



H.F. 1668
(Murphy, M.)

S.F. xxxx

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA plans
Relevant Provisions of Law: Special law provision
General Nature of Proposal: Erroneous deduction provision to apply to the City of Duluth and Duluth Airports Authority salary errors occurring from 1997 to 2008
Date of Summary: May 9, 2011

Specific Proposed Changes

- Creates special law provision which refunds the excess employee contributions plus interest, gives the employer a credit for excess employer contributions, permits recapture of benefit overpayments, and gives employing unit option to limit recovery to the fiscal year in which the errors are detected and the prior two fiscal years.

Policy Issues Raised by the Proposed Legislation

1. Unclear what general law would otherwise apply.
2. Whether proposed special law is needed, and whether there are sufficient equitable arguments to justify recommending it to pass.
3. Local approval concerns: City of Duluth testified in support of a similar 2009 special law to address this Duluth problem, but then failed to provide local approval.
4. Impact on PERA plans. The language appears to give the Duluth Airport Authority and the City of Duluth the authority to impose a loss on PERA plans.
5. Scope concerns; possible requests by other employing units for similar special law treatment.

Potential Amendments

H1668-1A specifically authorizes PERA to assess interest on the recovery of overpaid annuities in an effort to minimize harm to PERA.

H1668-2A expands the scope of the bill to include additional employing units where errors occurred: Western Lake Superior Sanitary District, the City of Virginia, and the City of Backus



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director ^{EB}

RE: H.F. 1668 (Murphy, M.); S.F. xxxx: PERA Plans; Special Law Provision: City of Duluth and Duluth Airports Authority; Correcting Erroneous Employee Deductions and Employer Contributions, and Adjusting Overpaid Benefits

DATE: May 9, 2011

Summary of H.F. 1668 (Murphy, M.); S.F. xxxx

H.F. 1668 (Murphy, M.); S.F. xxxx creates a special law provision for the City of Duluth and the Duluth Airport Authority to handle overpayments of employee and employer contributions, and the resulting overpayment of benefits that occurred due to use of invalid salary amounts for determining Public Employees Retirement Association (PERA) contributions reported from January 1, 1997, through October 23, 2008. For active employees the excess employee contributions will be refunded with interest, while the employer will receive a credit without interest for overpaid employer contributions. If benefits have commenced, the overpayment of employee contributions must be netted against the benefit overpayments. If the employer submits a resolution within 30 days of the effective date, the adjustments will be restricted to the fiscal year in which the error was found and the preceding two years. Local approval is required. This treatment is in lieu of treatment specified in the PERA general law correction of contribution provision.

Discussion and Analysis - Recent History

The bill represents a second effort to provide the City of Duluth and the Duluth Airport Authority with a special law procedure to address a problem caused by including improper amounts in the salary used for determining contributions to PERA. The salary was overstated, leading to higher contributions than required and permitted under law, and to annuities from the plan which overstated proper amounts, because the annuities are based on the high-five average salary as reported by the employer. The first legislative effort to address this situation occurred in 2009, shortly after the salary errors were detected, through an administrative bill.

The 2009 administrative bill for PERA, the Minnesota State Retirement System (MSRS), the Teachers Retirement Association (TRA), and the first class city teacher plans, 2009 S.F. 578 (Betzold); H.F. 1123 (Murphy, M.), as introduced, included revisions to PERA's general law erroneous receipts provision which prescribes procedures to address employee and employer contributions made in error, which would include cases where contributions were overpaid. In law, contributions to the fund are set at a fixed percentage of the employee's salary for pension purposes. Contribution overpayments can occur if the salary for pension purposes is overstated, perhaps by including employer contributions to deferred compensation plans, clothing allowances, or certain payments for insurance that are not includible in salary for purposes of computing pension benefits and contributions to the plan.

