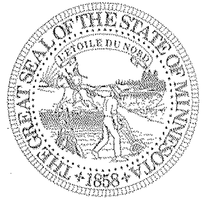

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: H.F. 889 (Murphy, M., by request); S.F.296 (Betzold): PERA Administrative Bill

DATE: March 1, 2007

General Summary of H.F. 889 (Murphy, M., by request); S.F.296 (Betzold)

H.F. 889 (Murphy, M., by request); S.F.296 (Betzold) contains the following provisions related to the Public Employees Retirement Association (PERA):

1. Increases death while active survivor benefits when benefits are deferred;
2. Authorizes health insurance withholding for certain public safety retirees of various plans;
3. Revises receivables allocation procedures for various plans;
4. Clarifies the included employee provision and elected official requirements to commence annuity payments;
5. Clarifies the governmental subdivision status of charter schools and mental health cooperatives;
6. Removes the requirement that the executive director be approved by the Senate;
7. Specifies that no action for recovery of contributions will commence before the initial coverage date;
8. Clarifies death while active or deferred surviving spouse provisions;
9. Temporarily offers full actuarial value service credit purchases for Comprehensive Employment Training Act (CETA) service; and
10. Repeals obsolete or redundant provisions.

Section-by-Section Summary and Analysis

Section 1 amends Minnesota Statutes, Section 353.01, Subdivision 2a, the included employee provision, by clarifying that salaries from all positions held by a person within a governmental unit will be totaled for purposes of meeting the $425 membership salary threshold, and by moving language from another section stating that elected officials retain plan membership for the duration of the person's employment in that position or incumbency in elected office.

PERA intends the changes in Section 1 as clarification rather than policy revision. The change regarding the elected official language is part of an effort to more clearly state PERA's policy on elected official terminations. In addition to the new language in this section of the bill, related new language regarding elected official terminations appears in Section 4 *(7.34 and 8.1-8.6)*. Reading the various statements in combination, if an elected official with PERA defined benefit plan coverage filed a termination of elected employment following a successful reelection but before the new term begins, PERA would not consider this a valid termination for purposes of commencing receipt of an annuity. PERA would recognize the termination notice as being valid for pension purposes if the official resigned from office and remains completely separated from the office for at least 30 days prior to the next election date. The individual might subsequently decide to run for reelection, but at least there is uncertainty whether the individual will be reelected to the office.

Policy issues raised by Section 1 are:

1. Potential for Complaints from Local Elected Officials. Although the revised language may be consistent with current PERA policy and PERA's interpretation of its laws, the more explicit statement proposed for law will make that policy more apparent, which may create complaints from a local elected official who previously was not aware of the policy.

2. Possible Impact on Individuals Other Than Elected Officials. The issue is whether the proposed revision might harm certain seasonal employees who were allowed to retain PERA membership in 2001 under a grandfather provision. The Commission may wish to hear brief testimony as to how PERA intends to interpret this language. In 2001, PERA coverage provisions were revised to exclude certain seasonal employees, in addition to elected officials, from commencing General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) coverage after June 30, 2002. As part of that legislative package, the now-existing law language in paragraph (b) *(2.4-2.11)* was added to grandfather any existing PERA members who otherwise would be excluded from membership due to that change. The question is whether the new proposed language *(2.8-2.10)* may impact some seasonal employees who appeared to be grandfathered in under the 2001 changes. The

existing law language retains membership until the employee terminates public employment or terminates plan membership; while under the proposed language the individual would remain covered "for the duration of the person's employment in that position..." While that seems more restrictive, if the individual were to move to another position which qualifies for PERA coverage, that individual would remain a PERA active member due to employment in that new position. The Commission may wish to explore through testimony if there is a circumstance under which the existing law continues coverage that the new language, in conjunction with other law, would not also cover, and whether any legislative remedy in the form of an amendment should be offered.

- **Amendment H0889-1A** retains the current membership retention for employees other than elected officials language to avoid an unintended impact on seasonal employees.

Section 2 amends Minnesota Statutes, Section 353.01, Subdivision 2b, PERA's excluded employee provision, by striking language to be moved to Section 1.

