MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES

Agenda Item Summary Sheet

Committee: Joint Finance and Human Resources Committee

Date of Meeting: May 12, 2012

Agenda Item: Proposed Board Policy 1C.4 Fiduciary Duty - System Pension Plans (First Reading)

- [x] Proposed Policy Change
- [ ] Approvals Required by Policy
- [ ] Other Approvals
- [ ] Monitoring
- [ ] Information

Cite policy requirement, or explain why item is on the Board agenda: The Joint Finance and Human Resources Committee seeks Board of Trustee approval of the proposed Board Policy 1C.4 Fiduciary Duty – System Pension Plans. This is the first reading.

Scheduled Presenter(s): Laura King, Vice Chancellor of Finance – CFO
Gail Olson, Office of General Counsel

Outline of Key Points/Policy Issues:
Under the proposed policy, the primary responsibility of the Board of Trustees and Board members continues to be oversight of the administration of the system pension plans, rather than direct involvement in determining pension investment options and administrative functions.

Background Information:
In 2009, the legislature transferred responsibility for selecting system pension plan investment options from the State Board of Investment to Minnesota State Colleges and Universities. To address that change and to codify fiduciary and administrative responsibilities for the system pension plans, the proposed policy describes the fiduciary expectations for administrators, individual trustees and the Board as the system's governing body.

BOARD OF TRUSTEES

MINNESOTA STATE COLLEGES AND UNIVERSITIES

BOARD ACTION ITEM

Proposed Board Policy 1C.4 Fiduciary Duty--System Pension Plans (First Reading)

BACKGROUND

The purpose of proposed Board Policy 1C.4 is to clearly identify fiduciary responsibilities for system pension plans. In 2009, the legislature transferred responsibility for selecting system pension plan investment options from the State Board of Investment to Minnesota State Colleges and Universities. To address that change and to codify fiduciary and administrative responsibilities for the system pension plans, the proposed policy describes the fiduciary expectations for administrators, individual trustees and the Board as the system's governing body. The draft policy is Attachment A.

The system administers three defined contribution plans created by the Minnesota Legislature:

- Individual Retirement Account Plan (IRAP) established under Minn. Stat. Ch. 354B, and subject to Internal Revenue Code § 401(a);
- Supplemental Retirement Plan (SRP) established under Minn. Stat. Ch. 354C, and subject to Internal Revenue Code § 401(a); and
- Tax-Sheltered Annuity Program (TSA) established under Minn. Stat. § 136F.45**.**

These three programs serve over 15,000 active and inactive plan participants. As of December 31, 2011, total investment in the combined system pension plan programs was approximately $1.3 billion. All mandatory contributions are invested on a pre-tax basis. Voluntary contributions may be invested on a pre-tax basis, or on an after-tax basis as a Roth Tax Sheltered Annuity. Total contributions by employees are governed by federal and state law. A description of the administration of these plans is included at Attachment B. A more detailed overview of system plans and other plans applicable to system employees is included in Attachment C.

SUMMARY OF PROPOSED POLICY

Minn. Stat. Ch. 356A articulates fiduciary responsibilities for state pension plans, including the system plans. The proposed policy consists primarily of provisions that either directly reflect state law or codify historical and current system practice with regard to the administration of the system pension plans; new provisions address education, indemnification and reporting. They include:

a. Provisions in Part 3 which directly reflect nondiscretionary state law; these are highlighted with shaded text in the draft policy. These provisions are included in the policy in order to provide trustees and employees with a single document containing essential information. Topics include the duty owed, use of the prudent person standard, activities covered, and the duty of loyalty owed.
b. Longstanding system administrative practices are codified in the policy provisions on board duties (Part 4), the investment committee (Part 5), and the advisory committee (Part 6).
c. New, more specific training and education expectations are addressed in Part 7. This provision requires annual training tailored to the needs of board members and employees with responsibilities under the policy. For example, board members will receive training necessary to oversee proper administration of the system pension plans; employees will receive training applicable to their administrative responsibilities.
d. The indemnification provision in Part 8 reflects authority in state law to provide indemnification to trustees and employees involved in administration of the plans. In order to be eligible for indemnification and representation, individuals must meet additional state law requirements, including requirements that the individual was acting within the scope of responsibility and authority; was not willfully or wantonly neglectful; and fully cooperates in representation.
e. The reporting provisions of Part 8 require annual reports to the Board as well as reports on any significant plan events.

