



S.F. 223
(Wiger)

H.F. 231
(Lillie)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-General
Relevant Provisions of Law: Special law provision
General Nature of Proposal: Retroactive exclusion from plan membership;
Restoration of eligibility for deferred annuities augmentation
Date of Summary: March 4, 2009

Specific Proposed Changes

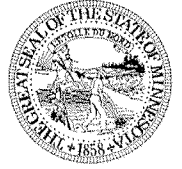
- The proposed legislation would retroactively exclude a constituent from PERA-General plan membership and restore eligibility for deferred annuities augmentation for a former state employee planning to retire under the "Rule of 90" early normal retirement age provision.

Policy Issues Raised by the Proposed Legislation

1. Adequacy of the proposed legislation to resolve the constituent problem.
2. Availability of non-legislative remedy.
3. Appropriateness of special legislative remedy; equitable considerations.
4. Precedent.
5. General or special legislation.

Potential Amendments

There are no technical or substantive amendments suggested by the Commission staff.



TO: Members of the Legislative Commission on Pensions and Retirement
FROM: Lawrence A. Martin, Executive Director *LAM*
RE: S.F. 223 (Wiger); H.F. 231 (Lillie): PERA-General; Retroactive Exclusion from Coverage for Certain MSRS-General Retiree
DATE: March 4, 2009

Summary of S.F. 223 (Wiger); H.F. 231 (Lillie)

S.F. 223 (Wiger); H.F. 231 (Lillie) permits Kathryn Freimuth, described as the likely sole member of a general class of individuals, to be excluded retroactively from General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) coverage for her Roseville teacher assistant service in 2006 following her termination of State of Minnesota employment and to regain eligibility for deferred annuities augmentation from the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) for that period, with a refund of PERA-General member and employer contributions for the period, with interest.

Public Pension Problem of Kathryn Freimuth

Kathryn Freimuth is a former local government employee who terminated her initial period of PERA General Employee Retirement Plan (PERA-General) covered service in July 1999, who was subsequently employed by the State of Minnesota, who terminated that employment in April 2006, and who became employed as a teacher's assistant for the Roseville Public School District in December 2007. Ms. Freimuth apparently intends to retire when she is eligible under the "Rule of 90" early normal retirement provision (on October 17, 2009, for the MSRS General State Employees Retirement Plan (MSRS-General) and on November 1, 2009, for PERA-General). Ms. Freimuth has received retirement benefit estimates in mid-2006 from PERA-General and Minnesota State Retirement System (MSRS)-General, which included deferral periods until "Rule of 90" eligibility. Ms. Freimuth's Roseville Public School employment ended in June 2008. In June 2008, Ms. Freimuth contacted PERA to determine what impact her additional six months of service credit from her Roseville Public School employment would have. PERA did not promptly provide Ms. Freimuth with a revised retirement annuity estimate and when a PERA estimate was provided in late October 2008, her revised PERA-General annuity was substantially less than previously estimated and she was told that her MSRS-General annuity also would be less than previously estimated. PERA indicated that her Roseville Public School employment interrupted her deferral period, eliminating the augmentation otherwise applicable. Ms. Freimuth would like to waive her PERA-General coverage for her Roseville Public School employment and become again qualified for PERA-General and MSRS-General deferred annuities augmentation.

Background Information

Attached is background information on deferred annuities augmentation (Attachment A) and on the Combined Service Annuity intra-Minnesota portability mechanism (Attachment B).

Discussion and Analysis

S.F. 223 (Wiger); H.F. 231 (Lillie) allows Kathryn Freimuth to undo the adverse ramifications of her post-state service employment with the Roseville Public Schools and regain deferred annuities augmentation for the period since the conclusion of her state employment.

The proposed legislation raises the following pension and related public policy issues for consideration by the Commission:

1. Adequacy of the Proposed Legislation to Resolve the Constituent Problem. The policy issue is whether or not the proposed solution contained in the proposed legislation actually resolves the problem of the constituent. Ms. Freimuth's problem is a function of the loss of deferred annuities augmentation caused by her re-entry into public employment her retirement annuity deferral period. Deferred annuities augmentation is governed by Minnesota Statutes, Section 352.72, Subdivision 2, for the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-