Section 3 amends Minnesota Statutes, Section 353.01, Subdivision 6, PERA's definition of governmental subdivision by:

1) Including units or instrumentalities of local governments;
2) Clarifying that a public body is a government subdivision if it is established under state or local government authority that has a governmental purpose, is under public control, is responsible for the employment and payment of the salaries of the entity's employees, and which receives a major portion of its revenues from taxation, fee assessment, or from other public purposes, rather than whose revenues are derived from those sources;
3) Including charter schools; service cooperatives exercising retirement plan participation under Section 123A.21; various joint powers boards, family service collaboratives, and children's mental health collaboratives, if the creating entities are governmental units that otherwise qualify for retirement plan membership;
4) Stating that family service collaboratives or children's mental health collaboratives are not governmental subdivisions if the board is not totally composed of representatives of governmental units;
5) Adding a paragraph stating that a 501(c)(3) nonprofit corporation or a nonprofit under Minnesota Statutes, Section 317A, is not a government subdivision unless the entity has obtained a written advisory opinion from the federal Department of Labor or an Internal Revenue Service (IRS) ruling declaring the entity to be an instrumentality of the state, and if its inclusion in PERA would be consistent with government plan qualification requirements in federal code; and
6) Adding a paragraph stating that if PERA determines that an organization is a government subdivision, it shall be subject to the PERA coverage for its eligible employees on a prospective basis.

Policy issues raised by Section 3 are:

1. Proper Date to Commence Coverage. Under proposed new language in paragraph (f), if PERA determines that an employing unit, which previously had not participated in the plan, meets the definition of a governmental subdivision under PERA law, coverage for the applicable employees is "on a prospective basis upon receipt of a written notice of eligibility from the association." PERA will not commence action to recover any omitted employee or employer contributions for any period prior to the initial plan coverage date of the governmental subdivision *(13.1-13.3)*. This treatment is appropriate if the employing unit met the definition of a governmental subdivision on the day that PERA made the determination. It raises questions if the employing unit met the definition of a governmental subdivision months or even years before the PERA review and determination letter. As drafted, PERA will neither require nor permit any past contributions or service credit purchases to cover this past service.

2. Equitable Treatment of Employees. The issue is whether the proposed treatment is fair to the employees if these employees were providing public-like service prior to the date of PERA's determination letter. Not allowing contributions or service credit purchases for periods when the individual was providing service that was equivalent to public employment or quasi-public employment seems inconsistent with general policy.

3. Likely Requests for Service Credit Purchases. This proposed treatment may lead to future special legislative requests to purchase this uncovered public or quasi-public service. However, any remedy, if the Commission deems it appropriate, may need to consider whether the individuals had some form of pension coverage during the period in question in order to avoid creating double coverage.

Potential Amendments. If the Commission concludes that coverage should be retroactive if PERA determines that an entity met the definition of a governmental subdivision before the date of PERA's determination letter, the Commission may wish to consider an amendment requiring contributions from the date that PERA concludes that an organization became a governmental subdivision. The plan's omitted deduction provision (which permits contributions to be required up to three years retroactively and places most of the payment obligation on the employer) could be used, at least in part, to address this situation. Several amendments for Commission consideration are:

- **Amendment H0889-2A** states that if the entity met the definition of a governmental subdivision prior to PERA's determination letter, PERA's omitted contribution provision would apply from the date that the organization first met the definition of a governmental subdivision. If the period exceeds three years, the individual could purchase that portion of the total period at full actuarial value. These procedures do not apply if the employment was covered by any public or private defined benefit or defined contribution plan, other than a volunteer fire plan.

- **Amendment H0889-3A** is comparable to H0889-2A, except that the procedures do not apply if the employment was covered by any Minnesota defined benefit plan, other than a volunteer fire plan.

- **Amendment H0889-4A** is also comparable to H0889-2A, except that rather than the individual purchasing service credit for any period in excess of three years, the employer would be required to make that purchase on behalf of the employee.

- **Amendment H0889-5A** is comparable to H0889-3A, except that the procedures do not apply if the employment was covered by any Minnesota defined benefit plan, other than a volunteer fire plan.

- **Amendment H0889-6A** is substantively different than the prior amendments. This amendment would simply delete all new language specifying treatment when an entity receives notice from PERA indicating that the organization is a governmental subdivision under PERA law and its members must be covered by PERA. By not including this language, the issue of whether coverage should be retroactive, if the entity met the definition of government subdivision prior to PERA's determination letter, is left unspecified. This would allow the Commission to further review the matter, and to decide on a policy next year rather than this year.

