



**H.F. 3242**  
(Peppin)

**S.F. 3127**  
(Limmer)

## **Executive Summary of Commission Staff Materials**

*Affected Pension Plan:* PERA-P&F  
*Relevant Provisions of Law:* Special legislation  
*General Nature of Proposal:* Service credit transfer from PERA-General to PERA-P&F  
*Date of Summary:* March 2, 2008

### **Specific Proposed Changes**

- A 17-year Maple Grove Fire Department employee seeks to transfer credit for the initial 5.75-year period from PERA-General to PERA-P&F.

### **Policy Issues Raised by the Proposed Legislation**

1. Equitable considerations.
2. Nature of 1990-1995 firefighter duties.
3. Adequacy of additional required funding for transfer.
4. Extent of municipal error and municipal financial responsibility.
5. Appropriate handling of past Social Security fire department employment coverage.
6. Past precedents for and potential adverse precedents from proposed special legislation.



TO: Members of the Legislative Commission on Pensions and Retirement  
FROM: Lawrence A. Martin, Executive Director *JAM*  
RE: H.F. 3242 (Peppin); S.F. 3127 (Limmer): PERA-P&F; Transfer of PERA-  
General Service Credit for Maple Grove Fire Inspector Employment  
DATE: March 2, 2008

Summary of H.F. 3242 (Peppin); S.F. 3127 (Limmer)

H.F. 3242 (Peppin); S.F. 3127 (Limmer) permits Marilyn Arnlund to have her 5.75 years of service credit in the Coordinated Program of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) for initial Maple Grove Fire Department employment transferred to the Public Employees Police and Fire Retirement Plan (PERA-P&F) if Ms. Arnlund applies for the transfer, is determined to have met the eligibility requirements for PERA-P&F coverage as a firefighter for the period April 2, 1990, to January 1, 1996, and makes an additional member contribution equivalent to the difference between the PERA-General and PERA-P&F member contribution rates, plus 8.5 percent compound interest. If Ms. Arnlund pays the additional member contributions and interest, the City of Maple Grove is required to pay the balance of the difference in the full actuarial value of the benefits for the 5.75-year period between PERA-General Coordinated Program and PERA-P&F not covered by the transfer of PERA-General assets accumulated on Ms. Arnlund's behalf and by Ms. Arnlund's additional member contribution payment. The transfer authority would expire on July 1, 2009.

Public Pension Problem of Marilyn Arnlund

Marilyn Arnlund is an employee of the City of Maple Grove in the Fire-Rescue Department, where her title is "Deputy Fire Marshal and Fire Inspector." Ms. Arnlund was hired by the City of Maple Grove as a full-time employee on April 2, 1990, as a fire inspector. Ms. Arnlund was covered by the Coordinated Program of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) from April 2, 1990, until January 1, 1996. On November 20, 1995, the Maple Grove city council approved a resolution that made Ms. Arnlund's position eligible for retirement coverage by the Public Employees Police and Fire Retirement Plan (PERA-P&F), effective January 1, 1996.

Ms. Arnlund is approaching retirement age, is concerned that her benefit coverage for the period April 2, 1990, to December 31, 1995, is less lucrative under the PERA-General Coordinated Program than under the PERA-P&F, and seeks to have her April 2, 1990, to December 31, 1995, service credited by PERA-P&F rather than by the PERA-General Coordinated Program. Ms. Arnlund and Maple Grove Finance Director Jim Knutson argue that she responded to day time fire calls as a fire inspector before 1996 with PERA-General Coordinated Program coverage in the same manner as she does now with PERA-P&F coverage and that all Maple Grove fire inspectors have had PERA-P&F coverage for their employment since January 1, 1996.

Ms. Arnlund does not address the question, but City of Maple Grove Finance Director Jim Knutson indicates that she understands that the coverage transfer would require her payment of the additional required PERA-P&F member contributions and that the city understands that it owes the additional required PERA-P&F employer contributions.

