**S.F. 2141**

(Pogemiller)

H.F. 2219

(Fritz)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-P&F
Relevant Provisions of Law: Proposed Special Law
General Nature of Proposal: Service credit purchase for four months of firefighter service when first employed as a Faribault firefighter
Date of Summary: April 18, 2005

Specific Proposed Changes

- Allow service credit purchase for four months of Faribault firefighting service when first employed in the early 1980s, at full actuarial value with the city paying most of the cost.

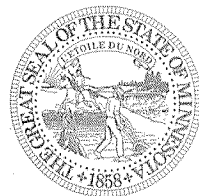
Policy Issues Raised by the Proposed Legislation

1. Equity concern. Uncovered period occurred in early 1980s; the long delay in seeking a remedy will greatly increase the city's cost.
2. City position. City acknowledges that city erred in not immediately reporting the individual for PERA-P&F coverage, and has expressed willingness to address the financial impact of the mistake, but city may not have received an estimate of the full cost.
3. Full actuarial cost. Hopefully, PERA has an estimate that it can provide.

Potential Amendments

Amendment LCPR05-253 makes technical corrections and adds requirements typically found in drafts which assume employer error, such as the requirement that the cost will be deducted from state aid if not promptly paid by the city.

Amendment LCPR05-254, an alternative to LCPR05-253, would make the individual responsible for paying the full actuarial value, if the Commission were to decide that the city should not be held responsible for the payment.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director ^{EB}

RE: S.F. 2141 (Pogemiller); H.F. 2219 (Fritz): PERA-P&F; Purchase of Service Credit for Period of Uncovered Faribault Firefighter Employment

DATE: April 13, 2005

Summary of S.F. 2141 (Pogemiller); H.F. 2219 (Fritz)

S.F. 2141 (Pogemiller); H.F. 2219 (Fritz) authorizes a certain Faribault firefighter, who is a Public Employees Police and Fire Plan (PERA-P&F) plan member due to that employment, to purchase service credit for a period from November 21, 1984, to March 16, 1985, when the individual was working as a firefighter for the city but was not in the plan due to an error made by the City of Faribault. The individual would pay the employee contributions that would have been made at that time plus 8.5 percent interest. The city would pay the remainder of the full actuarial value.

Background Information on Service Credit Purchase Special Legislation

Background information on the topic of special legislation authorizing public pension service credit purchases is attached. That attachment also discusses general law service credit purchase provisions which were enacted into law in 1999 through 2001. These general law service credit purchase provisions often conflicted with prior Commission service credit purchase policies, and may have harmed the pension funds by undercharging for the purchases. Most of these general law service credit purchase provisions were allowed to expire in 2004 by the 2004 Legislature, along with the methodology for computing the purchase amounts. The methodology now in use is less likely to understate the cost of any service credit purchase.

Public Pension Problem of Mr. Todd Rost

Apparently, Mr. Todd Rost has worked as a Faribault firefighter from November 23, 1984, to the current date. However, the city reported him as starting on March 16, 1985, approximately four months after his start date. As a result, the individual is missing about four months of allowable service credit in PERA-P&F.

I spoke with Michelle Mahold, an assistant to the city administrator, and she indicated that Mr. Rost approached the city within the last year indicating there was a problem with his PERA-P&F service credit. The city has reviewed the situation and can find no reason why Mr. Rost should have been excluded from the plan during the first few months of his firefighting service. City representatives have spoke with the Public Employees Retirement Association (PERA) about the situation and were informed that due to the long delay between the date the error occurred and the present time, special legislation would be needed to remedy Mr. Rost's situation. Ms. Mahold has indicated that the city is willing to do what is necessary to correct the situation. The city is aware that S.F. 2141 (Pogemiller); H.F. 2219 (Fritz) has been introduced to address the situation, and that under that language the city will be asked to make a payment to the fund, but it is unclear whether they have received an estimate of the amount of that payment.