ROLE OF THE BOARD

Until 2009, the State Board of Investment was statutorily responsible for choosing the investment options available to system pension plan participants. The Board's primary involvement historically has been to review and approve the selection of the third party administrator and authorize completion of a contract for those services. As part of that process, the Board has been advised about investment options that would be available to plan participants and the factors that supported selection of the recommended third party administrator, as well as being provided an overview of the system's pension plans.

Under the proposed policy, the primary responsibility of the Board of Trustees and Board members continues to be oversight of the administration of the system pension plans, rather than direct involvement in determining pension investment options and administrative functions. In contrast, state boards such as the Minnesota State Retirement System (MSRS) and the Public Employees Retirement Association (PERA) are responsible for investment decisions, actuarial benefit determinations, etc. Because the pension plans administered by the system all are defined contribution plans, the Board is not responsible for ensuring a particular benefit level. Rather, a participant's retirement benefits from these plans are based on employer and employee contributions, the investment options the participant has chosen, and the performance of those investment funds; participants are not guaranteed a particular benefit level. System administrative responsibilities include selecting the investment options available to participants in the system's plans and ensuring proper administration of plan contributions.

The federal law governing private pension plans, the Employee Retirement Income Security Act of 1974 (ERISA), also establishes fiduciary responsibilities. While ERISA does not apply to state plans, including MnSCU's pension plans, federal standards closely reflect the common law of trusts applicable to pension plans so ERISA standards can provide useful guidance for the administration of state plans.

COVERED PLANS

The proposed board policy on pension plan fiduciary duties codifies in Board policy the fiduciary duties of the Board and employees directly involved in the management of the system pension plans. Two of the system plans, IRAP and SRP, are specifically identified as plans covered by the fiduciary duty requirements in Minn. Stat. Ch. 356A. While Ch. 356A does not specifically address the system's TSA plan as a covered plan, the proposed policy includes the TSA plan for these purposes, as well. This is to ensure that each fiduciary understands their role with regard to TSA as well as the other plans, and because TSA is administered under the same guidance and using the same administrative processes as IRAP and SRP.

A second reading of the proposed policy by the Board is anticipated in June, 2012.

RECOMMENDED COMMITTEE ACTION:

The Joint Finance and Facilities Committee and Human Resources Committee recommends the Board of Trustees adopt the following motion:

The Board of Trustees approves Policy 1C.4 Fiduciary Duty – System Pension Plans as shown in Attachment A.

RECOMMENDED MOTION:

The Board of Trustees approves Policy 1C.4 Fiduciary Duty – System Pension Plans as shown in Attachment A.

Date Submitted to the Board of Trustees: May 15, 2012

First Reading

ATTACHMENT A

BOARD OF TRUSTEES
MINNESOTA STATE COLLEGES AND UNIVERSITIES

BOARD POLICY		**1C.4**
Chapter	#1C	Chapter Name Code of Conduct and Ethics
Section	#1C.4	Fiduciary Duty—System Pension Plans

[NOTE: Shaded areas indicate language substantially identical to Minnesota Statutes, including Minn. Stat. section 356.001 and Ch. 356A.]

Part 1. Purpose.
The Board of Trustees is responsible for oversight of the system pension plans administered by the system. The Board's policy is to administer its plans in accordance with Minn. Stat. Ch. 356A. This policy establishes standards for the Board, individual trustees, and employees delegated responsibilities pursuant to this policy, to fulfill their fiduciary responsibilities in the administration of system pension plans.

Part 2. Definitions.
For purposes of this policy, the following terms have the meanings provided.

Subpart A. Fiduciary. Fiduciary includes an individual trustee, the Board of Trustees acting in its official capacity, and an employee delegated responsibility under this policy. A person ineligible for fiduciary status under Minn. Stat. § 356A.03 shall not serve as a fiduciary.

Subpart B. Investment guidelines and objectives. Investment guidelines and objectives means the document approved by the Investment Committee to guide system pension plan investments and administration.

Subpart C. System pension plan. System pension plan means the Individual Retirement Account Plan (IRAP) established under Minn. Stat. Ch. 354B, the Supplemental Retirement Plan established under Minn. Stat. Ch. 354C, and the Tax-Sheltered Annuity program established under Minn. Stat. § 136F.45.

Part 3. Fiduciary Conduct.
Subpart A. Duty owed. Consistent with Minn. Stat. § 356A.04, subd. 1, each fiduciary owes a fiduciary duty to:

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1. The active, deferred, and retired members of the system pension plans, who are its beneficiaries;
2. The taxpayers of the state, who help to finance the system pension plans; and
3. The State of Minnesota, which established the system pension plans.

