



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director

RE: S.F. 1758 (Jungbauer); H.F. 1648 (Abeler): TRA; Service Credit Purchase for an Extended Leave of Absence, Anoka Hennepin Teacher

DATE: April 20, 2005

Summary of S.F. 1758 (Jungbauer); H.F. 1648 (Abeler)

S.F. 1758 (Jungbauer); H.F. 1648 (Abeler) authorizes a Teachers Retirement Association (TRA) member employed by the Anoka-Hennepin school district since the 1971-1972 school year, who has been on an extended leave of absence for the 2002-2003, 2003-2004, and 2004-2005 school years, to be allowed to purchase applicable service credit in TRA for the 2003-2004 year despite a failure to make the contribution for the 2003-2004 school year because of a claimed failure by TRA to forward paperwork to the administrator of the individual's tax-sheltered annuity Section 403 (b) account, which delayed the transfer of funds to TRA to cover the required contribution amount.

TRA's Current Extended Leave of Absence Provision

The Teachers Retirement Association (TRA) extended leave of absence provision is Minnesota Statutes, Section 354.094. Under that provision a teacher may be granted an extended leave of absence by the school district for a period not to exceed five years. When the leave is granted, the school district must notify TRA that the individual will be on an extended leave. To receive service credit for the leave period, the employee is required to make employee contributions to TRA based on the employee contribution rate for the plan and the individual's salary in the year immediately preceding the leave. The corresponding employer contribution must be paid by the employer, by the employee, or in any combination agreed to by the parties.

The contributions for the leave are due by June 30<sup>th</sup> each year without interest or, in some cases, by September 30<sup>th</sup> with interest. If contributions are not received by TRA, the member forfeits any right to service credit for that year, and is prohibited from making contributions for any remaining years of the leave.

Any individual on an extended leave must have reinstatement rights both during the leave and at the end of the leave. Service credit for the leave period is not authorized if the individual receives service credit during that leave period in any other Minnesota public pension plan, other than a volunteer fire plan.

Origin of the Extended Leave Provision

Minnesota's public defined benefit plans are a personnel policy tool of the employer in that they serve to attract sufficient numbers of new employees, to promote retention of capable existing employees, and to out-transition long-term employees at the end of their fully productive working life, by providing those long-term employees with retirement plan income which is sufficient, in conjunction with personal savings and social security, to allow the individual to retire without a significant drop in the standard of living.

Leave of absence provisions are found in most Minnesota defined benefit public pension plans. They permit the individual to receive either full or partial service credit for a period of break in service to the employer. The provisions are somewhat unusual in that they are providing service credit in the retirement plan for a period of time during which the individual was not providing service to the employer. The provisions presumably are justified in that they serve as retention tools. Another factor may be that the leave, if used to receive additional training or education, further enhances the productivity and value of the employee to the employer.

The Teachers Retirement Association (TRA) extended leave of absence provision was enacted in 1977, in Laws 1977, Chapter 447, Article 9, along with a few other teacher mobility incentives. The teacher mobility incentives were enacted as part of the 1977 school aids bill, represented a policy initiative of the

House of Representatives under Speaker Martin O. Sabo, and were developed to reduce a growing proportion of senior, highly compensated teachers. The extended leave of absence program was intended to allow a teacher to take a five-year leave of absence to attempt to make a career change without disrupting the teacher's retirement coverage for the period. The program was not reviewed by the Commission in 1977 and has never been subjected to any detailed scrutiny by the Commission. Given predicted teacher shortages in the years ahead, at some point the Commission may wish to consider whether the extended leave of absence provisions in teacher plans should remain in law.

### Situation of Cheryl Holm

S.F. 1758 (Jungbauer); H.F. 1648 (Abeler) is for an Anoka-Hennepin teacher, Ms. Cheryl Holm, who is on an extended leave of absence for the 2002-2003, 2003-2004, 2004-2005 school years. Under the leave of absence arrangement with the school district, Ms. Holm is responsible for paying the employee contribution and the district is to pay the employer contribution. There was no problem during the first year of the leave and Ms. Holm received service credit for that year. However, a problem arose during the second year. Ms. Holm's intention was to transfer assets from her tax-sheltered annuity Section 403(b) account to pay the employee contribution for the leave. Ms. Holm completed the TRA form on May 3, 2004, entitled "Authorization to Transfer Tax-Sheltered Funds" (copy attached). TRA received a copy of the form during May, several weeks before the June 30<sup>th</sup> due date for the contribution.

