



H.F. 3508
(Hausman)

S.F. 3188
(Anderson)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-General
Relevant Provisions of Law: Special law
General Nature of Proposal: Service credit purchase
Date of Summary: March 11, 2008

Specific Proposed Changes

- Allows individual to purchase PERA-General service credit for period which should have been covered, but was not due to apparent City of St. Paul error in failing to enroll the individual in PERA-General.

Policy Issues Raised by the Proposed Legislation

1. Employee willingness to pay if bill is passed.
2. Issue of whether the city caused harm, and whether the city should pay much of the full actuarial value as required under the bill.
3. Issue of responsibility of the individual to address the omitted service credit in a timelier manner.

Potential Amendment

- H3508-1A Requires the individual to cover the entire full actuarial value, rather than having the city cover any portion of the full actuarial value in excess of employee contributions plus interest.
- H3508-2A Requires equal sharing of the full actuarial value payment between the city and the employee (alternative to H3508-1A).



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director *EB*

RE: H.F. 3508 (Hausman); S.F. 3188 (Anderson): PERA; Service Credit Purchase by St. Paul Employee

DATE: February 29, 2008

Summary of H.F. 3508 (Hausman); S.F. 3188 (Anderson)

H.F. 3508 (Hausman); S.F. 3188 (Anderson) would allow Ronald C. Ross to purchase service credit in the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) for the period May 1, 1982, through March 31, 1984, a period of service that was not covered because of an apparent failure by the city of St. Paul to report him for plan coverage. To receive the service credit, the individual would pay the employee contributions that would have been made at that time plus 8.5 percent interest. The city would be mandated to pay the remainder of the full actuarial value payment. Authority to make the purchase expires on June 30, 2009, or upon termination of covered employment, whichever is earlier.

Public Pension Problem of Ronald C. Ross

Ronald C. Ross, who will be 48 years of age in March 2008, was first employed by the city of St. Paul in April 1979. Initially, his city employment did not qualify for PERA-General coverage because of an exclusion in PERA law, Minnesota Statutes 1978, Section 353.01, Subdivision 2b, Clause (m), which excluded from PERA coverage any individual who was a full-time student at an accredited school, college, or university. However, as of May 1982, that exclusion no longer applied to Mr. Ross, and PERA law required the city to report Mr. Ross for PERA coverage. Mr. Ross was not reported for PERA coverage until April 1984, nearly two years late.

Background Information

1. Service Credit Purchases. Attachment A provides background information on service credit purchases and the Commission's service credit purchase policy.
2. Public Employees Retirement Association. Attachment B provides background information on the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General).

Discussion and Analysis

H.F. 3508 (Hausman); S.F. 3188 (Anderson) allows Mr. Ross to purchase service credit for a period of uncovered service in PERA-General on a full actuarial value payment basis, with Mr. Ross paying an employee equivalent contribution plus interest and the City of St. Paul being required to pay the remainder of the full actuarial value.

H.F. 3508 (Hausman); S.F. 3188 (Anderson) raises the following pension and related public policy issues for Commission consideration and discussion:

1. Public Employment, Minnesota Connection. The issue is whether Mr. Ross's request is consistent with the typical Commission requirements that the service being purchased is a period of public or quasi-public employment with a Minnesota connection. Available information indicates that this situation meets that standard. During the applicable period, Mr. Ross was a public employee of the city of St. Paul.
2. Appropriate Service Credit Purchase Payment. When there is no indication that the pension fund caused harm, the Commission's policy is to require a full actuarial value payment to the pension fund, to avoid harming the fund by the purchase. A full actuarial value payment is intended to provide a total payment to the pension fund equal to the liability expected to be imposed on the fund by the extra service and/or salary credit to be received. The bill is drafted to require a full actuarial value payment. The eligible individual would pay the PERA-General employee contributions that would have been made if deducted from pay at the time, plus interest to correct for the time value of money and to

eliminate any windfall to the individual, while the city would be required to pay the remainder of the full actuarial value. This is the model the Commission typically follows when the Commission concludes that the employer caused harm.

