Minutes[*]

Senate Committee on Faculty Affairs
Tuesday, February 8, 2010
2:30 – 4:15
238A Morrill Hall

Present: George Sheets (chair), Ben Bornsztein, Carol Carrier, Dann Chapman, Vladimir Cherkassky, Randy Croce, Kathryn Hanna, Frank Kulacki, Karen Miksch, Jason Shaw, Roderick Squires, Pamela Stenhjem, James Wojtaszek

Absent: Arlene Carney, Richard Cline, Valerie Khominich, Theodor Litman, Chris Orlic, Geoffrey Sirc

Guests: Vice President Richard Pfutzenreuter; Jackie Singer (Director of Retirement Benefits)

Other: Nan Wilhelmson (Human Resources),

[In these minutes: possible changes to the Faculty Retirement Plan: (1) the budget context; (2) retirement plan information; (3) options; (4) Retirement Incentives Option]

1. Possible Changes to the Faculty Retirement Plan: The Budget Context

Professor Sheets convened the meeting at 2:35 and welcomed Vice President Pfutzenreuter. He noted that there was only one item on the agenda and that several people would speak to it: Discussion of proposed changes to the Faculty Retirement Plan (FRP) that are being contemplated. This is the first Senate Committee meeting that includes presentations of the possible choices.

There is a perception among the public and others that the Faculty Retirement Plan and other public-employee retirement plans are overly-generous, Professor Sheets commented, and this perception has led to expressions of discontent about public-employee retirement plans. Those expressions of discontent do not distinguish between defined-benefit plans (which guarantee a certain payment when a person retires) and defined-contribution plans (which provide tax deferred employer and employee contributions to employees' private retirement accounts during the period of employment.). There is no public debt associated with the University's FRP, which is a defined-contribution plan, but public perceptions tend to lump the FRP together with the defined-benefit plans of other public employees in the state.

Moreover, Professor Sheets said, the current financial situation and the potential projected shortfall in the University's budget next year could have an impact on the University's retirement plans. The University, he noted, is obligated to have a balanced budget.

He thus invited Vice President Pfutzenreuter to provide information to the Committee on the budget challenge the University faces, after which Vice President Carrier and Ms. Singer will discuss the retirement plans.

---

[*] These minutes reflect discussion and debate at a meeting of a committee of the University of Minnesota Senate; none of the comments, conclusions, or actions reported in these minutes represents the views of, nor are they binding on, the Senate, the Administration, or the Board of Regents.

Vice President Pfutzenreuter began by talking about the way they approach developing the University's budget, something they do every year. Doing so this year will be more difficult because the situation is more polarized at the Capitol; he said he is unable to see what the endgame will be. They think about the budget in three steps: (1) projected annual budget needs, (2) the state appropriation, and (3) budget-balancing strategies (because the state appropriation is likely to decline). He noted that he was talking only about the FY12 budget.

In terms of projected annual needs, the University typically needs an additional $80-90 million each year to cover modest compensation increases, safety and contractual obligations, technology licenses and costs, student financial aid, facility operations, and strategic investments, Mr. Pfutzenreuter said. Some of the items on that list are fixed; others are variable. They then make assumptions about the state budget, which is harder to do this year. Because the budget process starts in the fall, with compact discussions with the support units, they have to make assumptions about projected annual needs and the state budget, in order to get to the third step, the budget-balancing strategies.

They have already identified reductions in the projected budget needs, Mr. Pfutzenreuter related. They have assumed no compensation increase for FY12 (subject to collective bargaining), a message the President communicated recently to the University community. Facility costs are going to be lower than usual because there are no new buildings coming on line and utility costs are dropping because of conservation and low prices, and they have reduced the desirable level of new programmatic investments. The net total projected needs stand at $41.6 million (which includes $16.8 million in fringe-benefit costs because of a complicated federal formula on calculating them that involves a lag of two years), facility operations of $4 million (which is less than the typical $10-12 million), contractual obligations of $5 million, programmatic investments of $10.5 million, and a contingency of $5.3 million in light of the uncertainty about what the outcome of the legislative process will be. Both the programmatic investment and contingency are variable; the amounts could be reduced if need be.