Ms. Holm states that on or around June 30<sup>th</sup>, someone from TRA called her home phone and left a message stating that TRA had not received the employee contribution and that if it was not received within 24 hours, she would forfeit the right to make contributions for the leave. Ms. Holm did not get the message until a few days later. She called her 403(b) provider, MetLife, in an effort to understand what had gone wrong, and in early July both Ms. Holm and the 403(b) provider called TRA to ask if it was still possible to make the payment, along with any penalty or interest that might be required. They were told that it was too late to make the payment.

### Payment Deadline Provision

The Teachers Retirement Association (TRA) conclusion that it was too late to make payment by Ms. Holm is based on somewhat confusing wording in the extended leave provision. TRA's extended leave of absence law does include some language suggesting that, at least in some circumstances, payment can be made by June 30<sup>th</sup> without interest, or by September 30<sup>th</sup> with interest. TRA's extended leave of absence provision, in Section 254.094, in Subdivision 1, dealing with service credit contributions for the leave, states in relevant part:

Payment for the years for which a member is receiving service credit while on extended leave must be made on or before the later of June 30 of each fiscal year for which service credit is received or within 30 days after first notification of the amount due, if requested by the member, is given by the association. No payment is permitted after the following September 30. Payments received after June 30 must include interest at an annual rate of 8.5 percent from June 30 through the end of the month in which payment is received.

If September 30<sup>th</sup> is the last date for payment, at least in some circumstances, and payment must also be made within 30 days of notification by TRA, that would suggest that some people could be notified several months after the supposed June 30<sup>th</sup> deadline, as late as the end of August or during September, and payment would be accepted if made before the end of September with interest. The wording suggests that to be eligible to make payment by September 30<sup>th</sup> rather than June 30<sup>th</sup>, the notification from TRA must be the first notification that TRA provides, and the notification must be requested by the member. In Ms. Holm's case, TRA takes the position that first notification occurred in March or April, when TRA sent her the "Authority to Transfer Tax-Sheltered Annuity Funds" form, and neither that contact nor the June 30<sup>th</sup> phone call was specifically requested by the member. Therefore, in her case no payment can be accepted after June 30<sup>th</sup>.

Although TRA may be technically correct in not permitting Ms. Holm to make payment in early July, the policy reflected in the provision raises questions. It is unclear why some people must pay by June 30<sup>th</sup>, while others can pay as late as September 30<sup>th</sup> provided interest is included. It also is unclear why it should matter whether contact between TRA and the member is an initial contact rather than follow-up contact, or whether the contact is initiated by the pension fund administration, or by the member, or at the member's specific request.

## TRA's Position on Deadline Provision

Luther Thompson from the Teachers Retirement Association (TRA) has indicated that this TRA extended leave of absence payment deadline provision ought to be revised. During the last few years, pension funds have been given explicit authorization in Minnesota Statutes to accept rollovers from tax-sheltered accounts to pay for service credit purchases and leave of absence contribution requirements. TRA expects an increase in payment deadline problems due to this rollover authority. Some problems can be expected due to the time needed for processing, and further unexpected delays due to errors on the forms, insufficient assets in the account from which assets are to be rolled, and other matters. TRA's suggestion is to allow payment after June 30<sup>th</sup>, as late as September 30<sup>th</sup> with interest, providing that payment is by transfer from a pretax account and there is evidence of an effort to initiate the payment process by June 30<sup>th</sup>.

## Discussion

S.F. 1758 (Jungbauer); H.F. 1648 (Abeler) authorizes an Anoka-Hennepin teacher on an extended leave of absence for the 2002-2003, 2003-2004, and 2004-2005 school years, to purchase applicable service credit in TRA for the 2003-2004 year of the leave despite a failure to make payments for the 2003-2004 school year because of a claimed failure by Teachers Retirement Association (TRA) to forward paperwork to the administrator of the individual's 403(b) account, delaying the transfer of funds beyond the last permitted date.

At a minimum, the bill would need revision clarifying whether interest is to be charge, to allow TRA to accept the corresponding employer contribution for the 2003-2004 school year, and to ensure that the individual is authorized to make contributions for the next year of the leave. The Commission may also wish to address TRA's suggested changes in its extended leave payment provision.