In late February 2009, PERA sought to revise the proposed PERA erroneous receipts provision in the bill. At the Commission's February 27, 2009, meeting, Representative Mary Murphy offered an amendment requested by PERA (S0578-24A) to the PERA general law erroneous receipts language, and the amendment was adopted. That amendment specified that interest must be paid to employees when excess employee contributions are refunded, and an approximate three-year statute of limitations was added to the provision, under which the adjustment period was limited to the fiscal year in which the error occurred and the prior two fiscal years unless there is evidence of fraud or abuse, in which case a longer period may apply. All returned employer contributions are without interest and will be done through a credit against future contributions. The amendment also included new language specifying that any fees or penalties assessed by the Internal Revenue Service (IRS) for any failure by an employer to follow the statutory requirements for reporting eligible members and salary must be paid by the employer. The amendment also required that when benefit occurs due to the overpayment of contributions, the amount of the benefit overpayment recapture must be netted against the refund of the contributions. Apparently, these revisions were sought due to discussions PERA was having with the IRS. The amendment reflected PERA understanding of revisions required to PERA's erroneous receipts provision for compliance with IRS standards and federal law. Attached to this memo is a copy of a handout that PERA supplied to the Commission, dated February 25, 2009, in which PERA summarizes the IRS requirements as PERA understood them. That handout also gives background on problems PERA had with several employing units regarding overpaid contributions

which caused overpayment of benefits. The contributions, which were too high because they included, in various cases, employer payments for insurance, cashed-out leave time or cashed-out vacation time, employer payments to deferred compensation accounts, tool allowances, and other ineligible items. The employing units were the City of Duluth, the Duluth Airport Authority, the Duluth Entertainment Convention Center, the Western Lake Superior Sanitary District, the City of Virginia, and the City of Backus. The handout indicated (on page 4) that the largest amount of employee and employer contribution overpayments occurred with the City of Duluth, with overpaid employee contributions from that city totaling \$1.1 million and overpaid employer contributions totaling \$1.4 million.

Still later in the 2009 Legislative Session, PERA sought additional changes. At the Commission's final meeting during the 2009 Session (March 31, 2009), PERA requested another amendment (S0191-19A) to clean up the proposed PERA general law erroneous contribution amendment. The amendment was offered by Rep. Murphy and adopted by the Commission. Rep. Murphy then offered a further amendment, S0191-20A, which was a proposed special law to be used by the City of Duluth and the Duluth Airport Authority to address PERA contribution overpayments that had occurred from January 1, 1997, through October 23, 2008. The special law, if approved locally, would apply instead of the general law. Amendment S0191-20A was very similar to the proposed revised general law, although there was a significant difference. The proposed special law did not include any language limiting the corrections to the fiscal year in which the error was discovered and the prior two fiscal years. Perhaps the reason for this was given in the February 25, 2009, PERA handout mentioned above. The handout states (on page 1) that the PERA board took the position that the statute of limitations language should only apply to newly discovered errors, and not those in which corrections were already in process. Apparently, the PERA was already in the process of correcting errors due to the various Duluth employers.

At the March 31, 2009, Commission meeting, two individuals testified in support of amendment S0191 20A, the special law provision for Duluth and the Duluth Airport Authority. These were Erik Simonson, President of the International Association of Firefighters (IAFF), Duluth Local 101, and Mark Winson, City of Duluth Chief Administrative Officer. The amendment was adopted and became part of the 2009 Omnibus Retirement Bill. However, despite the testimony suggesting local support for the special law provision, neither Duluth nor the Duluth Airport Authority provided the necessary local approval to make the provision effective.

Discussion and Analysis – Policy Issues

H.F. 1668 (Murphy, M.); S.F. xxxx is another effort to create a special law provision to address the contribution rate and benefit overpayments that resulted due to the errors made by the City of Duluth and the Duluth Airport Authority during the period January 1, 1997, to October 23, 2008. The language is very similar to 2009 special law provision which was not approved locally, except that the new proposal (lines 3.7 to 3.17) includes language limiting the corrections to the fiscal year in which the errors became known by PERA and the preceding two fiscal years. This treatment will occur if the special law is approved locally and if the employing units specify in a resolution that the employer wants that statute of limitations treatment.

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

1. Need for Information about Options. In order for the Commission to better assess the merit of this proposal, it would be useful for the Commission to hear testimony from PERA regarding the treatment that will occur if this proposal were not adopted. It is somewhat unclear what general law would apply, because the PERA board took the position (according to attached February 25, 2009, PERA handout) that the statute of limitations language in the PERA revised general law as it passed in 2009 should not apply to cases already identified and in process. Does PERA take the position that the applicable provision of general law is the 2009 or current PERA general law provisions in its entirety, the 2009 or current PERA general law provisions minus the statute of limitations language, or is it the PERA general law provisions as they existed in 2008, when the applicable overpayments were first detected? Once the applicable general law is identified, a brief review of treatment under that provision would be helpful to the Commission.
2. Need for Proposed Special Law. Once the Commission understands what general law would otherwise apply and the implication of that law, the next issue is whether there is sufficient need or merit for this proposed special law. The Commission may wish to hear brief testimony regarding how the treatment under this proposed special law would differ from treatment under the applicable general law. The Commission may then wish to determine whether there is sufficient merit and general equity for the proposal.

