



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director ^{EB}

RE: Additional Review of Proposed Teachers Retirement Association Service Credit Revision, from S.F. 578 (Betzold); H.F. 1123 (Murphy): Administrative and Benefit-Related Provisions

DATE: June 3, 2009

Introduction

This memo and its attachments were prepared for the Commission's further review of the revised service credit procedure proposed by the Teachers Retirement Association (TRA) in the 2009 bill S.F. 578 (Betzold); H.F. 1123 (Murphy): Administrative and Benefit-Related Provisions. That bill contained administrative and benefit-related provisions for the various Minnesota State Retirement System (MSRS) plans, the Public Employees Retirement Association (PERA) plans, TRA, and first class city teacher plans. The Commission began hearing this bill at its February 27, 2009, meeting. After discussion and some testimony, the Commission set aside the proposed revised TRA service credit determination procedures. Various other sections from the bill were recommended to pass. At a later date the chairman asked the MSRS, PERA, TRA, and first class city teacher plan administrators to identify remaining provisions from the bill which were high priority and needed to pass during 2009. The plan administrators responded by recommending passage of every section of the bill which had not already been recommended for inclusion in the Commission's omnibus pension bill. At its March 6, 2009, meeting, the Commission recommended inclusion of all remaining provisions other than the TRA revised service credit procedures.

Existing Law Provision: TRA Service Credit Procedures for K-12 Teachers

TRA's procedure for computing service credit is found in Minnesota Statutes, Section 354.091. Under current law, teaching at least 170 full days in a fiscal year provides the K-12 teacher with a full year of service credit. Teaching at least five hours in a day results in a full day of service credit, while teaching less than five hours in a day results in fractional service credit (a teacher who teaches four hours a day would receive 4/5th service credit, or 80 percent of a full day's credit). A K-12 teacher with less than 170 full days of service credit receives a fraction of a full year's service credit, based on the relation of that service to 170 days. Special accommodation is made for employing units that have non-traditional work schedules or pay schedules. For those employing units, the procedure for determining service credit must be approved by the executive director.

One feature of existing law, a feature that is undesirable, is that each school district is responsible for determining the service credit earned by the given teacher under TRA's service credit law, and each employing unit is to report that service credit to TRA on a payroll cycle basis. TRA does not routinely receive any information on hours or days worked. Thus TRA does not have the information necessary for TRA to do the service credit determinations.

Proposed Revision

Section 19 in S.F. 578 (Betzold); H.F. 1123 (Murphy) proposes to revise Minnesota Statutes, Section 354.091, TRA's service credit provision, by changing the methodology for determining service credit for K-12 teachers. Under the proposal, TRA K-12 teacher service credit will be a function of the teacher's salary relative to a base salary in the district, rather than being based on hours of service. The district base salary is the salary paid in the prior year for the lowest Bachelor of Arts (BA) contract position. Service credit will be computed monthly by dividing the teacher's monthly salary by the monthly base salary for the applicable employing unit, and the result is multiplied by 11.1 percent. The result is then capped at 11.1 percent, so that a teacher may not earn more than 11.1 percent of one full year's service credit in a month. Annual service credit is calculated by adding the monthly service credit amounts for the months in the applicable fiscal year. A teacher may not earn more than one year of service credit in a fiscal year.

The changes are effective for teaching service performed after June 30, 2010.

Some further explanation of this procedure may be helpful. The procedure begins by computing monthly service credit. In determining monthly service credit, the first computation involves dividing the individual's actual monthly salary by the base salary, the amount that would be paid for full-time employment for the districts lowest paid BA contract position in the prior year. If an individual had salary equal to the base salary, the ratio would equal one. If the individual's salary was greater than the base salary, the result would be greater than one, while if the individual's salary was less than the base the result would be less than one. To ensure that an individual does not earn more than one month's service credit in a month, the salary ratio calculation is capped at one. (Otherwise, for example, an individual working full-time with a salary twice that of the lowest paid BA position would earn two months of service credit for a single month or work.). A further adjustment is needed because teachers typically work nine months per year. A teacher who works for nine months and who received a full month of service credit for each month of work would have only 90 percent of a full year's service credit. To correct for this, the capped monthly service credit ratio is multiplied by 11.1 percent. Therefore, when the monthly amounts are added up an individual with nine full month's of service credit would receive 99.9 percent of a full year's service credit (which presumably TRA would round up to 100 percent).

