understood in the actuarial community.

The phrase "other than the participant" in the definition of "beneficiary" in paragraph (4) creates a distinction between participants and beneficiaries. In essence, a participant expects benefits based on her own service, while a beneficiary expects benefits based on someone else's service. The phrase, however, does not preclude the possibility that someone can, at the same time, be both a participant based on her own service and a beneficiary based on someone else's service.

Paragraph (5) refers to the federal Internal Revenue Code of 1986. State and local retirement programs have varied and complex relationships to the Code, and the Act makes reference to it at several points. The National Conference recognizes that in some States this may give rise to problems of delegation of legislative power. However, given the complex relationship between many state laws and the Code, references of this type are increasingly common and have been sustained. *See*, *e.g.*, *McFaddin v. Jackson*, 738 S.W.2d 176 (Tenn. 1987); *Thorpe v. Mahin*, 250 N.E.2d 633 (Ill. 1969); *City National Bank of Clinton v. Iowa State Tax Commission*, 102 N.W.2d 381 (1960). In any event, whatever difficulties may be involved, the course adopted in this Act seems preferable to the alternative of restating federal tax law in the Act, continually monitoring that law for relevant changes, and repeatedly amending the Act in response to changes.

The definition of fiduciary in paragraph (11) is derived from ERISA § 3(21), 29 U.S.C. § 1002(21) (1994), and is intended to incorporate ERISA's general, discretion-sensitive conceptions of fiduciary status into the Act. The definition is important because it, along with the term trustee, specifies who may be liable under the Act. *See* MPERS Act § 11. At the same time, however, the definition of fiduciary in this Act is less important than the definition of fiduciary under ERISA because this Act, unlike ERISA, does not preempt other possible causes of action against actors who do not fit within this Act's definition of fiduciary. *See* MPERS Act § 11(a), Comment at ___. Nonfiduciaries under this Act would still be subject to actions outside this Act based on their contracts (which themselves could impose fiduciary duties); on any independent sources of fiduciary obligation; on other obligations under state law (such as agency, tort or professional responsibility law); or on federal law.

The definition of "furnish" in paragraph (12) is intended to require that information be made readily available to the intended recipient, but is not intended to limit the technology used to make the delivery. The definition is intended to be interpreted broadly to permit conveyance of information through a wide variety of modern technologies, such as by fax or electronic delivery, but only if the sender has reasonable grounds to believe that the information would reach the intended recipient through the use of those technologies. It draws on definitions in the Uniform Partnership Act, § 102(c) (1994) and the Uniform Commercial Code, § 1-201(38) (1994).

The definition of public employer in paragraph (18) tracks the definition of "governmental plan" in Section 3(32) of ERISA. 29 U.S.C. § 1002(32) (1994). *See also* I.R.C. § 414(d) (1994) (very similar definition of "governmental plan" used in the Code). ERISA is broadly preemptive of state law, but it does not cover governmental plans. ERISA §§ 4(b)(1), 514, 29 U.S.C. §§ 1003(b)(1), 1144 (1994). The Drafting Committee considered drafting language to include various types of state employers more specifically, for example, municipal corporations, home rule cities, charter cities, public school districts, and public hospital organizations. Instead, however, the Drafting Committee decided to track the ERISA language to make it clear that the definition is intended to reach all state employers that fall within ERISA's exemption for governmental plans. Thus, even though the definition does not specifically mention various types of state employers, the intent is to be broadly inclusive.

The definition of trustee in paragraph (22), by necessity, must cover a wide range of institutional arrangements for the allocation of ultimate authority over retirement systems. Some retirement systems have one set of trustees with ultimate authority over all aspects of the system. Other systems have more than one set of trustees, with each set having ultimate authority over a particular aspect of the system. The definition of trustee is intended to cover every person who has ultimate authority over any aspect of a retirement system. Later sections of the Act using the term "trustee" may refer to all trustees or to only some trustees, depending on context and the institutional arrangements of the particular retirement system. For example, as a general matter, all trustees may delegate functions under Section 6, but only trustees with authority to invest and manage retirement system assets are subject to the duties of Section 8.

The Drafting Committee decided not to include in the Act any rules for the selection or composition of boards of trustees. A principal reason for this was that the subject was outside the scope of the Committee's mission. Another reason was the considerable diversity of opinion on the Committee about whether stakeholder representation on boards was a good idea. Some thought that stakeholders (including employees, employers, participants, and

beneficiaries) should be represented on governing boards, while others saw little need for such representation. Finally, many on the Committee thought the issue would be difficult to resolve in a uniform law given that States differ legitimately on a number of issues relating to board selection and composition, such as the size of trustee boards, what stakeholder groups merit representation, the proportion of representation each group should have, who is entitled to select each stakeholder's representative, etc. It should be noted, however, that the Act does not leave completely unattended the interests that fuel concern about stakeholder representation on trustee boards; regardless of how they are selected or who they represent, the Act requires trustees to act solely in the interest of participants and beneficiaries. MPERS Act, § 7(1). *See NLRB v. Amax Coal Co.*, 453 U.S. 322 (1981) (fiduciary of employee benefit trust fund owes duties to beneficiaries of fund, not to party that appointed him).

SECTION 3. SCOPE. This [Act] applies to all retirement programs and retirement systems, except:

(1) a retirement program that is unfunded and is maintained by a public employer solely for the purpose of providing deferred compensation for a select group of management employees or employees who rank in the top five percent of employees of that employer based on compensation;

(2) a severance-pay arrangement under which:

(A) payments are made solely on account of the termination of an employee's service and are not contingent upon the employee's retiring;

(B) the total amount of the payments does not exceed the equivalent of twice the employee's total earnings from the public employer during the year immediately preceding the termination of service; and

(C) all payments are completed within 24 months after the termination of service;

(3) an arrangement or payment made on behalf of an employee because the employee is covered by Title II of the Social Security Act, as amended;

(4) a qualified governmental excess benefit arrangement within the meaning of Section 415(m) of the Code;

(5) an individual retirement account or individual retirement annuity within the meaning of Section 408 of the Code;

(6) a retirement program consisting solely of annuity contracts or custodial accounts satisfying the requirements of Section 403(b) of the Code; or

(7) a program maintained solely for the purpose of complying with workers' compensation laws or disability insurance laws.

Comment

Paragraph (1) provides an exception for unfunded programs maintained by an employer for a select group of management or highly compensated employees. It tracks language in ERISA that exempts "top hat" plans from many of that Act's requirements. ERISA §§ 201(2), 301(a)(3), 401(a)(1), 4021(b)(6), 29 U.S.C. §§ 1051(2), 1081(a)(3), 1101(a)(1), 1321(b)(6) (1994). *See also* 29 C.F.R. § 2520.104-24 (1997). The rationale for the exception is two-fold. First, a select group of management or highly compensated employees is likely to be sufficiently sophisticated and in an adequately secure position to protect its own interests, even without the protections afforded by this Act. *See* DOL ERISA Advisory Opinion 90-14A ("certain individuals, by virtue of their position or compensation level, have the ability to affect or substantially influence, through negotiation or otherwise, the design and operation of their deferred compensation plan, taking into consideration any risks attendant thereto, and, therefore, would not need the substantive rights and protections of [ERISA]"). Second, select groups by their nature are small, so the costs of compliance may well outweigh the likely benefits of coverage.

Paragraph (2) clarifies that severance pay arrangements are not subject to the Act. This Act is concerned with the special problems of retirement programs that arise, in large part, because of the long-term nature and complexity of the pension promise. Severance pay arrangements, in general, are one-time payments made pursuant to a relatively simple promise. The special protections of this Act, then, are not necessary or appropriate for severance pay arrangements. The drafters of ERISA made a similar calculation in authorizing the Secretary of Labor to exempt severance pay arrangements from that Act's definition of "pension plan." ERISA § 3(2)(B), 29 U.S.C. § 1002(2)(B) (1994). The language of paragraph (2) is based generally on the Secretary's regulation. 29 C.F.R. § 2510.3-2(b) (1997).

Paragraph (3) provides an exception for arrangements with or payments made to the federal social security system on behalf of employees who are covered by social security. Public employees may be covered by social security pursuant to a coverage agreement between their State and the Commissioner of Social Security under Section 218 of the Social Security Act, 42 U.S.C. § 418 (1994), or because the employees' public employer does not provide an adequate level of retirement benefits through a retirement program. 42 U.S.C. § 410(a)(7)(F) (1994). *See* Service by Employees Who Are Not Members of a Public Retirement System, 26 C.F.R. § 31.3121(b)(7)-2 (1997).

Paragraph (4) provides an exception for qualified governmental excess benefit arrangements. These types of arrangements were authorized by the Small Business Job Protection Act, enacted in 1996, to ease problems governmental employers were facing in complying with the benefit limitations of Section 415 of the Code. Small Business Job Protection Act, Pub. L. No. 104-188, § 1444(b)(1), 110 Stat. 1755, 1809-10 (1996) (to be codifed at I.R.C. § 415(m)). Qualified governmental excess benefit arrangements are not covered for two primary reasons. First, for tax reasons, these arrangements are likely to be either unfunded or funded through grantor trusts that are subject to the claims of the public employer's creditors. The requirements of this Act would be inconsistent with the latter approach and ill-suited for the former. Second, since these types of arrangements apply only to benefits in excess of the Section 415 limits, the class of employees affected, like the class excepted under paragraph (1), is likely to be sufficiently sophisticated and in an adequately secure position to protect its own interests, even without the protections afforded by this Act.

Paragraph (5) provides an exception for individual retirement accounts (IRAs). For most IRAs this is merely a clarification; most IRAs are established by individuals and, hence, would not be retirement programs within the definition of Section 2(19) because they are not established or maintained by a public employer. Some IRAs, however, are established or maintained by public employers. I.R.C. §§ 408(c), 408(k) (1994). This paragraph means that these types of IRAs are not governed by the Act either.

IRAs are not covered by the Act because they do not pose the special problems to which the protections of this Act are directed. IRAs require (1) the involvement of financial intermediaries (for example, banks or insurance companies) that are subject to independent sources of fiduciary obligation and (2) annual reports to employees by the organizations maintaining the accounts or annuities. 26 C.F.R. § 1.408-5 (1997). For IRAs, then, most of the protections of this Act would duplicate protections elsewhere. Thus, the costs of complying with the Act, although likely to be minimal, would not be justified. For the same reasons, paragraph (6) provides an exception for annuities or custodial accounts under I.R.C. § 403(b) (1994).

Paragraph (7) clarifies that workers' compensation and disability insurance programs are not subject to the Act even though the programs may provide retirement income to some employees and thus fit within a strict reading of the definition of retirement program in Section 2(19).

Several paragraphs in this section refer either to the federal Internal Revenue Code of 1986 or to the federal Social Security Act. The National Conference recognizes that in some States these references may give rise to problems of delegation of legislative power. However, given the complex relationship between state and federal laws, especially state law and the Internal Revenue Code, references of this type are increasingly common and have been sustained. *See*, *e.g.*, *McFaddin v. Jackson*, 738 S.W.2d 176 (Tenn. 1987); *Thorpe v. Mahin*, 250 N.E.2d 633 (Ill. 1969); *City National Bank of Clinton v. Iowa State Tax Commission*, 102 N.W.2d 381 (1960). In any event, whatever difficulties may be involved, the course adopted in this Act seems preferable to the alternative of attempting to restate federal law in the Act, continually monitoring that law for relevant changes, and repeatedly amending the Act in response to changes. The references to federal law identify with precision the exceptions intended, they speak clearly and succinctly to the intended audience who are likely to be familiar with the references, and they facilitate re-enactment when required by state law to incorporate changes to federal law.

SECTION 4. ESTABLISHMENT OF TRUST.

(a) Except as otherwise provided in subsection (b), all assets of a retirement system are held in trust. The trustee has the exclusive authority, subject to this [Act], to invest and manage those assets.

(b) Assets of a retirement system which consist of insurance contracts or policies issued by an insurer, assets of an insurer, and assets of the system held by an insurer need not be held in trust.
(c) If an insurer issues a guaranteed benefit policy to a retirement system, assets of the system include the policy but not assets of the insurer.

(d) If a retirement system invests in a security issued by an investment company registered under the Investment Company Act of 1940, the assets of the system include the security but not assets of the investment company.

Comment

Subsection (a) states the basic principle of this section: All assets of a retirement system are held in trust. Subsections (b) through (d) provide guidance on particular applications of the principle.

Subsection (b) applies the general principle to insurance contracts or policies and assets controlled by insurance companies. Insurance contracts and policies themselves need not be held in trust. This means, for example, that a system purchasing annuity contracts to provide future benefits for participants could permit those contracts to be held directly by the participants, rather than in trust by the trustee. Subsection (b) also provides that neither assets of an insurance company nor assets of a system which are held by an insurance company need be held in trust. Unless the assets fit within the narrower exception in subsection (c), however, the individuals managing the assets are subject to the fiduciary duties of Section 7 (for separate accounts) or 9(d) (for general accounts). The effect of this exception in subsection (b), then, is to abrogate obligations imposed by the trust requirement only, that is, by the trust requirement but not by the fiduciary duties of this Act. In particular, the primary effect is to permit insurance companies to commingle retirement system assets with other assets.

