State of Minnesota \ LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: H.F. 1139 (Murphy, M., by request); S.F. 629 (Betzold): MSRS Administrative Provisions

DATE: March 1, 2007

General Summary of H.F. 1139 (Murphy, M., by request); S.F. 629 (Betzold)

H.F. 1139 (Murphy, M., by request); S.F. 629 (Betzold) makes accrual date revisions in the Legislators and Judges plans to make them consistent with other Minnesota State Retirement System (MSRS) plans; clarifies University of Minnesota employee coverage; permits General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) coverage for incidental employment as state employees by teachers; revises interest payment requirements on authorized unpaid leaves of absence and requires full actuarial value payment if payment is not received within one year of the end of the leave; removes the death while active or deferred five-year, term-certain survivor option and removes the 75 percent of prior pay limit on those benefit amounts; clarifies applicable contribution rates on breaks in service to provide military service; clarifies the application of MSRS law to State Fire Marshal employees; adds an anti-garnishment provision to the health care savings account law; clarifies Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified) coverage groups; authorizes transfers from MSRS-Unclassified to MSRS-General up to one month after termination of employment; removes all retroactivity to MSRS-Unclassified annuities; and revises the MSRS/Public Employees Retirement Association (PERA) combined payment provision.

Section-by-Section Summary and Analysis

Section 1 amends Minnesota Statutes, Section 3A.02, Subdivision 1, the Legislators Retirement Plan retirement qualification provision, by having the annuity accrue following the executive director's receipt of the application rather than beginning with the first day of the month of receipt of application; by removing obsolete language; and by clarifying that an unreduced retirement requires that the annuity commence no earlier than normal retirement age (currently age 62).

Section 1 can be considered to be the Legislators Retirement Plan normal retirement age provision. The proposed revision clarifies the provision and removes obsolete language, but one question is whether it also may slightly revise accrual dates.

Policy issues raised by Section 1 are:

1. Possible Delay in Accrual Date. While the new language seems to revise accrual dates, the change may not have any substantive impact. The existing law language (which is being stricken) states (page 2, lines 8-9) that the annuity accrues "beginning with the first day of the month" in which the application is received. That suggests that if the application is made on, for example, the 20th of the month, the annuity is retroactive to the first of the month. In contrast, the new language states that the annuity accrues "following receipt by the director." That suggests that if application is made on the 20th the annuity would now accrue on the 20th rather than retroactive to the first of the month, or possibly in practice it would commence on the first day of the following month. However, none of this may matter because of existing law language, page 2, lines 14-16, which allows annuities to be retroactive up to 180 days. Thus, under the existing law language and under the proposed language, it seems that the retiring legislator could have the annuity accrue at the beginning of the month in which the application is made, or even earlier, provided that on or before the specified accrual date the legislator had left the Legislature and satisfied applicable age and service requirements.

2. Consideration of Legislators Plan Early Retirement Provision Revision. **Amendment H1139-1A** could be used to also clarify the plan's early retirement provision, Section 3A.02, Subdivision 1b, to more clearly state the minimum early retirement age, which is age 55, and to remove obsolete language. Under existing law, that minimum early retirement age was described, but not specified, to be set by the MSRS board with a requirement that it not be earlier than the MSRS-General early retirement age. When the board implemented that provision several years ago, it set the Legislators Retirement Plan early retirement age equal to that of MSRS-General, which is age 55. This amendment can be used to insert age 55 in place of the process described in the law to set that age.

Section 2 amends Minnesota Statutes, Section 352.01, Subdivision 2a, the MSRS-General included employees provision, by removing obsolete language and by clarifying that MSRS coverage includes employees of the University of Minnesota unless excluded by action of the University Board of Regents.

MSRS proposes to remove from the included employee provision employees of the Disabled American Veterans and Veterans of Foreign Wars if employed before July 1, 1963, and employees of the Armory Building Commission. Also, MSRS would add a University of Minnesota reference. That proposed language is a mirror opposite of language currently in the MSRS excluded employee provision. That existing law language, which appears on page 4, lines 14 and 15, excludes from MSRS coverage any University of Minnesota employees excluded by the Board of Regents.

Section 3 amends Minnesota Statutes, Section 352.01, Subdivision 2b, the MSRS-General excluded employees provision, by moving language to more appropriate clauses; by clarifying that independent contractors are excluded regardless of the payment arrangement excluding interns hired for six months or less unless the individuals are eligible for an immediate appointment at the end of that period; by removing obsolete language related to the Comprehensive Employment and Training Act (CETA); and by permitting MSRS-General coverage for teachers for incidental employment as a state employee not covered by one of the teacher retirement associations.

