MINNESOTA STATE COLLEGES AND UNIVERSITIES
BOARD OF TRUSTEES

Agenda Item Summary Sheet

Committee: Board of Trustees **Date of Meeting:** March 20, 2013

Agenda Item: Fiduciary Training on Retirement Program

☐ Proposed Policy Change ☐ Approvals Required by Policy ☐ Other Approvals ☐ Monitoring

☒ Information

Cite policy requirement, or explain why item is on the Board agenda: Board Policy 1C.4 part 7, provides guidance on the continuing education expectations for the Board of Trustees as a part of its oversight of the system-sponsored defined contribution plans. The purpose of the report is to provide a high level overview of the system's pension program, review of board policy, and a discussion of the responsibilities of the plan fiduciaries.

Scheduled Presenter(s): Laura M. King, Vice Chancellor of Finance – CFO
William Brady, Interim Director for Retirement Administration
Gail M. Olson, General Counsel
Scott Miller, Hewitt EnnisKnupp

Outline of Key Points/Policy Issues: This overview will provide context for board members regarding Minnesota State Colleges and Universities' retirement program. The Board of Trustees is responsible for the oversight of the system-sponsored defined contribution plans established in state law: Individual Retirement Account Plan (IRAP), Supplemental Retirement Plan (SRP), and Tax Sheltered Annuity Plan (TSA). The three plans have total assets of $1.492 billion and 19,170 participants.

Background Information: In 1995, MnSCU had 14 different retirement plans. Since then, the MnSCU retirement options have been simplified and consolidated to assist employees with overall retirement readiness and reduction of administrative complexity. The existing plans listed above are all defined contribution programs that serve current and former employees.

Background Reading (attached):

- Overview of system retirement plans
- Overview of Board Policy 1C.4
- Board Policy 1C.4
- Overview of the board's fiduciary responsibilities
- MnSCU retirement plans at a glance
- 2012 financial statements extract
- Glossary of terms

Overview of System Retirement Plans

I. <u>Oversight</u> The Board of Trustees is responsible for **oversight** of the system-sponsored defined contribution plans established in state law:
   a. Individual Retirement Account Plan (IRAP)
   b. Supplemental Retirement Plan (SRP)
   c. Tax Sheltered Annuity Plan (TSA)

II. <u>History</u>
   a. In 1995, MnSCU had **14** different retirement plans with over 100 investment options
   b. Significant strides have been made to simplify and consolidate MnSCU retirement options
      i. Greater simplicity assists employees with overall retirement-readiness and reduces administrative complexity.
      ii. MnSCU now operates three retirement programs—all defined contribution programs.
      iii. Some employees are also eligible for state-administered defined benefit programs, such as the Teachers' Retirement Association (TRA), Minnesota State Retirement System (MSRS), and the Public Employees Retirement Association (PERA)
   c. MnSCU and state plans serve current and former employees

III. <u>Defined Contributions vs. Defined Benefit</u>
   a. Defined contribution plans:
      i. Do not guarantee a specific benefit
      ii. Benefit amount received by retired employee is dependent exclusively on contributions made to the plan and investment returns
      iii. Because of contribution-based funding design, employers do <u>not</u> accrue unfunded liability
      iv. **All plans administered by MnSCU are defined contribution plans**
   b. Defined benefit plans:
      i. Guarantee a specific benefit based on salary and years of service
      ii. The amount of benefit received by retired employee is not affected by investment returns or other market forces
      iii. If not properly managed, the amount of benefits guaranteed to retirees can exceed the funds available

IV. <u>MnSCU Employee Groups and Retirement Program Participation</u>
   a. MnSCU's defined contribution plans
      i. IRAP & SRP

1. Faculty (IFO, MSCF, & MSUAASF)
    a. Faculty may elect between IRAP and TRA
2. Administrators
3. Unclassified Academic Employees (MAPE, MMA)
    a. MAPE and MMA employees can be either classified or unclassified, depending on the position

ii. TSA
1. Open to all system employees

b. Statewide defined benefit plans (administered by State of Minnesota)

i. Teacher's Retirement Association (TRA)
1. Faculty (IFO, MSCF, & MSUAASF)
    a. Faculty may elect between IRAP and TRA

ii. Minnesota State Retirement System (MSRS)
1. Classified Employees (AFSCME, MAPE, MMA)
    a. MAPE and MMA employees can be either classified or unclassified, depending on the position
2. Some administrators, depending on work history

V. <u>MnSCU's Retirement Plans – Overview</u>

a. Three plans: Individual Retirement Account Plan (IRAP); Supplemental Retirement Plan (SRP); and Tax Sheltered Annuity Plan (TSA)
b. Total assets for all three MnSCU plans: $1.492 billion (as of 12/31/12)
c. Total number of participants for all three MnSCU plans: 19,170 (as of 12/31/12)
d. Participants include both active and separated/retired employees
e. Participating employee groups:

i. IRAP & SRP
1. Faculty (IFO, MSCF, & MSUAASF)
2. Administrators
3. Unclassified Academic Employees (MAPE, MMA)

ii. TSA
1. Open to all system employees

f. MnSCU financial statements contain the assets for the IRAP and SRP programs as of June 30,2012 and 2011. The TSA assets, as a voluntary program, are not reported on the MnSCU financial statements.