Background Information

Relevant background information on the following topics attached:

- Attachment A: Background Information on the Coordinated Program of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General)
- Attachment B: Background Information on the Public Employees Police and Fire Retirement Plan (PERA-P&F)
- Attachment C: Comparison between PERA-General and PERA-P&F Benefit Plans

## Discussion and Analysis

H.F. 3242 (Peppin); S.F. 3127 (Limmer) assists Marilyn Arnlund, a Maple Grove deputy fire marshal and fire inspector, by transferring 5.75 years of service credit in the Coordinated Program of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) to the Public Employees Police and Fire Retirement Plan (PERA-P&F) related to earlier fire department service with the transfer of assets between the two retirement funds and the payment of additional amounts by the member and the municipality.

The proposed legislation raises several pension and related public policy issues for Commission consideration and discussion

1. Equitable Considerations. The policy issue is the nature and weight of the equitable considerations in favor of and against the proposed service credit transfer for Ms. Arnlund. While the Legislative Commission on Pensions and Retirement does not have a specific policy principle related to proposed service credit transfers, a general theme in the Commission's Principles of Pension Policy is that proposed legislation should not violate equitable considerations. While the attached written materials provided by Ms. Arnlund do not specifically address the equity issue, the materials indicate that her job responsibilities during the period covered by PERA-General were the same as they are now, when she is covered by PERA-P&F, suggesting that she is the victim of a mischaracterization of her initial full-time fire department employment period that now is working to her pension benefit detriment. The potential adverse consideration principally relates to the failure of either Maple Grove or Ms. Arnlund to address the proper retirement coverage issue for the 1990-1995 period when the retirement coverage was changed prospectively only in 1995 and the reasonableness of 12 years of delay since 1995 in seeking a resolution of any dispute over her eligibility for PERA-P&F coverage between 1990 and 1995. The Commission may wish to request that Ms. Arnlund and the City of Maple Grove provide additional information or arguments about why the 1995 retirement plan change was not accompanied by the resolution of the 1990-1995 retirement coverage issue and why a delay of an additional 12 years to address the past coverage issue is not unreasonable.
2. Nature of 1990-1995 Firefighter Duties. The policy issue is whether or not Ms. Arnlund's fire department duties during the period 1990-1995 were sufficiently akin to those of a firefighter that retirement coverage by the PERA-P&F plan would be appropriate. Section 1, Subdivision 5, of the draft conditions any service credit transfer on substantiation, to the satisfaction of the PERA executive director and/or PERA board, of the nature of 1990-1995 duties as public safety employment. Not all fire department positions qualify for PERA-P&F retirement coverage, which is reserved for those employees with the special or additional hazards associated with police or fire employment. If it is unlikely that Maple Grove or Ms. Arnlund can satisfactorily carry the burden of providing that substantiation, the Commission may need to consider whether or not to expend valuable legislative time on processing the proposed special legislation.
3. Adequacy of Additional Required Funding for Transfer. The policy issue is the adequacy of the additional funding that the proposed legislation requires to accompany the service credit transfer. Service credit transfers are either a version of service credit purchase or are closely related to service credit purchases, where Commission policy requires that some party other than the retirement fund provide additional funding to offset the additional pension liability resulting from the purchase or transfer. The proposed legislation complies with the Commission's primary prior service credit purchase requirement by requiring the new pension liability created in PERA-P&F by the transfer be offset by the PERA-General asset transfer, an additional member contribution payment, and an additional employer payment. Because pension benefit coverage is largely funded from anticipated investment income and because retroactive service credit is akin to purchasing fire insurance once a building already is on fire, the interest charge on the additional member contribution will be significant as will the total additional payments required.
4. Extent of Municipal Error and Municipal Financial Responsibility. The policy issue is the manner in which the additional financial burden of the service credit transfer is allocated, based on the extent of past error by the City of Maple Grove. As Commission policy has developed over the past decade in service credit purchases, if the employer made an error that caused a loss of service credit or incorrect service credit, the employer will be required to pay the largest portion of the additional funding required. In his May 7, 2007, memorandum to PERA, Maple Grove Finance Director Jim Knutson indicates that the city understands that it has an additional employer contribution responsibility, but does not specifically admit any municipal error and suggests that the city's additional liability would be limited to past due employer contributions. The proposed legislation limits Ms. Arnlund's

responsibility to the additional PERA-P&F member contributions payable, plus interest at the actuarial interest assumption rate of 8.5 percent, with the City of Maple Grove responsible for the balance of the unfunded pension liability to be caused by the service credit transfer, as if the city erred in Ms. Arnlund's situation. If the city does not believe that it erred in reporting Ms. Arnlund to PERA-General for pension coverage between 1990 and 1996, it may object to being assessed the most significant portion of the additional cost of the service credit transfer. The Commission likely will need additional information about any alleged city error in and after 1990.