A limit is also placed on annual service credit. No one may receive more than one year of service credit in a given year. This keeps administrators and others who might work ten, eleven, or twelve months in a year from receiving more than one year's service credit.

Proposal Discussion

TRA is proposing a fundamental shift in the way TRA service credit is determined, moving from a procedure based on hours and days worked to a process based on salary earned relative to district base salary. The current system was put into law at TRA's request and has been in TRA law for 40 years, since 1969. TRA contends the current system is badly flawed: many school districts are not keeping track of hours worked by their teachers, despite having a system where service credit is based on work hours and having school systems responsible for computing the service credit earned by their teachers.

A review of law suggests TRA does not receive any work hour information, only service credit as reported by the district, supposedly based on work hour information. Minnesota Statutes, Section 354.52, which covers reports from school districts to TRA, indicates that TRA receives information on the employment status of each teacher, including full-time, part-time, intermittent, substitute, or part-time mobility; and information on the amount of salary paid, but hours worked in not specifically included in the list.

While there is an obvious need to change the current situation, the question is how to change it and the nature of the change to make. A change which would be least disruptive is to leave the TRA service credit determination provision unchanged, except for shifting responsibility from the school districts to TRA for computing service credit. This will work if quality information on hours worked can be obtained and sent to TRA, even if it is not detailed. In most cases, TRA does not need detailed information. Under existing law any teacher working five or more hours in a day receives full service credit for that day. Thus, for most teachers TRA would not need to only that a teacher worked at least five hours. TRA would need more detailed information on teachers working less than five hours, so TRA could determine how to prorate the service credit.

TRA contended that many school districts are not keeping track of teacher hours worked because of a belief that the Fair Labor Standards Act applies to teachers, and that Fair Labor Standards Act requirements might lead to increased overtime payments to teachers if work hours were recorded. However, review by LCPR staff indicated that teachers are exempt from both the state and federal Fair Labor Standards Acts, a conclusion supported by Mr. Thompson, TRA's Deputy Director, at the February 27, 2009 Commission meeting. The exemption provision of the federal Fair Labor Standards Act indicates that K-12 teachers and school administrators are exempt from wage, maximum hour, and overtime pay provisions of the federal Fair Labor Standards Act. (Attached is part of the exemption section from the federal Fair Labor Standards Act, Section 213, Title 29, United States Code.) There is also a Minnesota Fair Labor Standards Act. Documentation provided by TRA suggests that the Minnesota Fair Labor Standards Act overtime provisions do not apply to nearly all teachers, due to exemptions. Minnesota Statutes, Chapter 177, a portion of which is cited as the Minnesota Fair Labor Standards Act, deals with minimum wage and overtime compensation standards. Minnesota Rules created to comply with that chapter indicate that any teacher receiving at least \$170 per week is exempted from overtime wage provisions of the Minnesota Fair Labor Standards Act. There is no need for school districts to be concerned about those earning less than \$170 per week. They are not working overtime hours. Material provided by TRA is also attached.

If school districts are not keeping track of hours worked due to Fair Labor Standards Act concerns, they are acting under a misconception. An unfortunate consequence of that action is that they are also unable to properly comply with the law requiring school districts to compute TRA service credit earned by the employed teachers. This has considerable implications for TRA. Service credit and salary credit determine the pension benefits being earned, which creates the plan's accrued liabilities. TRA's liabilities, according to its latest actuarial report, exceed \$22.2 billion. Depending on the extent of errors in reported service credit, that reported liability could overstate or understate what the liability ought to be by many millions of dollars, and perhaps billions of dollars.

To the extent there is misconception about the application of Fair Labor Standards Acts to teachers, information should be provided to school districts and teachers to correct this misconception. This would lead to improved tracking of teacher work hours creating better compliance with the existing TRA service credit procedure. That change, particularly if coupled by a shift in responsibility from the school districts to TRA for computing service credit, may be preferable to the more radical changes TRA is proposing.