As for the state appropriation, Mr. Pfutzenreuter reported, the legislature set the base budget for the University for the FY12-13 biennium at $642.2 million—which was $51.1 million higher than the actual state appropriation for FY11 ($591.1 million). So the net increase to the University for the biennium, were that base budget to be adopted by the state, would be $102.2 million ($51.1 x 2). The legislature has already adopted and sent to the governor legislation eliminating that $102.2 million increase. His view, Mr. Pfutzenreuter said, is that the legislature will likely cut the funding even more, below the $591.1 million, and it could be that the University's appropriation will be substantially lower. A projected cut has been built into the budget assumptions along with the projected increased needs of $41.6 million, which generates a "budget challenge" for FY12 that could be about $112 million. It is also likely that the largest part of any cut for the FY12-13 biennium would be front-loaded, so the biggest cuts would have to be made in the first year.

The President has indicated that he wishes about one-third of the projected shortfall to be offset by increased tuition revenues and about two-thirds by internal budget cuts, which would mean about a 5% cut across the University. They have been through the compacts with the support units and those units have been told to plan for a 5% cut.

The University has also received a letter from the chair of the House Higher Education Committee asking for a detailed explanation of how the University would respond to cuts of 15% and

20% in state funding, Mr. Pfutzenreuter told the Committee. The response is due February 17 and the University is asked to testify about it on February 22. And there has been a lot of talk about public employees: freezing pensions and salaries, and so on. It will take awhile for all of that to settle.

Professor Kulacki inquired if there has been any discussion in the legislature about programs they would not want to see eliminated. There has been nothing said of which he is aware, Mr. Pfutzenreuter responded. From a faculty perspective, Professor Kulacki said, the last thing they want to see is micromanagement by the legislature—that would be a no-win situation. Mr. Pfutzenreuter said the legislature has always respected the University's decision-making and it is aware that it elects the governing board that oversees that process.

Professor Sheets thanked Vice President Pfutzenreuter for joining the meeting.

2. Possible Changes to the Faculty Retirement Plan: Retirement Plan Information

Vice President Carrier next explained to the Committee that she meets with the Board of Regents' Faculty, Staff, and Student Affairs Committee, and that committee is very interested in health care and retirement benefits and in salaries. Last month she made a presentation on the Minnesota State Retirement System, which covers the University's civil service and union-represented employees, and the head of MSRS (which is a state agency, not a University unit) joined the Board meeting and presented MSRS' financial position to the Regents.

This month she will talk with the Board Committee about the Faculty Retirement Plan (FRP). She said she would present today the information she will provide to the Regents, and then she and Ms. Singer will provide this Committee information about possible changes they have been modeling for the FRP.

Vice President Carrier explained that MSRS is a defined-benefit plan; the FRP is a defined-contribution plan for the approximately 7,500 faculty and P&A staff at the University. The P&A category was created in 1980 by the Board of Regents to recognize the professional employees who support the University's mission; the Board specified that benefits for P&A staff would be the same as those for the faculty.

Ms. Singer next ran through some basic terminology that perhaps not everyone uses on a daily basis. There are six employee groups at the University: faculty, professional and administrative, civil service, union-represented, graduate students, and students. A defined-contribution plan is one where the ultimate retirement benefits come from the accumulated contributions plus the investment returns; it is defined by what goes in. A defined-benefit plan pays a retirement benefit based on a formula and is promised to people who participate in the system. A hybrid plan combines elements of both. Vesting occurs when the employee is entitled to receive the employer contribution to the plan. The "replacement ratio" is a way to compare retirement plans in that it identifies a ratio of retirement income to pre-retirement income (e.g., a plan might provide 70% of pre-retirement income). Most retirement planners suggest that people should have (in retirement) a minimum of 80% of their final salary while still working.

In terms of governance and oversight, the FRP has a plan document, a detailed description of how it works, that is filed with the IRS and that gets it tax-deferred status, Ms. Singer said. The Retirement

Subcommittee (a subcommittee of this Committee) recommends changes to the FRP and other plans (e.g., the optional retirement plans), and is composed of 7 faculty, 2 P&A staff, and 2 civil service staff. The Retirement Plan Fiduciary Advisory Committee is relatively new and makes recommendations to the plan trustee (Vice President Pfutzenreuter), and includes the Chief Investment Officer, the chair of the Retirement Subcommittee, and faculty, P&A, and civil service representatives.

Ms. Singer next did a brief comparison of the FRP and MSRS and noted that they are at the two ends of the spectrum. MSRS is a defined-benefit plan for civil service; the assets are managed by the State Board of Investment; employees and the University each contribute 5% of salary; University contributions are 100% vested after three years of service, or five years of service if hired after June 20, 2010. By contrast, the FRP is a defined-contribution plan; investments are employee-directed among several providers (including Fidelity, Vanguard, and Securian); employees contribute 2.5% of salary and the University contributes 13% of salary; the accounts are 100% vested.