5. Appropriate Handling of Past Social Security Fire Department Employment Coverage. The policy issue is how to handle the Social Security coverage that Ms. Arnlund has for her 1990-1996 Maple Grove Fire Department employment, when she was covered by the PERA-General Coordinated Program. PERA-P&F is retirement coverage that is provided instead of Social Security, while PERA-General Coordinated Program retirement coverage supplements Social Security. After three years, past Social Security coverage or the absence of past Social Security coverage cannot be revised under federal law, so Ms. Arnlund's Social Security coverage for the 1990-1996 period cannot be modified. Providing her with PERA-P&F coverage for the 1990-1996 period potentially constitutes excessive coverage on top of that Social Security coverage in comparison with any Maple Grove firefighter with solely PERA-P&F coverage during the same period. In at least one case, that of Rice County correctional employees inappropriately reported for PERA-P&F while remaining covered by Social Security during the mid-1990s, the Commission provided an offset from the PERA-P&F retirement annuity for any Social Security coverage from Rice County employment at the same time (see Minnesota Statutes, Section 353.652). If the Commission pursues the issue and believes that Ms. Arnlund is being inappropriately enriched by the double coverage by both Social Security and PERA-P&F during the period 1990-1996, some similar offset could be considered by the Commission in this instance.
6. Precedent. The policy issue is whether there is any precedent for this type of special legislation and whether the potential draft proposed legislation could constitute an inappropriate future precedent. There are some precedents for this proposed legislation, which are:
  - Laws 1977, Chapter 429, Section 57: Transfer of pre-1/1/1970 Ramsey County Sheriff's department employment covered by PERA-General to PERA-P&F.
  - Laws 1980, Chapter 341, Section 7: Extension of PERA-P&F coverage to St. Anthony City public works employee with secondary firefighter duties.

The proposed legislation could become a precedent within the Maple Grove fire department if there are other similarly situated fire inspectors before 1996 and could become a precedent for other fire marshals and other fire inspectors that could be problematic if the transfer is ultimately subsidized by the pension plan or if the transfer liability is disproportionately shifted to the city without ample documented evidence of a prior municipal error.

## Appendix A

### Background Information on the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General)

- a. History. The Public Employees Retirement Association (PERA) was established in 1931. The legislation governing the plan was modeled heavily on the 1929 law governing the State Employees Retirement Association (SERA), renamed in 1969 as the Minnesota State Retirement System (MSRS). PERA was the third major statewide public pension plan established by the Legislature, following the creation of the predecessor to the Teachers Retirement Association (TRA) in 1915 and the creation of SERA in 1929. PERA was the second public pension plan that was established by the Legislature for local government general (not specifically police or fire) employees, after the Minneapolis Municipal Employees Retirement Plan (now the Minneapolis Employees Retirement Fund (MERF)) in 1919. The 1931 PERA plan was the predecessor to the current PERA General Employee Retirement Plan.

Because PERA preceded the creation of the Social Security system (federal Old Age, Survivors, and Disability Insurance Program (OASDI)) and because Social Security initially did not extend to federal, state, or local government employees, PERA was a “basic” program. This means that the public employee’s entire retirement benefit comes from the public pension plan, without any Social Security benefit. PERA coordinated with Social Security for hospital employees in 1963 and for other local government employees in 1967.

The 1931 PERA plan membership was optional for governmental subdivisions and, if the governmental subdivision elected to be a participating employer, was optional for employees employed before April 24, 1931, and was mandatory for employees employed after April 23, 1931. All counties, all first (except Minneapolis), second, and third class cities, including home rule cities, all public schools (except the Minneapolis Public Schools), and all villages with a population of at least 7,000 were eligible to be participating employers. Employees of a participating employer who were not paid in whole or in part from public funds, or who were covered by another public pension plan, or who were temporary employees, or who had an average length of employment annually of less than six months were excluded from PERA membership.