VI. <u>IRAP (Individual Retirement Account Plan)</u>

a. IRAP Total Assets: $657,904,968 (as of 12/31/12)
b. IRAP Total Participants: 14,638 (as of 12/31/12)
c. Who Pays for the IRAP Plan?

i. Employee Contributions: 4.5% of employee's gross income
ii. Employer Contributions: 6% of employee's gross income

d. IRAP Plan Characteristics:
   i. **Primary, mandatory plan** for most unclassified employees.
   ii. Eligible employees working more than 25% time are automatically enrolled (but faculty may elect to move to the Teacher's Retirement Association (TRA) program, a defined benefit plan).
   iii. The plan features immediate vesting, meaning there is no waiting period for employees to "own" the funds in the account and take a qualified distribution or transfer funds to another plan upon separation.
   iv. Employees select the funds in which they wish to invest their assets

VII. <u>SRP (Supplemental Retirement Plan)</u>

a. SRP Total Assets: $568,597,788 (as of 12/31/12)
b. SRP Total Participants: 10,965 (as of 12/31/12)
c. Who Pays for the SRP Plan?
   i. Employee Contributions: 5% of gross income over $6,000 (to a maximum specified in contract/plan)
   ii. Employer Contributions: 5% of gross income over $6,000 (to a maximum specified in contract/plan)
d. SRP Plan Characteristics:
   i. Applies to all unclassified employees; participation is **mandatory** after reaching two years of full-time service in a qualifying position.
   ii. SRP features the same investment options available under IRAP

VIII. <u>TSA (Tax Sheltered Annuity Plan)</u>

a. TSA Total Assets: $266,008,477 (as of 12/31/12)
b. TSA Total Participants: 4,253 (as of 12/31/12)
c. Who Pays for the TSA Plan?
   i. Funded exclusively by employee; no employer contributions
   ii. Employee Contribution Limits: 100% of taxable income not to exceed $17,500 or $23,000 for those age 50 and older
d. Plan Characteristics:
   i. Open to all system employees on a **voluntary** basis.
   ii. Currently, approximately 25% to 30% of employees choose to participate in TSA.
   iii. TSA features the same investment options available under IRAP & SRP

IX. <u>Responsibility over System Retirement Plans</u>

a. Responsibility is vested in:
    i. Board of Trustees
    ii. Chancellor
    iii. Investment Committee
    iv. Advisory Committee
    v. Plan Administrator
    vi. Investment Advisor
b. Board of Trustees. Under Board Policy 1C.4, the Board's primary roles include:
    i. Selection of the system pension plan administrator and investment advisor.
        1. Current Plan Administrator: TIAA-CREF
        2. Current Investment Advisor: Hewitt EnnisKnupp
    ii. Oversight of the administration of the system pension plans, rather than direct involvement in determining pension investment options and administrative functions.
c. Investment Committee
    i. Authorized by Board Policy 1C.4, part 5
    ii. Composed of:
        1. Vice Chancellor of Finance
        2. Vice Chancellor of Human Resources
    iii. Facilitated by the system's director of retirement administration
    iv. Responsible for:
        1. Preparation and submission of system pension plan documents and amendments to the Internal Revenue Service or other entities
        2. Negotiation of contracts for the plan administrator selected by the board
        3. Obtaining expert consultation; and
        4. Selecting investment options available to plan participants
d. DCR Advisory Committee
    i. Authorized by Board Policy 1C.4, part 6
    ii. Advises the Investment Committee on issues surrounding operation, structure, and administration of the system's defined contribution pension plans
    iii. Composed of 7-9 members, including:
        1. Representatives of each bargaining unit with unclassified members in the defined contribution pension plans
            a. IFO, MSCF, MSUAASF, MMA, & MAPE

