TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director

RE: S.F. 996 (Betzold); H.F. 1636 (Hornstein): MSRS; Allowable Service Credit Purchase for Strike Periods

DATE: March 30, 2005

Summary of S.F. 996 (Betzold); H.F. 1636 (Hornstein)

S.F. 996 (Betzold); H.F. 1636 (Hornstein) authorizes members of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) to purchase service credit in the plan for a period of time while on strike without pay, not to exceed one year. To obtain the service credit, the individual must pay the employee and employer contributions that would have been paid if the individual was not on strike. If payment is not made within one year, the payment must included 8.5 percent interest, compounded annually. The provision is effective retroactive to March 1, 2004.

Background Information on Purchases of Service Credit for Strike Periods

Minnesota State Retirement System (MSRS) officials indicate that the bill is intended to allow Metro Transit bus drivers to purchase service credit in the plan for the recent strike period. The Commission last dealt with a situation similar to this in 2002, following a strike by various state employee groups in 2001. During the 2002 Session, S.F. 2773 (Pogemiller); H.F. 2829 (Smith) was introduced. That bill is identical in drafting to the current bill except for the effective date. In 2002, the Commission chose to recommend a staff amendment to pass, rather than the language of 2002 Session S.F. 2773 (Pogemiller); H.F. 2829 (Smith).

The chief concern expressed by Commission members about the 2002 bill language was that the purchase period was open-ended, allowing an individual to purchase service credit at any time prior to retirement for only contributions plus interest, which violates Commission policy. When there is a notable delay between the period to be covered and the date the payment is received, standard Commission policy is to require payment of the full actuarial value of the service credit purchase rather than to permit purchase for contributions plus interest. The policy the Commission chose was reflected in the amendment the Commission used. That amendment treated the situation like a leave of absence if the purchase was made within a year of the strike period, and if the delay was longer than one year, the individual would have to pay the full actuarial value.

Another issue in 2002 was that 2002 Session S.F. 2773 (Pogemiller); H.F. 2829 (Smith) permitted MSRS members who were on strike to obtain service credit only if the individual was a member of MSRS-General, but some of the striking state employees were covered by other plans, either the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) or the Teachers Retirement Association (TRA). The Commission chose to expand the amendment to allow service credit in MSRS-General, PERA-General, or TRA, whichever was applicable. In the case currently before the Commission, S.F. 996 (Betzold); H.F. 1636 (Hornstein), MSRS has determined that other plans do not need to be included because MSRS-General is the only plan providing coverage to Metro Transit drivers.

A third issue was that 2002 Session S.F. 2773 (Pogemiller); H.F. 2829 (Smith) did not require interest if payment was made within one year of the end of the strike period. This is not an ideal treatment, since it forces the pension fund t o forgo up to a year of assumed investment earnings on the contributions.

A fourth issue was whether or not to include a sunset on the legislation. No sunset provision was included in 2002 Session S.F. 2773 (Pogemiller); H.F. 2829 (Smith). The Commission chose to adopt a 12-month sunset from the date of enactment, allowing the Commission to revisit the issue if it chose to do so. Apparently, there was little interest or need to revisit the provision a year later, and the provision was allowed to sunset. The provisions that were enacted passed as Laws 2002, Chapter 392, Article 2.

Background Information on Payment Procedures

Two different payment procedures are used in law to purchase service credit in a defined benefit pension plan, as follows:

a. Payment of Contributions plus Interest. This approach is used in leave of absence/break in service situations. Examples include the military leave of absence/break in service provisions in MSRS plans, PERA plans, TRA, and the first class city teacher plans. The process is also used in general leave of absence provisions under MSRS and PERA, and for various leave provisions in teacher plans, including maternity, paternity, and family leaves; sick leaves; sabbatical leaves; and extended leaves. Although there are slight variations within this approach, in general the individual receives the service credit after the pension fund receives the employee and employer contributions that would have been made if the individual had worked during this period, plus interest on those amounts from the date the contributions would have been made until payment is made. The intention is to treat the individual as similarly as possible to those who worked and contributed during the period. The interest payment compensates for the time value of money, and is necessary to compensate the pension fund for the delay in receiving the payments. It is intended to replace the lost investment earnings due to the delayed receipt. In some provisions using this approach, the individual must pay both the employee and employer contributions, although the employer is allowed to cover the employer contribution for the individual. In the case of military leave/break in service provisions, the employer is mandated to cover the employer contribution for the employee.

The contributions plus interest approach works well when the leave or break in service is not of great duration and the contributions are made soon after the leave or break in service ends. The typical maximum delay permitted in law is one or two years. The longest delays permitted in current law provisions using a contributions plus interest approach are probably the delays allowed in military leave/break in service situations. Under these provisions (an example is the MSRS military leave provision, Section 352.27), the individual may be permitted to make the employee contribution as late as five years after returning to covered employment. This lengthy delay is permitted because it is required under federal code, and due to the importance of the service these individuals provide to their country. The contributions plus interest approach does not work well if there has been delay of several years, or even decades, in receiving the contributions. The longer the delay, the greater the likelihood that the liability placed on the pension fund due to the purchase will be considerably higher than the amount the pension fund receives; which would cause a considerable subsidy provided by the other plan members and employing units.

b. Full Actuarial Value Payment. The other approach is to require a full actuarial value payment. Generally, the Commission uses this approach in all purchase of service credit requests other than the leave of absence/break in service situations just mentioned. The Commission also uses the full actuarial value approach to deal with leave situations in which a problem or an error occurred, and payment was not made within the timeframes required in the leave/break in service provision.