Nature of PERA-P&F Plan

The Public Employees Police and Fire Plan (PERA-P&F) is a statewide public safety plan, covering police officers and paid firefighters throughout the state, except for a few remaining local police and paid fire relief associations. Thus, PERA-P&F is a multi-employer plan. The plan's benefits reflect the public safety nature of the plan. The individuals in these plans are assumed to be subject to high risk of injury or death due to the nature of the employment, compared to other public employees covered by general employee plans. A relatively young, vigorous workforce is needed, thus the plan provides high benefits per year of service and transitions individuals into retirement at relatively young ages. The plan provides a retirement benefit of 3.0 percent of the high-five average salary (the average of the salaries in the five-year period providing the highest average) per year of service. Members can retire as early as age 50 with modest reductions due to early retirement, or at age 55 (the normal retirement age for this plan) with no reduction. An individual retiring at age 55 with a high-five average salary of \$50,000 and with 30 years of service credit would receive an annual pension of \$45,000. ($\$50,000 \times 0.03 \times 30 \text{ years} = \$45,000$.) Public safety plan members need a disability benefit program which will provide for their families if the member becomes disabled due to injury, even if that disability occurs shortly after becoming a firefighter or police officer. The plan provides a minimum disability benefit for duty-related disabilitants of 50 percent of the high-five average salary. For disabilitants with longer service, the disability benefit would be computed like a retirement benefit, but without any reductions due to early receipt, if that provides a

higher benefit. The surviving spouse benefits are also generous. If a survivor annuity is payable, the minimum benefit is an annuity of 50 percent of the member's salary at death.

Discussion and Analysis

S.F. 2141 (Pogemiller); H.F. 2219 (Fritz) authorizes a certain Faribault firefighter, who is a PERA-P&F member due to that employment, to purchase service credit for a period from November 21, 1984, to March 16, 1985, when the individual was working as a firefighter for the city but was not in the plan due to an error made by the City of Faribault. The individual would pay the employee contributions that would have been made at that time plus 8.5 percent interest. The city would pay the remainder of the full actuarial value.

The bill raises the following pension and related public policy issues:

1. Consistency with Commission Policy Statement. The bill drafting is generally consistent with the Commission's policy statement regarding service credit purchases. The drafting requires PERA-P&F fund to receive a full actuarial value service credit purchase payment in order to provide the additional service credit. The uncovered service was a period of Minnesota public employment. The drafting assumes that an employer error occurred, and attempts to apply what has become the Commission's standard practice in dealing with these situations: requiring the eligible individual to pay the employee contributions that would have occurred at that time plus interest, while the city would pay the remainder of the full actuarial value. The treatment of the employee is an attempt to treat the individual as similarly as possible to those who worked at the time of the uncovered period but had contributions deducted from pay. The individual covered by this bill did not have contributions deducted. Therefore, if contributions are made now they should include interest to compensate for the time value of money (or alternatively, to compensate the pension fund for the lost investment earnings to the fund that occurred due to not receiving those assets in a timely manner). The interest rate used is equal to the pension fund's investment earnings assumption.
2. Equity Issue. In reviewing these cases, the Commission usually considers equity issues. An issue that does not help the individual is the long delay in seeking a remedy. The error occurred in the mid-1980s. The individual receives statements annually from PERA, and perhaps more frequently. A lack of service credit for the initial employment period should have been evident to the individual soon after the error occurred. At that time, the situation could have been easily remedied, possibly without any legislation, and in any event with a much lesser financial impact on the city. Delay has added to the city's burden. The individual brought the matter to the city's attention only during the last year.
3. City's Position. The bill draft follows the Commission's model for dealing with cases where an employer error occurred. The assistant to the city administrator has indicated to Legislative Commission on Pensions and Retirement staff that the city has researched the matter and can find no explanation for the error other than error by the city, and the city has indicated a willingness to take the actions which the Legislature deems appropriate to correct the situation so that Mr. Rost's pension is not harmed.
4. Cost of the Service Credit Purchase. The issue is whether the employee is willing to make the employee payments plus interest required under the bill, and the remaining amount of the full actuarial value, which the city will be required to pick up. The city has acknowledged error, but it is unclear whether it is aware of the cost that it will be required to cover. PERA hopefully can provide an estimate. Although this is a public safety plan pension, the total cost of the service credit should not be very large because only about four months of service credit would be purchased.

Amendments

Amendment LCPR05-253 makes technical corrections, and adds a few requirements usually contained in bills of this type as recommended to pass by the Commission, but which are missing from this bill draft. The first addition is a requirement that payment cannot be accepted after termination of service. The second addition is language specifying that the applicable service credit will be granted upon receipt of the employee contribution amount. This avoids continued harm to the individual if there is a delay in receiving the required contribution from the employer. The final addition is language specifying that the city contribution amount will be deducted from state aid to the city if not promptly paid by the city.