2. System administrators

e. Plan Administrator (TIAA-CREF)
   i. Outside administrator and record-keeper chosen through competitive RFP (request for proposal) process
   ii. TIAA-CREF is a national financial services company with history of providing retirement services to higher education institutions
   iii. TIAA-CREF provides several retirement annuity products available to MnSCU plan participants.
   iv. TIAA-CREF provides an array of services to the system and plan participants including:
      1. Answering participant questions in its call center through a MnSCU-dedicated phone number
      2. A website where participants can gain access to their retirement portfolio and make changes to their investment lineup
      3. Providing one-on-one, individualized retirement investment advice to participants at their campus/system office location
      4. Meeting with system representatives throughout the year
         a. Quarterly Defined Contribution Retirement Advisory Committee Meetings
         b. Monthly retirement issues conference calls with human resources staff
   v. In 2012, TIAA-CREF:
      1. Made 236 visits to MnSCU institutions and conducted 1,420 face-to-face meetings with system employees
      2. Handled 8,076 calls from plan participants through its call center and dedicated MnSCU phone number.

f. Investment Advisor (Hewitt EnnisKnupp)
   i. Chosen through competitive RFP (request for proposal) process
   ii. Hewitt EnnisKnupp is a global investment consulting firm
   iii. Recommends fund line up and monitors fund performance
   iv. Meets with the MnSCU Investment Committee quarterly to:
      1. review fund performance
      2. discuss overall market trends
      3. provide advice on plan design
   v. Monitors the “watch list” of funds performing below benchmarks
   vi. Makes recommendations to the Investment Committee regarding the system’s fund line-up
   vii. Assists with fiduciary training to the Board of Trustees and the Advisory Committee

X. <u>Statewide Pension Plans not administered by MnSCU</u>

a. MnSCU has no role in administration of the following plans established in law and administered by other state entities, but system employees may be included in these plans:
   i. Minnesota State Retirement System (MSRS):
      1. Defined benefit plan that covers most state employees in the classified service.
      2. Includes some MnSCU administrators, all AFSCME employees and all classified MAPE and MMA employees.
   ii. Teachers Retirement Association (TRA):
      1. Defined benefit plan for teachers, faculty
      2. Benefit based on a formula that includes employee years of service, highest average salary earned during any five consecutive years of service, and age at retirement.
      3. Plan may include MnSCU faculty employed at the time of the 1995 merger or faculty who opt to move to TRA from IRAP.
   iii. State of Minnesota Deferred Compensation Program:
      1. The state's Deferred Compensation Plan (IRC Section 457 plan) is administered by the Minnesota State Retirement System (MSRS).
      2. The deferred compensation plan is a voluntary, defined contribution plan.
      3. Any MnSCU employee may choose to participate in the program

XI. <u>Statement of Investment Guidelines</u>

a. The guidelines are used to assist the Investment Committee and Investment Advisor in supervising and managing the assets of the system's three defined contribution retirement plans
   i. Describes the investment philosophy and performance objectives
   ii. Defines the delegation of responsibilities
   iii. Describes the current investment structure and options
   iv. Outlines the investment guidelines for funds available through system plans
   v. Establishes criteria for selecting, monitoring and evaluating the performance of investment options
b. The guidelines are reviewed at least annually by the Investment Committee in consultation with the investment advisor.

c. The guidelines are subject to periodic revision to ensure that they continue to reflect the best interests of system pension plan participants.
d. Board Policy 1C provides for the board to annually review of the system's statement of investment guidelines and objectives, including investment option selection criteria

Overview of Board Policy 1C.4, Fiduciary Duty
System Pension Plans

I. Background

   a. In 2009, the legislature transferred responsibility for selecting pension plan investment options from the State Board of Investment to the Minnesota State Colleges and Universities
   b. State law imposes strict fiduciary responsibilities for administration of all state pension plans, including both defined contribution and defined benefit plans
   c. In 2012, the Board adopted Board Policy 1C.4 Fiduciary Duty – System Pension Plans

II. Scope

   a. Board policy 1C.4 establishes:
      i. Roles and Responsibilities of Board, Investment Committee, and DCR Committee
      ii. Fiduciary Standards
      iii. Fiduciary training requirements

III. Who Are Fiduciaries?

   a. Board of Trustees
   b. Individual Trustees
   c. Employees delegated responsibility under Board Policy 1C.4
      i. Includes Chancellor, Investment Committee members
      ii. May include others depending on responsibilities

IV. To Whom is the Duty Owed?

   a. Pursuant to Minn. Stat. § 356A.04, subd. 1 & Board Policy 1C.4, Part 3, a duty is owed to:
      i. Active, deferred and retired members of the system pension plans, who are its beneficiaries
      ii. Taxpayers of the state, who help to finance the plans
      iii. The State of Minnesota, which established the plans.

