



H.F. 2762
(Wardlow)

S.F. xxxx

Executive Summary of Commission Staff Materials

Affected Pension Plan: TRA
Relevant Provisions of Law: Special legislation
General Nature of Proposal: Prior out-of-state teaching service credit purchase
Date of Summary: March 2, 2008

Specific Proposed Changes

- Authorizes a relatively short-service TRA member with four years of prior teaching service in Illinois to purchase TRA service credit for that out-of-state teaching service.

Policy Issues Raised by the Proposed Legislation

1. Conformity with Commission's Principles of Pension Policy.
2. Appropriateness of a special law prior service credit purchase immediately after general law authority expired.
3. Service credit purchase cost and allocation.
4. Precedent for and any adverse precedent value in proposed legislation.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Lawrence A. Martin, Executive Director *JAM*
RE: H.F. 2762 (Wardlow); S.F. xxxx: TRA; Service Credit Purchase for Prior Illinois Teaching Service
DATE: March 2, 2008

Summary of H.F. 2762 (Wardlow); S.F. xxxx

H.F. 2762 (Wardlow); S.F. xxxx permits Cheryl Donely to purchase up to 4.188 years of TRA allowable and formula service credit for her Illinois teaching service upon the payment of a full actuarial value payment amount, including an institution-to-institution account balance transfer from the Illinois Teachers Retirement System. The special authority is effective immediately and expires on January 1, 2010.

Public Pension Problem of Cheryl Donely of Eagan, Minnesota

Cheryl Donely is a 31-year-old resident of Eagan, Minnesota, who is currently on a family leave of absence from her position as a mathematics teacher at Apple Valley High School, Independent School District No. 196, where she has taught since the 2002-2003 school year, is a member of the Minnesota Teachers Retirement Association (TRA), and has 4.2 years of prior teaching service in Illinois public education.

Ms. Donely seeks authority to purchase TRA service credit for her Illinois teaching service by rolling over her Illinois Teachers Retirement System account balance.

Background Information

Background information on the functions of service credit in a defined benefit retirement plan and the purchase of prior service credit is set forth in Attachment A.

Discussion and Analysis

H.F. 2762 (Wardlow); S.F. xxxx permits Cheryl Donely, an on-leave Apple Valley High School teacher and a resident of Eagan, Minnesota, with prior public school teaching service in Illinois to purchase from the Minnesota Teachers Retirement Association (TRA) service credit for that out-of-state teaching service with the payment of a full actuarial value purchase amount, including a transfer of her Illinois Teachers Retirement System account balance.

The proposed prior service credit purchase legislation raises several pension and related public policy issues for Commission consideration and discussion, as follows:

1. Conformity with Commission's Principles of Pension Policy. The policy issue is the extent to which the proposed legislation conforms with the Commission's pension policy principles. Although the 1996 Commission policy principle on prior service credit purchases is more constrained, Commission practice since 1999 has been less restrictive, principally requiring that the service credit purchase should not be subsidized by the retirement plan through a purchase at less than full actuarial value and should not replicate service credit purchased in some other defined benefit public pension plan. The proposed legislation requires a full actuarial value purchase payment and excludes from the purchase authority any service credit already purchased from another defined benefit public pension plan, thus complying with recent Commission policy principle practice.
2. Appropriateness of Permitting An Out-of-State Teaching Service Credit Purchase After the General Purchase Has Expired. The policy issue is the appropriateness of authorizing a special law out-of-state teaching service credit purchase when the general law out-of-state teaching service credit purchase authority enacted in 1999 has now expired. Former Minnesota Statutes, Section 354.534, permitting out-of-state teaching service purchases, was enacted in 1999 (Laws 1999, Chapter 222, Article 16, Section 16), with a scheduled expiration date of May 16, 2002, was extended in 2002 (Laws 2002, Chapter 392, Article 7, Section 1) to May 16, 2003, was extended in 2003 (First Special Session Laws 2003, Chapter 12, Article 6, Section 2) to May 16, 2004, and was extended in 2004

(Laws 2004, Chapter 267, Article 17, Section 6) to July 1, 2006, when it expired. By the 2005-2006 school year, Ms. Donely had the three years of Minnesota Teachers Retirement Association (TRA) service credit needed to be eligible to purchase this service credit at that time, but did not avail herself of that opportunity. Thus, the proposed special legislation effectively becomes a deadline extension, which Commission policy principles indicate are to be determined on a case-by-case basis and determined based on the equities. The Commission may wish to take testimony from Ms. Donely to determine whether or not the lack of utilization of Minnesota Statutes 2002, Section 354.534, in a timely fashion is problematic with respect to this request.