General) and by Minnesota Statutes, Section 353.71, Subdivision 2, for the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General). Both provisions entitle vested deferred plan members to augmentation in a deferred annuity if there has been a separation from active service that has not been interrupted by a return to active retirement plan coverage for at least two years. The two-year definition of “uninterrupted service” has been part of the two provisions since augmentation was introduced in 1971 (see Laws 1971, Chapter 274, Section 3, for MSRS-General and Laws 1971, Chapter 412, Section 5, for PERA-General). Because of her post-2006 reemployment in the public sector, with Minnesota public employee retirement coverage, she gained additional PERA-General service credit and earlier eligibility for the “Rule of 90” early normal retirement annuity, but did so at the cost of the deferred annuity augmentation that she otherwise would have earned. The goal of deferred annuity augmentation, according to written materials on file with the Commission from the late Dr. Franklin Smith, the consulting actuary retained by the Pension Commission at the time, was to maintain the purchasing power of the amounts of previously earned retirement annuities for employees who change employment during their career. With the 1975 enactment of the Combined Service Annuity provision (Minnesota Statutes, Section 356.30), Minnesota public pension plan portability was provided to Minnesota public employees who change employment within Minnesota, using a common final average salary that wholly accommodated inflationary impacts. For Ms. Freimuth, who resumed public employment after a period of deferral, she did so at the expense of a significant portion of the deferred annuities augmentation included in the benefit estimates made before the resumption of public employment.

2. Availability of Non-Legislative Remedy. The policy issue is whether or not Ms. Freimuth has a non-legislative remedy that could provide her the relief that she seeks. Ms. Freimuth does have a potential non-legislative remedy, but that potential remedy is unlikely to find in favor of her and to provide her with the greater retirement annuity amount that she thought that she was to receive under prior benefit estimates. Under Minnesota Statutes, Section 356.96, Ms. Freimuth can appeal her benefit determination to the Public Employees Retirement Association (PERA) board and, potentially, to the Minnesota Court of Appeals if the PERA board finds against her. Because the basis for PERA’s revised benefit estimate is statutory (Minnesota Statutes, Section 353.71, Subdivision 2), because the relevant portion of the statutory provision has not been changed since enactment, and because the statutory provision is not readily susceptible to variable interpretations, Ms. Freimuth is unlikely to prevail upon a subsequent appeal to the PERA board and upon appeal to the Minnesota Court of Appeals.
3. Appropriateness of Special Legislative Remedy; Equitable Considerations. The policy issue is whether or not the special legislative remedy is appropriate from a public policy perspective and whether or not the equitable considerations of the constituent merit the special remedy. Although nothing in the Commission’s Principles of Pension Policy deals specifically with deferred annuities augmentation or plan membership in subsequent employment, the two factors underlying Ms. Freimuth’s problem, the pension policy principles generally and frequently require that the special remedy to a pension problem not violate equitable notions. There are equitable considerations both in the creation of the problem and in the potential solution. On the period of time immediately prior to the Roseville employment that caused the deferred annuity augmentation loss problem, it is unclear what level of information Ms. Freimuth sought or obtained about the impact that taking the Roseville School District employment would have on her subsequent pension benefits. If Ms. Freimuth did not pursue any advice from the Public Employees Retirement Association (PERA) on the impact of renewed public employment or if she took the Roseville School District employment with the belief that she could thereby improve her pension benefit, either in amount or in the date for a “Rule of 90” retirement, the special legislation could be viewed as rewarding inactivity or a lack of diligence in gaining information or as rewarding an attempt for an arguably undeserved additional benefit. The special legislation, which permits Ms. Freimuth to receive a refund of her member contributions for her Roseville Public Schools employment with interest while also increasing her PERA General Employee Retirement Plan (PERA-General) and MSRS General State Employees Retirement Plan (MSRS-General) retirement benefit amounts, could be viewed as providing her with an undeserved double benefit (i.e., a higher benefit and a refund). If Ms. Freimuth has complaints about the quality and timeliness of the benefit counseling that she received from PERA and MSRS, an equitable consideration favorable to her, she should be prepared to set forth those objections in testimony on the proposed special legislation.
4. Precedent. The policy issue is the extent to which there is a precedent for this type of potential legislation and, if enacted, the extent to which the potential legislation would set an adverse precedent for additional legislation. The closest precedent of the potential legislation relating to regular public employees who also were local elected officials, who were covered by the General Employee

Retirement Plan of the Public Employees Retirement Association (PERA-General) for both employments, and who sought to retire from their primary public employment while continuing their elective service. On four occasions, employees with this combined regular and elective service were allowed to either discontinue PERA-General coverage for their elective service, with a refund, or transfer contributions on elective service compensation to the PERA Defined Contribution Retirement Plan (see Laws 1993, Chapter 307, Article 8; Laws 1998, Chapter 390, Article 3, Section 19; First Special Session Laws 2003, Chapter 12, Article 15, Section 5; and Laws 2008, Chapter 349, Article 16, Section 1). If enacted, the potential legislation would extend this “ex post facto” PERA-General Plan membership exclusion solution exclusively from local governmental elective service situations only to any local government employment situation, with the expectation that it could be precedent for a considerably larger number of future legislative requests.