In 1974, until 1977, the minimum salary threshold for PERA membership was increased to \$150 in any month during a year, or \$1,800 annually. The minimum salary threshold for PERA membership was increased in 1977 to \$250 in any month during a year or \$3,000 annually in 1977. In 1981, the minimum salary threshold for PERA membership increased to \$325 in any month during the year, or \$3,900 annually. The minimum salary threshold for PERA membership was set at \$425 in any month during the year or \$5,100 annually in 1988. In 2001, the exclusion from PERA membership was shifted from a minimum threshold salary to a minimum number of calendar days (185) per business year.

The 1931 PERA benefit plan provided a superannuation benefit at age 65 with 20 years of service credit or at any age with 35 years of service credit in an amount equal to 50 percent of the person’s final five years of service, to a maximum of \$150 per month, and subject to reduction if annual contributions to the pension plan were less than the total superannuation annuities payable. The superannuation annuity was not initially payable until July 1, 1935, and if the retiring member rendered or purchased PERA service credit was less than 20 years, the superannuation annuity would be prorated based on the relationship of total PERA service credit to 20 years. PERA initially also provided disability benefits, but did not provide survivor benefits. PERA repealed its disability benefit coverage in 1933.

In 1973, the salary base for calculating retirement annuities was shifted from a career average salary to a highest five successive years' average salary. The benefit accrual formula rates were also reset from the prior four-part backloaded percentages to a two-part set of backloaded percentages:

	Basic Program	Coordinated Program
First ten years	2.0 percent	1.0 percent
Thereafter	2.5 percent	1.5 percent

An unreduced normal retirement annuity also was made payable at age 62 with 30 years of allowable service.

In 1980, the 1969 Minnesota Adjustable Fixed Benefit Fund was replaced by the Minnesota Post Retirement Adjustment Fund and the basis for the post-retirement adjustment was shifted from a total rate of investment performance to investment yield.

In 1982, the "Rule of 90" early unreduced retirement annuity provision, when the sum of age and service credit total at least 90, was added. The actuarial equivalent early retirement reduction process was replaced by an early retirement reduction factor of one-quarter of one percent per month under age 65. In 1983, the 1982 early retirement reduction factor was extended to retirement before age 63 with 30 years of service. In 1984, the early retirement age was lowered to age 55 with 30 years of allowable service.

In 1987, vesting for a retirement annuity was reduced to five years of allowable service. In 1989, vesting for a retirement annuity was reduced to three years of allowable service. Two alternative benefit tiers were established, with the prior "Rule of 90" normal retirement age and a two-part backloaded benefit accrual rate provision constituting one benefit tier, and a later normal retirement age level benefit accrual rate provision constituting the other benefit tier. Normal retirement age for the level benefit formula tier is indexed to the Social Security full benefit receipt age. The early retirement reduction under the level benefit formula tier is set at the full actuarial equivalent amount.

In 1992, the Minnesota Post Retirement Investment Fund post-retirement adjustment formula was modified, with a portion based on the increase in the federal Consumer Price Index and a portion based on a five-year average of total rate of investment performance.

In 1997, the benefit accrual rate percentages were increased from 2.0 percent and 2.5 percent to 2.2 percent and 2.7 percent for the Basic Program and 1.0 percent and 1.5 percent to 1.2 percent and 1.7 percent for the Coordinated Program. The post-retirement adjustment formula under the Minnesota Post Retirement Investment Fund was also modified to reduce the Consumer Price Index portion.

- b. Current Actuarial Condition and Benefit Plan. The General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) is governed by Minnesota Statutes, Chapter 353, and various other provisions of law. It is a defined benefit retirement plan that provides disability coverage, survivor benefits, and retirement coverage to over 144,000 public employees throughout the state, other than public safety employees. PERA-General provides coverage to public employees who work for the counties, cities, and in non-teaching positions in school districts. PERA currently has over 56,000 retirees and 35,000 deferred retirees. PERA-General assets exceed \$12.5 billion, but liabilities exceed \$16.7 billion, creating a funding ratio of 74.7 percent. To deal with plan contribution deficiencies, the 2005 Legislature phased in contribution rate increases. The employee contribution rate is 6.0 percent of pay in 2008. The employer contribution rate is 6.0 percent in 2008, with an employer additional contribution of 1.0 percent of pay in 2010.