Subsections (c) and (d) clarify application of the Act to guaranteed benefit policies issued by an insurer and to securities issued by an investment company registered under the Investment Company Act of 1940. The basic approach for both is the same. The securities and policies themselves are "assets of the system" and, hence, subject to the Act's trust and fiduciary sections, but the underlying assets with the insurer and investment company are not "assets of the system" and, hence, are not subject to the trust and fiduciary sections. This means that decisions to invest in these types of policies or securities are fiduciary decisions and that the policies or securities themselves must be placed in trust (unless they fit within the subsection (b) exception). However, once the underlying assets are with the insurer or investment company, neither the trust nor fiduciary sections of this Act apply to decisions respecting those assets.

The general principle in operation, then, is the same for both guaranteed benefit policies and investment company securities: The obligations of this Act apply to decisions to invest in these types of policies and securities, but do not flow through to decisions made by the insurance or investment company respecting the underlying assets. Although subsections (c) and (d) provide safe harbors for these two circumstances, this general principle also applies in other circumstances (for example, to publicly-offered securities held by a retirement system). Like ERISA, however, this Act does not provide a detailed listing of these circumstances or a general definition of "assets of the system." The Drafting Committee thought it inadvisable to attempt to provide a listing or definition. Applying the principle is usually quite easy, so generally a listing or definition would not be necessary or helpful. The small class of difficult cases would require a lengthy list or complex definition; that class of cases is better left to the sound discretion of trustees, within the constraints imposed by their fiduciary and disclosure obligations. The subject would be an appropriate one for rule-making. *See* 29 C.F.R. §§ 2510.3-101, 2510.3-102 (1997) (rules defining when plan investments are "plan assets" under ERISA and the I.R.C.).

The basic principle of this section - the requirement that assets of retirement systems be held in trust - is one of the guiding principles of ERISA and is required of public retirement systems by the Constitutions in a number of States. *See* ERISA § 403(a), 29 U.S.C. § 1103(a) (1994); Cal. Const. art. XVI, § 17(a); Nev. Const. art. IX, § 2; Tex. Const. art. XVI, § 67(a). This section generally follows Sections 401(b)(1)-(2) and 403(b)(1)-(2) of ERISA. 29 U.S.C. §§ 1101(b)(1)-(2), 1103(b)(1)-(2) (1994).

SECTION 5. POWERS OF TRUSTEE.

(a) In addition to other powers conferred by the governing law, a trustee has exclusive authority, consistent with the trustee's duties under this [Act], to:

(1) establish an administrative budget sufficient to perform the trustee's duties and, as appropriate and reasonable, draw upon assets of the retirement system to fund the budget;
(2) obtain by [employment or] contract the services necessary to exercise the trustee's powers and perform the trustee's duties, including actuarial, auditing, custodial, investment, and legal services; and

(3) procure and dispose of goods and property necessary to exercise the trustee's powers and perform the trustee's duties.

(b) In exercising its authority under this section, a trustee is subject to the fiduciary duties of this [Act], but not to [civil service, personnel,] procurement, or similar general laws relating to the subjects of subsection (a).

Comment

This section is intended to ensure that retirement system trustees have a level of independence sufficient to permit them to perform their duties and to do so effectively and efficiently. Trustees are different from other state actors because they are subject to an extensive and stringent set of fiduciary obligations to retirement system participants and beneficiaries. These obligations both require and justify some level of trustee independence.

Independence is required because it permits trustees to perform their duties in the face of pressure from others who may not be subject to such obligations. In the absence of independence, trustees may be forced to decide between fulfilling their fiduciary obligations to participants and beneficiaries or complying with the directions of others who are responding to a more wide-ranging (and possibly conflicting) set of interests. In this sense, the independence of this section is an important corollary of the fiduciary obligations of other sections of this Act.

The fiduciary obligations of trustees also justify the level of independence protected by this section. Trustees are not independent without constraint; instead, they must comply with their fiduciary obligations when exercising judgment. This section provides trustees with more independence than many other state actors, but in exercising that independence the trustees are subject to a more extensive and stringent set of fiduciary obligations than other state actors.

The trustee independence protected by this section aligns well with the interests and prerogatives of the Legislature. First, the Legislature has a strong interest in effective and efficient management of public retirement systems. Mismanagement presents obvious political hazards and, in the long run, may result in lower benefits, higher contribution levels, or both. The trustee is already under a fiduciary duty to act effectively and efficiently; this section removes constraints that may interfere with the fulfillment of that duty. Second, the Legislature is interested in protecting its legitimate prerogatives. Subject to the state constitution and other law, the Legislature retains control over settlor functions; the Legislature, for example, creates retirement programs, establishes benefit levels, and determines funding methods. *Cf. Lockheed Corp. v. Spink*, 116 S. Ct. 1783 (1996) (employer did not violate fiduciary duties of ERISA by exercising settlor function to amend pension plan); *Haberern v. Kaupp Vascular Surgeons Ltd. Defined Benefit Pension Plan*, 24 F.3d 1491 (3d Cir. 1994), *cert. denied*, 513 U.S. 1149 (1995) (employer did not violate fiduciary duties of ERISA by exercising settlor functions of setting wages, creating defined benefit plan, or amending plan). *See generally*, Laurence B. Wohl, *Fiduciary Duties Under ERISA: A Tale of Multiple Loyalties*, 20 U. Dayton L. Rev. 1, 60-75 (1994) (discussing the distinction between settlor and fiduciary functions under ERISA). This section does not infringe on those prerogatives. Rather, it protects trustee independence only within the trustee's legitimate role of managing the operation, administration, and assets of a retirement system.

Subsection (a)(1) authorizes the trustee to draw upon retirement system assets to fund the administrative budget, but does not require the trustee to do so. Similarly, the paragraph does not obligate, or preclude, the State from providing revenues to fund the administrative budget. Thus, if the administrative budget is fully funded out of general state revenues, that could continue. On the other hand, if general state revenues are insufficient to fund an adequate administrative budget, the trustee has authority to supplement the revenues with retirement system assets. Similarly, if state revenues are encumbered in unacceptable ways or are inadequate for other reasons, this section ensures that the trustee has authority, within the confines of its fiduciary duties, to draw on retirement system assets to accomplish the purposes of the trust.

Subsection (a)(2) is intended to provide the trustee with broad authority over personnel matters. The intent is to free the trustee from restrictive civil service requirements; to shield the trustee against interference by others who do not share the trustee's fiduciary obligations; and to protect the trustee against representation by those with potentially conflicting interests. *Cf. People ex rel. Sklodowski v. Illinois*, 642 N.E.2d 1180 (Ill. 1994) (state attorney general not disqualified from representing three state retirement systems as defendants in a lawsuit, while also representing the State and various state officials as defendants in the same lawsuit); *Board of Trustees of the Teacher's Pension & Annuity Fund v. Verniero*, No. MER-L5119-96 (N.J. Super. Ct. Law Div., Mercer Co. filed Jan. 6, 1997) (lawsuit filed by board of public pension fund to disqualify attorney general's office from representing it in lawsuit challenging decisions to reduce state payments to fund).

The employment language is bracketed because some state constitutions may require certain retirement system employees to be within the civil service system. *See* Colo. Const. art. 12, § 13; La. Const. art. 10, § 1. In the absence of such a constitutional restriction, however, the Drafting Committee's recommendation is to include the bracketed language in the Act.

Subsection (a)(2) merely authorizes the trustee to obtain actuarial services free from interference. The paragraph does not address the effect of determinations by the trustee's actuary, nor require that the actuary obtained by the trustee under this paragraph be the only one. Those issues are decided elsewhere in state law. *Compare Dadisman v. Moore*, 384 S.E.2d 816 (W. Va. 1988) (state statutes and constitution violated when legislature failed to contribute amount to state pension funds determined appropriate by trustee's actuary) *with Jones v. Board of Trustees*, 910 S.W.2d 710 (Ky. 1995) (state statutes and constitution not violated when legislature failed to increase contribution rate recommended by trustee's actuary). *See* N.J. Rev. Stat. § 43:4B-1 (Supp. 1997) (committee designated to select an actuary for state retirement systems).

Subsection (a)(3) is intended to provide the trustee with broad authority over procurement matters. Under this subsection, trustee decisions on procurement matters must comply with the fiduciary sections of this Act, rather than with the requirements of state procurement laws.

Subsection (a) is not intended to be the sole, or even the primary, source of trustee powers. State and local laws establishing or authorizing the creation of a retirement system will remain the primary source. It is to those laws, and others governing the system or regulating its transactions, that one must look for a broader statement of trustee powers and for protections provided to third parties dealing with trustees and fiduciaries. *Cf.* Peter T. Wendel, *Examining the Mystery Behind the Unusually and Inexplicably Broad Provisions of Section Seven of the Uniform Trustees' Powers Act: A Call for Clarification*, 56 Mo. L. Rev. 25 (1991) (discussing protections provided to third parties dealing with trustees). The general powers of retirement system trustees and the protection of third parties dealing with trustees are important issues, but ones outside the scope of this Act.

Subsection (b) clarifies that the intent of the section is to subject the trustee to the fiduciary duties of this Act, but not to obligations imposed by general civil service, personnel, or procurement laws of a State or political subdivision. The subsection also clarifies that general laws that do not relate to the subjects of subsection (a), such as conflict of interest or code of ethics rules, are not affected by the section and, hence, continue to apply to the trustee. *See* Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money (3d ed. 1995) (citing conflict of interest and code of ethics laws applicable to trustees in most States).

SECTION 6. DELEGATION OF FUNCTIONS.

(a) A trustee or administrator may delegate functions that a prudent trustee or administrator acting in a like capacity and familiar with those matters could properly delegate under the circumstances.

(b) The trustee or administrator shall exercise reasonable care, skill, and caution in:

(1) selecting an agent;

(2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the retirement program; and

(3) periodically reviewing the agent's performance and compliance with the terms of the delegation.

(c) In performing a delegated function, an agent owes a duty to the retirement system and to its participants and beneficiaries to comply with the terms of the delegation and, if a fiduciary, to comply with the duties imposed by Section 7.

(d) A trustee or administrator who complies with subsections (a) and (b) is not liable to the retirement system or to its participants or beneficiaries for the decisions or actions of the agent to whom the function was delegated.

(e) By accepting the delegation of a function from the trustee or administrator, an agent submits to the jurisdiction of the courts of this State.

(f) A trustee may limit the authority of an administrator to delegate functions under this section.

Comment

This section follows the modern trend permitting prudent delegation. The traditional rule from the law of trusts prohibited delegation by trustees of all discretionary investment and management functions. That rule survived into the 1959 Restatement of Trusts, but the trend of subsequent legislation has been to permit delegation. Restatement (Second) of Trusts § 171 (1959) (hereinafter "Restatement of Trusts 2d"). *See* John H. Langbein, *Reversing the Nondelegation Rule of Trust-Investment Law*, 59 Mo. L. Rev. 105 (1994). The trend culminated in a reversal of the traditional rule in the third Restatement of Trusts. Restatement (Third) of Trusts: Prudent Investor Rule § 171. The new rule permitting delegation was incorporated into Section 9 of the Uniform Law Commission's Uniform Prudent Investor Act, which this section follows closely.

ERISA generally follows the modern trend on delegation, but nevertheless is more restrictive than this Act. ERISA permits broad delegation of authority over responsibilities other than the management or control of plan assets. ERISA §§ 405(c)(1), (2), 29 U.S.C. § 1105(c)(1) (1994). Authority to manage or control plan assets can also be delegated, but only to allocate responsibilities either among trustees or to "investment managers," a restrictively-defined type of agent. ERISA §§ 3(38), 402(c)(3), 403(a)(2), 405(b)(1)(B), 405(c), 405(d), 29 U.S.C. §§ 1002(38), 1102(c)(3), 1103(a)(2), 1104(b)(1)(B), 1104(c), 1104(d) (1994); 29 C.F.R. § 2509.75-8 (1997). This Act is more permissive than ERISA because it would permit broader delegations of authority to manage or control retirement system assets; under this Act, such delegations may be made to persons other than trustees or investment managers.

An intrinsic tension exists between granting trustees and administrators broad powers that facilitate flexible and efficient administration, on the one hand, and protecting beneficiaries from the misuse of such powers, on the other hand. A broad set of powers, such as those found in most lawyer-drafted instruments and exemplified in the Uniform Trustees' Powers Act (1964), permits the trustee or administrator to act vigorously and expeditiously to maximize the interests of the beneficiaries in a variety of transactions and administrative settings. Trust law relies upon the duties of loyalty and prudent administration, and upon procedural safeguards such as periodic accounting and the availability of judicial oversight, to prevent the misuse of these powers. Delegation, which is a species of trustee power, raises the same tension. If the trustee and administrator delegate effectively, the beneficiaries obtain the advantage of the agent's specialized investment skills or whatever other attributes induced the trustee or administrator to delegate. But if the trustee or administrator delegates to a knave or an incompetent, the delegation can work harm upon the beneficiaries.

Section 6 is designed to strike the appropriate balance between the advantages and the hazards of delegation. Section 6 authorizes delegation under the limitations of subsections (a) and (b). Subsection (a) imposes limits on the matters that can be delegated. Only functions that prudent trustees and administrators would delegate can be delegated. As a result, subsection (a) would generally not permit the trustees to delegate their obligation to adopt a statement of investment objectives and policies under Section 8(a), since prudent trustees would seldom delegate that function. At the same time, delegating the function of drafting and recommending such a statement would generally be appropriate.