Pension policy issues raised by the bill are:

1. Question of Consistency with Commission Principles/Appropriate Model. The issue is whether the bill drafting is consistent with the Commission's Statement of Pension Policy Principles. The bill is an effort to allow the eligible individual to purchase service credit in the plan under the TRA extended leave of absence provision. It is unclear from the drafting whether any interest is to be charged. In any event, the Commission's usual treatment when it is asked to address a leave of absence where the individual cannot receive service credit due to error by the employee, employer, or pension fund administration, or some combination of the three, is to use the a full actuarial value approach. There is no claim of employer error in the case before the Commission. If the Commission were to conclude that the employee bears full responsibility for the problem, the usual Commission action is to have the individual pay the full actuarial value of the service credit purchase. If the Commission were to conclude that the pension problem is due to error by the pension fund administration, then in the past the Commission has allowed the individual to pay contributions plus interest and has waived the remainder of the full actuarial value. Also, at times when the Commission and Legislature has decided that a general law change is needed, the Legislature has permitted the individual who had the pension problem which brought attention to the problematic general law provision to receive the revised general law treatment, by having that treatment apply retroactively to the eligible individual.
2. Employee Responsibility/Equity Issues. The Commission may wish to establish through testimony the extent to which the eligible teacher is responsible for the problem. Greater attention to detail may have avoided the problem. The problem also would not have occurred if the teacher had simply paid the required contribution by check from other assets, or had sought verification before June 30<sup>th</sup> that a contribution had been transmitted. On the other hand, rollovers from pretax accounts are an acceptable payment method under law, and the individual thought she had taken action to pay the required contribution well before the June 30<sup>th</sup> deadline, when she sent the "Authorization to Transfer Tax-Sheltered Funds" form to TRA in early or mid-May of 2004.
3. Pension Fund Administration Responsibility. The Commission may wish to hear brief testimony from TRA. The questions are whether TRA acted in a reasonable timeframe to alert the individual that payment had not been received, and whether TRA interpreted its extended leave of absence contribution provision in a reasonable manner in not allowing the individual to make the contribution after June 30<sup>th</sup>. Contacting the individual on or about June 30<sup>th</sup> to let her know that no contribution had been received left virtually no time to respond by the June 30<sup>th</sup> deadline.

4. Need to Revise Payment Requirement. The issue is whether the Commission should recommend revision in TRA's extended leave of absence contribution provision, as suggested by TRA to better accommodate problems that will arise with transfers from pretax accounts, and whether this individual should be permitted to make a contribution under the general terms of the revised provision.
5. Cost. The issue is the cost of the service credit purchase. That cost will depend greatly on the approach the Commission chooses to take. The contribution required from the individual in 2004 was \$3,295.16. If the individual is permitted to receive service credit for contributions plus interest, then some interest would be added to that amount. Presumably, TRA would also receive a similar amount from the employer.

If the individual were required to pay full actuarial value, the payment would be much higher, since the individual intends to retire under the Rule of 90 which she will soon reach. TRA may be able to provide an estimate.

6. TRA Condition. The issue is TRA's current actuarial condition, which is displayed below.

Teachers Retirement Fund Association (TRA)

		2004
<u>Membership</u>		
Active Members		72,008
Service Retirees		34,581
Disabilitants		589
Survivors		2,479
Deferred Retirees		10,767
Nonvested Former Members		<u>18,223</u>
Total Membership		138,647
<u>Funded Status</u>		
Accrued Liability		\$17,518,783,700
Current Assets		<u>\$17,519,909,350</u>
Unfunded Accrued Liability		(\$1,125,650)
Funding Ratio	100.01%	
<u>Financing Requirements</u>		
Covered Payroll		\$3,206,759,440
Benefits Payable		\$1,008,410,471
Normal Cost	8.07%	\$258,898,450
Administrative Expenses	<u>0.39%</u>	<u>\$12,506,362</u>
Normal Cost & Expense	8.46%	\$271,404,812
Normal Cost & Expense	8.46%	\$271,404,812
Amortization	<u>0.00%</u>	<u>\$0</u>
Total Requirements	8.46%	\$271,404,812
Employee Contributions	5.00%	\$160,337,972
Employer Contributions	5.00%	\$160,337,972
Employer Add'l Cont.	0.00%	\$0
Direct State Funding	0.00%	\$0
Other Govt. Funding	0.00%	\$0
Administrative Assessment	<u>0.00%</u>	<u>\$0</u>
Total Contributions	10.00%	\$320,675,944
Total Requirements	8.46%	\$271,404,812
Total Contributions	<u>10.00%</u>	<u>\$320,675,944</u>
Deficiency (Surplus)	(1.54%)	(\$49,271,132)
Amortization Target Date	2034	
Actuary	Segal	

Amendments

LCPR05-269 is a delete-everything amendment that would authorize the individual to receive service credit for the 2003-2004 school year by paying the full actuarial value. If that payment is made, the individual has continued eligibility under the extended leave provision for the next school year.