Policy issues raised by Section 3 are:

1. Implications of Intern Language. The Commission may wish to have testimony from MSRS regarding the proposed language for interns to determine whether this is a substantive change which could create harm, or whether it amounts simply to clarification. (On page 5, lines 18 to 19, MSRS is adding a statement that formally excludes from coverage "interns hired for six months or less" unless the individuals are eligible for immediate appointment to a permanent position at the end of the intern period.) The new language may be intended as clarification that interns are another name for or are equivalent to "trainee employees" who are already excluded from coverage unless they qualify for immediate appointment at the end of that period.

   **Amendment H1139-2A** would remove the proposed intern language.

2. Implications of Expanding Coverage to Include Certain Incidental Employment by Teachers. The language on page 5, lines 28 and 29, would allow certain teachers who are receiving a full year of service and salary credit in a teacher pension plan to be covered by MSRS-General for incidental employment as a state employee not covered by a teacher plan. An example provided by MSRS is that of a teacher who has a full year of coverage by the applicable teacher plan due to teaching service provided during the school year, and who is employed in the summer as a groundskeeper or maintenance worker at a state university. This secondary employment is state employment that would ordinarily qualify the individual for MSRS-General coverage, but existing law prohibits that coverage because of language (page 5, lines 25 to 27) excluding the individual due to the full year of teacher plan coverage.

   The most likely justification for the existing law language is to prohibit double coverage. Under that existing language, state employees who are teachers and who are covered for that teaching employment by a teacher plan cannot also be covered for that same employment by MSRS-General. However, it is unclear the extent to which the existing law language reflects an intended legislative policy regarding incidental state employment situations by teachers.

   Under existing law, a teacher who provides some additional employment beyond that necessary to qualify for a full year of service in the teacher plan will be treated differently for pension purposes depending upon the nature of the incidental employer. If the additional employment is teaching summer school for the same school district or another district covered by the plan, the additional salary would be included for pension purposes and would boost the eventual pension computation amount if it fell within the highest five salary years. However, if the supplemental employment was as a state employee in work not covered by the teacher plan, that employment would be uncovered. Under current law, MSRS is prohibited from providing coverage.

   MSRS is proposing to allow MSRS-General coverage for that incidental employment situation. The outcome would be similar to having all employment covered by the teacher plan, except that the eventual total pension benefit would be the sum of benefits from two plans, the teacher plan and MSRS-General, rather than from one plan. Presumably, the Combined Service Annuity provision, Section 356.30, would be used, and the benefit would be based on the combined salary from both positions, assuming these years fell into the high-five years.

The proposed treatment seems consistent with permitted treatment under current PERA law. PERA's excluded employee provision, Section 353.01, Subdivision 2b, Clause (6), excludes from PERA coverage any individual required by law to be covered by another plan. However, that clause includes a statement that "this clause must not be construed to prevent a person from being a member of and contributing to the Public Employees Retirement Association and also belonging to and contributing to another public pension plan or fund for other service occurring during the same period of time."

The Commission may wish to consider whether to allow the MSRS proposed treatment. The proposal does seem consistent with treatment permitted under PERA law. However, the proposal will increase MSRS liabilities, and seems likely to impact teacher plans through the effect of combining salary for benefit computation purposes under the combined service annuity provision. The Commission may wish to hear testimony from TRA or other teacher plans regarding concerns they may have about this provision.

**Amendment H1139-3A** removes the proposed teacher supplemental employment provision.

Section 4 amends Minnesota Statutes, Section 352.01, Subdivision 11, the MSRS allowable service provision, by removing obsolete language related to pre-July 1, 1957, service; by moving language to new paragraphs; and by revising the authorized leave of absence clause by referencing a new payment procedure found in Section 5.

Section 5 proposes new language in the form of Minnesota Statutes, Section 352.02, the authorized leave of absence service credit purchase procedure. Members of MSRS plans covered by Chapter 352 who go on an authorized leave of absence without pay, not to exceed one year, and who want to obtain service credit, can purchase service credit for the leave period by making the contributions plus interest within one year of the end of the leave, or by paying full actuarial value thereafter.

The intention of the revised leave payment requirements in Sections 4 and 5 is to address flaws in the payment requirements for MSRS authorized leaves to better protect the pension fund. Under the leave provision as stated in current law, an individual may obtain service credit by paying the employee and employer contributions within one year of returning from the leave, without interest. If contributions are not made within that timeframe, they may be made any time prior to retirement with 8.5 percent interest (the predicted long-term investment return rate; i.e., the assumed actuarial rate of return).

The existing law arrangement harms a defined benefit pension fund. Any delay in receiving contributions shortchanges the pension fund by not receiving interest to compensate for the lost investment earnings. When contributions are delayed more than one year, the existing law provision does require interest, but the total payments can be far less than the value of the service credit received if there is a considerable delay in making payment.