   Under a full actuarial value payment approach, the intention is to price the service credit at the full additional liability that will occur as a result of the purchase. For example, if the expected value of the individual's lifetime annuity would increase by $60,000 due to a service credit purchase, the fund must be paid $60,000 before the service credit is granted. Generally, the employee is required to make this payment if service credit is to be received. If the Commission determined that employer error caused the lack of service credit, the individual would be required to pay the employee contributions plus interest and the employer would be required to pay the remainder of the full actuarial value payment. The procedure used to compute the full actuarial value payment is found in Minnesota Statutes, Section 356.551.

Discussion and Analysis

S.F. 996 (Betzold); H.F. 1636 (Hornstein) authorizes MSRS-General members to purchase service credit in the plan for a period of time while on strike without pay, not to exceed one year. To obtain the service credit, the individual must pay the employee and employer contributions that would have been paid if the individual was not on strike. If payment is not made within one year, the payment must included 8.5 percent interest, compounded annually. The provision is effective retroactive to March 1, 2004.

The proposed legislation raises several pension and related public policy issues for potential consideration and discussion by the Commission, as follows:

1. Sufficient Need. The issue is whether there is sufficient need to consider this bill, given that the transit strike was not of great duration and thus the lost service credit will not have a significant impact on anyone's eventual pension.

2. Employment Policy – Treatment of Workers During Strike. The issue is employment policy; whether striking workers should be allowed to accrue service credit for a period while they are on strike. Not taking action on the bill would support a policy that lost service credit should be an accepted consequence of striking. That position, however, would be inconsistent with the past actions of the 2001-2002 Commission and Legislature, when provisions were enacted allowing striking state employees to receive service credit for the strike period if contributions were made, with interest, to the applicable pension fund within 12 months of the effective date of the 2002 legislation.

3. Payment Procedure Issues. The current bill is identical to 2002 Session S.F. 2773 (Pogemiller); H.F. 2829 (Smith), which the 2001-2002 Commission concluded was a flawed approach. The payment of contributions plus interest for the strike period can be made any time prior to retirement, which is

inconsistent with Commission policy of requiring payment of full actuarial value if the contributions are not made shortly after the end of the uncovered period. A second payment procedure issue is that no interest is required if payment is made within one year, which provides a subsidy of up to a year's worth of interest on the payment amount. Finally, there is no sunset.

4. Scope. While MSRS has indicated that dealing with the current situation would require a revision of only MSRS law, if the Commission concludes that it is appropriate to establish a general policy regarding strike periods, the Commission may choose to consider a provision to apply to all plans. Hopefully, this would eliminate a need to revisit this issue whenever a public employee strike occurs.

Potential Amendments for Commission Consideration

Amendments LCPR05-157 through LCPR05-161 are alternatives for addressing the MSRS situation. Amendments LCPR05-162 through LCPR05-164 are amendments that can be used if the Commission wishes to establish a general law procedure to be followed by most Minnesota defined benefit public plans.

Amendment LCPR05-157 limits the eligible payment period by having the provision expire one year after enactment. The MSRS-General covered employee would receive service credit for the strike period by making the employee and employer contributions, plus interest. The provision is uncoded and expires one year after enactment.

Amendment LCPR05-158 is similar to LCPR05-157, except that it is a coded provision and does not expire. MSRS members could receive service credit for a strike period by paying contributions plus interest within one year of the end of the strike, with a provision for the Metro Transit strikers to provide payment by March 1, 2006.

Amendment LCPR05-159. This amendment would allow individuals to make a payment of contributions plus interest if payment is received within one year or March 1, 2006, whichever is later, and if payment is made after that, individuals would pay the full actuarial value. The provision expires five years after enactment.

Amendment LCPR05-160. Under this amendment, individuals are given five years from the end of the strike to make payments. If made within the first year, the individual pays contributions plus interest. If made in years two through five, the individual would pay the full actuarial value. The provision does not expire, but payments after five years from the end of the strike are not permitted.

Amendment LCPR05-161. This amendment is identical to LCPR05-159, except that it does not expire. Individuals would pay contributions plus interest if made in the first year after the strike. If made later, the individuals would pay full actuarial value.

Note: If the full actuarial value procedure is sufficiently accurate, LCPR05-159, LCPR05-160, or LCPR05-161 should not harm the fund. However, an advantage of LCPR05-159 or LCPR05-160 is that they require the service credit issue to be promptly addressed, rather than having the pension fund administration compute full actuarial value estimates for minor amounts of service credit relating to a strike that occurred many years or even decades earlier. A second advantage is that if there is some inaccuracy in the full actuarial value methodology, the impact on the fund might be minimized if the payment is made within a few years of the strike.

Amendment LCPR05-162 is similar to LCPR05-158, except that it applies to all defined benefit plans included under the Combined Service Annuity provision. A member of an included plan could receive service credit for a strike period by paying contributions plus interest within one year of the end of the strike. Plans included under this amendment are MSRS-General, MSRS-Correctional, the Judges Retirement Plan, the Legislators Retirement Plan, the State Patrol Retirement Plan, PERA-General, PERA-P&F, PERA-Correctional, TRA, the first class city teacher plans, and the Minneapolis Employees Retirement Fund (MERF).

Amendment LCPR05-163 applies to all defined benefit plans included under the Combined Service Annuity provision. A member of an included plan could receive service credit for a strike period by paying contributions plus interest within one year of the end of the strike, or by paying the full actuarial value if payment is made within years two through five following the end of the strike. Payments can not be made after five years following the end of the strike.

Amendment LCPR05-164 is identical to LCPR05-163, except that payments are permitted after five years following the end of the strike (at full actuarial value).