Section 4 amends Minnesota Statutes, Section 353.01, Subdivision 28, PERA's definition of retirement, by removing language that prohibited individuals from receiving a coordinated plan annuity if the individuals were PERA-General Basic Plan members or PERA Police and Fire Plan members who, after brief termination, commence PERA-General coordinated employment but provide less than six months of coordinated service prior to again terminating; by permitting a PERA defined benefit plan retirement annuity to commence although an individual becomes an elected official within 30 days of separation from employment covered by one of PERA's defined benefit plans; and by permitting elected officials who were covered by PERA-General for that elected official employment to commence drawing an annuity if the individual resigns from office before filing for reelection and by remaining completely and continuously separated from that office for at least 30 days prior to the election date. The revisions to clarify elected official policy were discussed under Section 1, above.

PERA has indicated that it seeks the deletion of the provision relating to PERA-General Basic Plan members or Public Employees Police and Fire Plan (PERA-P&F) members who become coordinated members due to revisions in Social Security government pension offset law. An explanation of the government pension offset provision and an explanation of the motivation behind the provision, downloaded from the Social Security website, is attached. That provision considerably reduces the Social Security surviving spouse benefit that would be paid to a surviving spouse if that surviving spouse had coverage by a basic rather than coordinated retirement program. In the past, these Social Security offsets or reductions would not apply if the surviving spouse was covered by a coordinated retirement program, rather than a basic program, on the last day of employment. A change in Social Security law a few years ago made it much harder to avoid that offset. For those who terminate employment on or after July 1, 2004, they must have been covered by a coordinated program for at least five years, rather than one day, prior to termination.

Given the change in Social Security law from the one-day to five-year requirement, PERA contends that individuals seeking to shift from a basic plan to a coordinated plan for a brief period prior to actual retirement is no longer a factor, and that the applicable language can be stricken. The Commission may wish to hear testimony from PERA to determine the appropriateness of the proposed deletion.

- **Amendment H0889-7A** reinstates the "basic member shift to coordinated plan" language.

Section 5 amends Minnesota Statutes, Section 353.03, Subdivision 3, PERA's board powers provision, by revising the provision for style, and by authorizing PERA to adopt rules necessary to comply with IRS and federal Department of Labor requirements.

Section 6 amends Section 353.03, Subdivision 3a, the PERA executive director appointment provision, by striking the requirement that the appointment be made with the advice and consent of the Senate; and by stating that two unspecified positions may, rather than shall, serve in the unclassified service.

The requirement that an individual cannot become the executive director of PERA unless the Senate gives its approval is one of several changes made to PERA law in 1985, as the Legislature responded to PERA administrative problems and allegations of corruption.

In the 1970s and early 1980s, PERA had a 15-member board dominated by employee representatives. A report from Senate hearings in 1984 on PERA indicates that beginning in the mid-1970s, John Allers, then the president of School Service Employees Local #284, began using his influence to take control of the PERA board. Mr. Allers gained the loyalty of the elected board members, in part by using the resources he controlled to pay for mailings to promote certain candidates for the elected member board positions. By the late 1970s, Mr. Allers had effective control of the board, and his dominance extended to PERA staff and operations. Testimony and written documents provided to the 1984 Senate Government Operations Committee investigating PERA indicated that the PERA staff was intimidated by Mr. Allers' influence. PERA's executive director from 1979 through part of 1984, Michael McLaren, described Mr. Allers' extraordinary influence over the board and the entire PERA organization. When Mr. McLaren was asked what he thought would happen if he disagreed or failed to implement any request by Mr. Allers, Mr. McLaren responded, "I guess I was not sure, and I guess I probably didn't want to find out."

The Senate report also documented questionable favorable treatment provided to John Allers' son, Shane Allers. According to the report, in 1981 Shane Allers was hired by PERA in a position created for him at the insistence of John Allers and Mr. McLaren after Shane Allers failed to be hired for two open PERA positions because other candidates were more qualified. Initially, staff was directed to fire one of the two successful candidates, to be replaced by Shane Allers. When staff refused to do so, staff was then directed to create a third position, which was given to Shane Allers. After Shane Allers was hired, PERA administrators contended they were pressured to promote Shane Allers and to ignore normal promotion practices and other qualified candidates. Shane Allers progressed rapidly within PERA; within four years of starting at PERA, Shane Allers received 17 salary increases.

In addition to these management/staffing issues, a report by the Legislative Auditor (*PERA Financial and Compliance Audit for Fiscal Year 1984*) was sharply critical of questionable or clearly improper expenditures by the PERA board and executive director and of poor financial controls in general. Board members may have been reimbursed multiple times for the same expenses or received payments intended as reimbursement when the expenses had actually been covered by other parties. Decisions to attend out-of-state conferences seemed to be at the discretion of the individual board member, with no prior authorization needed from the board as a whole. In some cases, PERA paid for airline tickets and other expenses for business that did not appear to be related to PERA duties. PERA used pension assets to pay for a fishing trip for various legislators, lobbyists, PERA staff, and board members. PERA created a term life insurance program for PERA members without legislative authorization to do so. PERA made payments on contracts that were unsigned or otherwise not properly executed. PERA made payments to John Allers totaling $788, apparently for consulting services, although no written contract existed.

