University of Missouri Retirement Plan
Report from UM Retirement Plan Advisory Committee
March 2011

Background

UM has spent more than fifty years conservatively managing and diligently funding its defined benefit (DB) retirement plan (“UM DB plan”). As a result, the UM DB plan has served the University, its employees and other beneficiaries of the plan very well, producing both higher rates of return and lower costs over time than typically afforded by defined contribution (DC) plans. In addition, the University has been able to provide a competitive plan design at significantly lower cost than our peer institutions.

While many DB plans are clearly in trouble, due primarily to chronic underfunding and expensive plan features such as generous early retirement features, guaranteed retiree cost of living adjustments (COLA’s) and the ability to purchase additional service credits at a discount, the University has purposefully avoided those pitfalls, even during “good” times. In fact, the Board of Curators of the University of Missouri (the “Board”) and University administration have taken several additional steps to ensure the ongoing stability of the UM DB plan, including the adoption of smoothing (spreading both losses and gains over multiple years), the creation and funding of a stabilization reserve fund, and the implementation of mandatory employee contributions. However, the University is not immune to factors beyond its direct control, including increasing volatility in the investment market, changing mortality rates, and potential changes in Governmental Accounting Standards Board (GASB) regulations, all of which have increased either or both the University’s current liabilities and future risk. Employee demographics and expectations are changing as well, which may impact perceptions regarding value and competitiveness of benefits.

The University has been vigilant in its ongoing assessment and evaluation of benefits, including retirement, to ensure its limited resources are used as effectively as possible to deliver competitive programs and services that meet employer and employee needs throughout the entire employment lifecycle. As circumstances have changed and more frequently during the past ten years, the University has conducted and/or commissioned timely studies to determine whether it should continue or modify the UM DB plan. Reports of these efforts are available on the UM website at http://www.umsystem.edu/ums/departments/hr/benefits/retirementplanproject/.

In 2009, President Foresee reopened discussions regarding whether it would be in the University’s and its employees’ best interest to close the UM DB plan for new participants (continuing the UM DB plan for current participants), and create a new DC plan. His primary concern was focused on the significant risk borne by the University for the UM DB plan, especially as the investment returns have become even more volatile, further straining the University’s ability to fund periods of high and sustained cost in the context of severe budget constraints. A number of other concerns are shared by the President, Board, University administration, and critical stakeholders (including faculty and staff). The lack of resources to improve competitiveness in direct compensation has exacerbated competitiveness in total compensation even further, particularly since the value of many of the University’s benefits, including retirement, are tied to direct compensation. That said, it is difficult to predict what
impact retirement plan design may have on future talent attraction and retention, given changing employee demographics and needs. We are clearly unique in offering a University-managed DB plan design (particularly for faculty) compared to our peer institutions, but it is unclear whether that may be viewed as positive or negative with respect to attraction. In addition, the future sustainability of DB plans in general is a subject of much debate, both within the University and across the country.

After several months of presentations and discussions, the Board requested an additional special meeting of its Compensation and Human Resources Committee. The meeting took place November 1, 2010 and was dedicated to understanding the challenges for the UM retirement program. Outside experts and consultants provided information about the national context and debate on public pension plans, investment outlook and specific information about the UM investment portfolio's ability to meet assumed investment returns, actuarial information about the current plan now and projected over 30 years, comparative data from UM peer institutions, and feedback from UM faculty and staff. The final presentation of the meeting provided information on a generic DC plan design, including cost, for illustrative and comparative purposes. All of the presentations and materials from this special meeting are available on the UM website at http://www.umsystem.edu/ums/departments/hr/benefits/retirementplanproject/.

Given the importance of the subject and concerns voiced by faculty, staff, and some Board members, the President determined that next steps would include formation of a committee to provide advice to the Vice President for Human Resources. This committee, appointed on November 15, 2010, includes members of the Intercampus Faculty Council (IFC), the Intercampus Staff Advisory Council (ISAC), the UM Retirement and Staff Benefits Committee (the regular standing committee responsible for administering the retirement plan under Collected Rules and Regulations Section 530.010.M, and which has also served as a long-standing advisory committee on other faculty and staff benefits issues), and a representative from MU Healthcare. The UM Retirement Plan Advisory Committee’s specific charge is “to assist the Vice President for Human Resources in the development and communication of recommendations regarding retirement plan offerings, including the possibility of a Defined Contribution plan for future employees, and to facilitate the dissemination of information to and from stakeholders.”