LCPR05-270 is a delete-everything amendment that would revise the TRA extended leave of absence contribution requirement provision to allow payment after June 30<sup>th</sup> until September 30<sup>th</sup> with interest, if payment is by pretax asset transfer and providing that payment is initiated by June 30<sup>th</sup>. The amendment also authorizes the individual to receive service credit for the 2003-2004 school year by paying the employee contribution plus interest as required under terms specified in the of the full actuarial value provision (Section 356.551). TRA will bill the employer for the employer contribution amount, and the remainder of the full actuarial value will be waived. If the employee contribution is paid, the individual has continued eligibility under the extended leave provision for the next school year.

LCPR05-271 is a delete-everything amendment identical to LCPR-05-270, except that interest is charged only from June 30, 2004, until paid. This provides treatment for the individual that is most similar to what would have occurred if TRA had accepted the individual's 2003-2004 contribution after the June 30<sup>th</sup> date with interest.

## Attachment A

### General Service Credit Purchase: Legislative Commission on Pensions and Retirement Policy

When a problem occurs related to a leave of absence, causing the individual to forego service credit, and the Legislature is asked through special legislation to remedy the problem, the Commission generally reviews these cases in the context of its general service credit purchase procedures. The Commission's Principles of Pension Policy, last revised in December 1996, includes the following statement of purchase of service credit policy:

Purchase of public pension plan credit for periods of prior service should be permitted only if, on a case-by-case basis, it is determined that the period to be purchased is public employment or substantially akin to public employment, that the prior service period must have a significant connection to Minnesota, that the purchase payment from the member or from a combination of the member and employer must equal the actuarial liability to be incurred by the pension plan for the benefit associated with the purchase, appropriately calculated, without the provision of a subsidy from the pension plan, and that the purchase must not violate notions of equity.

The above statement indicates various policies and criteria applicable to the purchase requests:

1. Individual Review. The statement indicates that the Commission considers each case separately, whether the "case" is a single person bill or a bill covering a group of similarly situated individuals.
2. Public Employment. The period requested for purchase should be a period of public employment, or substantially akin to public employment. This is consistent with the notion that public plans should be providing coverage for public employees for periods of time where they were serving the public through public employment or quasi-public employment. Coverage for a period where 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 plans and bear the investment risk of investing 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 our state.
4. Presumption that an Employee is in Active Status at Time of Purchase. The statement refers to necessary contributions from the member or in combination from the member and employer. There is a presumption that the individual covered by the service purchase bill is an active employee, or an active employee on leave.
5. Presumption of Purchase in Defined Benefit Plan. The statement refers to contributions which in total match the liability. This statement, in conjunction with the specific procedures in Minnesota statutes and law for computing service credit purchase amounts (Minnesota Statutes, Section 356.55, 356.551, and elsewhere) presume that the purchase is in a defined benefit plan with a benefit based on the individual's high-five average salary.
6. Full Actuarial Value Purchase. Within the context of a defined benefit plan, the statement indicates that the pension fund is to receive a payment from the employee or from the employee and employer in combination, an amount which equals the additional liability placed on the fund due to the purchase. This is referred to as the full actuarial value of the service credit purchase. The statement emphasizes that the procedure used to compute this full actuarial value must be a methodology that accurately estimates the proper amounts.

The Commission does purposely depart 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 these situations, 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. Any difference between the payment and the full actuarial value would be absorbed by the pension fund.

Where there is clear evidence that the employing unit committed an error which 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, a sufficient amount to cover the remainder of the full actuarial value is deducted from any State aids that would otherwise be transmitted to the employer.

7. No Violation of Equity Considerations. The Legislative Commission on Pensions and Retirement principles statement specifies that purchases of service credit should not violate equity considerations. The dictionary defines “equity” as fairness; impartiality; justice. For purposes of law, “equity” is further defined as (a) “resort to general principles of fairness and justice whenever existing law is inadequate; and (b) a system of rules and doctrines, as in the United States, supplementing common and statute law and superseding such law when it provides inadequate for just settlement.” The Commission could view requests by existing retirees to purchase additional service credit and have their annuities recomputed as being a situation which violated equity considerations. New bills on behalf of individuals, who were covered by purchase of service credit bills 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 applicable law could also be considered as violating equity considerations, among other policy concerns relating to those considerations. Bills allowing purchase credit in a defined contribution plan, or to otherwise add assets to one of these plans, permitting the assets to grow tax-free until withdrawal, can be viewed as a violation of equity. Long delays in seeking remedial action can also be considered a violation of equity considerations. Individuals tend to wait until late in their career 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 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. In general, any issue or factor which the Commission views as lacking fairness or being less than impartial, can be a basis for not recommending a bill to pass.