The fundamental question raised by TRA's service credit proposal (primarily Section 19 of the bill) is whether that system should be abandoned and be replaced, as TRA has proposed, or whether to take actions to improve compliance with TRA's current service credit law.

The TRA proposal raises the following pension and related public policy issues for Commission consideration:

1. Possible TRA Management Issue. The current system, basing service credit on hours worked with five or more hours considered a full day, and 170 full days entitling the teacher to a year of service credit, has been in use for some or all TRA-covered teachers for 40 years. If this system has been problematic from the beginning, why did it take so long to recognize the problem and propose remedial legislation? If the reporting compliance problem is recent, what event or events caused the decline in the quality of reporting?
2. Flawed Nature of Proposal; Harm to Part-Time Teachers with Low Pay, Possible Harm to Substitute Teachers. The serious flaw in TRA's proposed procedure is that the higher an individual is paid, the easier it is for that individual to work part-time and receive full TRA service credit. For individuals who work full time, the present system and the proposed system are likely to provide the individuals with full service credit. However, treatment of part-time employees is an area of concern. The proposed system will strongly favor higher paid part-time individuals while possibly harming lower paid part-time teachers. The provision may also harm substitute teachers. The proposal, if implemented, may generate complaints from part-time teachers and substitute teachers.

For part-time teachers and administrators, the proposed system produces flawed results. Two part-time workers who work the same number of hours or days will receive different service credit if their salaries differ. Consider an individual with full-time salary equal to the base salary (the lowest BA rate for the district). If this individual worked half-time during a given month, he or she would receive half of full service credit. In contrast, another individual with full-time equivalent salary which is twice the base rate could work half time and would receive full service credit. A third individual with full-time equivalent salary equal to three times the base rate could work half time and receive full service credit. Actually, this individual could work as little as one-third time and receive full service credit. Only if the individual worked less than one-third time would he or she receive less than a full-month of service credit.

The proposal may also harm some substitute teachers. The Commission staff understanding is that some or all school districts provide a flat rate paid per day to short-term or occasional substitute teachers. If that daily rate is less than daily pay based on the base BA salary, these substitute teachers are almost surely to receive less service credit under the proposed system than under the current one. The Commission may wish to determine through testimony or other means the pay rates for substitute teachers. If these rates for some or all districts are below the annual base salaries as specified in section 17, some substitute teachers (other than TRA annuitants who return to teaching and are thus not earning new service credit) will be harmed by this proposal.

3. Appropriateness of Benefit Improvement/Redistribution in Administrative Bill. The issue is whether a provision which enhances benefits for some higher paid teachers/administrators, by making it easier for them to obtain full-time service credit for part-time work, is appropriate for inclusion in an administrative bill, particularly when the change seems likely to harm the lowest-paid teachers.

4. TRA Effort to Seek Better Compliance with Current Law. The issue is what steps TRA has taken to seek better compliance with existing school district service credit reporting requirements.
 - Has TRA made a serious effort to educate school districts about the reporting requirements in law?
 - Has TRA made a serious effort to inform school districts that Fair Labor Standards Act work hour/overtime provisions do not apply to teachers, since concern about coverage under those Acts may be hampering efforts to improve the quality of teacher work hour data?
 - Has TRA considered imposing fines (if permitted under existing law) for school districts that submit faulty information?
 - If this is not covered under existing law, has TRA considered seeking legislation to permit TRA to fine school districts to foster better compliance?
 - Has TRA sought assistance from the Department of Education to encourage school districts to obtain and report the information which TRA needs?
 - If not already in law, should the Legislature consider withholding some or all state aid to a school district which fails to submit service credit related information to TRA, or which submits faulty data?