V. Prudent Person Standard

   a. Fiduciaries must:
      i. Act in good faith
      ii. Exercise judgment and care that would be used by person of prudence, discretion and intelligence for their own interests

   iii. Not be speculative, but instead consider the safety of the plan capital and probable investment return

VI. Fiduciary Activities
   a. Activities must be carried out:
      i. Faithfully, without prejudice, consistent with law and plan documents
      ii. Solely to provide benefits to participants and beneficiaries
   b. Activities must incur and pay only reasonable and necessary administrative expenses
   c. Oversight activities must manage system pension plans in accordance with plan documents
   d. Examples of Fiduciary Activities:
      i. Exercising cofiduciary oversight as required by Minn. Stat. § 356A.10;
      ii. The investment and reinvestment of system pension plan assets;
      iii. The determination of benefits;
      iv. The determination of eligibility for membership or benefits;
      v. The determination of the amount or duration of benefits;
      vi. The determination of funding requirements or the amounts of contributions, to the extent applicable;
      vii. The maintenance of membership or financial records;
      viii. The reasonable expenditure of plan assets;
      ix. The selection of financial institutions and investment products; and
      x. Other activities involving the overall management of a system pension plan.

VII. Duty of Loyalty
   a. Plans are established for exclusive benefit of members and beneficiaries
   b. Fiduciaries must not:
      i. Receive direct or indirect compensation, fee, other item of more than nominal value from 3rd party in consideration of pension plan disbursement
   c. Fiduciaries must not profit directly or indirectly because of:
      i. Responsibilities for pension plan administration
      ii. The investment or management of system pension plan assets (except reimbursement of reasonable, approved expenses)

VIII. Continuing Fiduciary Education
   a. Education should include:
      i. Review of system pension plans, statutory authority, IRS plan documents
      ii. Review of fiduciary responsibilities

iii. Periodic briefings on duties and performance history of system pension plan administrator
iv. Annual review of system's statement of investment guidelines and objectives, including investment selection criteria
v. Other items of interest or concern

IX. <u>Indemnification</u>

a. Every fiduciary, advisory committee member or other employee with plan responsibilities is entitled to indemnification from liability for fiduciary breach related to plan decisions or oversight, subject to state law

X. <u>Reporting</u>

a. Chancellor to timely report significant legal or other issues affecting system pension plan administration
b. Chancellor to annually report on plan performance and any substantive administrative or plan changes and fiduciary education provided

1C.4 Fiduciary Duty - System Pension Plans

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:

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 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. Contract approval. The Board is responsible for approving the selection of the system pension plan administrator and investment advisor.

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 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: *06/20/12,*
Date of Implementation: *06/20/12,*

Date and Subject of Revision:

Overview of Board's Fiduciary Responsibilities

I. Parties to a Trust and Their Roles

a. Settlor – Creator of the Trust (State of Minnesota).
b. Trustees – Those who oversee the trust.
c. Beneficiaries – Those who are intended to receive payments from the Trust, including members, retirees, and survivors of deceased members.
d. Settlor decisions/functions are subject to the business judgment rule rather than fiduciary rules.
    i. Implementation of settlor decisions is subject to fiduciary rules
    ii. Costs relating to settlor role (e.g., advice on plan design or accounting requirements imposed on employer) typically cannot be paid by plan assets
    iii. Costs of implementing a settlor decision may be payable from the plan

II. Who Are Fiduciaries?

a. Generally a fiduciary is someone that stands in a special relation of trust, confidence, or responsibility in certain obligations to others.
b. Fiduciary includes an individual trustee, the Board of Trustees acting in its official capacity, and an employee delegated responsibility under Board policy. *Board Policy 1C.4*
c. All Trustees are fiduciaries, without exception.
d. De Facto fiduciaries
    i. One can become a "de facto" fiduciary by assuming responsibilities even though the responsibilities have not been assigned
    ii. Examples
        1. an actuary acted as the investment consultant
        2. a board member acted as an investment manager
        3. an executive director managed assets "on the side" for the fund
        4. one staff member volunteering to do another's job

III. Basic Fiduciary Duties

a. Numerous fiduciary duties exist but most fall under three basic duties:
    i. The duty of **prudence** requires expertise and more than a good faith attempt to do the right thing
    ii. The duty of **loyalty** requires a steadfast commitment to stay focused on the interests of the beneficiaries of the fund

iii. The duty to **follow laws** requires compliance with federal and state laws, rules and regulations and relevant court decisions

b. Duty of Prudence

i. "**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."

ii. Prudence standards evolve over time, getting higher as more complex issues arise

iii. Prudence requires good judgment and informed decision-making

1. It is not impolite to question the "experts"
2. At times you may need to hear what you don't want to hear from those advising you (investment staff, attorneys, consultants, etc.)

iv. Delegation of Duties

1. Trustees need not perform all functions of the organization.
2. General trust law <u>allows</u> and <u>even encourages</u> the delegation of duties.
3. Delegation must be done with care and "agents" must be carefully selected.
4. It is best to have clear, understandable, written position descriptions, statements of delegation, contracts, and performance criteria.
5. Ongoing monitoring by the Trustees is necessary.
6. Trustees have a duty to take action and make changes if their agents are performing poorly.

c. The Duty of Loyalty

i. "**Duty owed.** Consistent with Minn. Stat. § 356A.04, subd. 1, each fiduciary owes a fiduciary duty to:

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."