Subsection (b) imposes duties of care, skill, and caution on the trustee and administrator in selecting the agent, in establishing the terms of the delegation, and in reviewing the agent's compliance. The trustee and administrator's duties of care, skill, and caution in framing the terms of the delegation should protect the beneficiary against overbroad delegation. For example, a trustee could not prudently agree to an investment management agreement containing an exculpation clause that leaves the trust without recourse against reckless mismanagement. Leaving one's participants and beneficiaries remediless against willful wrongdoing is inconsistent with the duty to use care and caution in formulating the terms of the delegation. This sense that it is imprudent to expose beneficiaries to broad exculpation clauses underlies both federal and state legislation restricting exculpation clauses. *See* ERISA §§ 404(a)(1)(D), 410(a), 29 U.S.C. §§ 1104(a)(1)(D), 1110(a) (1994); New York Est. Powers & Trusts Law § 11-1.7(a)(1) (McKinney 1967).

Although subsection (d) exonerates the trustee or administrator from personal responsibility for the agent's conduct when the delegation satisfies the standards of subsection (a) and (b), subsection (c) makes the agent responsible to the retirement system and to participants and beneficiaries. Moreover, as noted in the Comments to Sections 2(11) and 11(a), the agent, whether or not a fiduciary under this Act, may be subject to liability elsewhere based on fiduciary or other obligations imposed by contract or by state or federal law.

The duty to incur only appropriate and reasonable costs articulated in Sections 7(2) and (5) of this Act apply to delegation as well as to other aspects of fiduciary decision-making. In deciding whether to delegate, the trustee or administrator must balance the projected benefits against the likely costs. Similarly, in deciding how to delegate, the trustee or administrator must take costs into account. The trustee or administrator must be alert to protect participants and beneficiaries from "double dipping." If, for example, the trustee has traditionally handled the investment management function in-house, it should ordinarily follow, other things being equal, that the trustee will lower its internal expenses when delegating the investment function to an outside manager. The precise amount of the reduction would depend on factors such as the costs of monitoring and the relative efficiency of the internal and external managers, but generally trustees should be able to reduce internal expenses through delegation.

Subsection (e) requires an agent to submit to the jurisdiction of the courts of a State. The section is not intended to limit other types of agreements that might be made on similar issues. The section is not intended, for example, to preclude a choice-of-law or venue provision in an agreement between a trustee or administrator and an agent.

SECTION 7. GENERAL FIDUCIARY DUTIES. A trustee or other fiduciary shall discharge duties with respect to a retirement system:

(1) solely in the interest of the participants and beneficiaries;

(2) for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses of administering the system;

(3) with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose;

(4) impartially, taking into account any differing interests of participants and beneficiaries;

(5) incurring only costs that are appropriate and reasonable; and

(6) in accordance with a good-faith interpretation of the law governing the retirement program and system.

Comment

This section establishes the general duties of all trustees and other fiduciaries. The duties derive from trust law and, consequently, draw upon recent articulations of that law. Restatement of the Law of Trusts 3d: Prudent Investor Rule; Uniform Prudent Investor Act. The duties also draw upon federal and state pension law. With only slight variations, ERISA and every state pension law impose these duties on retirement system fiduciaries. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994); Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money (3d ed. 1995) (surveying the fiduciary standards in state pension law).

Paragraph (1) articulates the well-recognized trust duty of loyalty. In exercising discretion, a fiduciary must act exclusively for the participants and beneficiaries, as opposed to acting for the fiduciary's own interest or that of third parties. The duty is not limited to settings entailing self-dealing or conflict of interest in which the fiduciary would benefit personally. A fiduciary is under a duty to participants and beneficiaries "not to be influenced by the interest of any third person." Restatement of Trusts 3d: Prudent Investor Rule § 170, comment q, at 201. Thus, it is as improper for a fiduciary to take actions for the purpose of benefiting a third person as it is for a fiduciary to act in its own interest. In the retirement system setting, it is important to note that this duty includes the obligation to set aside the interests of the party that appoints a trustee or fiduciary. A trustee, for example, must act solely in the interests of participants and beneficiaries and set aside any interests of a party responsible for the trustee's appointment, such as an employer or union. *See NLRB v. Amax Coal Co.*, 453 U.S. 322 (1981); *City of Sacramento v. Public Employees Retirement Sys.*, 280 Cal. Rptr. 847 (Cal. Ct. App. 1991). The duty of loyalty is central to every statement of fiduciary duties. Restatement of Trusts 3d: Prudent Investor Rule § 170; Uniform Prudent Investor Act § 5; ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (1994).

Paragraph (2) specifies the fiduciary's purposes: To provide benefits to participants and beneficiaries and to pay reasonable expenses. Specification of purpose is important because the duty of loyalty precludes a fiduciary from being influenced "by motives other than the accomplishment of the purposes of the trust." Restatement of Trusts 3d: Prudent Investor Rule § 170, comment q, at 201. Paragraph (2), then, requires fiduciaries to be motivated only by the objective of providing benefits and paying reasonable expenses.

Paragraph (3) imposes another well-recognized fiduciary obligation, the obligation to act prudently. The prudence standard for trust investing dates back to *Harvard College v. Amory*, 26 Mass. (Pick.) 446 (1830), and has been an important part of virtually every subsequent codification effort. *See* Mayo A. Shattuck, *The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century*, 12 Ohio St. L.J. 491 (1951) (discussing the Model Prudent Man Rule Statute of 1942, which codified the *Amory* rule, and its adoption in several States); Restatement of Trusts 2d § 227 (1959); Uniform Probate Code § 7-302 (1969); Restatement of Trusts 3d: Prudent Investor Rule § 227; ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1994).

The concept of prudence is essentially relational or comparative. In this respect, it resembles the "reasonable person" rule of tort law. A prudent trustee behaves as other trustees similarly situated would behave. The standard is, therefore, objective rather than subjective.

Paragraph (3), in applying this objective standard, requires comparison to a prudent person "acting in a like capacity and familiar with those matters." This language comes from ERISA and stakes out a middle ground. On the one hand, it is not intended to impose a rigid "prudent expert" rule. Retirement systems differ on a wide variety of parameters and the prudence standard is sensitive to factors such as the size, complexity, and purpose of each system. Fiduciaries should be evaluated, not against a single prudent expert, but in terms of the actions of prudent fiduciaries for other similar systems facing similar circumstances. At the same time, paragraph (3) does not permit comparison to a prudent amateur. Fiduciaries will be held to no lower standard than that of others "familiar with those matters." *See Marshall v. Glass/Metal Ass'n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Haw. 1980) ("While there is flexibility in the prudence standard, it is not a refuge for fiduciaries who are not equipped to evaluate a complex investment"); *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir.), *cert. denied*, 469 U.S. 1072 (1984) ("A trustee's lack of familiarity with investments is no excuse: ... trustees are to be judged 'according to the standards of others "acting in a like capacity and familiar with such matters""). This contrasts with conventional private trusts, where the law anticipates amateur trusteeship and allows comparison to the standards of a prudent amateur. Uniform Prudent Investor Act § 2, Comment at 21.

The articulation of the prudence standard in paragraph (3) differs slightly from the articulation in ERISA, which has been followed in many state statutes. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (1994) (fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims"). *See* Idaho Code § 59-1301(2)(b) (1994); Ohio Rev. Code Ann. § 145.11(B) (Anderson Supp. 1996). The differences are not intended to change the prudence standard substantively. Instead, the differences merely reflect style changes and efforts to align articulation of the obligation in this Act with that of the Prudent Investor Act.

The duty of impartiality in paragraph (4) derives from the duty of loyalty. A fiduciary for a retirement system owes a duty of loyalty to all participants and beneficiaries; respecting that duty requires the fiduciary to be impartial among any differing interests of participants and beneficiaries. The duty is well-recognized in trust law. Restatement of Trusts 2d §§ 183, 232; Uniform Prudent Investor Act § 6.

Differing interests are inevitable in the retirement system setting. Differences can arise between retirees and working members, young members and old, long- and short-term employees, and other groupings of those with interests in the retirement system. The duty of impartiality does not mean that fiduciaries must accommodate such interests according to some notion of absolute equality. The duty of impartiality permits a fiduciary to favor the interests of one group of participants and beneficiaries over another in particular circumstances, but requires that such decisions be made carefully and after weighing the differing interests. *See Ganton Techs., Inc. v. National Indus. Group Pension Plan,* 76 F.3d 462 (2d Cir. 1996) (no fiduciary violation to prohibit transfer of funds when employees exit from multi-employer plan, even though rule treats exiting members less favorably than members remaining in plan); *Mahoney v. Board of Trustees*, 973 F.2d 968 (1st Cir. 1992) (no fiduciary violation to grant benefit increase favoring working longshoremen over retirees); *DeCarlo v. Rochester Carpenters Pension, Annuity, Welfare & S.U.B. Funds*, 823 F. Supp. 115 (W.D.N.Y. 1993) (no fiduciary violation to grant benefit increase favoring active participants over retirees). *See also* Restatement of Trusts 2d § 232 (impartiality requires trustee for successive beneficiaries to act "with due regard" for their respective interests).

Paragraph (5) incorporates the traditional duty to incur only expenses that are appropriate and reasonable. Wasting the money of participants and beneficiaries is imprudent. This duty is present in every statement of fiduciary duties. Restatement of Trusts 2d § 188; Uniform Prudent Investor Act § 7; ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (1994). As under the Restatement of Trusts and the Uniform Prudent Investor Act, determining what costs are appropriate and reasonable will depend on factors such as the purposes of the trust (which for retirement systems covered by this Act are specified in paragraph (2)), the types of assets held, and the skills of the trustee or other fiduciary. On this last factor, for example, trustees who are quite inexperienced on investment issues may be justified in expending more for investment advice than trustees who are quite experienced.

Paragraph (6) requires trustees and other fiduciaries to discharge their duties in accordance with a good-faith interpretation of the law. Fiduciaries are expected to exercise prudence in determining what the law requires and to comply with the law to the best of their abilities, but the good-faith element recognizes that they are not expected to be infallible predictors. A fiduciary who discharges her duties prudently and with a good-faith belief that her actions are in compliance with the law does not violate this paragraph, even if a court later determines that the course of conduct was not in compliance with law. *See Wisconsin Retired Teachers Ass'n v. Employee Trust Funds Bd.*, 558 N.W.2d 83 (Wis. 1997) (trustees did not violate fiduciary duties when they implemented a law relying in good faith on legal advice, even though law was later found to be unconstitutional). Not all failures to comply with the law are fiduciary violations, but only those that do not reflect a good-faith attempt to comply. Viewed properly in this way, the good-faith requirement reinforces Section 10(1) of this Act, which requires that compliance with fiduciary obligations be determined at the time of the trustee or fiduciary's action, and not by hindsight.

Sections 7 and 8 follow trust and pension law in imposing general affirmative duties upon fiduciaries. Fiduciaries, for example, must diversify investments and act loyally, prudently, and impartially. As applied to non-governmental plans, federal pension law also imposes negative duties upon fiduciaries. Fiduciaries may not engage in specified types of "prohibited transactions." ERISA §§ 406-408, 29 U.S.C. §§ 1106-1108 (1994); I.R.C. § 4975 (1994). For several reasons, this Act does not contain an equivalent set of negative duties. First, the prohibited transaction provisions in federal law have necessitated an extremely complex set of statutory exemptions and administrative waivers. For a brief review, see Michael J. Canan, Qualified Retirement and Other Employee Benefit Plans § 16.7 (1996) (listing 27 class exemptions granting broad administrative waivers and 5 categories of statutory exemptions). The Drafting Committee was reluctant to duplicate that complexity in every adopting State. Second, the negative duties would add little to the affirmative fiduciary duties of the Act. Properly applied, the fiduciary standards already guard against all the more specific hazards that would be targeted by prohibited transactions rules. Third, the negative duties would tend to duplicate protections elsewhere in state law. Most States have conflict of interest and code of ethics rules that apply to a broad range of government employees and officials (and, hence, would not be repealed when this Act is enacted) and that prohibit some of the same conduct targeted by the prohibited transactions rules. Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money (3d ed. 1995) (citing the conflict of interest and code of ethics rules in each State). Finally, this Act requires disclosure of transactions between the retirement system and significant actors. *See* MPERS Act §§ 16(12) and (13). Disclosure will subject such transactions to public scrutiny, including possible claims of fiduciary violations and, hence, should discourage many of the same activities forbidden by the prohibited transaction rules. *See* ERISA §§ 3(14), 406(a), 29 U.S.C. §§ 1002(14), 1106(a) (1994) (limiting transactions between a pension plan and a party in interest).

For similar reasons, this Act does not follow ERISA in providing a special set of rules that apply to co-fiduciary liability. ERISA § 405, 29 U.S.C. § 1105 (1994). Properly applied, the general fiduciary standards in this Act already impose the duties specified in more detail in ERISA's Section 405. For example, a fiduciary who knowingly participates in another fiduciary's breach would already be in breach of her duties under Section 7 of this Act. Restating that liability more specifically in another section of the Act would serve little purpose.

SECTION 8. DUTIES OF TRUSTEE IN INVESTING AND MANAGING ASSETS OF RETIREMENT SYSTEM.