3. Local Approval Issues. The Commission may wish to seek assurance that the special law provision will be approved locally. If not, there is little reason for the Commission to give further consideration to the proposal. The need for a firm local commitment seems heightened given that the similar 2009 special law for the City of Duluth and the Duluth Airport Authority was not approved locally, despite testimony in support of the 2009 proposal by the City of Duluth's chief administrative officer.
4. Implications for PERA. The issue is whether PERA suffers financial harm under this proposal and the extent of that harm, compared to the treatment that will occur under general law. The contribution overpayments occurred over and approximate 11½ year period (January 1, 1997, to October 23, 2008). The special law language (lines 3.7-3.17) appears to give the city and the Duluth Airport Authority the authority to limit the period subject to correction to a period not to exceed three years. Does the language on lines 3.7-3.17, in effect, give the City of Duluth and the Duluth Airport Authority the authority to impose a loss on PERA? Presumably, PERA can provide to the Commission estimates of these amounts and the impacts on PERA plan funds, if any.
5. PERA Actuarial Condition. The issue is the actuarial condition of PERA and the Public Employees Police and Fire Retirement Plan (PERA-P&F). Below is an actuarial summary of the most recent actuarial valuations for PERA-General and PERA-P&F.

| | PERA-General 2010 | | PERA-P&F 2010 | |
|-------------------------------|----------------------|-------------------------|------------------|------------------------|
| <u>Membership</u> | | | | |
| Active Members | | 140,389 | | 11,002 |
| Service Retirees | | 59,159 | | 5,354 |
| Disabilitants | | 2,215 | | 859 |
| Survivors | | 7,120 | | 1,413 |
| Deferred Retirees | | 45,151 | | 1,315 |
| Nonvested Former Members | | <u>126,027</u> | | <u>930</u> |
| Total Membership | | 380,061 | | 20,873 |
| <u>Funded Status</u> | | | | |
| Accrued Liability | | \$17,180,956,000 | | \$5,963,672,000 |
| Current Assets | | <u>\$13,126,993,000</u> | | <u>\$5,188,339,000</u> |
| Unfunded Accrued Liability | | \$4,053,963,000 | | \$775,333,000 |
| Funding Ratio | 76.40% | | 87.00% | |
| <u>Financing Requirements</u> | | | | |
| Covered Payroll | | \$5,160,545,000 | | \$795,171,000 |
| Benefits Payable | | \$906,300,000 | | \$326,041,000 |
| Normal Cost | 6.50% | \$335,526,000 | 19.65% | \$156,244,000 |
| Administrative Expenses | <u>0.18%</u> | <u>\$9,289,000</u> | <u>0.10%</u> | <u>\$795,000</u> |
| Normal Cost & Expense | 6.68% | \$344,815,000 | 19.75% | \$157,039,000 |
| Normal Cost & Expense | 6.68% | \$344,815,000 | 19.75% | \$157,039,000 |
| Amortization | <u>5.78%</u> | <u>\$298,280,000</u> | <u>5.77%</u> | <u>\$45,881,000</u> |
| Total Requirements | 12.46% | \$643,095,000 | 25.52% | \$202,920,000 |
| Employee Contributions | 6.13% | \$316,120,000 | 9.50% | \$75,541,000 |
| Employer Contributions | 7.13% | \$367,746,000 | 14.25% | \$113,312,000 |
| Employer Add'l Cont. | 0.00% | \$0 | 0.00% | \$0 |
| Direct State Funding | 0.00% | \$0 | 0.00% | \$0 |
| Other Govt. Funding | 0.00% | \$0 | 0.00% | \$0 |
| Administrative Assessment | <u>0.00%</u> | <u>\$0</u> | <u>0.00%</u> | <u>\$0</u> |
| Total Contributions | 13.25% | \$683,866,000 | 23.75% | \$188,853,000 |
| Total Requirements | 12.46% | \$643,095,000 | 25.52% | \$202,920,000 |
| Total Contributions | <u>13.25%</u> | <u>\$683,866,000</u> | <u>23.75%</u> | <u>\$188,853,000</u> |
| Deficiency (Surplus) | (0.79%) | (\$40,771,000) | 1.77% | \$14,067,000 |

6. Treatment of Other Employers: Possible Later Requests for Special Law Treatment. In addition to the City of Duluth and the Duluth Airport Authority, the attached PERA handout identified three other employers where errors occurred, the Western Lake Superior Sanitary District, the City of Virginia, and the City of Backus. The Commission may wish to determine whether PERA has addressed these cases and how they were, or will be, treated. The Commission may also wish to consider whether the proposed special law treatment for the City of Duluth and the Duluth Airport Authority will lead to requests for similar treatment from those employers, or others.