- ii. The duty of loyalty has remained rigid over time
- iii. Historical interpretation of loyalty:
  1. Fiduciaries can **"only wear one hat"**
  2. The law has been very clear about the requirements of loyalty
  3. Courts have been strict and consistent in their rulings
  4. Trustees are not to balance interests of outside parties
- iv. Practicing Loyalty
  1. Avoid conflicts of interest, or even the appearance of conflicts.
  2. If avoidance is impossible, disclose your conflicts promptly and manage them to the best of your ability.
  3. Sometimes this means recusing yourself from votes or forgoing other actions you would like to take.
  4. Fiduciary duty takes precedence over other duties – fiduciary duty has been called the "highest duty imposed by law".
  5. The courts are extremely strict on fiduciaries who have conflicts of interest.
  6. The "court of public opinion" is very strict as well.
  7. The laws are complex so if in doubt about whether or not you have a conflict of interest, seek legal advice.

d. The Duty to Follow the Law
- i. State laws
  1. Statutes
  2. Administrative rules
- ii. Plan documents established pursuant to law
- iii. Federal laws
  1. Internal Revenue Code
  2. Securities laws

IV. <u>Additional Considerations</u>

a. Be sensitive to legal issues and the reputation of MnSCU.
b. Some actions might be legally permissible but not wise to pursue.
c. When in doubt about legal risks or compliance requirements, ask for advice.
d. Weigh the pros and cons of taking a certain path.
e. Legal issues and business issues sometimes collide and need thoughtful discussions.

V. <u>Fiduciary Liability</u>

a. Activities that may result in liability:
- i. Personal actions violating the trust

   ii. Breaches of loyalty or prudence; failure to follow the law
   iii. Criminal actions

b. The consequences of those activities can be severe:
   i. Personal liability for losses
      1. Restoration of profits
      2. Other equitable or remedial relief
      3. Loss of reputation
   ii. Potential criminal liability

c. Co-Fiduciary Liability
   i. If you **know** of a violation and do nothing about it, you are breaching **your** fiduciary duty
   ii. Trustees have a duty to remedy the fiduciary breaches of other fiduciaries
   iii. It is important to have a good process in place to deal with this

d. Avoiding Liability
   i. A thorough orientation and continuing education on fiduciary responsibility
   ii. A good understanding of common scenarios where fiduciary duties come into play
   iii. A pure, thorough and scrupulous decision-making <u>process</u> with clear <u>documentation</u> of actions and rationale
   iv. Expert advice from the staff, legal counsel, and others, when needed
   v. Good board governance policies including clear accountability and a commitment to ongoing oversight activities
   vi. Fiduciary insurance can help limit liability, as can indemnification from the plan sponsor.
   vii. Fiduciary bonds provide protection to the system, rather than the fiduciaries.

MnSCU Defined Contribution (DC) Plans

(All numbers as of 12/31/12)

Total Assets for all plans: $1.492 billion **Total Number of Participants: 19,170**

I. Individual Retirement Account Plan (IRAP) (Mandatory Participation)

Total Assets: $657,904,968 Total Participants: 14,638

Employee Contributions: 4.5% of gross income

Employer Contributions: 6% of gross income

Plan Characteristics: Unclassified employees working more than 25% time are automatically enrolled.

II. Supplemental Retirement Plan (SRP) (Mandatory Participation)

Total Assets: $568,597,788 Total Participants: 10,965

Employee Contributions: 5% of gross income over $6,000 (to a maximum specified in contract/plan)

Employer Contributions: 5% of gross income over $6,000 (to a maximum specified in contract/plan)

Plan Characteristics: Unclassified employees automatically enrolled beginning the July after reaching two years of full-time service in a qualifying position.

III. Tax Sheltered Annuity Plan (TSA) (Voluntary Participation)

Total Assets: $266,008,477 Total Participants: 4,253

Employee Contribution Limits: 100% of taxable income not to exceed $17,500 or $23,000 for those age 50 and older

Employer Contributions: None

Plan Characteristics: Open to all system employees on a voluntary basis. Currently, approximately 25% to 30% of employees choose to participate in TSA.

