



S.F. 2169
(Hayden)

H.F. 2316
(Kahn)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA-General
Relevant Provisions of Law: Special Law Provision
General Nature of Proposal: Service credit purchase for certain Hennepin Co. elected service
Date of Summary: March 3, 2014

Specific Proposed Changes

- Permits Randy Johnson, a Hennepin County Commissioner, to purchase service credit from the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) for his years of service as a Hennepin County Commissioner with the payment of the full actuarial value amount for the benefit to be obtained by the purchase.
- The purchase would be made by a transfer of his account balance in the Public Employees Defined Contribution Plan and, if insufficient, from his accounts in the Hennepin Co. Supplemental Retirement Plan or in the State Deferred Compensation Program.
- If, before June 30, 2018, the interest rate actuarial assumption or the mortality actuarial assumption of PERA-General is modified, Mr. Johnson would be obligated to pay an additional amount that would equal the unfunded actuarial accrued liability that PERA-General would otherwise incur as a result of the assumption change.

Policy Issues Raised by the Proposed Legislation

1. Conformity with Commission pension policy principles.
2. Existence of self-help remedy; logic of full actuarial value purchase.
3. Appropriateness of PERA-General selling annuities.
4. Precedent.
5. Appropriateness of additional required reserve payment requirement.
6. Appropriateness of continuing to limit elected officials to defined contribution plan coverage.

Potential Amendments

S2169-1A would reset the termination date for the additional funding requirement from 2018 to 2020 to accommodate any mortality or interest rate actuarial assumption changes that may arise out of the experience studies scheduled in 2019.

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TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: S.F. 2169 (Hayden); H.F. 2316 (Kahn): PERA-General; Permitting the purchase of service credit for certain Hennepin County elected service.

DATE: March 3, 2014

Summary of S.F. 2169 (Hayden); H.F. 2316 (Kahn)

S.F. 2169 (Hayden); H.F. 2316 (Kahn) permits Randy Johnson, a Hennepin County Commissioner, to purchase service credit from the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) for his years of service as a Hennepin County Commissioner with the payment of the full actuarial value amount for the benefit to be obtained by the purchase. The purchase would be made by a transfer of his account balance in the Public Employees Defined Contribution Plan and, if that account is insufficient, from his accounts in the Hennepin County Supplemental Retirement Plan or in the State Deferred Compensation Program. If, before June 30, 2018, the interest rate actuarial assumption or the mortality actuarial assumption of PERA-General is modified, Mr. Johnson would be obligated to pay an additional amount that would equal the unfunded actuarial accrued liability that PERA-General would otherwise incur as a result of the assumption change. The service credit purchase authority expires on December 31, 2015, or upon the conclusion of his service as a Hennepin County Commissioner, whichever occurs first.

Public Pension Request of Randy Johnson

Randy Johnson of Bloomington, Minnesota, is 66 years of age and has been a Hennepin County Commissioner since 1978. Until 2003, elected local government officials who were compensated in excess of a threshold amount (\$250 per month from 1978 to 1980, \$325 per month from 1981 to 1998, and \$425 per month after 1988) were permitted to be members of the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), but the membership was optional rather than mandatory and the PERA-General membership option was available only at the start of each new term in office. Mr. Johnson did not elect PERA-General coverage in 1979 when he initially became a County Commissioner or at the start of each new term in office thereafter, but did become a member of the Public Employees Defined Contribution Plan and made additional contributions for prior service to that plan under Minnesota Statutes, Section 353D.12. Mr. Johnson's wife reportedly has retired from the Teachers Retirement Association (TRA) and this has prompted him to pursue the opportunity to purchase PERA-General service credit for his past elected official service at full actuarial value.

Relevant Background Information

Background information on past special legislation permitting the purchase of allowable service credit is contained in **Attachment A**.

Discussion and Analysis

S.F. 2169 (Hayden); H.F. 2316 (Kahn) permits a full actuarial value service credit purchase of a long local elected official service career by Hennepin County Commissioner Randy Johnson from the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), replacing his current retirement coverage by the Public Employees Defined Contribution Plan.