The table below presents the plan's actuarial condition as of June 30, 2007:

	2007	
<u>Membership</u>		
Active Members		146,226
Service Retirees		52,554
Disabilitants		1,988
Survivors		6,894
Deferred Retirees		39,722
Nonvested Former Members		<u>109,599</u>
Total Membership		356,983
<u>Funded Status</u>		
Accrued Liability		\$17,705,626,649
Current Assets		<u>\$13,500,024,678</u>
Unfunded Accrued Liability		\$4,205,601,971
Funding Ratio	76.25%	
<u>Financing Requirements</u>		
Covered Payroll		\$4,957,789,826
Benefits Payable		\$784,013,433
Normal Cost	7.78%	\$385,359,657
Administrative Expenses	<u>0.19%</u>	<u>\$9,419,801</u>
Normal Cost & Expense	7.97%	\$394,779,458

2007		
Normal Cost & Expense	7.97%	\$394,779,458
Amortization	<u>4.77%</u>	<u>\$236,486,575</u>
Total Requirements	12.74%	\$631,266,033
Employee Contributions	5.88%	\$291,588,497
Employer Contributions	6.38%	\$316,425,146
Employer Add'l Cont.	0.00%	\$0
Direct State Funding	0.00%	\$0
Other Govt. Funding	0.00%	\$0
Administrative Assessment	<u>0.00%</u>	<u>\$0</u>
Total Contributions	12.26%	\$608,013,643
Total Requirements	12.74%	\$631,266,033
Total Contributions	<u>12.26%</u>	<u>\$608,013,643</u>
Deficiency (Surplus)	0.48%	\$23,252,390

Being a defined benefit plan means that PERA-General's retirement benefit is specified by a formula in law. Under these formulas, the average of salary close to retirement (the average of the five consecutive years that provides the highest average salary) is multiplied by a factor or factors referred to as accrual rates. An accrual rate is the percentage of the high-five salary that the individual receives per year of service. This result is then multiplied by the number of years of service to determine the benefit. For a PERA-General member who started covered service in one of the larger Minnesota public plans before 1989, the normal retirement age is 65. That is the age at which an individual, following termination of covered service, can receive an annuity without any penalty due to early commencement of the benefit. Under law, a terminated employee may begin drawing an annuity as early as age 55, but with a reduction due to early retirement. If a PERA member starts drawing an annuity at the normal retirement age, the accrual rate in law is 1.7 percent (assuming a coordinated member, which means a member who is also covered by the Social Security Old Age, Survivor, and Disability Program for the covered employment). If the high-five average salary happened to be \$40,000 and the individual had 30 years of service, the annual benefit would be \$40,000 x 1.7 percent x 30 years = \$20,400.

As noted, the normal retirement age (the age at which an individual can retire with full, unreduced benefits) is about age 65, although individuals can retire as early as age 55. If individuals retire before normal retirement age, generally a reduction in the monthly benefit is required to compensate for the longer period during which a person will be receiving a benefit. (If two individuals have the same salary and same years of service credit, but one is retiring at age 65 while the other retires at age 55, the individual who retires at age 55 is likely to be drawing a monthly benefit for ten years longer than the age-65 retiree.) For individuals who began employment after July 1, 1989, the reduction to compensate for early retirement is a full actuarial reduction. In other words, the monthly benefit to the younger retiree must be reduced so that the present value of the lifetime stream of monthly benefits is worth no more than if that individual had retired at the plan's normal retirement age.

Different rules apply to those employees who commenced covered employment before July 1, 1989. If a pre-July 1, 1989, hire qualifies for the "Rule of 90" (age plus years of service equal 90 or more), no reduction is required for early retirement. For other pre-July 1, 1989, employees who retire early, a lesser reduction is required. In many cases, the benefit reduction is three percent per year, which is considerably less than a full actuarial reduction.