5. Alternatives Regarding Service Credit Reporting. The issue is whether other alternatives should be explored. Some alternatives are:
 - a) Take no action. The problem with this approach is that TRA contends the current system is not working due to school district reluctance to record work hours, and taking no action will continue those questionable results into the future.
 - b) Retain the present system, leaving the computation of service credit in TRA law unchanged and with the reporting of service credit remaining the responsibility of the school districts, but make a serious effort to educate school districts of their responsibilities under TRA law, and provide information about the application of the Fair Labor Standards Acts to teachers and school administrators.
 - c) Retain the present system, leaving the computation of service credit in TRA law unchanged but shift responsibility from the school districts to TRA to compute the service credit. This would also include a requirement that school districts report work hours to TRA, at a level of detail needed by TRA. This will need to be coupled by some program to improve the recording of work hours by school districts.
 - d) Revise TRA's proposal by comparing the salary earned by the teacher with the full-time equivalent contract salary of that teacher, rather than compare it to lowest BA level salary in the district. It would be possible under this approach to develop system which closely matches the results in current law without having to collect any work hour information. However, TRA contends this approach is not practical because it would require TRA to keep track of separate contracts for each of its over 70,000 active members, and those contracts may change during the year when teachers take on revised duties. The Commission may wish to explore this further through testimony to ensure this approach is not practical. TRA receives individual-specific salary information on an ongoing basis through its payroll reporting system, used to receive and credit contributions from salary. Given the level of computerization at TRA, perhaps the problem is a concern that the school districts would fail to provide updates on contracts in a timely manner, leading to errors in TRA's system.

6. Annual Base Salary Definition Issues. The annual base salary definitions which appear in Section 15 of the bill include a provision to set annual base salary in the first year of operation for new employing units. While existing employing units will use the lowest salary from the prior year as the base salary, new employers must use the current year's lowest salary, since there was no prior year. This may be unavoidable given the proposed system, but it can harm a part-time teacher in the new district, assuming salaries increase over time. This year's base salary is higher than last year's would have been, which tends to reduce the service credit the part-time teacher will earn in the employing unit's first year of operation. Another issue is that because base salaries will differ across school districts, two part-time teachers or administrators in different school districts earning the same salary and working the same hours may receive different amounts of service credit. The individual in the district with the higher base salary might receive less service credit.

7. Issue of Unspecified Procedure for Non-Traditional Work Schedule. Under TRA law, service credit procedures for non-traditional work schedules are not specified in law, but must be approved by TRA's executive director. (In S.F. 578 (Betzold); H.F. 1123 (Murphy, M.), the applicable language is being moved from page 13.27 to 12.31 to page 14.27 to 14.29.) While this authority is not new, an

issue is whether the Commission continues to be comfortable extending that discretion to TRA, without having any legislative review of those procedures or without specifying those procedures in law, given the fundamental changes being proposed for computing TRA service credit in traditional situations.

8. Inconsistent Treatment within TRA. The problem is the numerous procedures that may be used, resulting in inconsistent treatment of seemingly comparable TRA-covered teachers. Under this proposal, service credit for Minnesota State Colleges and Universities System (MnSCU) members with TRA coverage will continue as in current law, with service credit based on definitions for full- and part-time employment as found in collective bargaining agreements. For most K-12 teachers, service credit will be determined based on comparisons of the individual's salary to BA base salary, as specified in the bill draft; while for others, deemed "non-traditional" under some unspecified criteria, service credit will be determined under an unspecified procedure or procedures to be specified by the TRA executive director.
9. Inconsistency across Teacher Plans. The issue is that the various procedures in the draft, some unspecified, will result in greater disparity between TRA's service credit procedures compared to those of the St. Paul Teachers Retirement Fund Association (SPTRFA) and the Duluth Teachers Retirement Fund Association (DTRFA). It is unclear how first class city teacher plans compute service credit. Currently, I find nothing in law specifying how service credit is to be determined in the SPTRFA or DTRFA beyond a general statement in the first class city teacher plan definition of "allowable service," which reads in part: "Allowable service" means any service rendered by a teacher during a period in which the teacher receives salary from which employee contribution salary deduction are made and credited by the teachers retirement fund association..." It is unclear how much service is needed to qualify for a year of service credit, or how part-time employee service credit is determined.
10. Support by TRA Members and Teacher Unions. The issue is whether this service credit proposal is supported by full-time teachers, part-time and substitute teachers, and by teacher unions. Since this proposal may harm part-time and substitute teachers, the proposal may not have universal support.
11. Cost Implications. The issue is the cost of this change. The proposal makes it easier for some to earn service credit and harder for others. Unless these impacts exactly offset, the proposal will have some impact on the total service credit awarded to TRA members in aggregate in a given year and in the resulting plan liabilities. Service credit is a key component in benefit computations, so any net change in crediting service in the plan will revise plan cost and contribution requirements. TRA has claimed the cost is negligible. The Commission may wish to question TRA on this matter and insist that the Commission be provided with an actuarial cost estimate by the actuary.