The committee’s full charge, additional information about the appointment process, and the list of committee members is in Appendix Section 1.

The Committee Process

The UM Retirement Plan Advisory Committee (“Committee”) has been very actively engaged, reviewing UM-specific historical materials and more recent national and UM-specific information compiled and provided by the Vice President for Human Resources and data and analyses from the University’s consultants. In addition to studying the topic independently and soliciting and receiving input from stakeholders across all campuses, the Committee formally convened for two days in November 2010, one day in December 2010, twice in January 2011, and twice in February 2011. The Committee's work initially focused on understanding the design and funding of the current UM DB plan. Given the complexity of the actuarial analysis, the Committee developed a set of questions and answers. These Q and As are provided in
Appendix Section 2 as the work of the Committee. They are intended to be used as information for decision makers and an educational tool for various university committees. They are available on the web at http://www.umsystem.edu/ums/departments/hr/benefits/retirementplanproject/ for all employees.

The Committee spent significant time developing a set of objectives to guide its discussion and facilitate the evaluation of potential plan designs in light of the many competing and valid interests of the University and its diverse employee population. Primary objectives include facilitating competitiveness with peer institutions, rewarding long term service, meeting employee needs across the employment life cycle, providing equity among employee groups (both actual and perceived), mitigating and sharing risk, providing benefit adequacy (particularly at time of retirement), facilitating attraction and retention of talent, increasing budget predictability and minimizing complexity. While the objectives were not otherwise ranked or weighted, income adequacy at retirement was determined by the Committee to be the most critical objective for any retirement plan design.

After significant review, discussion and analyses, the Committee developed an initial set of findings and related recommendations for implementation regardless of what plan design changes might otherwise be made. These base findings and recommendations are provided below.

Base Findings/Recommendations of the Committee

1. Further study confirms there is no inherent harm to the UM DB plan if closed to new employees. However, the group strongly recommends that the Board and UM administration document their continued and shared commitment to the UM DB plan so that, if the current plan is closed to new employees, there are no questions regarding the intent of the University to continue the current UM DB plan for existing employees until all obligations have been met and the plan can be terminated. At a minimum, the documentation should cover 3 areas:
   a. Commitment that UM will fully fund the actuarially determined Annual Required Contribution (as defined in the Q and As);
   b. Commitment that UM will continue to pay off all unfunded liability—slowly over time or recognizing that at ‘end of plan’ the final payment will be met; and
   c. Commitment to continue the stabilization fund (as defined in the Q and As) with the primary purpose of minimizing mandatory employee contributions.

2. Statistics show that as long as an employer’s retirement offerings are perceived as competitive, retirement plan design is not typically a primary determinative factor in an employee’s decision to accept or leave employment, except perhaps for some longer service (beyond 15 years) and older employees older (over age 50).

3. The University should strive to maintain low mandatory employee contributions overall. Any mandatory employee contributions to ‘new’ plans should not be less than those required by employees who would remain in the current UM DB plan.

4. The University needs a strategic communication plan on benefits to foster employee understanding and appreciation of the value of the array of benefits available to them.

5. The most important retirement plan objective is ‘income adequacy’ at retirement. That objective guided the Committee’s deliberation process.
6. Any plan design(s) must include options to reduce employee investment and other retirement risk. The University should provide adequate education for employees to make informed decisions.

Final Recommendation
The Committee has conducted an extensive study of the issues within its charge. Following months of additional fact gathering and intense deliberation and debate, the Committee has reached consensus with respect to a final recommendation. In making its recommendation, the Committee is compelled to acknowledge and emphasize the complexity of the issues and the difficulties inherent in attempting to weigh and balance numerous legitimate and competing interests. This is not a burden that the Committee has undertaken lightly. Clearly, the health and wellbeing of the University is built upon the contributions of its employees and the Committee is fully aware that any decisions made as a result of its deliberations will have significant and lasting impacts on both the University and its employees.

The Committee also acknowledges that no single solution exists that would respond perfectly to all of the diverse needs of the University and the members and beneficiaries of the University’s retirement program. Retirement plan objectives are complex and, at times, conflicting. Moreover, individual needs vary significantly. It is simply not possible to design a plan that would meet all of the objectives for all employees and the University. Still, the Committee was determined to meet its charge in good faith and to the best of its ability. It has carefully considered all of the information presented (both formally and informally), identified and analyzed a number of options, and weighed and balanced objectives and needs, with the following result:

The Committee has reached consensus that if, after thorough and careful study of the viability of the current UM DB plan (both short term and long term), the Board determines it is not in the University’s interest to continue to bear the financial risks implicit in the current UM DB plan, the preferred alternative plan design is a new retirement plan, for new employees only, that provides a ‘combination’ of defined benefit and defined contribution elements, along with other mechanisms for reducing risk.