(a) In investing and managing assets of a retirement system pursuant to Section 7, a trustee with authority to invest and manage assets:

(1) shall consider among other circumstances:

(A) general economic conditions;

(B) the possible effect of inflation or deflation;

(C) the role that each investment or course of action plays within the overall portfolio of the retirement program or appropriate grouping of programs;

(D) the expected total return from income and the appreciation of capital;

(E) needs for liquidity, regularity of income, and preservation or appreciation of capital; and

(F) for defined benefit plans, the adequacy of funding for the plan based on reasonable actuarial factors;

(2) shall diversify the investments of each retirement program or appropriate grouping of programs unless the trustee reasonably determines that, because of special circumstances, it is clearly prudent not to do so;

(3) shall make a reasonable effort to verify facts relevant to the investment and management of assets of a retirement system;

(4) may invest in any kind of property or type of investment consistent with this [Act]; and

(5) may consider benefits created by an investment in addition to investment return only if the trustee determines that the investment providing these collateral benefits would be prudent even without the collateral benefits.

(b) A trustee with authority to invest and manage assets of a retirement system shall adopt a statement of investment objectives and policies for each retirement program or appropriate grouping of programs. The statement must include the desired rate of return on assets overall, the desired rates of return and acceptable levels of risk for each asset class, asset-allocation goals, guidelines for the delegation of authority, and information on the types of reports to be used to evaluate investment performance. At least annually, the trustee shall review the statement and change or reaffirm it.

Comment

This section specifies the fiduciary duties of trustees who have the ultimate responsibility for the investment and management of retirement system assets. Since a trustee covered by this section is also a fiduciary under the Act, MPERS Act § 2(11), these duties supplement the general duties of Section 7.

This section applies only to a trustee with authority to invest and manage retirement system assets. The "trustee" requirement means that only those with "ultimate authority" to invest and manage system assets are covered. *See* MPERS Act § 2(22) (defining "trustee"). Delegates who invest and manage system assets are covered by Sections 6 and 7, but not this section. The "invests and manages" requirement means that only a trustee with those responsibilities is covered. A trustee who does not have authority to invest or manage system assets is contemplated by the Act, but is not covered by this section. *See* MPERS Act § 2(22), Comment at ___.

Subsection (a)(1) provides a non-exclusive list of factors that commonly bear on risk/return preferences in retirement system investing, and requires trustees to consider them in making investment and management decisions. Read in conjunction with Section 10(2), this subsection sounds the main theme of modern investment practice, sensitivity to the risk/return curve. Subsection (a)(1) tracks appropriate language from Section 2(c) of the Uniform Prudent Investor Act.

Subsection (a)(2) integrates a diversification requirement into the concept of prudent investing. Once again, this follows the lead of the Restatement of Trusts 3d and the Uniform Prudent Investor Act. Restatement of Trusts 3d: Prudent Investor Rule § 227(b); Uniform Prudent Investor Act § 3. ERISA also contains a diversification requirement. ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (1994).

Modern portfolio theory strongly supports a diversification requirement. Modern theory divides risk into the categories of "compensated" and "uncompensated" risk. The risk of owning shares in a mature and well-managed company in a settled industry is less than the risk of owning shares in a start-up high-technology venture. A higher expected return is required to induce an investor to bear the greater risk of disappointment associated with the start-up firm. This is compensated risk - the firm pays investors for bearing the risk. By contrast, nobody pays an investor for owning too few stocks. An investor who owned only international oil stocks in 1973 (immediately before the Arab oil embargo) was running a risk that could have been reduced by configuring the portfolio differently - to include investments in different industries. Risk that can be reduced by adding different stocks (or bonds) is uncompensated risk - nobody pays the investor for owning shares in two few industries and too few companies. The object of diversification is to minimize this uncompensated risk: "As long as stock prices do not move exactly together, the risk of a diversified portfolio will be less than the average risk of the separate holdings." R.A. Brealey, An Introduction to Risk and Return from Common Stocks (2d ed. 1983).
This Act does not contain a simple and easy-to-apply rule for identifying how much diversification is enough, because one does not exist:

There is no defined set of asset categories to be considered by fiduciary investors. Nor does a trustee's general duty to diversify investments assume that all basic categories are to be represented in a trust's portfolio. In fact, given the variety of defensible investment strategies and the wide variations in trust purposes, terms, obligations, and other circumstances, diversification concerns do not necessarily preclude an asset allocation plan that emphasizes a single category of investments as long as the requirements of both caution and impartiality are accommodated in a manner suitable to the objectives of the particular trust. . . .

Significant diversification advantages can be achieved with a small number of well-selected securities representing different industries and having other differences in their qualities. Broader diversification, however, is usually to be preferred in trust investing.

Restatement of Trusts 3d: Prudent Investor Rule § 227, comment g, at 26-27. *See also* Jonathan R. Macey, An Introduction to Modern Financial Theory 23-24 (American College of Trust and Estate Counsel Foundation, 1991); R.A. Brealey, *supra*, at 111-13. *Cf.* Richard H. Koppes & Maureen L. Reilly, *An Ounce of Prevention: Meeting the Fiduciary Duty to Monitor An Index*, 20 J. Corp. L. 413, 445-47 (1995) (cautioning against overdiversification which can occur because of the cost of monitoring investments).

Subsection (a)(2), like the authorities from which it is drawn, contains a limited exception to the diversification requirement. Restatement of Trusts 3d: Prudent Investor Rule § 227(b) (duty to diversify "unless, under the circumstances, it is prudent not to do so"); Uniform Prudent Investor Act § 3 (duty to diversify "unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying"); ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C) (1994) (duty to diversify "unless under the circumstances it is clearly prudent not to do so"). For private trusts, a number of circumstances might exist which would legitimately justify underdiversification. The Uniform Prudent Investor Act, for example, lists tax considerations and the interest in retaining a family business as such circumstances. Section 3, Comment at 11. *See also* Restatement of Trusts 3d: Prudent Investor Rule § 227, comment at 25. The circumstances justifying underdiversification are less likely to be present for public pension trusts. As a result, only very rarely, if ever, will it be prudent for the trustee of a public pension fund to underdiversify.

Subsection (a)(3) incorporates the traditional responsibility of the fiduciary investor to examine information likely to bear importantly on the value or security of an investment, for example, audit reports or records of title. *E.g.*, *Estate of Collins*, 139 Cal. Rptr. 644 (Cal. Ct. App. 1977) (trustees lent on a junior mortgage on unimproved real estate, failed to have land appraised, and accepted an unaudited financial statement; held liable for losses). This subsection follows Section 2(d) of the Uniform Prudent Investor Act. In this subsection, and elsewhere, "management" embraces monitoring, that is, the trustee's continuing responsibility for oversight of the suitability of investments already made, as well as the trustee's decisions respecting new investments.

In the absence of statutory language elsewhere, subsection (a)(4) abrogates categoric restrictions on investments. No particular kind of property or investment is inherently imprudent. The universe of investment products changes incessantly. Investments that were once thought too risky, such as equities, or more recently, futures, are now used in fiduciary portfolios. By contrast, the investment that was at one time thought ideal for trusts, the long-term bond, has been discovered to import a level of risk and volatility - in this case, inflation risk - that had not been anticipated. Under subsection (a)(4), the propriety of including an investment in a retirement system portfolio must be judged, not on the basis of a categoric restriction, but instead in terms of its anticipated effect on the particular system's portfolio. The premise of the subsection is that participants and beneficiaries are better protected by the Act's emphasis on close attention to risk/return objectives, as prescribed in subsection (a)(1) and Section 10(2), than in attempts to identify categories of investment that are prudent or imprudent *per se*. In this respect, subsection (a)(4) follows the lead of the Restatement of Trusts 3d and the Prudent Investor Act. Restatement of Trusts 3d: Prudent Investor Rule § 227, comment f, at 24; Uniform Prudent Investor Act § 2(e), Comment, at 21.

More than half the States currently have statutes that impose some type of categoric restriction on investments. Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money 99-100 (3d ed. 1995). These are commonly known as "legal list" statutes. The Drafting Committee suggests that those statutes be repealed when this Act is enacted. To the extent they are not repealed, subsection (a)(4) must be read in conjunction with Section 7(6), which requires fiduciaries to act in accordance with a good-faith interpretation of the law governing the retirement program and system. Thus, compliance with legal list statutes would be required because the standards of the Act require compliance; subsection (a)(4) would apply only to investments that are not inconsistent with existent legal list restrictions.

Subsection (a)(5) deals with the issue of collateral benefits. Collateral benefits refer to benefits other than investment return. Investments raising collateral benefits issues come in a variety of forms, including investments that involve moral or political issues (such as investments in South Africa or Northern Ireland), investments targeted to improve the general economic well-being of a State or region, and investments intended to protect or enhance the job prospects of pension plan participants. Retirement systems subject to this Act invest significant sums in investments that produce collateral benefits and, undoubtedly, refrain from investing another significant (but undeterminable) amount in investments that are disfavored. U.S. General Accounting Office, Public Pension Plans: Evaluation of Economically Targeted Investment Programs 2 (March, 1995) (in a 1992 survey, 50 of the largest public pension systems had invested $19.8 billion, or 2.4 percent of assets, in economically targeted investments); James A. White, *Divestment Proves Costly and Hard*, Wall St. J., Feb. 22, 1989 (New Jersey public plan required to divest $4.2 billion of assets under statute prohibiting South African investments). There is a large literature on the subject. *See* Maria O'Brien Hylton, *"Socially Responsible" Investment: Doing Good Versus Doing Well in an Inefficient Market*, 42 Am. U. L. Rev. 1 (1992); Joel C. Dobris, *Arguments in Favor of Fiduciary Divestment of "South African" Securities*, 65 Neb. L. Rev. 209 (1986); John H. Langbein, *Social Investing of Pension Funds and University Endowments: Unprincipled, Futile, and Illegal, in* Disinvestment, Is it Legal? Is it Moral? Is it Productive?: An Analysis of Politicizing Investment Decisions (John H. Langbein et al. eds., 1985); James D. Hutchinson & Charles G. Cole, *Legal Standards Governing Investment of Pension Assets for Social and Political Goals*, 128 U. Pa. L. Rev. 1340 (1980); John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 Mich. L. Rev. 72 (1980).

Subsection (a)(5) follows the basic approach of the Department of Labor's Interpretive Bulletin on economically targeted investments. 29 CFR § 2509.94-1 (1996). Arrangements designed to bring areas of investment opportunity which provide collateral benefits to the attention of the trustee will not by themselves constitute a fiduciary violation, so long as the arrangements do not restrict the exercise of the trustee's investment discretion. Similarly, the trustee does not violate any fiduciary responsibilities by making a decision based on collateral benefits *if* the investment is justified even absent the collateral benefits. Thus, as under the Labor Department's interpretive bulletin, an investment would be appropriate under this subsection if it is expected to provide an investment return commensurate with available alternative investments having similar risks. On the other hand, an investment will not be prudent if it is expected to produce a lower expected rate of return than available alternative investments with commensurate risk, or if it is riskier than available alternative investments with commensurate rates of return.

A number of States currently have statutes that relate to investments producing collateral benefits. Cynthia L. Moore, National Council on Teacher Retirement, Protecting Retirees' Money viii-ix (3d ed. 1995) (listing 22 States with statutory language on economically targeted investments and 10 States with language limiting investments in South Africa, Northern Ireland, Cuba, or companies complying with the Arab League's boycott of Israel). The Drafting Committee suggests that these statutes be repealed when this Act is enacted. To the extent they are not repealed, they must be read in conjunction with subsection (a)(5). To the extent the statutes are not mandatory, the trustee must exercise the discretion permitted by the statutes within the constraints of subsection (a)(5). *See* Minn. Stat. § 11A.241 (1988) (state board of investment directed to encourage affirmative action by companies operating in Northern Ireland). To the extent the statutes are mandatory, the trustee must comply with them and subsection (a)(5) would apply only in other areas where the trustee retains investment discretion. *See* Fla. Stat. ch. 215.471, 215.472 (Supp. 1995) (requiring divestiture of and prohibiting investments in companies dealing with Cuba).

Subsection (b) requires the trustee to adopt a statement of investment objectives and policies. The statement must include various estimates of desired rates of return; these estimates, obviously, are intended to reflect long-range expectations and are not intended as specific predictions of actual, short-term returns. Section 17(c)(7) requires the statement to be included in the annual disclosure of financial and actuarial status. A number of States already have statutes requiring their trustees to adopt such a statement. *See* Ark. Code Ann. § 24-3-410(a)(2)(A) (1996); N.D. Cent. Code § 21-10-02.1 (Supp. 1995); Or. Rev. Stat. § 293.731 (1995); W. Va. Code § 12-6-12 (Supp. 1996). The requirement is also consistent with the fiduciary duties of ERISA. 29 C.F.R. § 2509.94-2(2) (1997). The Act lists certain information that must be included in the statement, but the list is not exclusive. Where appropriate, a trustee may include other information in the statement, such as guidelines for proxy voting decisions.

SECTION 9. SPECIAL APPLICATION OF DUTIES.

(a) A trustee may return a contribution [with interest] to a public employer or employee, or make alternative arrangements for reimbursement, if the trustee determines the contribution was made because of a mistake of fact or law.

(b) Upon termination of a retirement program, a trustee may return to a public employer any assets of the program remaining after all liabilities of the program to participants and beneficiaries have been satisfied.