Amendment LCPR05-254 is a substantive amendment, an alternative to LCPR05-253. Amendment LCPR05-254 would require the eligible individual to pay the full actuarial value, with no mandatory city contribution. This approach is used in cases where the Commission concludes that a service credit purchase is appropriate but the employer did not cause harm and should not be required to pay any of the cost.

Background Information on Service Credit Purchase Special Legislation

Prior service credit purchases are a phenomenon of defined benefit pension plans. Defined benefit plans specify the pension benefit amount, typically through the use of a formula based on the amount of compensation and on the length of service.

Prior service credit purchases are opportunities for pension plan members to obtain allowable service credit and, if applicable, covered salary credit in a defined benefit pension plan for a period that was not otherwise credited through normal pension plan membership. A process is followed in obtaining credit for a prior service credit purchase period, usually involving the payment of some amount to defray all or a portion of the actuarial cost attributable to the purchase and the provision of documentation relating to the service period.

Pension plan members seek prior service credit purchases for a variety of reasons, including a desire to gain defined benefit pension plan portability, a desire to obtain a larger pension benefit, or a desire to qualify for a special early retirement provision.

Principle II.C.10 of the Commission's Principles of Pension Policy, last revised in 1996, covers purchases of service credit and has the following elements:

1. Individual Review. The Commission considers each service credit purchase request separately, whether the request is proposed legislation for a single person or is proposed legislation relating to a group of similarly situated individuals.
2. Public Employment. The period requested for purchase should be a period of public employment or service that is substantially akin to public employment. This is consistent with the notion that public pension plans should be providing coverage for public employees for periods of time when they were serving the public through public employment or through quasi-public employment. Coverage for a period when an individual provided private sector employment is not consistent with this statement.
3. Minnesota Connection. The employment period to be purchased should have a significant Minnesota connection. This is consistent with the notion that Minnesota taxpayers support these public pension plans and bear the investment risk in amassing plan assets. Given the support that taxpayers provide, it is appropriate that the service have a Minnesota connection, reflecting services provided to the people in the state.
4. Presumption of Active Member Status at the Time of Purchase. The principle states that contributions should be made by the member or in combination by the member and by the employer. It is presumed that the individual covered by the service purchase request is an active employee, because retirees generally are not considered to be "members" of a plan and these individuals no longer have a public employer. If there are unresolved issues of whether an individual should have service credit for a given period, those issues should be resolved before the individual terminates from public service, and certainly before the individual retires. The act of retiring undermines a claim that there is sufficient need for the Legislature to consider the coverage issue. If there were considerable hardship caused by the lack of service credit, presumably the individual would not have retired. Entering retirement suggests that the associated pension benefit is adequate without any further increase in the benefit level due to a purchase. Only on rare occasions have the Commission and the Legislature authorized service credit purchases by retirees.
5. Presumption of Purchase in a Defined Benefit Plan. The prior service credit purchase contributions in total should match the associated actuarial liability. The specific procedures in Minnesota Statutes and law for computing service credit purchase amounts, Minnesota Statutes, Section 356.551, presume that the purchase is in a defined benefit plan with a benefit based on the individual's high-five average salary. There is no process in law specifying a procedure for computing a "full actuarial value" purchase in a defined contribution plan, or even defining what that concept means in the context of a service purchase or service credit purchase in a defined contribution plan.
6. Full Actuarial Value Purchase. Within the context of a defined benefit plan, the pension fund should receive a payment from the employee, or from the employee and employer in combination, which equals the additional liability placed on the fund due to the purchase. This amount is referred to as the full actuarial value of the service credit purchase. The procedure used to compute this full actuarial value should be a methodology that accurately estimates the proper amounts. When clear evidence indicates that the employing unit committed an error that caused the individual to not receive pension plan coverage, the Commission has permitted the employee to make the employee contribution for the relevant time period, plus 8.5 percent interest, and the employer has been mandated to cover the remainder of the computed full actuarial value payment. If the employer does not directly make the payment following notification that the employee has made his or her portion of the full payment, the Commission has required that a sufficient amount to cover the remainder of the full actuarial value be deducted from any state aids that would otherwise be transmitted to the employer. The Commission has purposely departed from the full actuarial value requirement when there is evidence that the

pension plan administration created the lack of service credit coverage due to pension plan administration error. In situations of pension plan error, the employee may be required to pay the contributions that would have been required for the relevant time period, plus 8.5 percent interest to adjust for the time value of money, leaving any difference between that payment and the full actuarial value to be absorbed by the pension fund.