MINNESOTA STATE COLLEGES AND UNIVERSITIES
STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS HELD FOR PENSION BENEFITS
MINNESOTA STATE COLLEGES AND UNIVERSITIES DEFINED CONTRIBUTION RETIREMENT FUND
FOR THE YEARS ENDED JUNE 30, 2012 AND 2011
(IN THOUSANDS)

	2012	2011
Additions:		
Contributions		
Employer	$ -	$ 41,307
Member	-	34,853
Contributions from roll overs and other sources	-	1,901
Total Contributions	-	78,060
Net Investment Gain (Loss)	-	178,092
Total Additions	-	256,152
Deductions:		
Benefits and refunds paid to plan members	-	48,536
Administrative fees	-	324
Total Deductions	-	48,860
Net Increase (Decrease)	-	207,292
Net Assets Held in Trust for Pension Benefits, Beginning of Year	1,093,691	886,399
Net Assets Held in Trust for Pension Benefits, End of Year	$ 1,093,691	$ 1,093,691

The notes are an integral part of the concolidated financial statements.

GLOSSARY OF TERMS

ADVISORY COMMITTEE – The committee which is charged under board policy with advising and making recommendations to system leadership. (See DCR Advisory Committee, below.)

CO-FIDUCIARY – A person or entity that, because of their role as a fiduciary, has responsibilities for other fiduciaries.

DCR ADVISORY COMMITTEE – The Defined Contribution Retirement Advisory Committee is the name used for the advisory committee established by Board Policy 1C.4. The Committee advises and makes recommendations to the Investment Committee on matters related to system pension plan administration, operation, and structure. The DCR Committee is made up of representatives of the system, including administrators and unclassified union representatives.

DEFINED BENEFIT PLAN – A pension plan that guarantees a particular benefit based on salary and years of service.

DEFINED CONTRIBUTIONS PLAN – A retirement plan that pays a non-guaranteed benefit based exclusively on employer and employee contributions and the investment earnings on those contributions.

FIDUCIARY– A person or entity that, through designation or action, owes a duty of prudence and duty of loyalty to the beneficiaries of the retirement plan in all of their actions with regard to the plan.

IMMEDIATE VESTING – When a plan participant "immediately vests" they are fully entitled to all contributions and investment returns in their account, regardless of how long they have been participating in the plan.

INVESTMENT COMMITTEE – A committee established by Board Policy 1C.4 comprising the Vice Chancellor for Finance and Vice Chancellor for Human Resources. This committee is responsible for administering the system's pension plans, including selection of investment funds available to participants.

IRAP – Individual Retirement Plan Account, MnSCU's primary defined contribution plan, authorized by Minnesota Statutes, Chapter 354B.

PLAN ADMINISTRATOR – Currently TIAA-CREF, the plan administrator essentially operates the mechanics of the entire pension plan enterprise, with a particular focus on maintaining the individual accounts for all participants. Other duties include communication with participants, retirement counseling, financial transaction processing, and assisting with interpretation of plan documents.

SRP – Supplemental Retirement Plan, an additional defined contribution plan for qualifying unclassified MnSCU employees, authorized by Minnesota Statutes, Chapter 354C.

STATEMENT OF INVESTMENT GUIDELINES AND OBJECTIVES – A document created by the Investment Committee that outlines investment guidelines and the system's investment objectives as they relate to pension plans.

TSA – The Tax Sheltered Annuity Plan is a voluntary retirement program allowed under the Internal Revenue Code, Section 403(b).

VESTING – The period of time in which a plan participant must wait before they are entitled to the contributions and investment returns.

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Fiduciary Duties for MnSCU's Defined Contribution Plans: An Overview

March 20, 2013

Laura M. King, Vice Chancellor for Finance-CFO

William Brady, Interim Director for Retirement Administration

Gail M. Olson, General Counsel

Scott Miller, Hewitt EnnisKnupp

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Board of Trustees Oversight

The Board of Trustees is responsible for **oversight** of the system-sponsored defined contribution plans established in state law:

- Individual Retirement Account Plan (IRAP)
- Supplemental Retirement Plan (SRP)
- Tax Sheltered Annuity Plan (TSA)

MnSCU’s Pension Plans
IRAP, SRP, & TSA

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- Total Assets (as of 12/31/12):
  $1.492 billion
- Total Number of Participants (as of 12/31/12):
  19,170
- All plans require employee contributions
- IRAP & SRP have employer contributions
- Some employees may belong to other statewide defined benefit plans

Minnesota STATE COLLEGES & UNIVERSITIES

Role of the Board of Trustees

Under Board Policy 1C.4, the Board's primary roles include:

- Selection of the system pension plan administrator and investment advisor
  - Current Plan Administrator: TIAA-CREF
  - Current Investment Advisor: Hewitt EnnisKnupp
- Oversight of the administration of the system pension plans
  - System administrators are assigned responsibility for determining pension investment options and administrative functions.

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Who are Fiduciaries?

- **Fiduciary**. "Fiduciary includes an individual trustee, the Board of Trustees acting in its official capacity, and an employee delegated responsibility under this policy." *Board Policy 1C.4, Part 2*

- Generally a fiduciary is someone that stands in a special relation of trust, confidence, or responsibility in certain obligations to others.

- All trustees are fiduciaries, without exception.