To keep a pension fund whole when contributions are made shortly after returning from the leave, interest is needed. When delays are longer, it is best from the standpoint of the pension fund to not allow any service credit purchase. The next best alternative, when there is a long delay, is to require payment of full actuarial value. A full actuarial value payment is intended to equal the additional liability created in the fund by the purchase. Thus, the individual is neither penalized nor subsidized, and none of the true cost of the service credit purchase is shifted to other plan contributors. Any full actuarial value estimation method, however, must be accurate to provide the desired result. Allowing full actuarial value payments does place some risk on the pension fund – the risk that the payments will not be sufficient due to errors in the methodology and in the many assumptions used in the computation.

Although in recent decades the Commission has emphasized maintaining the financial health of the pension funds, the payment policy for leave of absence situations in pension plans is often deficient, because the Commission has not recently reviewed and revised those payment terms. Section 356B.05 requires pension plan administrators to adopt uniform proposals to address features of their defined benefit plans. One area where that law specifically requires the administrators to recommend uniform proposals to the Commission is leaves of absences. Although this administrative proposal mandate has been in the law since the mid-1990s, the administrators have yet to provide a proposal.

Attachment A provides a brief summary of payment terms for leave of absence provisions in the general employee plans, MSRS, PERA, TRA, and the first class city teacher plans. Measured against a goal of protecting the pension fund, many of the procedures are deficient, some considerably deficient. The attachment indicates that many plans have provisions allowing service credit for military leaves/breaks in service. The federal government requires consistency of pension plan provisions with the Uniformed Services Employment and Reemployment Rights Act (USERRA). The military leaves/breaks in service provisions in Minnesota law are the result of legislation enacted in 2004 (Laws 2004, Chapter 267, Article 3) to make Minnesota plans compliant with USERRA. That federal-mandated compliance required some tradeoff against protecting to the fund. Under these provisions, individuals who went on a military leave from their Minnesota public employment or who had a break in that Minnesota public service to provide military service, can make employee contributions to the pension fund during a time period that is three times the length of the provided military service, but not less than one year or more than five years. If the employee makes the contribution, the employer is required to make the employer contributions. USERRA is generally interpreted as prohibiting charging the employee any interest. To limit the shortfall to the pension fund, the Legislature required the employer to cover the interest on the employee and employer contributions. Despite that interest requirement, because of the possible extended time periods, the actuarial value could exceed the payments made to the pension fund.

The plans also have service credit purchase for uncredited military service provisions. These are the last of the full actuarial value service credit purchase provisions enacted into law in the late 1990s and early 2000s covering various types of uncovered service. All provisions except those involving military service have expired. These provisions allow service credit purchases by individuals who performed military service before becoming public employees, or who had a break in public service but failed to take advantage in a timely manner of the more generous treatment under the military leaves/breaks in service provision discussed above. The purchase terms are full actuarial value and prior to retirement.

In non-military service situations, the PERA personal/parental/medical leave provisions protect the fund reasonably well. The provision requires payment of contributions plus interest within one year of the end of the leave, with payments not permitted after that date. An improvement might be to require interest from the midpoint of the leave. The PERA periodic/repetitive leave has similar requirements. The TRA sabbatical leave treatment is fiscally sound – the employee, who must receive a minimum of one-third salary while on the leave, will have full-time equivalent employee contributions deducted from pay, and the employer also transmits the corresponding employer contributions to the fund, so payment is received by the fund at the time that the service credit would be earned. Other TRA leave provisions are not fiscally sound, as they delay receipt of contributions until after the end of the leave and do not require interest. The TRA parental leave requires payment of contributions by the end of the fiscal year following the fiscal year in which the leave occurs, but without interest. The TRA family leave is similar. First class city teacher plan leave requirements tend to be similar to those of TRA. MSRS, rather than having several different leave provisions, has one, its general leave of absence provision. The provision is not fiscally sound – it permits payments to be made within one year of the leave without interest, or with 8.5 percent annual interest any time prior to retirement. The lack of interest in the year following the leave, and the lack of a full actuarial value requirement when payment is made many years later can harm the fund.

The last leave provision noted in Attachment A is a service credit for strike periods provision applicable to most plans, coded in Chapter 356. This provision represents the Commission's most recent work on leave of absence or similar provisions, and was enacted in 2005. To receive service credit for a strike period, the provision requires payment of employee and employer contributions plus interest within one year of the end of the strike, or a full actuarial value payment if made after one year and before five years of the end of the strike. Payments are not permitted after five years.

Policy issues raised by Sections 4 and 5 are:

1. <u>Treatment of Current Leaves</u>. The new payment procedure would apply to leaves commencing after the effective date. The issue is the whether the revision should apply to existing leaves.