Additional Comments
Given the importance of the subject and in the interest of transparency, the Committee offers the following additional comments with respect to its deliberations and final recommendation.

Without question, DB plans, when designed appropriately, provide the best guarantee for adequate income at retirement for those employees who stay for a full career. And the University of Missouri is both fortunate and unique in the stable financial position of the UM DB plan. The Board and University administration are to be applauded for their discipline and foresight in past decisions, which have made this possible. Nonetheless, given the many factors noted in the background section of this report, it behooves the University to study the future of the UM DB plan and to consider possible alternatives. The University’s retirement trust fund and its corresponding liabilities continue to grow, both in terms of real dollars and with
respect to its size in comparison to the entire enterprise. It is necessary to investigate whether continuing to provide guaranteed income at retirement may place the University, and ultimately its employees, at more significant financial risk in the future.

The Board must consider carefully and with a long term view what constitutes manageable risk and what proportion of the University’s finances it considers reasonable to allocate to retirement in comparison to other institutional priorities, especially direct compensation for the University’s most valuable asset, its employees. Over the years, direct compensation paid to our employees has been less than that provided by our peers. Many have been willing to accept such lower salaries in exchange for the guaranteed retirement income the UM DB plan provides. If the University is not able to resolve the shortfall in direct compensation, adopting a different retirement program may only serve to further exacerbate competitiveness in total compensation.

President Forsee advised the Committee at its first meeting that considering changes to the UM DB plan for current employees was not within its charge. The Committee acknowledges that President Forsee and the University made a commitment to continue the DB Plan for current employees prior to the Committee’s formation and that it must be honored. Eliminating this option from the Committee’s charge, however, constrained the Committee from considering a feasible DB plan design for new employees that also met the objectives given to the Committee as part of its charge.

Income adequacy at retirement was identified by the Committee as the most important objective for any retirement program, and this objective guided much of its discussion. That being said, the Committee was also very mindful of both the University’s and its employees’ need to mitigate risk. DC plans, if properly managed, can certainly achieve income adequacy. The Committee is not prepared, however, to recommend a plan design that completely shifts investment risk from the University to the individual employee. Doing so would represent a significant departure from the assignment of risk predominantly to the University for current employees. Moreover, it would completely eliminate the advantage of the longer-term investment horizon enjoyed by the University, which is not available to individuals. The Committee was also reluctant to recommend a pure DC plan design since, given the University’s limited resources, such a plan would, at best, be undistinguished from those offered by our peers.

Each and every employee contributes directly to the success of the University. Much of the University’s reputation is driven by the strength and stability of its faculty and staff. Attraction and retention of talent were, therefore, critical objectives identified by the Committee quite early in its work. In an effort to better understand the potential impact of plan design on attraction and retention, the Committee reviewed available research literature on the subject and UM turnover data. The data show that more than 60% of employees do not vest and that only 16% reach 20 or more years of service.

The Committee acknowledges that long term service is highly valued by the University but also notes that shorter-term employees deliver valuable service. It is important that all employees perceive any plan design as attractive. The Committee also emphasizes that turnover data alone do not accurately convey the impact of retirement plan design on those who come to the University, those who leave and, perhaps most importantly, those who do stay for a full career. The Committee did find that turnover is highest in the first five years of employment, particularly for our lowest paid staff. Perhaps not surprisingly, turnover is lowest for faculty members who have achieved tenure.
Academic leadership and many of our faculty members are rightfully concerned about the impact of any decisions made by this project on the University’s ability to retain tenured faculty. It was not possible to accurately assess whether the current plan design plays a significant role in keeping tenured faculty members but it would be unwise to assume that plan design plays no role in this. It would be a great disservice to the University to implement a plan design that does not encourage tenured faculty members to remain.

The Committee’s charge was to recommend a retirement plan to meet the needs of all of the University’s diverse employee population. In its deliberations, the Committee was committed to ensuring that recommendations support the University’s longstanding interest in rewarding long term service. Long-term service employees include career employees, of course, but also include those who spend a significant portion of their career but do not reach twenty or more years of service.