Basic Fiduciary Duties

- Numerous fiduciary duties exist, but most fall under three basic duties:
  - The duty of **prudence** requires expertise and more than a good faith attempt to do the right thing.
  - The duty of **loyalty** requires a steadfast commitment to stay focused on the interests of the beneficiaries of the fund.
  - The duty to **follow laws** requires compliance with federal and state laws, rules and regulations and relevant court decisions.
- The duties are simple to state, but not so simple to follow.

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Slide 6

Minnesota STATE COLLEGES & UNIVERSITIES

Purpose of Fiduciary Activities

- Activities must be carried out faithfully, without prejudice, consistent with law and plan documents
- Solely to provide benefits to participants and beneficiaries
- Incur and pay only reasonable and necessary administrative expenses
- Manage system pension plans in accordance with plan documents

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Primary Fiduciary Activities of Board of Trustees

- Oversight of administration:
  - Maintenance of membership or financial records;
  - Reasonable expenditure of plan assets;
  - Selection of financial institutions and investment products
- Approval of contracts for Investment Advisor and Plan Administrator
- Other activities involving the overall management of a system pension plan

Prudent Person Standard

Fiduciaries must:

- Act in good faith
- Exercise judgment and care that would be used by person of prudence, discretion and intelligence for their own interests
- Not be speculative, but instead consider the safety of the plan capital and probable investment return

Board Policy 1C.4, Part 3

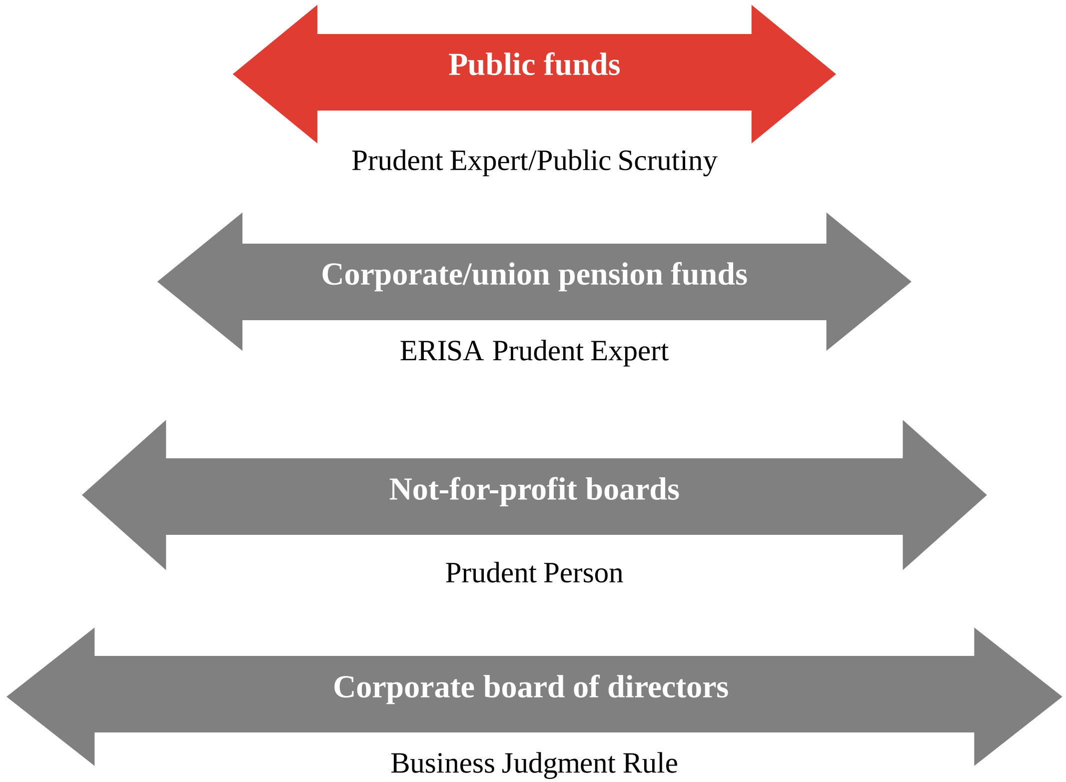
Minn. Stat. § 356A.04, subd. 2

The Duty of Prudence

- Prudence standards evolve over time, getting higher as more complex issues arise
- Prudence requires good judgment and informed decision-making
  - It is not impolite to question the “experts”
  - At times you may need to hear what you don’t want to hear from those advising you (investment staff, attorneys, consultants, etc.)
- Prudence requires more than a “good heart and an empty head”
- Delegation must be done with care and “agents” must be carefully selected

The Duty of Prudence

- The graphic below demonstrates the latitude allowed to fiduciaries for different types of systems and funds. It is important to note that trustees of public funds have the most narrow latitude.