Potential Amendments for Commission Consideration:

The provisions to implement the TRA service credit revisions as proposed last year by TRA are found in LCPR09-04A. This is drawn as a blind amendment which can be inserted into next year's omnibus pension bill. If the Commission does not want to implement the TRA recommendation and wishes to leave current statutes unchanged, the Commission should decline to act on LCPR09-04A or any of the amendments below, which are drawn to LCPR09-04A. If the Commission wishes to leave in place the TRA existing law service credit procedure based on hours, but wishes to revise school district hour reporting to ensure better results, the Commission may wish to consider LCPR09-04A with either amendments LCPR0904A-1A or LCPR0904A-2A.

- Amendment LCPR0904-1A leaves the existing service credit procedure based on hours in place, but shifts the responsibility for computing service credit from the school districts to TRA and requires the school districts to report work hour data to TRA to enable TRA to do the service credit calculation. For each teacher, the school districts would report hours worked if less than five hours, and for other teachers certify that the teacher worked at least five hours in the day.
- Amendment LCPR0904-2A, an alternative to Amendment LCPR0904-1A, is identical to the -1A amendment except that this amendment also imposes an additional non-compliance penalty on school districts which fail to report hourly work information or which file inaccurate or incomplete information. The amount of the penalty is to be specified by the Commission by filling in a blank in the amendment. The TRA executive director is authorized to require an employing unit to provide whatever information or data TRA deems necessary to determine compliance with the work hour reporting requirement.

2008 Minnesota Statutes

354.091 SERVICE CREDIT.

(a) In computing service credit, no teacher may receive credit for more than one year of teaching service for any fiscal year. Additionally, in crediting allowable service:

(1) if a teacher teaches less than five hours in a day, service credit must be given for the fractional part of the day as the term of service performed bears to five hours;

(2) if a teacher teaches five or more hours in a day, service credit must be given for only one day;

(3) if a teacher teaches at least 170 full days in any fiscal year, service credit must be given for a full year of teaching service; and

(4) if a teacher teaches for only a fractional part of the year, service credit must be given for such fractional part of the year in the same relationship as the period of service performed bears to 170 days.

(b) A teacher must receive a full year of service credit based on the number of days in the employer's full school year if that school year is less than 170 days. Teaching service performed before July 1, 1961, must be computed under the law in effect at the time it was performed.

(c) A teacher must not lose or gain retirement service credit as a result of the employer converting to a flexible or alternate work schedule. If the employer converts to a flexible or alternate work schedule, the forms for reporting teaching service and the procedures for determining service credit must be determined by the executive director with the approval of the board of trustees.

(d) For all services rendered on or after July 1, 2003, service credit for all members employed by the Minnesota State Colleges and Universities system must be determined:

(1) for full-time employees, by the definition of full-time employment contained in the collective bargaining agreement for those units listed in section 179A.10, subdivision 2, or contained in the applicable personnel or salary plan for those positions designated in section 179A.10, subdivision 1;

(2) for part-time employees, by the appropriate proration of full-time equivalency based on the provisions contained in the collective bargaining agreement for those units listed in section 179A.10, subdivision 2, or contained in the applicable personnel or salary plan for those positions designated in section 179A.10, subdivision 1, and the applicable procedures of the Minnesota State Colleges and Universities system; and

(3) in no case may a member receive more than one year of service credit for any fiscal year.

History: 1974 c 289 s 13; 1981 c 160 s 3; 1982 c 578 art 1 s 6; 1989 c 319 art 2 s 8; 1994 c 528 art 3 s 11; 2000 c 461 art 3 s 29; 2004 c 267 art 3 s 4; 1Sp2005 c 8 art 10 s 52