(c) If a retirement program provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in such an account and a participant or beneficiary exercises control over those assets:

(1) the participant or beneficiary is not a fiduciary by reason of the exercise of control; and

(2) a person who is otherwise a fiduciary is not liable for any loss, or by reason of any breach of fiduciary duty, resulting from the participant's or beneficiary's exercise of control.

(d) If an insurer issues to a retirement system a contract or policy that is supported by the insurer's general account but is not a guaranteed benefit policy, the insurer complies with Section 7 if it manages the assets of the general account with the care, skill, and caution under the circumstances then prevailing which a prudent person acting in a like capacity and familiar with those matters would use in the conduct of an activity of like character and purpose, taking into account all obligations supported by the general account.

Comment

Subsection (a) is based on ERISA § 403(c)(2), 29 U.S.C. § 1103(c)(2) (1994). The subsection clarifies that a trustee does not violate the Act's fiduciary obligations by returning mistaken contributions or by making alternative arrangements for reimbursement (such as a setoff against future contributions). Following ERISA, the subsection is permissive. It permits, but does not require, a trustee to return mistaken contributions; a suit seeking to require a trustee to return contributions must be based elsewhere in plan documents or the law. *See Brown v. Health Care & Retirement Corp.*, 25 F.3d 90 (2d Cir. 1994) (ERISA does not entitle employer to offset for mistaken contributions, but plan is permitted to offset in accordance with its own policy); *UIU Severance Pay Trust Fund v. Local Union No. 18-U*, 998 F.2d 509 (7th Cir. 1993) (ERISA permits but does not require return of mistaken contributions; union can seek to recover contributions through common law action for restitution). Subsection (a) has bracketed language permitting interest to be paid on a returned contribution. This Act takes no position on that issue. If a State wants to permit interest to be paid, it should include the language in the Act; if not, it should not include the language. *See Whitworth Bros. Storage Co. v. Central States, Southeast & Southwest Areas Pension Fund*, 982 F.2d 1006 (6th

Cir.), *cert. denied*, 479 U.S. 1007 (1986) (ERISA bars an award of interest on returned contributions). *See also Stanley v. Retirement & Health Benefits Div.*, 310 S.E.2d 637 (N.C. Ct. App.), *review denied*, 315 S.E.2d 692 (N.C. 1984) (retirement system not required to pay interest under state law).

Subsection (b) provides a narrow exception to the loyalty and exclusive purpose obligations of Section 7(1) and 7(2) in the event a retirement program is terminated. As with subsection (a), this subsection is merely permissive; it provides only that a trustee does not violate its fiduciary obligations if excess assets are paid to employers after termination and after all liabilities to participants and beneficiaries have been satisfied. Any action attempting to require a trustee to return excess assets to a public employer must be based elsewhere in state law. Similarly, the subsection does not in any way preclude or prejudice the return of excess benefits to participants and beneficiaries; that possibility is not mentioned in this subsection only because returning excess assets to participants and beneficiaries would not require an exception to the normal fiduciary obligations of Section 7. Terminations raise a host of other issues that are beyond the scope of this Act and, hence, are left to other law. *See generally* Michael J. Canan, Qualified Retirement and Other Employee Benefit Plans §§ 20.1-20.7 (1996); Jeffrey D. Mamorsky, Employee Benefits Law: ERISA and Beyond §§ 9.01-9.03, 13.01-13.09 (1995).

Subsection (c) provides two exceptions to the fiduciary rules for retirement programs providing participant-directed individual accounts: (1) a participant who exercises control over assets in an individual account is not a fiduciary under this Act by reason of the exercise, and (2) a person who is otherwise a fiduciary is not liable under the fiduciary sections for any losses that result from the participant's exercise of control. In the absence of this subsection, retirement programs would be reluctant to offer participant-directed accounts for two reasons: First, because participants exercising control would be fiduciaries and, hence, potentially liable to subsequent beneficiaries for failure to comply with the fiduciary standards (for example, for failing to adequately diversify) and, second, because the programs' non-participant fiduciaries may also be liable for investment decisions made by participants.

Subsection (c) derives from ERISA § 404(c), 29 U.S.C. § 1104(c) (1994). The Department of Labor has issued regulations to clarify application of § 404(c). While those regulations, obviously, are not binding under this Act, they can and should be relied on for interpretive guidance; they provide a thoughtful analysis and resolution of several issues presented by participant-directed accounts. For example, to qualify as a § 404(c) plan under ERISA, a plan must (1) provide an opportunity for participants or beneficiaries to exercise control over assets in their accounts, including the opportunity to obtain sufficient information to make informed decisions on investment possibilities, and (2) provide participants and beneficiaries with a broad range of investment alternatives. 29 C.F.R. § 2550.404c-1 (1997). *See In Re Unisys Savings Plan Litigation*, 74 F.3d 420, 443-48 (3d Cir.), *cert. denied,* 117 S. Ct. 56 (1996). Similar requirements should apply to retirement programs seeking to fall under subsection (c).

Subsection (d) deals with a special problem that occurs when retirement system assets are placed in the general accounts of insurance companies. The essence of the problem is that, to the extent those assets are not used to support "guaranteed benefit policies" (which are exempted), the insurance companies will be subject to this Act's fiduciary duties when handling the assets. A central feature of those fiduciary duties is that the fiduciary must pay *exclusive* attention to the interests of participants and beneficiaries. State law, however, generally imposes a fiduciary obligation on insurers to attend to the interests of *all* those with investments in the insurer's general account, not just the interests of the retirement system's participants and beneficiaries. *See, e.g.,* N.Y. Ins. Law § 4224(a)(1) (McKinney Supp. 1997); Neb. Rev. Stat. § 44-1525(7) (Cum. Supp. 1996) (statutes prohibiting discrimination by insurance companies between contract holders). *See generally,* Stephen H. Goldberg & Melvin S. Altman, *The Case for the Nonapplication of ERISA to Insurers' General Account Assets*, 21 Tort & Ins. L.J. 475, 476-77 (1986); *Mack Boring & Parts v. Meeker Sharkey Moffitt*, 930 F.2d 267, 275 n. 17 (3rd Cir. 1991). Thus, application of this Act's fiduciary duties without modification would mean that, when an insurance company's general account includes retirement system assets, the company would be required by this Act to pay exclusive attention to the interests of participants and beneficiaries, but would be required by state insurance law to pay attention to the interests of all those with interests in the account, including many non-participants and non-beneficiaries.

Subsection (d) deals with this problem by modifying the Act's fiduciary duties for insurance companies handling retirement system assets in general accounts. In that situation, the insurer need not act exclusively for the benefit of participants and beneficiaries, but instead must act prudently taking into account all obligations supported by the general account.

This solution is a middle ground between alternatives suggested by the experience under ERISA. One alternative would be to say in Section 4 of this Act that retirement system assets held in an insurer's general account are not assets of the system. Until 1993, this was the generally accepted interpretation under ERISA, based on a 1975 Department of Labor interpretive bulletin. Interpretive Bulletin Relating to Prohibited Transactions, 29 C.F.R. § 2509.75-2(b)(1995), removed from C.F.R., 61 Fed. Reg. 33,847 (July 1, 1996) ("If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, the assets in such account shall not be considered to be plan assets"). This solution, in essence, would treat insurance companies like investment companies registered under the Investment Company Act of 1940 by deferring to other regulatory authority. For investment companies, the Act defers to the securities laws and their enforcement by the SEC and through private actions; for insurance companies, the deferral would be to state insurance law and its enforcement mechanisms. The Drafting Committee decided not to pursue this alternative primarily because it was not confident that state insurance law would always be adequate as an alternative regulatory and enforcement regime.

Another solution suggested by ERISA would be to apply the normal fiduciary obligations to insurance company general accounts, while providing a grandfather period that would permit insurers to adjust their contracts and practices to the new rules. This is the approach of ERISA after the 1996 enactment of the Small Business Job Protection Act. ERISA § 401(c), 29 U.S.C. § 1101(c) (19XX). This part of the Small Business Job Protection Act was a reaction to the Supreme Court's *Harris Trust* decision, in which it rejected the prior understanding that retirement system assets in an insurer's general account were not "assets of the system." *John Hancock Mutual Life Ins. Co. v. Harris Trust & Savings Bank*, 510 U.S. 86, 106-110 (1993). The Department of Labor is now engaged in a mandatory rule-making effort to provide guidance on the many issues raised by the Act. The Drafting Committee was reluctant to follow that path because it could not adequately address within the Act all of the likely issues that would arise, and the Act creates no agency which could issue rules to provide guidance.

SECTION 10. REVIEWING COMPLIANCE. In evaluating performance of a trustee or other fiduciary:

(1) Compliance by the trustee or other fiduciary with Sections 6 through 8 must be determined in light of the facts and circumstances existing at the time of the trustee or fiduciary's decision or action and not by hindsight.

(2) The trustee's investment and management decisions must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the program or appropriate grouping of programs.

Comment

Subsection (a) derives from Section 8 of the Prudent Investor Act, which draws upon Restatement of Trusts 3d: Prudent Investor Rule § 227, comment b, at 11. Trustees and fiduciaries are not insurers. Not every investment or management decision will turn out in the light of hindsight to have been successful. Hindsight is not the relevant standard. In the language of law and economics, the standard is *ex ante*, not *ex post*.

Subsection (b) emphasizes the consolidated portfolio standard for evaluating investment decisions. An investment that might be imprudent standing alone can become prudent if undertaken in sensible relation to other assets of the program or appropriate grouping of programs. This "sensible relation" should be supported by the statement of investment objectives and policies required by Section 8(b). In the retirement system setting, the term "portfolio" embraces all assets of a program or appropriate grouping of programs.

Subsection (b) also sounds the main theme of modern investment practice, sensitivity to the risk/return curve. Returns correlate strongly with risk, but tolerance for risk may vary with the circumstances of the retirement program or appropriate grouping of programs. A program that has a large proportion of its participants and beneficiaries near and beyond retirement age may have a lower risk tolerance than a program that has a large proportion of young participants.

Subsection (b) follows Section 2(b) of the Uniform Prudent Investor Act, which in turn followed Section 227(a) of the Restatement of Trusts 3d: Prudent Investor Rule. For introductions to modern portfolio theory, and its application to trust investment law, which provide the intellectual underpinnings for all these provisions, see the discussion and reporter's notes by Edward C. Halbach, Jr., in Restatement of Trusts 3d: Prudent Investor Rule; Edward C. Halbach, Jr., *Trust Investment Law in the Third Restatement*, 27 Real Property, Probate & Trust J. 407 (1992); Jonathan R. Macey, An Introduction to Modern Financial Theory (American College of Trust & Estate

Counsel Foundation, 1991); Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (1986); Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U. L. Rev. 52 (1987); R.A. Brealey, An Introduction to Risk and Return from Common Stocks (2d ed. 1983); John H. Langbein & Richard A. Posner, *The Revolution in Trust Investment Law*, 62 A.B.A. J. 887 (1976); Note, *The Regulation of Risky Investments*, 83 Harvard L. Rev. 603 (1970).

SECTION 11. FIDUCIARY LIABILITY.

(a) A trustee or other fiduciary who breaches a duty imposed by this [Act] is personally liable to a retirement system for any losses resulting from the breach and any profits made by the trustee or other fiduciary through use of assets of the system by the trustee or other fiduciary. The trustee or other fiduciary is subject to other equitable remedies as the court considers appropriate, including removal.

(b) An agreement that purports to limit the liability of a trustee or other fiduciary for a breach of duty under this [Act] is void.

(c) A retirement system may insure itself against liability or losses occurring because of a breach of duty under this [Act] by a trustee or other fiduciary.

(d) A trustee or other fiduciary may insure against liability or losses occurring because of a breach of duty under this [Act] if the insurance is purchased or provided either by the trustee or fiduciary personally or, on the trustee or fiduciary's behalf, by this State, the retirement system, a public employer whose employees participate in a retirement program served by the trustee or fiduciary, an employee representative whose members participate in a retirement program served by the trustee or fiduciary, or the trustee or fiduciary's employer.

Comment

Section 11 places primary responsibility for fiduciary violations on trustees and fiduciaries: They are liable in the first instance and subsections (b) through (d) regulate their ability to shift the liability to others. The Drafting Committee considered and rejected standards that would have eased the potential liability of trustees and fiduciaries for fiduciary violations. For example, the Committee considered holding trustees and fiduciaries liable only for knowing and willful violations. The Committee opted for the current approach for three principal reasons.

First, the current approach provides strong protection for the retirement system against losses resulting from fiduciary violations. Any lesser standard than the one in Section 11 would mean that a fiduciary violation could occur for which no one would be liable. For example, with a "knowing and willful" standard, any non-knowing or non-willful fiduciary violation resulting in a loss would impose a loss on the system that could not be recouped from the violator. A loss from a non-knowing or non-willful fiduciary violation is just as real as any other loss. The crucial question is who should bear the loss: The violator or the retirement system. The standard in Section 11 attempts to shield the system from the loss and impose it instead on the violator.

Second, the possibility of liability tends to focus the attention of trustees and fiduciaries on their fiduciary responsibilities. The deterrence function of this section will work well only if trustees and fiduciaries act with their responsibilities firmly in mind. The hope is that, if the deterrence function of the section works well, less unfortunate circumstances will arise in which the issue of fiduciary liability must be faced at all.