The Committee was also very mindful of the impact of its recommendations on the University’s lowest paid employees. As previously stated, the University’s lowest paid staff members are least likely to vest. Employees who do not vest receive no benefit from the UM DB plan (with the exception of the return of their mandatory contributions). These same employees are also least likely to be able to afford voluntary retirement offerings that are more portable (such as the University’s tax deferred investment plans).

**Plan Design Elements**

The Committee was not charged with recommending specific plan design features, but several key elements were identified and are deemed critically important to its recommendation.

The Committee feels strongly that, in order to encourage retention, the plan should have a vesting period. This does reduce competitiveness with respect to our peers that offer DC plans with little or no vesting. In addition, a vesting requirement does not address the elimination of value for the significant number of employees who leave prior to vesting. It is the Committee’s position, nonetheless, that a vesting period is important for meeting the Committee’s objectives related to both retention and equity (since the current UM DB plan requires vesting).

In addition, plan design should encourage and reward employees for making contributions toward their retirement (e.g., provide a matching component). In order to fully maximize the potential for adequate income at retirement, voluntary contributions are critical. The Committee emphasizes the importance of developing and providing accurate and adequate information for employees to make informed decisions. The University should exercise its best efforts to encourage employees to make appropriate voluntary contributions and prudent investment decisions to meet their individual needs.

The plan must provide some acceptable minimum level of ‘guarantee’ (e.g., the DB component) for both individual investment risk protection and for those who may not have the financial means to make additional or significant voluntary contributions. The table below compares the current UM DB plan to a possible combination plan.
Plan Design Elements | Combination Plan Design | Current DB Plan
--- | --- | ---
**DB Portion** |  |  |
Multiplier Formula | 1.1% of Pay, average of 5 highest consecutive years of salary | 2.2% of Pay, average of 5 highest consecutive years of salary |
UM Contribution | 3.4% of salary | 7.25% of salary |
Vesting | 5 years | 5 years |
Employee Mandatory DB Contribution | None | 1% up to $50,000, 2% of amount above $50,000 |
Minimum Value Accumulation* | None | 5% of pay at time of termination |
**DC Portion** |  |  |
UM Automatic Contribution | 2% of Pay |  |
UM Match | 100% up to an additional 3% of pay |  |
Employee Mandatory Contribution | 1% of Pay |  |
Vesting | 3 years |  |
Estimated UM Contribution | 7.5 to 7.9% of Pay | 7.25% |

* Provides a cash out or rollover equivalent to 5% of salary plus interest for vested employees who terminate prior to retirement eligibility.

There was discussion throughout the Committee’s deliberations about whether to offer a voluntary ‘opt out’ of the UM DB plan and opportunity to move to the new plan for new employees, including the potential implications of such an offering to both the current and new plan. However, considering such an option to be outside the scope of the Committee’s charge, we recommend that this option should be part of the future work on any new plan design.

If a different plan is offered, the Committee emphasizes that the University’s costs for each plan are likely to be different. Plan design decisions should be made to ensure that, to the extent practicable, equity exists between plan designs with respect to this issue. The Committee recognizes, however, that some adjustment may be appropriate in order to recognize the shifting of additional risk to employees participating in the new plan.

Most importantly, if a new retirement plan is introduced and the existing UM DB is closed to new employees, the University must determine and clearly communicate in advance to employees how it intends to administer funding of the plans. As the UM DB plan winds down, the cost for that plan (while shrinking in total dollars) will rise as a percentage of payroll associated with those employees who remain in the plan. Both current and future employees will be justifiably concerned regarding differences in cost between plans and who will be asked to bear those costs. The Committee strongly recommends that funding of both plans be managed by the University to mitigate these concerns.

**CLOSING REMARKS**

It is important to acknowledge that the Committee, despite its best effort, was not able to reach a unanimous decision. Some members of the Committee believe it is in the best interests of the University and its employees to maintain the current UM DB plan if at all
possible. Others believe that closing the UM DB plan and offering a combination plan for new employees best meets the needs of the University and its employees at this time. And at least one Committee member’s first preference would be to offer a pure DC plan. Such differences of opinion are very much respected and are, at least in part, a reflection of our differing needs and perspectives as faculty and staff members. Nonetheless, every member of the Committee supports the consensus reached by the Committee.

The Committee wishes to thank the UM advisors and consultants for their support of its work. Finally, the Committee expresses its deep appreciation to the many faculty, staff, retiree groups, and individuals, for their thoughtful input and their deep and abiding concern and interest in this project and in the health and wellbeing of our University.