3. Cost of the Service Credit Purchase and Its Allocation. The policy issue is the cost of the service credit purchase and the allocation of that cost. The service credit purchase payment is calculated as the actuarial present value of the purchase and the cost is payable by the plan member unless the employer decides to participate or is mandated to share a portion of the cost because of its error causing the service credit loss. TRA has apparently estimated that the prior service credit purchase payment would be approximately \$12,000. The value of Ms. Donely's Illinois Teachers Retirement System account is approximately 80 percent of that payment obligation, leaving her to fund the balance from other sources. The full actuarial value cost of prior service credit purchases is highly dependent on the age of the purchaser, the length of service credit to be purchased, and whether or not the purchase is covered by the "Rule of 90" or other early normal retirement access provisions. Even though this purchase involves a relatively long period, the full actuarial value payment obligation is mitigated by Ms. Donely's relatively young age for a service credit purchase and by her status as a post-1989 hire and coverage solely by the level benefit TRA benefit tier rather than by the "Rule of 90."
4. Precedent. The policy issue is whether or not there is previously enacted legislation that could be considered to be a binding precedent for this special legislation request and whether or not the requested special legislation, if enacted, would create an adverse or detrimental precedent for future additional special legislation requests. The 1999 general authorization of prior out-of-state teaching service credit purchases (Laws 1999, Chapter 222, Article 16, Section 16, Section 2) would constitute a favorable precedent for the substance of the requested special legislation, but its expiration could be argued to constitute an adverse precedent for new or continuing out-of-state teaching service credit purchase authorizations. In 2006 (Laws 2006, Chapter 271, Article 14, Section 3), the Commission approved a special law out-of-state teaching service authorization for a Northfield, Minnesota, teacher with 11.2 years of prior Montana teaching service, which is a closely analogous situation to Ms. Donely's. If enacted, the requested special legislation would not appear to create any additional detrimental precedent.

Attachment A

Background Information on Retirement Plan Service Credit and Service Credit Purchases

- a. Defined Benefit Plans. Most Minnesota public pension plans are defined benefit plans. In defined benefit plans, the pension benefit amount that is ultimately payable is pre-determinable or fixed using a formula or comparable arrangement. The fixed element of the benefit amount leaves a variable element, which is the funding required to provide that benefit. The formula utilizes allowable service credit and salary credit in the calculation, averaging the salary amounts for the five successive years' average salary period that produces the highest amount for use as the base to which is applied a total percentage amount determined by assigning a percentage amount to each year of allowable service credit.
- b. Historical Shift in Plan Types and to Salary-Based Plans. Minnesota's statewide retirement plans were not originally salary-related pension plans, with the predecessor to TRA established in 1915 as a money purchase (defined contribution) plan, with MSRS-General established in 1929 as a set dollar amount (\$200 per month) plan, and with PERA-General established in 1931 also as a set dollar amount (\$200 per month) plan. Conversion to salary-related pension plans occurred for MSRS-General and PERA-General in 1957, which was a recommendation of the initial interim predecessor to the Legislative Commission on Pensions and Retirement, and for TRA in 1969, which was a recommendation of the initial permanent predecessor to the Pension Commission. The first class city teacher retirement fund associations and Minneapolis Employees Retirement Fund (MERF) generally shifted to salary-related pension plans in the 1950s (the Duluth Teachers Retirement Fund Association (DTRFA) shifted in 1971).
- c. Definition of Minnesota Defined Benefit Public Pension Plan Service Credit. Allowable service credit in Minnesota's statewide and major local defined benefit retirement plans generally includes many different service periods, which are:
 1. Covered Current Service. Employment is a covered position with a covered employer for which member contributions have been deducted and transmitted to the retirement plan;
 2. Historic Credit in Plan Records. Service credit as reflected in the records of the retirement plan that predates the plan's establishment or reformulation;
 3. Military Service Leave. Periods of service in the U.S. Armed Forces during a leave of absence;
 4. Temporary Disability Periods. Periods of leaves caused by a temporary disability;
 5. Credit Reinstated by a Refund Repayment. Periods of service covered by a prior refund of member contributions which have been repaid subsequently;
 6. Part-Time Employment. Periods where full service credit is granted for part-time employment;
 7. Sabbatical Leaves and Other Leaves of Absence with Pay. Periods of an authorized leave of absence during which the member is paid a whole or a partial salary;
 8. Extended Leaves of Absence Without Pay. Periods of an authorized leave of absence without pay;
 9. Labor Union Employment or Elective Service. Periods of employment as an exclusive collective bargaining representative or as an elected official;
 10. Parental or Family Leaves of Absence. Periods of leaves or breaks in service for parental or family reasons;
 11. Strike Periods. Periods of a labor union strike; and
 12. Out-of-State Teaching or Other Outside Service. Periods of teaching service, Peace Corps service, or VISTA service.
- d. Purpose of Service Credit. Service credit in a Minnesota defined benefit retirement plan exists for three reasons, determining vesting rights, determining eligibility for an early normal retirement annuity, and determining the amount of a retirement annuity.