The audit report contended that the PERA board reimbursed Executive Director Michael McLaren for certain moving expenses which were inappropriate, and recommended that the board seek repayment of more than $9,000. In addition, the Legislative Auditor concluded that the board overpaid Mr. McLaren by $6,000 for education expense reimbursement, paying the tuition cost of an MBA program even though Mr. McLaren dropped out of the program. The report also suggested that PERA's executive director may have improperly increased the annuities of two influential individuals. The executive director personally revised those pension benefit computations, overriding the computations of his staff. According to Mr. McLaren, he made those changes based on his interpretation of the applicable statutes. However, in questioning those actions, the audit report noted that the executive director did not seek any input from the Office of the Attorney General regarding his interpretations, and the report claims that comparable changes were not made in the annuities of similarly situated individuals. During 1984, Mr. McLaren left PERA to take a similar position with the California Teachers Retirement System. The audit questioned the severance pay provided to Mr. McLaren relating to unused vacation and other matters, and recommended that the board seek reimbursement from Mr. McLaren for a week he was in California on personal business and for which he failed to use vacation time. Soon after Mr. McLaren started his new position in California, it became publicly known that

he had a consulting contract with the California system in addition to his salary and position as executive director of the California pension plan. A California newspaper speculated that the combination of the executive director salary and the consulting contract was an effort to circumvent maximum salary limitations that applied to the executive director position. Questions also arose about the nature of his expenses and expense reimbursement while employed by the California fund. About two months after starting the California position, he was terminated by the California Teachers Retirement System.

John Allers served for a while as PERA's executive director. After Mr. McLaren's dismissal from the California executive director position, there was speculation that Mr. McLaren might return as PERA's executive director, but that did not occur given the 1985 legislation.

To address the many problems at PERA, the 1985 Legislature removed PERA's board and replaced it with a smaller board, with the composition revised to reduce the influence of employee representatives. The 15-member board was replaced with an 11-member board, the State Auditor or designee was added, and five of the remaining ten positions are appointed by the Governor. As a further check on hiring decisions of the board, the PERA executive director was required to be confirmed by the Senate. A requirement was added that the executive director must have a minimum of five years experience in a pension fund and have demonstrated management ability. PERA was required to follow personnel policies generally applicable to state employees. State law, which previously set a maximum salary for the executive directors of the Minnesota State Retirement System (MSRS) and Teachers Retirement Association (TRA), was revised to also include the PERA executive director (previously, the salary had been set by PERA's board, and the PERA executive director's salary had been considerably in excess of that paid to the TRA and MSRS executive directors, although the duties were comparable). The PERA executive director also had more generous expense account provisions, including a car allowance.

The policy issue raised by Section 6 is:

1. Continuing Need for Safeguard. The issue is whether there is a continuing need to require Senate approval of the PERA executive director. The requirement was placed in PERA law in the mid-1980s as part of a package to address problems with PERA's board and the administration of PERA pension funds. The Commission might conclude that the safeguard should remain; or conclude that the situation that necessitated this provision has passed and the requirement can be removed. The MSRS and TRA executive directors are not required to be approved by the Senate.

- **Amendment H0889-8A** would reinstate the requirement that the PERA executive director be approved by the Senate.

Section 7 revises Minnesota Statutes, Section 353.03, Subdivision 4, a provision regarding PERA office space in the State Capitol or other state government buildings, to remove obsolete language since PERA is now located in the public pension plan building.

Section 8 amends Section 353.27, Subdivision 12, PERA's omitted salary deduction provision, by adding a paragraph stating that the association will not commence action for any omitted employee or employer deductions for any period prior to the initial plan coverage date of the governmental subdivision. This change is part of the change discussed above under Section 3, and policy issues and potential amendments are discussed there.

Section 9 amends Section 353.28, Subdivision 6, a collection provision which allows PERA to tap aid or appropriations to a government entity to cover obligations to PERA which are at least 60 days overdue, by adding language specifying how collected amounts will be prorated if the amount is insufficient to meet the full obligation, and by specifying that if the applicable government subdivision has been dissolved or closed, the 60-day waiting period is waived and amounts can be immediately certified for collection.