Subpart B. Prudent person standard. Consistent with Minn. Stat. § 356A.04, subd. 2, each fiduciary shall act in good faith and shall exercise that degree of judgment and care, under the circumstances then prevailing, that persons of prudence, discretion, and intelligence would exercise in the management of their own affairs, not for speculation, considering the probable safety of the plan capital as well as the probable investment return to be derived from the assets.

Subpart C. Applicability. The activities of fiduciaries under this policy must be carried out faithfully, without prejudice, and in a manner consistent with law and system pension plan documents, solely to:

1. Provide authorized benefits to system pension plan participants and beneficiaries;
2. Incur and pay reasonable and necessary administrative expenses; or
3. Manage a system pension plan in accordance with the purposes and intent of the plan document.

Subpart D. Fiduciary activity. The activities of a fiduciary that must be carried out in accordance with the requirements of Minn. Stat. Ch. 356A, other applicable law and this policy include, but are not limited to:

1. Exercising cofiduciary oversight as required by Minn. Stat. § 356A.10;
2. The investment and reinvestment of system pension plan assets;
3. The determination of benefits;
4. The determination of eligibility for membership or benefits;
5. The determination of the amount or duration of benefits;
6. The determination of funding requirements or the amounts of contributions, to the extent applicable;
7. The maintenance of membership or financial records;
8. The reasonable expenditure of plan assets;
9. The selection of financial institutions and investment products; and
10. Other activities involving the overall management of a system pension plan.

Subpart E. Duty of loyalty. System pension plans are established and must be maintained for the exclusive benefit of the members and the members' beneficiaries. Fiduciaries and advisory committee members are prohibited from receiving any direct or indirect compensation, fee or other item of more than nominal value from any third party in consideration of a system pension plan disbursement. Fiduciaries and

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advisory committee members are prohibited from personally profiting directly or indirectly as a result of their responsibilities for administration of a system pension plan, as a result of the investment or management of system pension plan assets, except for reimbursement of reasonable, approved expenses associated with their duties under this policy, including membership in or receipt of benefits from a pension plan.

Part 4. Board Duties.

Subpart A. Fiduciary responsibility. The Board of Trustees and its individual members are fiduciaries of the system pension plans. The Board shall oversee the administration of the system pension plans in accordance with federal and state law and this policy.

Subpart B. Pension plan administrator approval. The Board is responsible for approving the selection of the system pension plan administrator.

Part 5. Investment Committee.

Subpart A. Composition. The investment committee shall comprise the vice chancellor for finance and one other vice chancellor delegated by the chancellor. The chancellor may delegate additional employees as advisors to the investment committee regarding the system pension plan and its administration.

Subpart B. Duties. The investment committee shall be responsible for preparation and submission of system pension plan documents and amendments to the Internal Revenue Service or other regulatory bodies, negotiation of contracts for the plan administrator selected by the Board, obtaining expert consultation, selecting investment options available to system pension plan participants, and other duties related to the proper administration of system pension plans. All system pension plan investment and administrative decisions made by the investment committee and the system pension plan administrator must comply with the approved guidelines and state laws relating to investment of pension funds.

Part 6. Advisory Committee.

Subpart A. Composition. The advisory committee shall include at least seven and not more than nine members. Members shall be eligible current employees and shall include no more than two representatives from each affected bargaining group, appointed by the exclusive representative for the bargaining group. Additional members representing affected personnel plans may be appointed by the chancellor. Terms of each member shall be three years; to the extent possible, terms shall be staggered to ensure continuity. No advisory committee member shall serve more than two consecutive terms.

Subpart B. Role. The advisory committee advises the investment committee on the structure and operation of system pension plans; consults with industry experts on the

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selection of financial institutions and types of investment products offered by the plan; and advises the chancellor or designee and the investment committee on the administration of the system pension plans, including selection of a third-party administrator.

Part 7. Continuing Fiduciary Education Plan.
It is the responsibility of each fiduciary and advisory committee member to make reasonable efforts to obtain the knowledge and skills needed to adequately perform their respective responsibilities under this policy.

The chancellor annually shall provide continuing education opportunities to fiduciaries and advisory committee members designed to provide them with knowledge and skills needed to adequately perform their responsibilities for system pension plans. The training shall include:

a. Review of system pension plans, the related statutory authority, and related IRS plan documents.
b. Review of system pension plan fiduciary responsibilities as provided by state law and this policy.
c. Periodic briefings on the duties and performance history of the system's contracted pension plan administrator.
d. Annual review of the system's statement of investment guidelines and objectives, including investment option selection criteria.
e. Briefings as needed on topics of special interest or concern.