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Final Points about the Duty of Prudence

- Careful, thorough, and scrupulous behavior is expected of trustees and those who work for them
- A good decision-making process is essential, regardless of outcome
- Trustees and other fiduciaries are not expected to be perfect, but are expected to be prudent

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The Duty of Loyalty

- **Duty owed.** Each fiduciary owes a fiduciary duty to:
  1. The active, deferred, and retired members of the 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.

  Board Policy 1C.4, Minn. Stat. § 356A.04, subd. 1

- The duty of loyalty has remained rigid over time
- Historical interpretation of loyalty:
  - Fiduciaries can **“only wear one hat”**
  - The law has been very clear about the requirements of loyalty
  - Courts have been strict and consistent in their rulings
  - Trustees are not to balance interests of outside parties

Duty of Loyalty

- Fiduciaries and advisory committee members must not:
  - Receive direct or indirect compensation, fee, other item of more than nominal value from 3rd party in consideration of pension plan disbursement

- Fiduciaries and Advisory Committee Members must not profit directly or indirectly because of:
  - Responsibilities for pension plan administration
  - The investment or management of system pension plan assets (except reimbursement of reasonable, approved expenses)

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Practicing Loyalty

- Avoid conflicts of interest, or even the appearance of conflicts
- If avoidance is impossible, disclose your conflicts promptly and manage them to the best of your ability
- Sometimes this means recusing yourself from votes or foregoing other actions you would like to take
- Fiduciary duty takes precedence over other duties – fiduciary duty has been called the “highest duty imposed by law”
- The courts are extremely strict on fiduciaries who have conflicts of interest
  - The “court of public opinion” is very strict as well
- The laws are complex so if in doubt about whether or not you have a conflict of interest, seek legal advice

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Final Points about the Duty of Loyalty

- Pension scandals in the corporate world have made many employees worry about their retirement security
- Public funds also have had their share of trouble and bad press
- An unwavering commitment to act solely for the benefit of the trust is expected of trustees
- Disappointing others outside the fund is not as serious or costly as violating fiduciary obligations

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The Duty to Follow the Law

- State laws
  - Statutes
  - Administrative rules
  - Plan documents established pursuant to law
- Federal laws
  - Internal Revenue Code
  - Securities Laws

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Additional Considerations

- Be sensitive to legal issues and the reputation of MnSCU
- Some actions might be legally permissible but not wise to pursue
- When in doubt about legal risks or compliance requirements, ask for advice
- Weigh the pros and cons of taking a certain path
- Legal issues and business issues sometimes collide and need thoughtful discussions

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Indemnification

Every fiduciary, advisory committee member or other employee with plan responsibilities is entitled to indemnification from liability for fiduciary breach related to plan decisions or oversight, subject to state law.

Board Policy 1C.4, Part 8.

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Fiduciary Liability

- Activities that may result in liability:
  - Personal actions violating the trust
  - Breaches of loyalty or prudence; failure to follow the law
  - Criminal actions
- The consequences of those activities can be severe:
  - Personal liability for losses, lost profits, other relief, loss of reputation
  - Potential criminal liability
- You are your brother’s keeper: being a co-fiduciary
  - Fiduciary breach if you know of a violation and do nothing
  - Trustees have a duty to remedy the fiduciary breaches of other fiduciaries
  - Important to have a good process in place to deal with this

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Tips for Avoiding Liability

- Thorough orientation and continuing education on fiduciary responsibility
- Good understanding of common scenarios where fiduciary duties arise
- Pure, thorough and scrupulous decision-making process with clear documentation of actions and rationale
- Expert advice from the staff, legal counsel, and others, when needed
- Good board governance policies including clear accountability and a commitment to ongoing oversight activities

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Key Issues for Public Boards, Defined Contribution Plans

- Ethics and conflicts of interests
  - Pay-to-play allegations have severely affected the public's perception of public retirement boards
  - Less likely with defined contribution plans
- Communication with plan members
- Documentation of plan activities, and retention of that documentation in a manner that is recoverable
- Eligibility determinations

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Summary of Fiduciary Duties

- All trustees are fiduciaries and have stringent legal requirements imposed upon them
  - consequences of breaching fiduciary duties are severe
- Trustees and the board may delegate certain duties but cannot abdicate overall fiduciary responsibility
- Three core duties:
  - Prudence
  - Loyalty
  - Legal Compliance
- When in doubt, seek advice about fiduciary issues

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Core Investment Principles

- Diversification
  - A broad range of investments, including at least three core options that are internally diversified, materially different in risk and return characteristics, and, in the aggregate, allow participants to minimize risk through diversification
- Benchmarking
  - Use of “Watch List” for funds not meeting benchmarks
- Vigilance
  - Timely and thorough review of fund performance, market trends, and employee retirement needs