The proposed legislation raises a number of pension and related public policy issues for consideration and possible discussion by the Commission, as follows:

1. Conformity with Commission Pension Policy Principles. The policy issue is the extent of compliance of the proposed legislation with the Principles of Pension Policy of the Commission. Before 1999, the Commission policy had several components, but since 1999, the Commission has approved a variety of service credit purchases so long as the purchase was accompanied by a full actuarial value purchase payment and, if the service was Minnesota public employment, the employment was not excluded from public pension coverage when rendered. The proposed legislation requires the payment of the full actuarial value of the benefit to be obtained by the purchase through a transfer from the Public

Employees Defined Contribution Plan, and if that is insufficient, from other tax deferred savings programs. Mr. Johnson's service credit purchase period was eligible for coverage by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) when it was initially rendered as service covered by an optional membership provision that Mr. Johnson, for whatever reason, did not exercise in 1978. Thus, the potential proposed legislation conforms with the post-1999 Commission practice and also appears to conform with the pre-1999 Commission practice. The sole gray area for the pre-1999 Commission policy compliance is the question of Mr. Johnson being or not being a current plan member. Mr. Johnson is a current member of the Public Employees Defined Contribution Plan, from which most or all of the purchase payment would be made, rather than PERA-General. The PERA-General optional membership provision for all new elected officials was eliminated in 2003 and was not exercised by Mr. Johnson as a pre-2003 incumbent elected official before that date. To the best of the Commission staff's determination, no member of the Public Employees Defined Contribution Plan has ever been permitted by the Legislature to purchase a PERA-General annuity previously.

2. Existence of Self-Help Remedy; Logic of Full Actuarial Value Purchase. The policy issue is the existence of a self-help remedy for Mr. Johnson and the unclear logic of purchasing service credit at the full actuarial value price. Most service credit purchases occur when current public employees seek to round out their public career by acquiring credit for prior uncredited periods or periods of quasi-public employment, frequently to reach an early retirement eligibility provision. In this case, Mr. Johnson would be purchasing the entirety of his public career without having any period of current defined benefit plan retirement coverage and is already at the applicable normal retirement age. The Public Employees Defined Contribution Plan, which is the sole retirement plan coverage for elected officials since 2003, provides only a lump sum benefit upon retirement. Like all Public Employees Defined Contribution Plan retirees, absent the potential proposed legislation, Mr. Johnson would likely use his lump sum benefit to purchase an annuity from an insurance company to provide periodic income during retirement. With a full actuarial value purchase of a retirement annuity from PERA-General if market forces operate correctly, Mr. Johnson should not be gaining any advantage over an insurance company annuity by the purchase unless he concludes his public career in the future after achieving a significantly better compensated public employment position than his current position, or if PERA-General uses interest or mortality assumptions that translate a lump sum amount into a larger annuity compared to available insurance annuities, or if PERA-General provides an annuity that is better structured to meet his needs than an insurance annuity because of its automatic post-retirement adjustments or its available optional annuity forms. In 2012, based on a Commission recommendation, the Legislature shifted from an 8.5% pre-retirement interest rate assumption/6.5% post-retirement adjustment, further adjusted for the 2010 post-retirement adjustment reductions under Minnesota Statutes, Section 356.415, Subdivision 3, to a select-and-ultimate set of interest rate assumptions, with a 0.5% reduction in the pre-2012 rates for the period 2012 until 2017 and then a resumption of the pre-2012 rates after 2017. This indicates some concern by the Commission about the appropriate interest rate assumption applicable for the PERA-General in 2012, which concern continues, with the Commission having discussed interest rate assumptions as a 2013-2014 Interim topic. If the current select-and-ultimate interest rates are modified before 2017, the service credit purchase payment could provide an actuarial value gain to Mr. Johnson if the assumption rate is not increased above the current select rate or could provide PERA-General with an actuarial gain if the assumption rate is increased prematurely.
3. Appropriateness of PERA-General Selling Annuities. The policy issue is the appropriateness of an arrangement where the PERA General Employee Retirement Plan begins to function as if it were a general insurance company in selling annuities. Boiled down to the essentials, retirement plans are really just highly specialized insurance programs that operate under a different regulatory structure than do insurance companies. Indeed, Minnesota Statutes, Section 353.16, enacted in 1931, provides that the state's insurance laws do not apply to PERA. PERA is not currently well positioned to market single premium retirement annuities, which is the equivalent to what this potential proposed service credit purchase would authorize, and the field of available insurance products is unlikely to benefit from the addition of an alternative vendor in the form of PERA. The Commission should use care in authorizing service credit purchases on this scale when they equate to a Minnesota public retirement plan selling an annuity on the open market.
4. Precedent. The policy issue is whether there are precedents for the proposed legislation and whether the situation underlying the draft proposed legislation could establish an undesirable precedent for future requests or demands. Numerous precedents exist for approving prior service credit purchases at full actuarial value and some of those precedents include purchases by local elected officials. There are relatively few, if any, local elected officials in counties with substantial compensation for their services who have lengths of service that approach or exceed Mr. Johnson's length of service, so there is little chance of an identical or substantially similar fact situation arising. However, any pre-2003 local elected officials who failed to elect coverage by the PERA General Employee Retirement Plan