Finally, a standard that penalized trustees and fiduciaries only for knowing and willful violations of their fiduciary duties would tend to undermine, through a weak enforcement scheme, the strong statement of fiduciary duties articulated elsewhere in the Act. The enforcement scheme is intended to reaffirm, rather than diminish, the notion that the fiduciary duties of the Act are intended to be taken seriously.

The Drafting Committee also considered and rejected the possibility of easing the liability standard for trustees only, but not for other fiduciaries. In addition to the reasons above, the Committee rejected this possibility because the underlying standard of fiduciary conduct already distinguishes between trustees and other fiduciaries. Trustees are held to the standard of other trustees for similar systems facing similar circumstances. Thus, if the system is small and the trustees for such systems are generally fairly unsophisticated, the prudence standard applying to the trustees of the system will reflect that level of knowledge and competence. On the other hand, professional money managers will be held to the much higher level of knowledge and competence expected of them. Since the underlying standard

of fiduciary conduct already distinguishes between trustees and other fiduciaries, the Drafting Committee thought it unnecessary to duplicate the distinction in the liability standard itself.

Subsection (a) provides equitable remedies only. The language providing for personal liability for losses should not be misunderstood as providing legal relief. The possibilities for recovery under subsection (a) track those noted by the Restatement of Trusts 2d in cases of breach of trust, and those remedies are exclusively equitable. Restatement of Trusts 2d § 205. The equitable nature of the available remedies is evident again later in this Act in the enforcement section and in the suggested approach to a statute of limitations. MPERS Act §§ 19(a), 20.

Subsection (a) is clear that only trustees and other fiduciaries under this Act can be liable for fiduciary violations under this Act. Since the definition of fiduciary in this Act follows ERISA, service providers, such as attorneys, accountants and actuaries, will generally not be fiduciaries under this Act. *See* 29 C.F.R. § 2509.75-5, D-1 (1997) ("attorneys, accountants, actuaries and consultants performing their usual professional functions will ordinarily not be considered fiduciaries"). As a result, they will not generally be subject to liability under this Act. Under ERISA, this result presents the possibility of no liability at all for these service providers - none under ERISA because they are not fiduciaries and none under other state law because of the broad preemptive effect of ERISA. *See Mertens v. Hewitt Assocs.*, 508 U.S. 248 (1993) (no money damages against a nonfiduciary under ERISA); *Reich v. Rowe*, 20 F.3d 25 (1st Cir. 1994) (no nonfiduciary liability under ERISA). *See also Mertens, supra,* 508 U.S. at 267 n. 2 (White, J., dissenting) ("it is difficult to imagine how any common-law remedy for [a breach by a nonfiduciary] could have survived enactment of ERISA's 'deliberately expansive' pre-emption provision"). *But see Custer v. Sweeney*, 89 F.3d 1156 (4th Cir. 1996) (ERISA does not preempt state causes of action against nonfiduciary service provider); *Airparts Co. v. Custom Benefit Services of Austin, Inc.*, 28 F.3d 1062 (10th Cir. 1994) (same). That is not a possibility under this Act, however, because it does not preempt other causes of action against service providers. Service providers would still be subject to actions outside this Act based on the terms of their contracts with retirement systems and on other independent sources of fiduciary or other obligations under state or federal law (such as actions alleging causes of action under agency, tort, or professional responsibility law).

Subsections (b) through (d) limit and regulate the ability of trustees and fiduciaries to shift to others any liability for fiduciary violations. Subsection (b) broadly prohibits any type of insurance or indemnification for fiduciary liability, unless the arrangement is permitted by subsection (c) or (d). Although subsection (b) is restrictive, note that it voids only agreements relieving a trustee or fiduciary from liability for *breaches* of fiduciary duty. Thus, as under ERISA, an agreement to cover the legal expenses of a trustee or fiduciary for *successful* defenses against claims of fiduciary violations would not be void. *See Packer Engineering, Inc. v. Kratville*, 965 F.2d 174 (7th Cir. 1992) (ERISA § 410(a) is not violated by agreement to indemnify fiduciaries for legal expenses incurred in successfully defending claims of fiduciary violations); *Moore v. Williams*, 902 F. Supp. 957 (N.D. Iowa 1995) (ERISA § 410(a) does not void agreement to cover legal expenses in defending claims of fiduciary violations; plan must forward to fiduciary money to cover expenses).

Subsection (c) permits retirement systems to pursue a wide variety of arrangements for insuring against losses resulting from fiduciary violations, ranging from self-insurance, to risk retention groups, to commercially-obtained fiduciary liability insurance. The decisions whether to insure and, if so, how to insure are, of course, fiduciary decisions that must be made carefully.

Subsection (d) permits trustees and fiduciaries to insure against losses resulting from fiduciary breaches, but only if the insurance is purchased on their own account or on the account of the State, the retirement system, a public employer, an employee representative, or their employer. These possibilities generally track those of ERISA. 29 C.F.R. § 2509.75-4 (1997) (ERISA fiduciaries can be indemnified by their own employers, employers who have employees covered by the plan served by the fiduciary, or employee representatives who have members covered by the plan). As with subsection (c), the intent is to permit a wide variety of arrangements.

Section 11 is intended to waive any sovereign immunity defense that might be asserted by a trustee or fiduciary. Similarly, it is intended to supersede any protection against liability otherwise available under state tort claims acts, and similar acts, that have replaced application of sovereign immunity in certain States. *See*, *Moore v. City of Lewiston*, 596 A.2d 612 (Me. 1991); *Harden v. State*, 434 N.W.2d 881 (Iowa), *cert. denied*, 493 U.S. 869 (1989). To the extent a state constitution limits the power of the legislature to waive sovereign immunity, the waiver under this Act should be interpreted to be as broad as constitutionally permissible. If the constitutional limitation is quite broad, the legislature may want to consider other alternatives for protecting against losses from fiduciary violations, such as mandatory bonding requirements. *See* Ga. Const. art. 1, § 2, ¶ IX (limiting ability of legislature to waive sovereign immunity for state officers and employees); ERISA § 412, 29 U.S.C. § 1111 (1994) (imposing bonding requirements).

In addition to monetary liability, Section 11(a) specifies removal as a permissible form of relief for a fiduciary violation, but does not specify any specific grounds for removal. This follows ERISA and the Restatement of Trusts 2d § 107. *See generally* Restatement of Trusts 2d § 107, Comment on Clause (a), at 235-37 (discussing grounds for court removal of a trustee).

This section derives from Sections 409 and 410 of ERISA, 29 U.S.C. §§ 1109, 1110 (1994).

[SECTION 12. [OPEN OR PUBLIC] MEETINGS AND RECORDS.

(a) A multimember body having authority to invest or manage assets of a retirement system may deliberate about, or make tentative or final decisions on, investments or other financial matters in executive session if disclosure of the deliberations or decisions jeopardizes the ability to implement a decision or to achieve investment objectives.

(b) A record of a retirement system that discloses deliberations about, or a tentative or final decision on, investments or other financial matters is not an [open or public] record under [the State Open Records Law] to the extent and so long as its disclosure jeopardizes the ability to implement an investment decision or program or to achieve investment objectives.]

Comment

Section 12 is intended to work in conjunction with the enacting State's open records and open meetings laws. "Open" or "public" would be used depending on the phraseology used in the particular State. Except for the narrow circumstances defined in this section, the substance, procedures, and sanctions of the State's open records and open meetings laws would apply. For example, if a State's open meetings law provided an exception for meetings to discuss pending litigation or personnel matters, that exception would also apply to retirement systems. Section 12 is intended to clarify application of the general openness principle of open records and open meetings laws in circumstances of special relevance to retirement systems, specifically, to safeguard the interest of the system in protecting the privacy of information when necessary to permit pursuit of an investment or financial strategy.

Section 12 is bracketed to account for local circumstances. In some States, for example, the open records and open meetings laws may already deal with these issues adequately, so that Section 12 is unnecessary. In other States, enacting these types of limits on public disclosure may present constitutional problems. *See* Mont. Const. art. II, § 9 (documents and deliberations must be open unless "demand of individual privacy clearly exceeds the merits of public disclosure").

SECTION 13. DISCLOSURE TO PUBLIC.

(a) An administrator shall prepare and disseminate:

(1) a summary plan description of each retirement program;

(2) a summary description of any material modification in the terms of the program and any material change in the information required to be contained in the summary plan description, to the extent the modification or change has not been integrated into an updated summary plan description;

(3) an annual disclosure of financial and actuarial status; and

(4) an annual report.

(b) An administrator shall make available for public examination in the principal office of the administrator and in other places if necessary to make the information reasonably available to participants:

(1) the governing law of the retirement program and system;

(2) the most recent summary plan description;

(3) summary descriptions of modifications or changes described in subsection (a)(2) that have been provided to participants and beneficiaries but have not yet been integrated into the summary plan description;

(4) the most recent annual disclosure of financial and actuarial status; and

(5) the most recent annual report.

(c) Upon written request by a participant, beneficiary, or member of the public, an administrator shall provide a copy of any publication described in subsection (b). Except as otherwise provided in Section 14(a), the administrator may charge a reasonable fee to cover the cost of providing copies. The administrator shall provide the copies within 30 days after the request or, if a fee is charged, within 30 days after receiving payment.

Comment

Sections 13 to 18 contain the reporting and disclosure requirements of the Act. Three types of reports must be produced and distributed by each retirement system. In general terms, they are:

(1) A summary plan description (and updates). Basically, this is a description of the retirement program and its benefits. It must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

(2) An annual disclosure of financial and actuarial status. This is a compilation of a great deal of information about the retirement system and program, its financial position, and, for defined benefit plans, its actuarial position. It does not need to be distributed to each participant and beneficiary. Instead, it has a very limited required distribution intended to make the report widely available to interested parties at modest cost to the retirement system.

(3) An annual report. This is a summary of the annual disclosure of financial and actuarial status. It must contain certain key financial information and, for defined benefit plans, key actuarial information. The annual report must be distributed to participants and beneficiaries receiving benefits, and be made available to the public.

Subsection (b) requires the administrator to make information available for public examination in the principal office of the administrator and in other places "if necessary to make the information reasonably available to participants." This latter requirement is intended to ensure that, whenever reasonably possible, the materials are readily available to participants who live some distance from the principal office. The requirement should never be read to require the establishment of a branch office, but it may require that materials be made available in a branch office already in existence or on the premises of a major public employer participating in the system. The major factors determining when the information must be made available in a place other than the principal office are the distance from the principal office; the number of participants who live in the remote area; and the cost of making the information available.

Subsection (c) is not intended to preclude or discourage retirement systems from accepting and responding to requests for information made by telephone or electronically. The subsection, however, does protect systems by providing that an enforceable obligation to provide information arises only when a request is made in writing.

Subsections (b) and (c) of this section are based generally on ERISA §§ 104(b)(2) and (4), 29 U.S.C. §§ 1024(b)(2) and (4) (1994).

SECTION 14. DISCLOSURE TO PARTICIPANTS AND BENEFICIARIES.

(a) An administrator shall furnish to each participant and to each beneficiary who is receiving benefits under a retirement program:

(1) a copy of the most recent summary plan description, along with any summary descriptions of modifications or changes described in Section 13(a)(2), within [three] months after a person becomes a participant or, in the case of a beneficiary, within [three] months after a person first receives benefits, or, if later, within [four] months after the retirement program becomes subject to this [Act];

(2) the summary description of any modifications or changes described in Section 13(a)(2), within [seven] months after the end of the fiscal year in which a modification or change has been made;

(3) a copy of an updated summary plan description that integrates all modifications and changes at intervals not exceeding five years; and

(4) the annual report within [seven] months after the end of each fiscal year.

(b) An administrator shall provide to a participant or beneficiary a statement containing information that would permit the participant or beneficiary to estimate projected benefits reasonably, to the extent the information is regularly maintained by the retirement system. The information must be provided with the annual report or upon written request of the participant or beneficiary. The information need not be provided to a participant or beneficiary who is currently receiving benefits.

(c) A participant who is not currently receiving benefits is entitled without charge to one statement under subsection (b) during any fiscal year. An administrator may charge a reasonable fee to cover the cost of providing other statements. The administrator shall provide the statements within 30 days after the participant or beneficiary's request or, if a fee is charged, within 30 days after receiving payment.

Comment

Subsection (a) specifies the types and timing of reports that must be distributed to participants and beneficiaries receiving benefits. The types and times generally follow ERISA. ERISA § 104(b), 29 U.S.C. § 1024(b) (1994). Most of the time limits are in brackets to permit adjustment for local circumstances.

Participants and eligible beneficiaries need only receive the annual report, which is a summary of the annual disclosure of financial and actuarial status. They need not be furnished with the annual disclosure of financial and actuarial status itself. There are two primary reasons for this. First, the annual disclosure of financial and actuarial status is quite comprehensive. It would be extremely burdensome on retirement systems to require broad distribution of such a large report. Second, the requirement attempts to make the appropriate trade-off between comprehensiveness and comprehensibility. The goal is to provide participants and beneficiaries with sufficient information to inform them clearly and adequately, without overwhelming them with detail. Additional detail is available to interested parties in the annual disclosure of financial and actuarial status itself. The obligation to supply only the annual report, and not the annual disclosure of financial and actuarial status, aligns with notice requirements elsewhere in pension law that recognize that "[c]larity and completeness are competing goods." *Lorenzen v. Employees Retirement Plan of the Sperry & Hutchinson Co.*, 896 F.2d 228, 236 (1990) (holding that a summary plan description need not detail every contingency). *See* Disclosure to Participants, 60 Fed. Reg. 34,412, 34,412 (1995) (PBGC rejects claims that more information should be provided in notice of underfunded status, emphasizing that information should be "clear, concise, and focused").