Vesting is the circumstance of possessing a non-forfeitable right to an eventual retirement annuity, even if covered employment is terminated before reaching retirement age. In virtually all Minnesota defined benefit retirement plans, the vesting period is three years of service credit, which need not be consecutive periods of service and which may include service covered by more than one Minnesota defined benefit retirement plan.

Early normal retirement annuity eligibility in Minnesota defined benefit retirement plans generally means qualification for the “Rule of 85,” where a member can retire with an unreduced retirement annuity when the sum of the person’s age and service credit total at least 85, or for the Minneapolis Employees Retirement Fund (MERF) or the Basic Program of the Minneapolis Teachers Retirement Fund Association (MTRFA-Basic), means qualification for the “30 and out” unreduced retirement annuity payable when a person has credit for at least 30 years of service credit.

Retirement annuity determination is the calculation of a member’s defined benefit retirement annuity, using the plan’s benefit accrual rate percentage (frequently 1.7 percent per year of service credit), multiplied by the member’s service credit, and the total applied to the member’s final average salary figure (highest five years average salary).

Defined benefit retirement plans exist to provide a retirement annuity at the conclusion of an employee’s normal working lifetime. Service credit allows for the retirement plan to bear its proportional share of the burden of the ultimate total retirement annuity amount.

- e. Special Legislation Service Credit Purchase Authorization. In Minnesota, until 1999, there were few general law service credit purchase authorizations, and service credit purchase authorizations were generally special law provisions.

The primary general law service credit purchase authorization was Minnesota Statutes 2004, section 354.51, enacted in 1931, when the Teachers Retirement Association (TRA) was a defined contribution retirement plan, which allows TRA members with 15 years of service who have pre-1953 out-of-state teaching service to purchase that service by making equivalent member contributions, plus interest at the rate of 8.5 percent per annum.

During the period 1957-2007, the Legislature has enacted 257 special laws authorizing one person or a small group of individuals to purchase prior service credit, distributed as follows:

| Year | Number | Year | Number | Year | Number | Year | Number | Year | Number |
|------|--------|------|--------|------|--------|------|--------|------|--------|
| 1957 | 1 | 1974 | 5 | 1983 | 2 | 1992 | 6 | 2001 | 10 |
| 1959 | 4 | 1975 | 10 | 1984 | 3 | 1993 | 7 | 2002 | 2 |
| 1961 | 5 | 1976 | 4 | 1985 | 2 | 1994 | 8 | 2003 | 6 |
| 1963 | 6 | 1977 | 9 | 1986 | 6 | 1995 | 7 | 2004 | 1 |
| 1965 | 5 | 1978 | 9 | 1987 | 3 | 1996 | 6 | 2005 | 1 |
| 1967 | 1 | 1979 | 7 | 1988 | 7 | 1997 | 3 | 2006 | 14 |
| 1969 | 2 | 1980 | 4 | 1989 | 12 | 1998 | 9 | 2007 | 3 |
| 1971 | 2 | 1981 | 14 | 1990 | 10 | 1999 | 8 | | |
| 1973 | 4 | 1982 | 16 | 1991 | 6 | 2000 | 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 80 special laws relating to the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and with 50 special laws relating to the Teachers Retirement Association (TRA).