2. <u>Need for Change/Nature of Change</u>. The issue is whether the revised MSRS authorized leave of absence payment procedure should be enacted. The revised procedure will better protect the pension fund by requiring interest on payments made within the year following the leave, and by requiring a full actuarial value payment thereafter.

   **Amendment H1139-4A** removes the revised procedure, leaving the existing process unchanged.

   **Amendment H1139-5A** keeps the proposed revised procedure but prohibits payments after five years (like the five-year requirement enacted in 2005 in the strike period service credit purchase provision) rather than allowing full actuarial value payments up to the time of retirement.

   Another alternative is for the Commission to remind plan administrators of the requirement in law that they submit a uniform proposal to the Commission in an administrative bill, and to delay any action until a future year when that more global proposal can be reviewed. An argument for not delaying is that the types of changes MSRS is proposing are likely to be part of any uniform approach that the Commission might adopt, and any delay will only prolong harm to the fund.

Section 6 revises Minnesota Statutes, Section 352.12, Subdivision 2a, the MSRS-General death while active or deferred surviving spouse term-certain provision, by striking the five-year term-certain option, and by striking the requirement that monthly payments not exceed 75 percent of the high-five monthly salary of the deceased employee.

MSRS notes that the five-year term-certain option in death while active or deferred cases is one that might be selected by a surviving spouse who is gravely ill with a very limited life expectancy. In recent years, MSRS and PERA have proposed removing the five-year term-certain annuity, in part because that option no longer qualifies for favorable tax treatment.

The proposal is to strike the five-year term-certain option and the requirement that payment not exceed 75 percent of the deceased member's high-five average salary. The Commission and the Legislature revised the comparable PERA provision in 2006 (Laws 2006, Chapter 271, Article 3, Section 24), but in a manner that differs from the MSRS proposal. PERA proposed to remove the five-year option but did not recommend removing the 75 percent cap on monthly payments. Consistent the PERA's request, the 2006 Legislature removed the PERA five-year term-certain but left the 75 percent cap language in law. In written comments, MSRS contends that the 75 percent of high-five salary limit creates a hardship for some surviving spouses facing financial difficulty, and that the existing law language negatively impacts the survivors of a deceased long-service employee near retirement. The Commission may wish to consider that if the five-year option is removed, (which requires a large payout over a few-year period), it is less likely that the 75 percent of salary cap language will be problematic. That might be why PERA did not propose striking its 75 percent cap language in 2006.

The policy issue raised by Section 6 is:

1. Nature of the Change. The issue is whether to remove the MSRS five-year death while active or deferred term-certain survivor annuity option and the 75 percent of salary cap, or just the five-year term certain, or just the 75 percent cap, or neither. The Commission may wish to hear testimony from PERA about the 2006 legislation and from MSRS regarding why its proposal should differ from PERA law. In 2006, the Commission removed PERA's five-year term certain, but left the 75 percent cap.

   **Amendment H1139-6A** removes section 6, leaving the provision unchanged.

   **Amendment H1139-7A** removes the five-year term-certain option but leaves the 75 percent cap.

   **Amendment H1139-8A** leaves the five-year term-certain option but removes the 75 percent cap.

Section 7 revises Minnesota Statutes, Section 352.27, the MSRS credit for break in service to provide uniformed service provision, by clarifying that the applicable contribution rates are those of the plan under Chapter 352 that provides the coverage. As discussed previously, this is a USERRA-compliant military leave/break-in-service provision enacted in 2004 and covering employees in the MSRS plans included in Chapter 352 (MSRS-General for most employees; MSRS-General with minor variations for certain Military Affairs employees, transportation pilots, and State Fire Marshal employees; and the Correctional Employees Retirement Plan of the Minnesota State Retirement System (MSRS-Correctional), all of which are defined benefit plans. The drafting is an effort to clarify that the applicable contribution rates are those in the chapter for the specific plan providing the coverage.

The policy issue raised by Section 7 is:

1. Lack of a Provision for Defined Contribution Plans. The proposed clarification of applicable contribution rates in this provision is not controversial. If there is a noticeable deficiency in military leave/break-in-service policy, it is the lack of any provision for USERRA-compliant military leave/break-in-service provisions for defined contribution plans. In 2004, the Legislature made the various defined benefit plan provisions USERRA-compliant, but did not address the question of what, if anything, should be done for defined contribution plans. The primary defined contribution plans are the Unclassified Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), covering legislative employees, high-level officials in the Executive Branch, and many legislators; the PERA Defined Contribution Plan, covering local government officials, some public employee physicians, city managers, St. Paul Port Authority employees, and emergency rescue personnel; and the various individual retirement account plans (IRAP, for higher education employees, the Arts Board, Humanities Commission, and Minnesota Historical Society).