Subsections (b) and (c) require the administrator to provide information that will permit participants and beneficiaries to estimate their benefits reasonably, to the extent the information is regularly maintained by the retirement system. Consequently, retirement systems would normally provide information on all the factors necessary to estimate projected benefits, such as the participant's salary history (to the extent relevant to benefit determination), years of service credit, contributions, and vesting status. Not all retirement systems regularly maintain information on all these factors. For example, not all systems maintain information on each participant's salary history. In that case, the administrator need only provide information that the system regularly maintains. The administrator need not provide this type of information to participants and beneficiaries who are currently receiving benefits, as they will already know the level of benefits they are receiving.

Subsections (b) and (c) are based generally on ERISA §§ 105(a) and (b), 29 U.S.C. §§ 1025(a) and (b) (1994).

SECTION 15. REPORTS TO [AGENCY]. An administrator shall file with the [Agency] [and others] a copy of:

(1) the governing law of the retirement program and system within [four] months after the system becomes subject to this [Act] and an updated copy at least once every year thereafter;

(2) the summary plan description within [four] months after the system becomes subject to this [Act] and of updated summary plan descriptions at the same time they are first furnished to any participant or beneficiary under Section 14(a)(3);

(3) any summary description of modifications or changes within [seven] months after the end of the fiscal year in which a modification or change has been made; and

(4) the annual disclosure of financial and actuarial status and annual report within [seven] months after the end of each fiscal year.

Comment

This section requires reports to be filed with an agency. The intent is to create a central repository of information on all retirement programs and systems in a State. Designation of the entity is left to the discretion of the enacting State, but the designation should be to an entity that can fulfill the two intended functions under the Act: (1) to serve as a central and easily accessible repository of information and (2) to enforce the obligation to file the required materials. States currently allocate similar responsibilities to a variety of entities, including specialized agencies whose primary responsibility is to oversee public retirement systems; agencies with more general responsibilities, one of which is oversight of retirement systems; various executive branch officials, such as the Attorney General or State Auditor; and specialized legislative bodies. The enacting State could designate any of these entities, or another, as the "Agency."

Enacting States may also want to require the administrator to file the information required by this section with entities other than the designated agency, such as employers participating in programs managed by the retirement system, legislative oversight committees, or various executive branch officials. The purpose of requiring such additional filings would not be primarily to create a central repository of information (that function would be served by the filing with the designated agency), but rather to ensure that information about the retirement system is made available to entities with special interest in its functioning. The area with the bracketed language "and others" is reserved for designation of these other entities.

SECTION 16. SUMMARY PLAN DESCRIPTION.

(a) A summary plan description and a summary description of modifications or changes under Section 13(a)(2) must be written in a manner calculated to be understood by the average participant and be accurate and sufficiently comprehensive reasonably to inform the participants and beneficiaries of their rights and obligations under the retirement program.

(b) A summary plan description must contain:

(1) the name of the retirement program and system and type of administration;

(2) the name and business address of the administrator;

(3) the name and business address of each agent for service of process;

(4) citations to the governing law of the retirement program and system;

(5) a description of the program's requirements respecting eligibility for participation and benefits;

(6) a description of the program's provisions providing for nonforfeitable benefits;

(7) a description of circumstances that may result in disqualification, ineligibility, or denial or loss of benefits;

(8) a description of the benefits provided by the program, including the manner of calculating benefits and any benefits provided for spouses and survivors;

(9) the source of financing of the program;

(10) the identity of any organization through which benefits are provided;

(11) the date the fiscal year ends;

(12) the procedures to claim benefits under the program and the administrative procedures available under the program for the redress of claims that are denied in whole or in part; and

(13) notice of the availability of additional information pursuant to Sections 13(b), 13(c), 14(b), 14(c), and 15.

Comment

The primary purpose of the summary plan description is to inform participants and beneficiaries of benefits available under their retirement program. Consequently, the administrator must produce and distribute a summary plan description for each retirement program. Section 16 is based generally on ERISA § 102, 29 U.S.C. § 1022 (1994).

Subsection (b) lists elements that must be included in every summary plan description. The description of benefits required by paragraph (8) should cover all benefits provided by a program including, where appropriate, a discussion of any options to purchase service credit. Where appropriate, information additional to that listed in subsection (b) may be included in the summary plan description, such as citations to applicable collective bargaining agreements or information on the availability of retirement planning services.

SECTION 17. ANNUAL DISCLOSURE OF FINANCIAL AND ACTUARIAL STATUS.

(a) As used in this section, "qualified public accountant" means:

(1) an auditing agency of this State, or a political subdivision of this State, which has no direct relationship with the functions or activities of a retirement system or its fiduciaries other than:

(A) functions relating to this [Act]; or

(B) a relationship between the system and the agency's employees as participants or beneficiaries on the same basis as other participants and beneficiaries; or

(2) a person who is an independent public accountant, certified or licensed by a regulatory authority of a State.

(b) As used in this section, "related person" of an individual means:

(1) the individual's spouse or a parent or sibling of the spouse;

(2) the individual's descendant, sibling, or parent, or the spouse of the individual's descendant, sibling, or parent;

(3) another individual residing in the same household as the individual;

(4) a trust or estate in which an individual described in paragraph (1), (2), or (3) has a substantial interest;

(5) a trust or estate for which the individual has fiduciary responsibilities; or

(6) an incompetent, ward, or minor for whom the individual has fiduciary responsibilities.

(c) An annual disclosure of financial and actuarial status must contain:

(1) the name of the retirement system and identification of each retirement program and, if programs are in an appropriate grouping of programs, of each appropriate grouping of programs;

(2) the name and business address of the administrator;

(3) the name and business address of each trustee and each member of a board of trustees and a brief description of how the trustee or member was selected;

(4) the name and business address of each agent for service of process;

(5) the number of employees covered by each retirement program not in an appropriate grouping of programs, or by each appropriate grouping of programs, or both;

(6) the name and business address of each fiduciary;

(7) the current statement of investment objectives and policies required by Section 8(b);

(8) financial statements and notes to the financial statements in conformity with generally accepted accounting principles;

(9) an opinion on the financial statements by a qualified public accountant in conformity with generally accepted auditing standards;

(10) in the case of a defined benefit plan, actuarial schedules and notes to the actuarial schedules in conformity with generally accepted actuarial principles and practices for measuring pension obligations;

(11) in the case of a defined benefit plan, an opinion by a qualified actuary that the actuarial schedules are complete and accurate to the best of the actuary's knowledge, that each assumption and method used in preparing the schedules is reasonable, that the assumptions and methods in the aggregate are reasonable, and that the assumptions and methods in combination offer the actuary's best estimate of anticipated experience;

(12) a description of any material interest, other than the interest in the retirement program itself, held by any public employer participating in the system or any employee organization representing employees covered by the system in any material transaction with the system within the last three years or proposed to be effected;

(13) a description of any material interest held by any trustee, administrator, or employee who is a fiduciary with respect to the investment and management of assets of the system, and, if the fiduciary is an individual, by a related person of the beneficiary, in any material transaction with the system within the last three years or proposed to be effected;

(14) a schedule of the rates of return, net of total investment expense, on assets of the system overall and on assets aggregated by category over the most recent one-year, three-year, five-year, and 10-year periods, to the extent available, and the rates of return on appropriate benchmarks for assets of the system overall and for each category over each period;

(15) a schedule of the sum of total investment expense and total general administrative expense for the fiscal year expressed as a percentage of the fair value of assets of the system on the last day of the fiscal year, and an equivalent percentage for the preceding five fiscal years; and

(16) a schedule of all assets held for investment purposes on the last day of the fiscal year aggregated and identified by issuer, borrower, lessor, or similar party to the transaction stating, if relevant, the asset's maturity date, rate of interest, par or maturity value, number of shares, cost, and fair value and identifying any asset that is in default or classified as uncollectible.

Comment

The annual disclosure of financial and actuarial status is intended to make information available to interested persons sufficient to enable them to assess the management, financial position, and, if applicable, actuarial position of each retirement program. The annual disclosure of financial and actuarial status requires the disclosure of a great deal of information, but its distribution list is extremely limited. In essence, the annual disclosure is a filing requirement rather than a publication requirement.

Subsection (c)(8) requires that the annual disclosure contain financial statements and notes in conformity with generally accepted accounting principles. The principal current articulation of those principles is GASB Statement No. 25, which requires two financial statements (a statement of plan net assets and a statement of changes in net plan assets) and accompanying notes. GASB Statement No. 25 also addresses a multitude of other issues that must be addressed in preparing the financial statements and notes. *See also* Government Finance Officers Ass'n, Pension CAFRs: Guidelines for the Preparation of a Public Employee Retirement System Comprehensive Annual Financial Report 9-28 (1996) (hereinafter "Pension CAFRs").

Subsection (c)(10) requires the annual disclosure for defined benefit plans to contain actuarial schedules and notes in conformity with generally accepted actuarial principles and practices for measuring pension obligations. The principal current articulations of these principles and practices are GASB Statement No. 25 and Measuring Pension Obligations, Actuarial Standard of Practice No. 4 (Actuarial Standards Board, 1993) (hereinafter "Actuarial Standard of Practice No. 4"). GASB Statement No. 25 requires two actuarial schedules (a schedule of funding progress and a schedule of employer contributions) and accompanying notes. The actuarial disclosures, however, need not be limited to the disclosures required by these sources. Those preparing actuarial statements may also be subject to guidelines from other sources that suggest or require more extensive disclosure. *See* Pension CAFRs, at 35-43. Complying with these guidelines and including other actuarial information in the annual disclosure would be consistent with this subsection, provided that all the information required by generally accepted actuarial principles and practices is also disclosed.

Subsection (c)(11) requires actuarial assumptions and methods to be reasonable both individually and in the aggregate. This follows the guidelines of Actuarial Standard of Practice No. 4, § 5.2.4. The subsection is based on ERISA and the Internal Revenue Code, but differs from them on the issue of assumptions and methods. ERISA requires the assumptions and methods to be reasonable only in the aggregate, ERISA § 103(a)(4)(B)(i), 29 U.S.C. § 1023(a)(4)(B)(i) (1994), while the Internal Revenue Code requires them to be reasonable either in the aggregate or individually for non-multiemployer plans and reasonable in the aggregate for multiemployer plans. I.R.C. § 412(c)(3) (1994).

Subsection (c)(12) and (13) requires disclosure of information about significant actors of the retirement system. As indicated in the Comment to Section 7 above, this disclosure requirement supports the fiduciary sections of the Act by exposing and discouraging improper transactions between a retirement system and significant actors. At the same time, the subsection should not impose significant extra burdens on retirement systems; investigating these types of interests are already a standard part of the auditor's duties. *See* American Institute of Certified Public Accountants, Audits of Employee Benefit Plans, §§ 11.01-11.16 (1995).

The definition of related person in subsection (b) supports the disclosure requirement in subsection (c)(13). The definition tracks the definition of the same term in the Model Business Corp. Act § 8.60(3) (Business Law Section, ABA, 1984). The Model Business Corp. Act's definition of "related person" is currently in the statutes of nine States.
Subsection (c)(14) and (15) uses the terms "investment expense" and "general administrative expense." These are terms that are used and discussed in GASB Statement No. 25. GASB Statement No. 25, ¶¶ 29-30, 103-104, 107. As a result, the terms have a well-settled meaning amongst professionals in the field, even though gray areas of application that call for the exercise of professional judgement will inevitably arise. *See id.* at ¶ 107 (difficulties in separating investment expenses from investment income and general administrative expenses call for the exercise of professional judgement).

The annual disclosure of financial and actuarial status need not be limited to the disclosures required by this section. The disclosure may also include other information that, although not required by this section, would assist recipients in assessing the status of the retirement system. For example, the annual disclosure of financial and actuarial status might include additional information of the type generally included in a comprehensive annual financial report, such as additional investment and statistical information. Pension CAFRs, at 29-33, 45-48.

SECTION 18. ANNUAL REPORT. An annual report must contain:

(1) the name and business address of each trustee and each member of a board of trustees;

(2) the financial statements, but not the notes, required by Section 17(c)(8);

(3) for defined benefit plans, the actuarial schedules, but not the notes, required by Section 17(c)(10);

(4) the schedules described in Section 17(c)(14) and (15).

(5) a brief description of and information about how to interpret the statements and schedules;

(6) other material necessary to summarize fairly and accurately the annual disclosure of financial and actuarial status; and

(7) notice of the availability of additional information pursuant to Sections 13(b), 13(c), 14(b), 14(c), and 15.

Comment

The annual report, as indicated in the Comment to Section 14 above, is intended to provide participants and beneficiaries with sufficient information to inform them clearly and adequately about the status of the system, without overwhelming them with detail. Additional detail is available to interested parties in the annual disclosure of financial and actuarial status itself.