In considering special law service credit purchase requests, the Legislative Commission on Pensions and Retirement has generally followed the Principles of Pension Policy, restated and revised in 1996, with the pertinent principle requiring:

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, Sections 356.55 and 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 Equitable Considerations. Purchases of service credit should not violate equitable 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.

f. 1999-2004 General Service Credit Purchase Provisions. The recently expired full actuarial value service credit purchase provisions and the years in which they were enacted are as follows:

1999

- Military service (TRA and first class city teacher plans)
- Out-of-state teaching service (TRA and first class city teacher plans)
- Maternity leave or absence or maternity break-in-service (TRA and first class city teacher plans)
- Parochial or private school teaching service (TRA and first class city teacher plans)
- Peace Corps and VISTA service (TRA and first class city teacher plans)
- Charter school teaching (TRA and first class city teacher plans)
- Previously uncredited part-time teaching service (first class city teacher plans)

2000

- Military service (various MSRS plans, PERA plans)
- Teaching service credit for various nonprofit Community Based Corporation service (TRA and first class city teacher plans)

2001

- Out-of-country and tribal teaching service credit (TRA and first class city teacher plans)
- Developmental Achievement Center teaching service (TRA and first class city teacher plans)
- Uncovered teaching service at University of Minnesota (TRA and first class city teacher plans)
- Parental leave/break-in-service (teacher plans, various MSRS and PERA plans, various other plans)

In 1999, the Commission was persuaded to support several proposed generalized service credit purchase provisions applicable to the Teachers Retirement Association and the first class city teacher retirement fund associations (the Duluth Teachers Retirement Fund Association, the Minneapolis Teachers Retirement Fund Association, and the St. Paul Teachers Retirement Fund Association). Under these provisions, classes of individuals (those with prior military service, out-of-state teaching service in a K-12 situation, individuals who taught in parochial schools, provided Peace Corps service and various other groups), were permitted to purchase service credit in the applicable Minnesota plan for the specified service. These provisions, which were strongly supported by teacher groups, conflicted with the Commission's policy statement in several ways. All lacked any requirement of an individual review of the circumstance. Others were not related to public service or had no Minnesota connection.

In 2000, more service credit purchase provisions were added to law, this time for non-teacher plans, providing a full actuarial value service credit provision for individuals who had military service prior to becoming a public employee, or who failed to pay contribution requirements in a timely manner under other military leave service credit purchase provisions. These provisions enacted in 2000 were comparable to the military service credit provisions added to teacher plan law a year earlier. In 2000, teacher plan law was also revised to permit full actuarial value service credit purchases for non-profit community-based teaching service.

In 2001, several other service credit purchase provisions were enacted. An out-of-country teaching service credit purchase provision was created in teacher plan law, and also one for Development Achievement Center teaching. These new provisions included sections of law permitting purchase of service credit, not to exceed ten years, in the teacher plans for service while teaching at the University of Minnesota which was not covered by a pension plan at the university. These provisions stemmed from a legislative request for the executive director of the Minneapolis Employees Retirement Fund, who many years earlier taught some accounting courses at the University while employed in a position that was excluded from pension plan coverage. The final generalized service credit provision enacted was a family leave provision permitting individuals who may be covered by a teacher plan, or any of several other general employee and public safety plans, to purchase service credit for the past family leaves or family-related breaks-in-service.

There are several reasons why the Commission and Legislature may have supported the general law service credit provisions since 1999. First, the provisions were intended to be temporary. Each was set to expire a few years after enactment. The departure from policy may have been viewed as a short-term departure from established policy to address short-term market conditions for teachers. Second, the Legislature had been given assurances that the provisions created no financial harm to the pension funds because the purchases would be at full actuarial value. The methodology to compute full actuarial value purchase prices had been revised in 1998, and the teacher unions and the administrators of the teacher pension funds were confident that the procedures would produce accurate price estimates, thereby shielding other fund contributors from subsidizing these purchases. When the revised methodology was enacted in 1998 as Minnesota Statutes, Section 356.55, the section included