Because the FRP is self-directed investing, the Regents directed the administration to provide retirement education, so participants are provided printed and online information, offered seminars (about 500 faculty, staff, and partners attended the most recent pre-retirement seminar), provide investment seminars, individual meetings with faculty and staff both for investments and for benefits counseling.

Ms. Singer next reviewed the historical contribution rates. The plan began in the 1930s with very limited contributions and individual annuity purchases. In 1963 the employees began contributing 2.5% of salary and the University contributed 2.5% on the first $5000 in salary plus 7.5% of salary over $5000. By 1968 the University contribution was 2.5% of the first $5000 plus 13.0% of salary over $5000. Beginning in 1992, the University contribution was set at 13% of salary (the employee contribution remained the same, at 2.5%). The reason the amounts were lower from 1963 until 1992 is that the retirement plan was integrated with Social Security. Now they are entirely independent of each other.

Ms. Singer next provided a table of information about faculty retirement plans at other institutions—FRP benchmarks. This group of institutions is one approved by the Board of Regents as the University's comparison group among public research universities. [DB = defined-benefit plan, DC = defined-contribution plan]

Institution	Employee %	University %	Repl Ratio	Plan Type
Ohio State*	10	14	91	(choice, DC listed)
UC Berkeley	2	4	85	DB (normal cost 17.6%)
UCLA	2	4	85	DB (normal cost 17.6%)
Penn State	6.25	4.11	85	(choice, DB listed)
U Texas	6.4	6.4	76	(choice, DB listed)
U Illinois*	8	9.1	74	(choice, DB listed)
U Wash-Seattle	5-10	5-10	63	DC
U Minnesota	2.5	13	61	DC
U Michigan	5	10	59	DC
U Wisconsin	0	11-11.9	57	DB
U Florida	0	8.74	56	(choice, DB listed)

* Does not participate in Social Security

Ms. Singer pointed out that although the Ohio State replacement ratio looks high, retirees do not receive social security (nor do U of Illinois employees). That is usually counted for about 20-25% of replacement income, so even Florida, at 56%, would be at about 81% when Social Security income is factored in. And Ohio State, minus Social Security income, is at about 66% for comparative purposes (91% minus 25% for Social Security); Illinois is at about 49%.

Professor Sheets observed that of the four defined-contribution systems listed, excluding Ohio State, the range of replacement ratios is 59-63% and the University is second, so it is not providing a high replacement ratio because of more generous contributions than other institutions. Ms. Singer agreed and observed that most of the institutions listed also provide retiree medical benefits, which the University of Minnesota does not (nor does Florida). Those are not technically part of the retirement plan, but they make a big difference in calculating retirement income.

Professor Sheets wondered how the UC system could provide an 85% replacement ratio with contributions totaling only 6%. That system has current challenges, Ms. Singer said. There were no contributions to the plan for 19 years because it was over-funded; when it began to be under-funded, the contributions were not begun again, and contributions now are not meeting the system costs. They are considering a lot of changes to it.

Ms. Singer cautioned that the data she presented tells the story of retirement plans, but one must look at them in the context of total compensation. Total compensation includes cash and cash equivalents, such as base salary, bonus, incentive pay, stock options/grants, defined-contribution retirement plan contributions (not defined-benefit because of the difficulty of translating them to cash and cash equivalents), and mandatory benefits. Total compensation also includes benefits: medical/dental, life insurance, disability coverage, retiree medical/dental coverage, tuition (self/dependents), paid time off (holidays, vacation, sick leave). If one compares jobs in the private sector to higher education, many of the cash and cash equivalents are not available in higher education. It is difficult to show all benefits, and the Board of Regents hears about variations in programs across institutions. One organization can have a costly plan that does not provide great benefits while another organization can have a rich benefit plan that costs less because it has more skillful managers. What also affects the assessment of a benefits plan is where one is in life; a tuition benefit might be more valuable to a younger employee with children while medical benefits might be more valuable to older faculty. Some value paid time off more than life insurance. So, Ms. Singer concluded, it is difficult to compare benefits.

Ms. Singer next noted salary versus compensation for the University vis-à-vis the top 11 public institutions, rankings that are important when it comes to recruiting and retention.