(PERA-General) when initially taking office and who subsequently desire defined benefit plan coverage could point to this proposed legislation, if enacted, as a precedent for similar requests. Also, any person who is a member of the Public Employees Defined Contribution Plan who wants an annuity rather than a lump sum benefit may also argue that the proposed legislation is a precedent for converting the lump sum amount into a PERA-General annuity. If it becomes a precedent, converting Public Employees Defined Contribution Plan account amounts into PERA-General annuities places pressure on the PERA-General annuity conversion factors and on the funding of PERA-General if mortality tables or interest rate assumptions are not kept up-to-date.

5. Appropriateness of Additional Required Reserve Payment Requirement. The policy issue is the appropriateness of the proposed legislation requiring Mr. Johnson, a current active member and future retired member, to make an additional lump sum payment to PERA-General to retain the PERA-General annuity that he is purchasing, in the event of a PERA-General interest rate or mortality actuarial assumption change on or before June 30, 2018. One difficulty is the calculation of the amount due. Although the consulting actuary retained by PERA calculates the accrued liability change attributable to actuarial assumption changes, the calculation is not done on an individual-by-individual bases as provided in the potential proposed legislation. Another difficulty is the process for collecting the additional reserves from Mr. Johnson if future actuarial assumption changes occur, especially if Mr. Johnson has retired before that date and his Hennepin County Supplemental Retirement Program account or deferred compensation program account may no longer be available as a source. PERA-General is not a bank and does not operate a collection service beyond certifying amounts due from governmental entities to the applicable county auditor. An additional difficulty is the cut-off date for the length of the additional funding requirement for future assumption changes. Since the PERA-General mortality assumption was recently changed, it is unlikely to be modified after the next PERA experience study due in 2015. The legislature's decision on interest rate assumptions is not tied to an experience study, but could be triggered by a future market correction at an undetermined future date. The June 30, 2018, cut-off date appears to be an arbitrary choice, just before the due date for the 2019 experience study. A final difficulty relates to the administrative complexity that the calculation, collection, and cut-off date arrangements will become for PERA of more PERA members pursue the same special legislation as Mr. Johnson.

- If the Commission wishes to accommodate any mortality or interest rate actuarial assumption changes that may arise out of the experience studies scheduled to be reported to the Commission in 2019, **Amendment S2169-1A** would reset the termination date for the additional funding requirement to 2020 from 2018.

6. Appropriateness of Continuing to Limit Elected Officials to Defined Contribution Retirement Plan Coverage. The policy issue, looking at the situation in its broadest terms, is the appropriateness of providing defined contribution retirement plan coverage as the sole retirement coverage option for elected officials. Since 1997, legislators and elected state officers who newly take office are covered by the Unclassified State Employees Retirement Program of the Minnesota State Retirement System (MSRS-Unclassified), a defined contribution plan rather than the Legislators Retirement Plan or the Elective State Officers Retirement Plan and, since 2003, newly elected local government elected officials are covered by the Public Employees Defined Contribution Plan rather than the PERA General Employees Retirement Plan. For elected officials who serve short duration elective careers, the defined contribution plan coverage is likely to be very suitable and appropriate. For elected officials who serve essentially an entire career in elective service, defined contribution plan coverage may be deemed by them to be less suitable and appropriate. If a change in coverage options for elected officials is to occur, however, the problem of being able to predict their future service length will again arise, making shifts from one plan type to another difficult to handle.

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Background Information on Special Law Service Credit Purchases

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% per annum.