5. General or Special Legislation. The policy issue, related to the precedent issue, is whether or not the potential legislation should be general legislation rather than special legislation. The proposed special legislation will provide a solution desired by Ms. Freimuth, but would be limited to her. General legislation would be appropriate if enacting the solution for Ms. Freimuth is likely to become a request by a number of similarly situated current or former public employees and the remedy is not sufficiently problematic if it were extended broadly. A shift from special legislation to general legislation changes the manner in which the potential proposed legislation is presented to the Commission and to the standing committees of the Legislature with jurisdiction because the very specific focus and factual basis for the request becomes broader and less certain upon it becoming a general provision.

Attachment A

Background Information on Deferred Annuities Augmentation

- a. Definition. Deferred annuity augmentation refers to increasing the amount of a deferred retirement annuity by a percentage or dollar amount over time prior to receipt. This replaces all or part of any lost purchasing power in the unpaid retirement annuity due to inflation. Under current law, for members who terminate from statewide or major local retirement plan coverage after 1989 and who have a right to a deferred annuity due to their covered service, the deferred annuity increases (augments) by three percent annually until the first of the year after the individual turns age 55, and by five percent per year thereafter. Deferred annuity augmentation was added in 1971 to Public Employees Retirement Association (PERA) plans, Minnesota State Retirement System (MSRS) plans, the Teachers Retirement Association (TRA), and was also added to first class city teacher plans in 1989, and also applies to the Minneapolis Employees Retirement Fund (MERF).

Minnesota public pension plans are relatively unique among public and private defined benefit plans in providing deferred annuities augmentation. To the best knowledge of the Commission staff, only the Oregon statewide public employee defined benefit plans also provide deferred annuity augmentation.

The Minnesota and Oregon plans that have deferred annuities augmentation are defined benefit plans. Defined benefit plans utilize a fixed formula to determine pension benefit amounts (typically years of service multiplied by a percentage benefit accrual rate amount and applied to a final salary or final average salary base). Since the benefit is fixed or specified in law from the individual's salary and service, the variable element is the contributions needed to fund those benefits. Defined benefit plans are distinguished from defined contribution plans, such as the Higher Education Individual Retirement Account Plan (IRAP), Individual Retirement Accounts (IRAs), or Section 401(k) plans, where the fixed element is the level of contributions funding the plan, and the variable element is the benefit to be derived, which is dependent on the investment earnings over time on the stream of contributions and the age of the individual at retirement. When an individual covered by a defined contribution plan changes employment and thus is no longer eligible for the employer's plan, the value of the account will continue to increase over time due to investment earnings on the account. Thus, the eventual retirement annuity that can be supported by the account's value will increase. Deferred annuity augmentation in a defined benefit plan provides a somewhat comparable effect. The individual's deferred retirement annuity is not locked in amount at the time the individual leaves covered service. It continues to grow over time by the percentages specified in law.

Deferred annuity augmentation in a defined benefit plans does add to plan cost. Because of the augmentation, the deferred annuitants receive higher benefits at the time of retirement than would be the case if the benefit were fixed at the time of termination of the covered employment.

- b. Application in Service in More Than One Plan Provisions. When deferred annuities augmentation was first added to various Minnesota plans in 1971, the record suggests that the Legislature wanted to add a tool to complement the service in more than one retirement plan provisions (Minnesota Statutes, Section 352.72 (MSRS-General); Minnesota Statutes, Section 353.71 (PERA); and Minnesota Statutes, Section 354.60 (TRA)), to make that portability provision more adequate. However, the Legislature did not restrict its use solely to that provision. Deferred annuity augmentation applied to all deferred annuities, including those where the service in more than one plan provisions do not apply.

The service in more than one plan provisions were early portability provisions, preceding the Combined Service Annuity provision, Minnesota Statutes, Section 356.30, which was enacted in 1975. The service in more than one plan provisions, which still exist in law, allow service with one of the plans covered by these provisions to be used for purposes of vesting in another covered retirement plan. This was an important feature back in the 1970s and early 1980s because vesting normally required ten years of service. Without the service in more than one plan provisions, individuals who were employment-mobile, moving to various positions covered by various Minnesota public plans within different systems, might fail to vest in some of the plans due to the long vesting requirement. By allowing service in one fund to be used for purposes of vesting in another, the service in more than one plan provisions helped job mobile individuals to vest in the applicable plan or plans and made them eligible to receive benefits.