Policy issues raised by Section 9 are:

1. Appropriateness of the Prorating Procedure. The issue is whether any prorating procedure is needed and, if it is, whether the proposed prorating procedure is appropriate. Under the drafting, if the amount collected is not sufficient to cover the full obligation, the amount will be applied first to unpaid employee deductions, second to unpaid employer contributions, and third to unpaid interest on the employee and employer amounts.

2. Effectiveness of the Procedure if the Governmental Unit is Closed. The Commission may wish to hear brief testimony from PERA on whether it is practical to collect amounts from a governmental subdivision that has been dissolved or closed. PERA contends that appropriations or aid amounts are

sometimes made shortly after a unit has been dissolved, and that these amounts could be tapped to meet PERA or other public pension plan obligations. However, due to the requirement in existing law that the plan must wait at least 60 days after amounts have become due before taking any collection action, any available amounts have already been seized by other creditors. Hence, PERA is proposing in the draft to waive the 60-day requirement if the employing unit has been closed.

- **Amendment H0889-9A** removes the proposed procedure for closed or dissolved employing units by deleting paragraph (c) *(13.29-13.32)*.

Section 10 amends Minnesota Statutes, Section 353.29, Subdivision 3, a PERA retirement annuity formula provision, by removing obsolete cross-references and revising for style.

Section 11 amends Section 353.30, Subdivision 1a, PERA's "Rule of 90" provision, by correcting cross-references and by clarifying that the individual must terminate from service before the annuity can commence.

Section 12 amends Section 353.30, Subdivision 1b, a PERA pre-1989, 30 years of service provision, is revised by correcting cross-references, clarifying language, including clarifying that the individual must terminate from service before the annuity can commence.

Section 13 amends Section 353.30, Subdivision 1c, by clarifying that the individual must terminate from service before the annuity can commence, by correcting cross-references, and by removing redundant 30 years of service language (which also is found in section 12 above).

Section 14 amends Section 353.32, Subdivision 1a, a PERA death while active or deferred surviving spouse benefit provision, by clarifying which benefit computation procedures apply to survivors of pre-July 1, 1989, hires rather than survivors of employees hired on or after that date; by generally clarifying language; and by stating that the payment is to be based on the allowable service on the date of death, and the age of the survivor and the age the member would have been on the date that the benefit commences, rather than upon their ages on the date of death.

Section 14 increases survivor benefits in cases where the survivor delays receipt of the survivor annuity. Existing law bases the annuity amount on the age of deceased and the age of the survivor on the date of the member or former member's death. Under the proposed drafting, the survivor annuity would be based on the survivor's age and the age that the member would have been on the date payment begins. This increases the survivor annuity amount compared to current law whenever the survivor delays receipt of the annuity, because the ages used in the calculation will be older (thus, any reduction due to receipt of an annuity before normal retirement age will be reduced). Except for this change, all other revisions in this section are intended as clarification, and if the PERA executive director determines that any of these other changes have the effect of revising annuity amounts, the executive director is required to propose corrective legislation (this requirement is found in the effective date section, 20.23-20.32 and 21.1-21.2).

Policy issues raised by Section 14 are:

1. Appropriateness of Benefit Improvement in Administrative Legislation. The issue is whether a benefit improvement, although modest, should be included in an administrative bill. In the past, the Commission has often removed benefit enhancement provisions from administrative bills. In some instances, however, the Commission has decided that provisions impacting benefits may be included, provided that the Commission has had adequate information about the changes and adequate time to consider them.

2. Inconsistencies Between Comparable Plans. The Commission and the Legislature have generally tried to keep benefit plans for similar employees comparable. Prior to 2004, the death while active or deferred surviving spouse provisions of the major general plans (MSRS-General, PERA-General, TRA, and the first class city teacher plans) all based the annuities on the ages of the survivor and the deceased on the date of death. In 2004, the Legislature revised the TRA procedure to base death while active or deferred survivor annuities on the age of the deceased at the time of death and the age of the survivor when the benefit commences. PERA is now proposing a third variation, to base the survivor annuity on the age of the survivor when benefit commences and the age the deceased would have been on that date.

   The three procedures should produce comparable results in comparable situations if the survivor benefit commences immediately following the death of the active or deferred member. (In addition to assuming that the deceased individuals from the various plans all had the same salary and length of service, we must also assume the same accrual rates are used. This latter assumption will not hold exactly for TRA going forward, because the 2006 legislation merging the Minneapolis Teachers Retirement Fund Association into TRA also increased the TRA accrual rate for post-July 1, 2006,