7. No Violation of Equity Considerations. Purchases of service credit should not violate equity considerations. Equity is a resort to general principles of fairness and justice whenever the existing law is inadequate. In general, any issue or factor associated with a service credit purchase request which can be viewed as lacking fairness or being less than impartial can be a basis for rejecting a request. Requests by existing retirees to purchase additional service credit and have their annuities recomputed could be viewed as being a situation that violated equity considerations. New requests on behalf of individuals who were covered by purchase of service credit authorizations passed by earlier Legislatures but who are dissatisfied with the purchase of service credit terms that were provided can be considered as violating equity considerations. Individuals requesting service credit purchases for periods specifically excluded from plan coverage under the applicable law could be considered as violating equity considerations, among other policy concerns relating to those considerations. Requests to purchase service credit for periods covered by another pension plan may raise equity concerns. Generally, a service credit purchase is intended to fill a gap in coverage, not to create double coverage. Long delays in seeking remedial action can also be considered a violation of equity considerations. Individuals tend to wait until late in their career before seeking any remedial action for lost service credit. Prompt action, closer to the time period when the service credit problem occurred, would often result in a solution at a lower cost and would avoid efforts by the Commission to try to determine the factual situation many years, or even decades, after the event occurred.

During the period 1957-2004, the Legislature has enacted 240 special laws authorizing one person or a small group of individuals to purchase prior service credit, distributed as follows:

<u>Year</u>	<u>Number</u>	<u>Year</u>	<u>Number</u>	<u>Year</u>	<u>Number</u>	<u>Year</u>	<u>Number</u>	<u>Year</u>	<u>Number</u>	<u>Year</u>	<u>Number</u>
1957	1	1971	2	1979	7	1986	6	1993	7	2000	8
1959	4	1973	4	1980	4	1987	3	1994	8	2001	10
1961	5	1974	5	1981	14	1988	7	1995	7	2002	2
1963	6	1975	10	1982	16	1989	12	1996	6	2003	6
1965	5	1976	4	1983	2	1990	10	1997	3	2004	1
1967	1	1977	9	1984	3	1991	6	1998	9		
1969	2	1978	9	1985	2	1992	6	1999	8		

A majority of special prior service credit purchase laws relate to the three major general employees retirement plans, with 33 special laws relating to the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), with 76 special laws relating to the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and with 43 special laws relating to the Teachers Retirement Association (TRA).

General Law Service Credit Purchase Provisions

In recent years (1999, 2000, and 2001) the Legislature enacted several temporary general law service credit purchase provisions. These were initially added to teacher plan law for TRA and first class city teacher plan members, enabling members to purchase service credit in the applicable plan for a variety of periods. These included periods of military service which occurred before the individual became a teacher, or which occurred during the individual’s teaching career but for which the individual failed to make timely contributions to receive the service credit under other plan law. Other provisions permitted service credit purchases for out-of-state teaching service, maternity leaves/breaks in service, parochial or private school teaching service, Peace Corps or VISTA service, prior charter school service, and periods of teaching employment with nonprofit community-based corporations. In 2000 or 2001, similar military service credit purchase provisions were enacted into law for members of other general employee and public safety plans.

In 2003 the Commission studied the impact of the general law service credit purchase provisions enacted during the 1999 through 2001 period. More than 955 public pension plan members purchased service credit under these provisions. While that number is large in an absolute sense, it represents less than one percent of all public pension plan members.

The general purchase of service credit legislation enacted in 1999, 2000, and 2001 conflicted with the Commission policy as stated in the 1995-1996 Commission Statement of Pension Principles. The 1999-2001 legislation may be viewed as temporary provisions to address a short-term labor shortage situation, warranting a temporary waiver of the standard Commission purchase of service credit policy. No individual review was required. Some of the provisions, like those dealing with military service credit

purchases, violate notions of equity because in some cases they extended a service credit purchase to those who had failed to make the contributions to receive service credit for the military period under other existing military leave laws. The out-of-state teaching service provisions, and some others, lack a Minnesota connection, while other provisions allowed service credit for periods of private rather than public service.