Part 8. Indemnification; Reporting.
Subpart A. Indemnification. Every fiduciary, advisory committee member or other employee with responsibilities delegated pursuant to this policy shall be entitled to indemnification from liability for fiduciary breach related to system pension plan decisions or oversight and shall be held harmless from reasonable costs or expenses incurred as a result of any actual or threatened litigation or other proceedings, subject to the standards and procedures for representation and indemnification under Minn. Stat. § 3.736, as determined by the Board.

Subpart B. Reports to the Board.

1. Compliance. The chancellor timely shall report to the Board any legal, policy compliance, or other significant issues affecting system pension plan administration.

2. Annual report. The chancellor annually shall provide to the Board a plan performance review, and a report on substantive administrative or plan changes and fiduciary education provided.

Date of Adoption: *6/20/2012 (proposed)*
Date of Implementation: *6/20/2012 (proposed)*

ATTACHMENTS

The following attachments provide additional detailed information:

Attachment A	Proposed Board Policy 1C.4
Attachment B	Program Administration Overview
Attachment C	Overview of Pension Plans Applicable to System Employees

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PROGRAM ADMINSTRATION OVERVIEW

In order to effectively manage the complex administrative requirements for the system's pension plans and ensure compliance with federal and state law, the system contracts with a third party administrator, an investment advisor, and specialized legal counsel, described below.

1. Third Party Administrator

The administrative requirements of the system pension plans (IRAP, SRP and TSA) are managed in conjunction with TIAA-CREF, the third party administrator for the system's pension plans.[1] Oversight and coordination of pension related matters are provided by system office finance and human resources staff. Campus and system office human resources staff manage the enrollment and education of their respective employees. The system office finance division handles financial reporting and contract administration. As part of its third party administrator responsibilities, TIAA-CREF provides record keeping related services, including:

- Providing custody of plan assets;
- Providing participants with quarterly and annual asset statements;
- Processing and investing all payroll contributions as directed by each plan participant, on a bi-weekly basis;
- Processing payment of withdrawals and distributions to plan participants;
- Providing record-keeping reports and plan-related communications to the system and system pension plan participants;
- Hosting a website customized for MnSCU plan participants;
- Providing a dedicated 800-telephone call center for MnSCU plan participants;
- Providing training to campus human resources administrators and monthly financial education webinars to plan participants; and
- Providing compliance testing for contribution limits.

2. Investment Advisor

The investment advisor firm Hewitt EnnisKnupp serves as investment advisor to the system pension plans, assisting in the selection and monitoring of investment options available to participants in system pension plans, including:

- Providing expertise in the selection of the third party administrator;

[1] The Board reviewed and approved the third party administrator contract in March, 2011; the current contract term is through 2016.

- Conducting a “best in class” fund analysis of investment funds offered to system pension plan participants;
- Preparation of a Statement of Investment Guidelines and Objectives for the Investment Committee’s consideration and approval.
- Monitoring the performance of investment funds available to system pension plan participants against the pre-selected benchmarks in the Statement of Investment Guidelines and Objectives;
- Preparing a quarterly analysis and report of economic conditions and fund performance in accordance with the Investment Guidelines and Objectives and presenting the report to the Investment Committee and the DCR Advisory Committee;
- Recommending funds to be placed on a watch-list for continuing availability and regularly monitoring those funds against appropriate benchmarks and other criteria as listed in the Investment Guidelines; and
- Recommending funds for replacement or elimination to the Advisory Committee and Investment Committee.

3. Special Outside Counsel

Technical and legal expertise on plan and related issues is provided by Leonard Street and Deinard, P.A., under a special attorney appointment by the Office of the Attorney General.

4. Statement of Investment Guidelines and Objectives

A Statement of Investment Guidelines and Objectives is used to assist the system, the Investment Committee, and the investment advisor in effectively supervising and managing the assets of the three defined contribution retirement plans managed by the system (IRAP, SRP and TSA).

This Statement of Investment Guidelines and Objectives:

- Describes the investment philosophy and performance objectives for funds available through the system pension plans;
- Defines the delegation of responsibilities of the Investment Committee, the investment fund manager, the investment advisor, the third party administrator and recordkeeper, system pension plan participants and the Board as plan sponsor;
- Describes the current investment structure and options;
- Outlines the investment guidelines for funds available through system plans; and
- Establishes criteria for selecting, monitoring and evaluating the performance of the investment options available to system pension plan participants, including the watch list policy. The watch list policy provides guidance to

evaluate fund performance over time as measured against comparable industry bench marks.