This section does not require voluminous amounts of information to be included in the annual report. Subsections (2) and (3) require financial statements and actuarial schedules to be included in the annual report, but not the notes to the statements and schedules. The statements and schedules themselves are generally considerably more concise than the notes that accompany them. Subsection (4) requires the schedules described in Section 17(c)(14) and (15) to be included in the annual report. It should also be possible to present these schedules concisely. *See* Pensions CAFRs, at 30 (presenting a half-page schedule presenting the type of information required by Section 17(c)(14)). Similarly, the information required by subsections (5) through (7) should not be lengthy. The goal, once again, is to provide fair notice of the current status of the system, rather than to provide a large amount of information. More information is available for those who desire it in the annual disclosure of financial and actuarial information.

Retirement systems currently produce and distribute publications that, with minor modification, may satisfy the requirement to produce and furnish an annual report. For example, some systems currently distribute summaries of their comprehensive annual financial report or component unit financial report to all participants and beneficiaries receiving benefits. With only minor modifications, these summaries could constitute the annual report required by this section. These systems, then, could meet the annual report requirement with virtually no increase in their marginal costs. Similarly, most systems currently produce and distribute a newsletter of one sort or another to all participants and beneficiaries receiving benefits. Some systems already use their newsletters to convey virtually all of the information required to be in an annual report. With only slight modifications, these newsletters could satisfy the annual report requirement. Other systems devote considerable newsletter space to information that is less than essential, for example, information on how to protect yourself against Lyme disease or on how members have done at the most recent state senior games. These systems could meet the annual report requirement by replacing that information with the information required to satisfy the annual report requirement. In both of these situations, once again, the annual report requirement could be met with virtually no increase in marginal costs.

Retirement systems that do not currently communicate with participants and beneficiaries receiving benefits will incur a new, and not insignificant, expense because of the obligation to produce and distribute an annual report. Two points about this expense should be noted, however. First, annual report aside, most systems currently communicate with their participants and beneficiaries through a newsletter or even a more expensive publication. Thus, most systems currently think that the expense of this type of communication is justified. The Act may well have a beneficial side-effect if it encourages retirement systems that engage in only very limited communication with participants and beneficiaries to reconsider that policy. Second, the annual report, like the current newsletters, need not be a glossy, professionally-produced document. Some newsletters are that way, but others are very modest, typewritten documents. Either type could be used to meet the annual report requirement. The expense of satisfying the requirement will never disappear, but it can be minimized.

The annual report requirement of this section is met if the required information is communicated to participants and beneficiaries receiving benefits in a timely fashion. The annual report need not be labeled "The Annual Report," it need not be separate from other reports, and it need not be limited to the information specified by this section.

SECTION 19. ENFORCEMENT.

(a) A public employer, participant, beneficiary, or fiduciary may maintain an action:

(1) to enjoin an act, practice, or omission that violates this [Act];

(2) for appropriate equitable relief for breach of trust under Section 11; or

(3) for other appropriate equitable relief to redress the violation of or to enforce this [Act].

(b) [The Agency] may maintain an action to enjoin a violation of Section 15.

(c) In an action under this section by a participant, beneficiary, or fiduciary, the court may award reasonable attorney fees and costs to either party.

Comment

This section is based generally on ERISA § 502, 29 U.S.C. § 1132 (1994). The section applies only to enforcement of this Act. Unlike ERISA, this Act does not preempt other possible causes of action. Thus, many actions against retirement systems (for example, actions to collect benefits) may be permissible, but are not provided for in this section. Such actions must be based elsewhere in state or federal law.

Subsections (a) and (b) provide only for equitable relief. This has two important effects that, although fairly obvious, are worth noting. First, damages are limited to traditional equitable remedies, such as injunctions and restitution. Other forms of relief, such as compensatory and punitive damages, are not available under the Act. Second, jury trials are not available under the Act.

Subsection (c) authorizes a court to award an attorney's fee and costs to either party. Subsection (c) is based on § 502(g)(1) of ERISA, 29 U.S.C. § 1132(g)(1) (1994), but differs from the ERISA provision in that it does not use the phrase "in its discretion" to describe the court's authority to award attorney's fees and costs. This was a stylistic, rather than a substantive, change. The subsection says that the court "may" award fees and costs and, hence, is intended to follow § 502(g)(1) in authorizing, but not requiring, courts to award them. Consequently, since the provision tracks ERISA, it would be appropriate for courts exercising their discretion under this section to rely on the factors developed under ERISA for determining whether an award of attorney's fees is appropriate. *See Eaves v. Penn*, 587 F.2d 453, 464-65 (10th Cir. 1978) (first case to articulate five factors relevant to fee determination under ERISA); *Eddy v. Colonial Life Ins. Co.*, 59 F.3d 201, 206-07 (D.C. Cir. 1995) (citing cases indicating that all circuits apply the five-factor test).

Subsection (c) does not authorize an award of attorney's fees and costs for every type of plaintiff who might bring an action under the section. The primary purpose of the provision is to facilitate appropriate enforcement actions by those who might sue not only on their own behalf, but also on behalf of others. In the absence of a provision shifting fees and costs, one would expect too little enforcement because this type of plaintiff would bear all the costs of an enforcement action, but would recoup only a small share of the benefits of a successful action. *See generally* Mancur Olson, The Logic of Collective Action 30-31 (1965). Subsection (c) authorizes attorney's fees and costs only in actions brought by a participant, beneficiary, or fiduciary. These are actions in which the plaintiff is likely to be forwarding the interests of others, as well as its own. This provision facilitates such actions by making the anticipated costs of the action align more closely with the benefits anticipated by the individual plaintiff. Subsections (a) and (b) also permit actions to be brought by a public employer or the agency designated by the Act. An award of attorney's fees and costs is not authorized for those actions. The conditions that might lead to under-enforcement through actions by participants, beneficiaries, and fiduciaries are less likely to be present in actions brought by public employers or the designated agency. *Cf. Self-Insurance Institute of America, Inc. v. Korioth*, 53 F.3d 694, 696-97 (5th Cir. 1995) (attorney's fees denied under ERISA because prevailing plaintiff was not a participant, beneficiary or fiduciary); *Associated Gen. Contractors v. Smith*, 74 F.3d 926, 930-31 (9th Cir. 1996) (attorney's fees denied under another federal statute since prevailing plaintiff would not have been able to recover fees under ERISA because not a participant, beneficiary or fiduciary).

Although subsection (c) authorizes an award of attorney's fees to either party, the public goods rationale underlying the provision suggests that courts should not treat claims by prevailing plaintiffs and defendants the same. Courts applying ERISA's attorney's fees provision, which has the same operative language as this provision, have generally looked favorably on claims for attorney's fees from prevailing plaintiffs, but skeptically at claims for fees from prevailing defendants. *See Rodriquez v. MEBA Pension Trust*, 956 F.2d 468 (4th Cir. 1992) (stating presumption in favor of attorney's fees to prevailing plaintiffs); *Eddy v. Colonial Life Ins. Co.*, 59 F.3d 201 (D.C. Cir. 1995) (rejecting presumption in favor of prevailing plaintiffs, but nevertheless applying five-factor test to overturn lower court's denial of fees); *Tingey v. Pixley-Richards West, Inc.*, 958 F.2d 908, 909 (9th Cir. 1992) (denying attorney's fees to prevailing defendant, while indicating that fees should seldom be awarded to prevailing defendants); *Nachwalter v. Christie*, 805 F.2d 956, 962 (11th Cir. 1986) (same as *Tingey*). At the same time, however, ERISA does confer discretion on the courts so that, in compelling circumstances, attorney's fees can be denied to prevailing plaintiffs or awarded to prevailing defendants. *See Armistead v. Vernitron Corp.*, 944 F.2d 1287 (6th Cir. 1991) (denying attorney's fees to prevailing plaintiffs because success did not confer adequate common benefit on others); *Credit Managers Ass'n v. Kennesaw Life & Accident Ins. Co.*, 25 F.3d 743 (9th Cir. 1994) (awarding attorney's fees to prevailing defendant when plaintiff acted in bad faith by pursuing "groundless" claims). This same approach has been applied to the attorney fees provisions of the major civil rights statutes. *See* Title VII, § 706(k), 42 U.S.C. § 2000e-5(k) (1994); 42 U.S.C. § 1988 (1994). These provisions authorize the courts to award attorney's fees to any "prevailing party," but the courts have interpreted the language to mean that prevailing plaintiffs will almost always receive an award of attorney's fees, while a prevailing defendant will almost always be denied attorney's fees. *See Newman v. Piggie Park Enter.*, 390 U.S. 400 (1968) (prevailing plaintiffs should ordinarily recover attorney's fees unless special circumstances render an award unjust); *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412 (1978) (prevailing defendants should recover attorney's fees only if plaintiff's action was frivolous, unreasonable, or without foundation). Subsection (c) should also be interpreted in this way.

[**SECTION 20. STATUTE OF LIMITATIONS.** An action under Section 19 must be commenced within the period of limitations in this State, if any, for actions for breach of trust or, if none, within three years.]

Comment

This section is intended to alert States to the need to provide a statute of limitations for actions arising under the Act and to provide general guidance. The section is bracketed because States differ in a number of ways which may affect the precise way in which a statute of limitations might be implemented. For example, some States, but not others, have general statute-of-limitations provisions which are codified separately and which may deal adequately with issues, such as discovery and tolling, that are likely to be salient in this context. Similarly, some States, but not others, may provide for administrative review of decisions subject to this Act and those procedures may deal adequately with limitations issues. The Drafting Committee thought it inadvisable to attempt to deal with the many difficult and technical issues that arise in connection with a statute of limitations given the diversity of ways in which the States deal with statutes of limitations generally. At the same time, it wanted to alert States to the need to attend to these issues when the Act is enacted.

SECTION 21. ALIENATION OF BENEFITS. Benefits of a retirement program may not be assigned or alienated and are exempt from claims of creditors, except [to the extent expressly permitted by other law of this State].

Comment

This section states the well-accepted general rule that benefits from retirement programs cannot be assigned or alienated. The section recognizes, however, that in certain limited circumstances the legislature may decide that assignment or alienation is appropriate and consistent with the underlying policy of protecting retirement benefits. A number of States, for example, permit alienation for domestic relations orders and participant loans. Instead of attempting to list every circumstance in which the legislature might make such a determination, the bracketed language states that the general anti-alienation rule of this section shall yield to state laws that expressly permit assignment or alienation of retirement benefits. The "expressly permitted" language imposes the burden of proving an exemption on those seeking an exemption and requires proof of unmistakable legal language indicating that the appropriate authority has actually considered the question of an exemption and determined that one is warranted. For analogous language in other uniform laws, see U.C.C. § 2A-104 (1990); U.C.C. § 9-203(4) (1977); Model State Administrative Procedure Act, § 1-103(b) (1981). This language is bracketed because some States may prefer to insert their particular exceptions, or provide cross-references to them, instead of using the generic language suggested.

SECTION 22. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this [Act], consideration must be given to the need to promote uniformity of the law with respect to its subject among States that enact it.

SECTION 23. SEVERABILITY. If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 24. EFFECTIVE DATE. This [Act] takes effect ....

SECTION 25. REPEALS. The following acts and parts of acts are repealed:

(1) ....

(2) ....

(3) ....

SECTION 26. SAVINGS AND TRANSITIONAL PROVISIONS. [Before January 1, 1999, this [Act] does not apply to an eligible deferred compensation plan that was in existence on August 20, 1996, and satisfies the requirements of Section 457 of the Code, unless all assets and income of the plan are held in trust for the exclusive benefit of participants and their beneficiaries.]

Comment

This section is transitional only. It provides a limited exception from the Act only until January 1, 1999. On that date and thereafter, the provision should not be included in the Act, as it would have no effect.

This section deals with a special problem posed by eligible deferred compensation plans under Section 457 of the Internal Revenue Code. Prior to the Small Business Job Protection Act, the assets of a Section 457 plan had to remain solely the property of the employer and subject to the claims of the employer's general creditors. I.R.C. § 457(b)(6) (1994). These requirements were inconsistent with both the general approach and specific obligations of this Act, which require that the assets of retirement plans be held in trust solely for the benefit of participants and beneficiaries. As a result, early drafts of this Act provided that Section 457 plans were not subject to the Act.
In the Small Business Job Protection Act, Congress amended this part of Section 457. New subsection (g)(1) now provides that all assets and income of a Section 457 plan must be "held in trust for the exclusive benefit of participants and their beneficiaries." Small Business Job Protection Act, Pub. L. No. 104-188, § 1448(a), 110 Stat. 1755, 1812-13 (1996) (to be codified at I.R.C. § 457(g)). New subsection (g)(3) makes it clear that the trust requirement may be satisfied either through the creation of a trust or through the establishment of custodial accounts or contracts described in section 401(f) of the Code. *Id.* The Act also provides, however, that Section 457 plans in existence on the enactment date of the Small Business Job Protection Act (August 20, 1996) are not required to comply with the new trust requirement until January 1, 1999. *Id.* at § 1448(c), 110 Stat. at 1813.

This section provides an exception for Section 457 plans that have not yet been amended to comply with the new trust requirement of the Small Business Job Protection Act. Those plans are exempt from this Act. On the other hand, as soon as a plan complies with the new trust requirement of Section 457(g), either through the creation of a trust or pursuant to subsection (g)(3), it also becomes subject to the obligations of this Act.