During the period 1957-2013, the Legislature has enacted 269 special laws authorizing one person or a small group of individuals to purchase prior service credit, distributed as follows:

Year	#	Year	#	Year	#	Year	#	Year	#
1957	1	1974	5	1983	2	1992	6	2001	10
1959	4	1975	10	1984	3	1993	7	2002	2
1961	5	1976	4	1985	2	1994	8	2003	6
1963	6	1977	9	1986	6	1995	7	2004	1
1965	5	1978	9	1987	3	1996	6	2005	1
1967	1	1979	7	1988	7	1997	3	2006	14
1969	2	1980	4	1989	12	1998	9	2007	3
1971	2	1981	14	1990	10	1999	8	2008	4
1973	4	1982	16	1991	6	2000	8	2009	2

A majority of special prior service credit purchase laws relate to the three major general employees retirement plans, with 34 special laws relating to the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), with 88 special laws relating to the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General), and with 54 special laws relating to 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% 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% 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.

1.1 moves to amend S.F. No. 2169; H.F. No. 2316...., as follows:

1.2 Page 2, line 12, delete "2018" and insert "2020"

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SENATE
STATE OF MINNESOTA
EIGHTY-EIGHTH SESSION

S.F. No. 2169

(SENATE AUTHORS: HAYDEN)

DATE	D-PG	OFFICIAL STATUS
03/03/2014		Introduction and first reading Referred to State and Local Government

1.1 A bill for an act
 1.2 relating to retirement; general employees retirement plan of the Public
 1.3 Employees Retirement Association; permitting the purchase of service credit for
 1.4 certain Hennepin County elected service.

1.5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MINNESOTA:

1.6 Section 1. **PERA-GENERAL; HENNEPIN COUNTY ELECTED SERVICE**
 1.7 **CREDIT PURCHASE.**

1.8 (a) Notwithstanding any provision of Minnesota Statutes, chapters 353 and 353D,
 1.9 or other law to the contrary, an eligible person described in paragraph (b) is entitled to
 1.10 purchase allowable service credit from the coordinated program of the general employees
 1.11 retirement plan of the Public Employees Retirement Association for the period of service
 1.12 as an elected county commissioner for Hennepin County that is not otherwise covered
 1.13 under Minnesota Statutes, chapter 353, if the eligible person makes the payment required
 1.14 under paragraph (d).

1.15 (b) An eligible person is a person who:

1.16 (1) was born on November 18, 1946; and

1.17 (2) was first elected as a Hennepin County commissioner in November 1978 and
 1.18 was sworn in as a commissioner on January 2, 1979.

1.19 (c) If the eligible person described in paragraph (b) elects to participate in the general
 1.20 employees retirement plan of the Public Employees Retirement Association governed by
 1.21 Minnesota Statutes, chapter 353, effective on the first day of the month next following the
 1.22 effective date of this section, the eligible person may apply to the executive director of
 1.23 the Public Employees Retirement Association to make the service credit purchase under
 1.24 this section. The application must be in writing and must be accompanied with necessary

2.1 documentation of the applicability of this section and of any other relevant information
2.2 that the executive director may require.

2.3 (d) Allowable service credit under Minnesota Statutes, section 353.01, subdivision
2.4 16, must be granted by the coordinated program of the general employees retirement plan
2.5 of the Public Employees Retirement Association to the eligible person upon the receipt
2.6 of the prior service credit purchase payment amount required under Minnesota Statutes,
2.7 section 356.551. The payment obligation must be offset first by a transfer of the account
2.8 balance to the credit of the eligible person from the defined contribution plan of the Public
2.9 Employees Retirement Association. If that transfer is insufficient, the balance of the
2.10 service credit purchase payment may be made from amounts to the credit of the eligible
2.11 person under Minnesota Statutes, section 352.965 or 383B.46.

2.12 (e) If, before July 1, 2018, the interest rate actuarial assumption, the mortality
2.13 actuarial assumption, or both actuarial assumptions of the general employees retirement
2.14 plan of the Public Employees Retirement Association are modified and the net result of
2.15 any modification is to increase the actuarial accrued liability of the retirement plan, the
2.16 eligible person, as a condition of a continued receipt of an annuity from the retirement
2.17 plan, shall reimburse the retirement fund for the amount of the increase in required
2.18 reserves for the annuity, determined as the difference between the present value of the
2.19 annuity on the effective date of the assumption change or changes before the assumption
2.20 change or changes and after the assumption change or changes. The executive director
2.21 shall certify the amount due, if any, to the eligible person and payment is due 30 days later.

2.22 (f) Authority for an eligible person to make the prior service credit purchase
2.23 under this section expires on December 31, 2015, or upon the termination of service as
2.24 a Hennepin County commissioner, whichever is earlier.

2.25 **EFFECTIVE DATE.** This section is effective the day following final enactment.