In addition to generally being inconsistent with the Commission's prior service credit purchase policies, the 1999 to 2001 general law service credit purchase provisions used a method to compute full actuarial value which may have harmed the pension funds, particularly in cases where the service credit purchase occurred shortly before retirement. The 2004 Legislature allowed all the provisions to expire except for the military service provisions, which were extended for a few more years. However, the method used to compute the full actuarial value amounts to be charged in these general law service credit purchase provisions (Section 356.55) was allowed to expire. The procedure now in use (Section 356.551) is less likely to harm the pension fund.

1 M moves to amend S.F. No. 2141; H.F. No.
2 2219, as follows:

3 Page 1, lines 9, 12, and 15, delete "fund" and insert "plan"

4 Page 2, after line 11 insert:

5 Subd. 4. [ADDITIONAL REQUIREMENTS.] (a) In addition to the
6 one-year payment limitation in Minnesota Statutes, section
7 356.551, the authority provided by this section is voided if the
8 amount required under subdivision 3, clause (1), from an
9 eligible person is not paid to the executive director of the
10 Public Employees Retirement Association prior to termination of
11 service by the eligible person.

12 (b) Notwithstanding Minnesota Statutes, section 356.551,
13 allowable service credit in the public employees police and fire
14 plan for the eligible person must be granted upon receipt by the
15 executive director of payment from the eligible person of the
16 amount required under subdivision 3, clause (1).

17 (c) If the city of Faribault fails to pay the amount
18 required under subdivision 3, clause (2), within 30 days of
19 notification from the executive director of the amount required,
20 the executive director shall inform the commissioner of the
21 Department of Finance of the amount of the deficiency, and the
22 amount must be deducted from any subsequent state aid to the
23 city."

1 M moves to amend S.F. No. 2141; H.F. No.

2 2219, as follows:

3 Page 1, lines 9, 12, and 15, delete "fund" and insert "plan"

4 Page 1, line 16, delete "due to a mistake made by the city

5 of Faribault" and insert "despite the provided firefighting

6 service"

7 Page 2, line 1, delete "Of this"

8 Page 2, delete lines 2 to 11 and insert:

9 "Subd. 4. [ADDITIONAL REQUIREMENT.] In addition to the

10 one-year payment limitation in Minnesota Statutes, section

11 356.551, the authority provided by this section is voided if the

12 amount required under subdivision 3 is not paid to the executive

13 director of the Public Employees Retirement Association prior to

14 termination of service."

Senator Pogemiller introduced--

S.F. No. 2141: Referred to the Committee on State and Local Government Operations.

1 A bill for an act

2 relating to retirement; authorizing purchase of
3 service credit from the public employees police and
4 fire fund.

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

6 Section 1. [PURCHASE OF SERVICE CREDIT.]

7 Subdivision 1. [ELIGIBILITY.] An eligible person may
8 purchase allowable service credit from the public employees
9 police and fire fund for the period from November 23, 1984, to
10 March 16, 1985. An eligible person is a person who:

11 (1) is currently a member of the public employees police
12 and fire fund; and

13 (2) was employed by the city of Faribault as a firefighter
14 since November 23, 1984, but was not covered by the public
15 employees police and fire fund from November 23, 1984, until
16 March 16, 1985, due to a mistake made by the city of Faribault.

17 Subd. 2. [PURCHASE REQUIREMENTS.] An eligible person must
18 apply to the executive director of the Public Employees
19 Retirement Association to make the service credit purchase
20 authorized in this section. The application must be in writing
21 and must contain documentation required by the executive
22 director.

23 Subd. 3. [PAYMENT.] If an eligible person meets the
24 requirements to purchase service credit under this section, the
25 public employees police and fire fund must be paid the amount

1 determined under Minnesota Statutes, section 356.551. Of this
2 amount:

3 (1) the eligible person must pay an amount equal to the
4 employee contribution rate during the period of service to be
5 purchased, applied to the actual salary in effect during that
6 period, plus interest at the rate of 8.5 percent per year
7 compounded annually from the date on which the contributions
8 should have been made to the date on which payment is made under
9 this section; and

10 (2) the city of Faribault must pay the remainder of the
11 amount determined under Minnesota Statutes, section 356.551.

12 Sec. 2. [EFFECTIVE DATE.]

13 Section 1 is effective the day following final enactment.