The Investment Guidelines are reviewed at least annually by the Investment Committee in consultation with the investment advisor and are subject to period revision to ensure that they continue to reflect the best interests of system pension plan participants

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OVERVIEW OF PENSION PLANS AVAILABLE TO MNSCU EMPLOYEES

Almost all Minnesota State Colleges and Universities employees are required to participate in one of the primary retirement plans available through the State of Minnesota or the system. A variety of plans cover current employees; only those plans open to new employees are listed below. The following general information should also be noted:

- Automatic retirement plan deductions are sheltered from federal or state income tax.
- Employee and employer contributions vary according to specific plans.
- Several retirement plans are provided by the state depending on employment status.
- Certain unclassified employees (generally, those who have always been employed for less than 25% of a full-time position) may not be covered.

I. PLANS ADMINISTERED BY MINNESOTA STATE COLLEGES AND UNIVERSITIES

A. Defined Contribution Retirement (DCR) Plans

The DCR consists of two parts: a primary retirement plan called the Individual Retirement Account Plan (IRAP), and a Supplemental Retirement Plan (SRP).

Participation in the DCR is mandatory for new unclassified employees who are employed 25% time or more of a full academic year excluding summer session. Once eligibility is met, an employee remains eligible even if their level of employment is less than 25% in later years.

1. Individual Retirement Account Plan (IRAP)
Minn. Stat. Ch. 354B, IRC § 401(a)

IRAP is a defined contribution plan in which retirement benefits are based on the dollar amount in the employee's account at retirement. Under Minnesota law, employees contribute 4.5% of earnings, and the state provides a 6.0% matching contribution. The account, which includes employee contributions, employer contributions, and investment earnings, belongs to the employee beginning on the date of the first contribution. The employee makes all the investment decisions, and can change the investment funds as often as allowed by the fund managers.

With certain statutory exceptions, system employees are automatically enrolled in the Individual Retirement Account Plan (IRAP) program upon eligibility. Employees have up to one year to make an irrevocable decision to participate in the Teachers

Retirement Association (TRA), a Defined Benefit Plan, in lieu of IRAP. Individuals who elect TRA as their primary plan will be moved prospectively to that program.

2. Supplemental Retirement Plan (SRP)
Minn. Stat. Ch. 354C, IRC § 401(a)
Participation in SRP is mandatory following two years of full-time covered service regardless of whether the employee remains in IRAP or has elected TRA. SRP is a defined contribution plan with the same investment vendors as the IRAP plan. The employee and employer contributions vary depending on the union contract or personnel plan.

B. MnSCU Tax Sheltered Annuity Program (TSA)

Minn. Stat. § 136F.45, IRC § 403(b)

In addition to the state's Deferred Compensation program, the System also sponsors a 403(b) Tax Sheltered Annuity (TSA) program, which is also a Defined Contribution Plan. The investment choices for the TSA program are the same as those offered in the IRAP and SRP funds. Both a pre-tax plan and a post-tax (Roth) option are available.

II. PLANS ADMINISTERED BY OTHER STATE ENTITIES

Minnesota State Colleges and Universities has no role in administration of the following plans established in law and administered by other state entities.

A. Minnesota State Retirement System (MSRS)

The MSRS general plan is a defined benefit plan that covers most state employees in the classified service. The MSRS unclassified plan covers some administrators depending on their work history.

B. Teachers Retirement Association (TRA)

TRA is a defined benefit plan which provides a retirement benefit based on a formula that takes into account employee years of service, highest average salary earned during any five consecutive years of service, and age at retirement. Taxes on all contributions to the TRA plan are deferred until withdrawal.

C. State of Minnesota Deferred Compensation Program

The state's Deferred Compensation Plan (IRC Section 457 plan) is administered by the Minnesota State Retirement System (MSRS). Classified employees under

American Federation of State, County and Municipal Employees (AFSCME), Minnesota Nurses Association (MNA), Minnesota Government Engineers Council (MGEC), Managerial Plan, Commissioner's Plan, Minnesota Association of Professional Employees (MAPE), and Middle Management Association (MMA) may voluntarily make contributions and may receive a matching contribution from the State. Unclassified faculty and staff may also participate in this program, but without a State matching contribution.