	Salary	Total Compensation
Professor	8th (of 11)	4th (of 11)
Associate Professor	8th (of 11)	4th (of 11)
Assistant Professor	8th (of 11)	3rd (of 11)
Combined	9th (of 11)	4th (of 11)

The University is in the bottom third of its peer group in salaries only but in the top half when total compensation is calculated. These ranks have been consistent for a number of years, Ms. Singer said.

Mr. Croce noted that the University's 13% contribution to the FRP is seen by some as high, and there were previous efforts to put some of the money into health-care savings plan. Will that possibility be revived? It was reported that it would not be worth the effort because of the changes required by the new federal health-care law. Ms. Singer said that lump-sum contributions to health-care savings plans for employees who leave the University will work, but it is not yet clear that ongoing contributions for current employees will, because they could contribute to the problem of becoming a "Cadillac" plan.

3. Possible Changes to the Faculty Retirement Plan: Options

Vice President Carrier turned now to options they are considering for changes to the FRP. Three possible scenarios were discussed, along with the pros and cons of each. It was emphasized that these are preliminary ideas subject to further discussion and possible modification, including the possibility of not making any changes at all.

Option 1 is to create a two-tiered retirement contribution plan with no salary increase. For current employees, the contributions would remain as they are now, 2.5% by the employee and 13% by the University, for a total of 15.5%. For new employees, the University would contribute 10%.

Option 2 is a single-tier retirement contribution with no salary increase: The University's contribution would be dropped to 10% for all employees, new and current,

Option 3 phases in Option 2 over three years for current employees with no salary increase. The University's contribution would be decreased by 1% point per year for three years.

There are pros and cons with each option, Dr. Carrier observed. With option 1, the pro is that it has no impact on current employee retirement plan contributions or savings rates. The cons are that it significantly increases administrative complexity (and error risk), leads to the perception of inequity, dilutes the impact on public perceptions, and reduces new employee retirement plan contributions and savings rate.

For option 2, the pros are that it provides the greatest long-term savings for the University, is likely to cause the most positive public reaction, presents no equity issues within employee groups, and provides the easiest administrative implementation. The cons are that it reduces the University's competitive position in terms of total compensation, it will cause the greatest negative employee reaction, and reduces contributions and savings rate.

For option 3, the pros are that it provides long-term savings equal to option 1, presents no long-term equity issues, and the phased approach might make it more acceptable to employees. The cons are the same as those for option 2 plus it increases administrative complexity.

One option they took off the table, Dr. Carrier said, is adding to employee salaries and then shifting the money into the retirement pool so that the mandatory contribution from employees could be raised to 5%. That would incur a lot of additional costs, however, such as increased FICA contributions, costs related to retirement, and it would look like a salary increase to other employee groups. It may also be that in some fields, because of market competition, there would be higher salaries paid if total compensation is reduced (that is, the retirement plan contribution is reduced by three percentage points).

Professor Hanna said that the options look only at the beginning of the employee's participation in the plan, but one must look at the effect of the change over a career. The reduced contribution cuts into the replacement ratio, so people will need to work longer. Only 25% of employees currently participate in the optional retirement plans, she said,

Mr. Croce suggested that with a two-tiered system, older P&A staff members, who do not have tenure, could be seen as more expensive than new hires because their University retirement contributions would be lower. In addition, he worried that the impact of a two-tiered system could be to make higher education less attractive to employees and would send the wrong message to the next generation. The question is whether there might be pressure to hire new people and get rid of more senior people; he noted that that has happened in the private sector, but said that there may be greater salary differentials in the private sector than there are in the University. Dr. Carrier agreed that the differentials at the University may not be great enough to create much incentive to hire new employees and get rid of more senior staff, and added that she has never heard the issue raised. Ms. Singer said that the incentive is there now, and units could hire new people with lower salaries if they had a mind to. But they do not see that happening.

Professor Kulacki said an important factor is the demographics of the P&A staff. Every week there are articles in Inside Higher Education and The Chronicle of Higher Education that old-style compensation and perks are under attack. This happens about every ten years, it is such a period now, and is exacerbated by the budget situation. One should not jump to conclusions.

Professor Kulacki also inquired about the possibility of allowing variable contributions, up to a maximum of 5%, for employees, so a junior person could contribute less. They can do that with the two optional plans now, Dr. Carrier observed, but there is a low participation rate, so the University would have to argue that people should make contributions to those plans. Professor Kulacki said that there was talk some time ago at another Big Ten university about a cafeteria plan, allowing employees to pick the benefits they wanted. They studied that possibility a couple of years ago, Dr. Carrier said, and it did not appear feasible.