While this helped employment-mobile individuals to vest, these individuals still faced a problem. The value of the benefit from the early plans would erode considerably in value over time if the benefit was fixed at the time the individual left that service. Deferred annuities augmentation addressed that problem by allowing the annuity from the early plan or plans that provided coverage to increase over time, providing a benefit at retirement that was at least somewhat similar to what would have occurred if coverage had been provided by a single plan for the individual's entire public service.

To demonstrate, the following compares the total retirement annuity of a public employee retiring in 2000 with 30 years of public service under three different scenarios. Scenario A shows coverage by three different plans and without deferred annuity augmentation. Scenario B shows coverage by three

different plans with deferred annuity augmentation. Scenario C shows coverage by one plan for all service. The individual is assumed to begin service in 1970 with TRA coverage, and the individual leaves that service after ten years with a high-five average salary of \$22,500. The individual then moves to PERA-covered employment, having that coverage until 1990, with a high-five from that service of \$33,100. The individual then moves to MSRS-covered employment, retiring in 2000 with a high-five of \$46,660. Without deferred annuities augmentation, Scenario A, the sum of the three retirement annuities is \$13,492 per year. Under Scenario B, deferred annuities augmentation is applied and it boosts the value of the TRA and PERA pensions, creating a total from the three plans of \$17,117 per year. Under Scenario C, the individual spends all 30 years of employment under a single plan, the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General). The individual's pension is \$23,796 per year. While deferred annuities augmentation does help, in this example, it falls short of providing the same pension that would have occurred if all service had been under a single plan.

Scenario A		Scenario B		Scenario C	
Coverage by TRA, 1970-1980		Coverage by TRA, 1970-1980		Coverage by MSRS, 1970-2000	
Final Average Salary	\$22,500	Final Average Salary	\$22,500	Final Average Salary	\$46,660
Annual Deferred Retirement Annuity	\$2,250	Initial Annual Deferred Retirement Annuity	\$2,250	Annual Retirement Annuity	\$23,796.60
Coverage by PERA, 1980-1990		Coverage by PERA, 1980-1990			
Final Average Salary	\$33,100	Final Average Salary	\$33,100		
Annual Deferred Retirement Annuity	\$3,310	Annual Deferred Retirement Annuity	\$3,310		
Coverage by MSRS, 1990-2000		Coverage by MSRS, 1990-2000			
Final Average Salary	\$46,660	Final Average Salary	\$46,660		
Annual Retirement Annuity	\$7,932	Annual Retirement Annuity	\$7,932		
Total Annual Annuity		Total Annual Annuity			
TRA Annuity	\$2,250.00	TRA Annuity	\$4,503.60		
PERA Annuity	\$3,310.00	PERA Annuity	\$4,682.00		
MSRS Annuity	\$7,932.00	MSRS Annuity	\$7,932.00		
Total	\$13,492.00	Total	\$17,117.60		

- c. Combined Service Annuity Provision. Service in more than one fund provisions are less used now than in the distant past. In 1975, the Legislature enacted the Combined Service Annuities law, Section 356.30, which was an improvement in many cases over the service in more than one fund provisions. The Combined Service Annuities law applies to those Minnesota public defined benefit plans which base annuities on the high-five average salary. Local police or paid fire plans are not included under the Combined Service Annuities provision because those plans base their annuities on the salary of a certain position, usually a top grade patrol officer or firefighter. The Combined Service Annuities calculation begins by determining the high-five average salary of the individual, which could include service under more than one employer, and that common high-five average salary is then used to compute the annuities from all the plans included in the calculation. Thus, the salary used to compute the annuities from the earlier plan or plans may be much higher than the salary the individual was receiving before terminating that earlier employment. The benefit computed from each of the applicable plans is determined using the most recent version of law, thus allowing the individual to access any benefit improvements that occurred in the earlier plans after the individual left service covered by the applicable plan. The individual must begin drawing annuities from all the plans included in the person's Combined Service Annuities benefit calculation within a one-year period. The use of Combined Service Annuities is in lieu of deferred annuities augmentation from the earlier covered plans.

Some individuals have service in more than one of the plans covered by the Combined Service Annuities law, but choose not to use that provision. In these cases, deferred annuity augmentation would apply if the plan has an applicable provision. This can occur in cases where the normal retirement ages in the plans that provided coverage to the individual are very different. If an individual age 55 had prior Public Employees Police and Fire Plan (PERA-P&F) coverage (a plan with normal retirement age of 55), and the individual is now covered by the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General) (which has an age of 65 or 66 normal retirement age), the individual may be reluctant to leave current employment in order to use the Combined Service Annuities provision. He would face a stiff early retirement penalty from the MSRS plan if he begins drawing an MSRS annuity at age 55. Instead, the individual may choose