3. Employee Willingness to Pay. The issue is whether the individual is willing to make the employee payment required under the bill, or any revised employee payment under a revised bill after possible Commission amendments. Payment of employee contributions plus interest as required by the bill would be favorable to the employee. In September 2007, PERA estimated the employee contribution plus interest to be \$3,232. As of this writing, I do not have an estimate of the full actuarial value. Although the terms are favorable to the employee, the Commission may choose not to consider the bill further if the individual is not willing to make that payment, or is unwilling to make the payment that would be required under any revised bill that the Commission might recommend.
4. Actuarial Condition of PERA. The issue is PERA-General's current actuarial condition. Detailed information on the plan's actuarial condition as of July 1, 2007, is presented in Attachment B. As of the July 1, 2007, PERA-General's liabilities exceeded its assets by \$4.72 billion, and its funding ratio was 73 percent. The required contributions as determined by the actuary were more than the contributions required under law, resulting in a contribution deficiency of 1.06 percent of payroll, or \$52 million.
5. Question of Responsibility/Harm. The bill is drafted assuming that the city caused harm and should be responsible for addressing that harm. The Commission may wish to hear testimony from the individual, the city, and PERA on this matter. PERA statutes place responsibility on the employer for enrolling the individual in PERA. On September 18, 2007, PERA staff provided Mr. Ross with an estimate of the cost of employee contributions plus interest to purchase the period May 1, 1982, through March 31, 1984. Presumably, PERA would not have provided that estimate before checking whether this period should have been covered by the plan. Mr. Ross should have been reported for PERA coverage on May 1, 1982, but the city did not report him until March 31, 1984.

Regarding the question of whether employee's actions contributed to the current situation, the Commission may wish to hear testimony about whether the individual knew early during his employment that there was an improper delay in reporting him for PERA coverage, and whether he tried to address the problem at that time. The problem arose in 1982, but the Commission is being asked to address it many years later, in 2008. It is possible that the individual was aware of the delay in PERA coverage shortly after it occurred, but took no action to address the situation because at that time it was not viewed by him as a problem. Young employees rarely value pension coverage. If the plan coverage problem had been addressed shortly after it occurred, it could have addressed with minimal cost, considerably reducing the city's financial liability, and without any need for a legislative solution. The city might contend that it should not be burdened with the cost of paying the remainder of the full actuarial value if much of the cost stems from delay by Mr. Ross in addressing the coverage problem.

Potential Amendments for Commission Consideration

1. Amendment H3508-1A revises the bill to place full responsibility on Mr. Ross to pay the full actuarial value if he is to receive the service credit. The amendment can be used if the Commission concludes that the city did not cause harm and should not be required to pay a significant part of the full actuarial value, or if city should be permitted but not required to cover any portion above the employee contribution plus interest.
2. Amendment H3508-2A, an alternative to Amendment H3508-1A, would require the individual to cover half of the full actuarial value if he wishes to purchase the service credit. If that payment is made, the city is required to pay the remaining half. This amendment could be used if the Commission concludes that the city caused harm but should be relieved somewhat in its financial burden because of employee delay in addressing the issue, while the required full actuarial payment amount has been increasing considerably over time. If the Commission wishes to modify the sharing of the burden from the equal sharing specified in this amendment, that modification can be done with a verbal amendment on line 1.2 of the amendment, which specifies the portion of the total cost the employee must pay.

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 predeterminable 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 the Teachers Retirement Association (TRA) established in 1915 as a money purchase (defined contribution) plan, with the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) established in 1929 as a set dollar amount (\$200 per month) plan, and with the General Employees Retirement Plan of the Public Employees Retirement Association (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), 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 1957-2006, the Legislature has enacted 254 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	Year	Number
1957	1	1971	2	1979	7	1986	6	1993	7	2000	8
1959	4	1973	4	1980	4	1987	3	1994	8	2001	10
1961	5	1974	5	1981	14	1988	7	1995	7	2002	2
1963	6	1975	10	1982	16	1989	12	1996	6	2003	6
1965	5	1976	4	1983	2	1990	10	1997	3	2004	1
1967	1	1977	9	1984	3	1991	6	1998	9	2005	1
1969	2	1978	9	1985	2	1992	6	1999	8	2006	14

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 79 special laws relating to the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and with 48 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 its Principles of Pension Policy, which require:

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 was 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 careers 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 the 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 (TRA) and the first class city teacher retirement fund associations (the Duluth 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 nonprofit 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 (MERF), 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 above provisions. 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