Professor Sheets went on to raise another issue that he said is bound to come up. Any option other than number 1 could implicate the tenure code, and specifically section 4.3 language about a reduction in compensation of faculty members. It is almost certain that if the contributions are reduced there will be litigation. It is said that the University adjusts health-care benefits routinely, but that is different because health care is not dollars that are vested in the employee and subject to tax, but retirement benefits are both immediately vested and subject to income tax, when withdrawn. Thus retirement benefits are "income," while health benefits are not. Vice President Carrier said that they are seeking a formal opinion from the General Counsel on that point.

Professor Miksch said that the Academic Freedom and Tenure Committee has also started looking at the question Professor Sheets raised. The tenure code talks about changes in compensation and in salary, and those mean different things. The record may suggest that the word "salary" was changed to "compensation" by the Faculty Senate when the code was being debated in the 1980s. She is looking at the code in terms of statutory analysis, because one cannot read the language and know exactly what it means. The Academic Freedom and Tenure Committee has not taken a position on how the code might be implicated if there were to be a change in the FRP for current faculty.

If there were a wave of litigation, the University would need to factor in the cost of that litigation when it calculates any potential savings, Professor Sheets suggested. He has heard the President say that he prefers option 1, Professor Sheets said, because that keeps faith with people who were hired with the understanding of the current FRP contributions. Option 1 would not implicate the tenure code and might also be offset, as was suggested, in the form of higher starting salaries for new faculty because the reduction in the retirement benefit makes the total compensation less competitive. For that reason there is less likelihood discontent in the workforce from Option 1. That may be true, Dr. Carrier said, but then the question is what contribution new employees are asked to make.

Professor Kulacki said one must think about market forces; salary concerns will outweigh concerns about fringe benefits. Professor Sheets observed that the market is already creating different salaries in different fields. Professor Kulacki agreed and said that high-quality institutions always get high-quality applicants and they are in a different universe with respect to tweaks in compensation and benefits. So if new employees were required to contribute more, that would not affect hiring, Professor Sheets asked? Prospective faculty members will look at salary, the quality of the institution, the quality of life, graduate students, etc.—factors outside financial compensation, Professor Kulacki maintained. Professor Kulacki's point is true for junior faculty but less so for senior faculty, Professor Cherkassky commented.

Professor Sheets thanked Vice President Carrier and Ms. Singer for the report.

4. Retirement Incentive Option

Vice President Carrier said she wished to report on one other topic. The administration will propose to the Board of Regents another Retirement Incentive Options (RIO) plan. If someone meets the eligibility requirements, a department cannot deny someone the choice of retiring. The suggested eligibility rules are the same as those for the last plan: age 50 with 15 or more years of service, or age 55 with five or more years of service, or regardless of age with 30 years of service, actively working a 75%+ appointment of nine months or more. People would have between February 15 and May 15, 2011, to decide to accept the offer; they would have to retire no later than January 11, 2012. Those who select the RIO would have a deposit to a health-care savings plan equivalent to 52 pay periods (two years) as subsidy for medical and dental coverage, based on the coverage level, permanent residence, and work location on the last day of employment. Anyone who selected RIO could not be rehired for three months, and after that only in a non-benefits-eligible position of no more than 19.5 hours per week.

In the past, it has been primarily civil service and bargaining-unit employees who have used the option, although some P&A and faculty have also done so, Dr. Carrier said.

Phased retirement also remains an option for faculty members, Professor Sheets said. The terminal agreement option is still in place, although not used very much; it pays one year's salary and two years of health coverage, and one leaves at the end of the academic year it is taken. It is more expensive for the unit, but it is a one-time expense. The option should be encouraged more, he suggested.

The deans know about it, Dr. Carrier said, and it is up to them to decide. Some have used it more than others. It might be used more if there were broader notification to the faculty, Professor Sheets said. That may be true but it is not guaranteed, Dr. Carrier pointed out; the dean has to make the case for a

terminal agreement. It may be that the deans see it as a tool to be used as appropriate, but that they do not use more because of the high costs up front.

Professor Sheets thanked Dr. Carrier and Ms. Singer for the presentation and adjourned the meeting at 4:15.

-- Gary Engstrand

University of Minnesota