Potential Amendments for Commission Consideration

H1668-1A specifically authorizes PERA to assess interest on the recovery of overpaid annuities in an effort to minimize harm to PERA.

H1668-2A would include the additional employing units identified in the PERA handout (the Western Lake Superior Sanitary District, the City of Virginia, and the City of Backus) in the treatment proposed in the bill. This amendment can be used with or without Amendment H1668-1A.

Amendment to Section 353.27, subdivisions 7 and 7b

The language changes that are being presented accommodate the following:

- ◇ Authorizes the payment of interest on the refunded employee deductions that were taken in error – required by Internal Revenue Service (IRS)
- ◇ Directs that the return of any overpaid employer contributions must be through credits against future employer obligations – required by IRS
- ◇ Institutes a statute of limitations (following the IRS self-correction period) of current plan year in which an error is discovered plus two previous plan years as the “statute of limitations” for correcting future invalid salary discoveries
- ◇ Institutes a statute of limitations of three years from effective date of benefit payments as the limitation when benefit payments may be corrected.
- ◇ Sets forth the process for refunding erroneous employee deductions and employer contributions paid, and the recovery of overpaid benefits.
- ◇ Requires the employer, who didn’t follow the statutory reporting requirements, to pay penalties and fees that may be assessed by the IRS – required under Voluntary Compliance Procedures, under IRS Revenue Procedures 2008-50, Section 10.01 – “... requirements ... are satisfied ... if the Plan Sponsor pays the compliance fee ... Defines Plan Sponsor under Revenue Procedure 2008-50, section 5.01(6) as “.. the employer that ... maintains a qualified plan for its employees.” Response to question asked of IRS personnel via e-mail “the compliance procedures are clear... the compliance fee should not be coming out of the Plan’s assets either directly or indirectly.”

The Board took the position that the statute of limitations should only apply to newly discovered errors. Therefore, those corrections already in process, such as the City of Duluth, should be corrected retroactively for the entire period of invalid salary reported. However, given the IRS requirement that interest must be paid to the employees on the deductions reported on invalid salary, that particular change in this amendment will apply to refunds processed for anyone after the effective date. And, since we do not expect to refund anything to the employees of Duluth and the other employers currently in process for adjusting errors until the appeal period has expired – targeted to be in June -- this effective date works. See background below.

Background

On July 31, 2007, a staff member in the PERA Account Information Management Division received an e-mail message from Duluth’s city auditor asking us to review some language in the collective bargaining agreements to provide our interpretation as

to whether the arrangement referred to in the (current years') agreement would be considered salary on which PERA employee deductions and employer contributions should be reported. PERA responded that we did not view the arrangement to which we were referred as eligible salary for PERA purposes, but instead viewed it as an "employer-paid fringe benefit." There was no further communication on the issue thereafter between the City of Duluth and PERA until the following.

In September 2008, PERA received a letter from the City of Duluth notifying us employee deductions and employer contributions had been reported on an employer paid contribution that was to be paid as designated by the employee to either deferred comp or health insurance. We were told that this had been going on for many years, dating back into the mid 1990s, and that the city's administration was still researching the extent of the issue. PERA staff contacted the City administration to learn more about the details of this issue and after reviewing all of the collective bargaining and personnel agreements for the City, dating back to 1994, we determined that the provisions of the agreements allowing the employees to direct an employer contribution to either deferred compensation or to dependent health insurance was an "employer-paid fringe benefit" that we do not consider to be salary on which deductions and contributions should be reported and on which pensions should be calculated. Another provision within the insurance section of the agreements authorizes the employer to deposit a specific dollar amount into the employee's deferred comp account or into a flexible spending account, as designated by the employee. PERA again has determined the employer contribution under this provision to not be salary for PERA purposes, as provided under our statutes, section 353.01, subdivision 10, which states in part: "Salary does not mean ... employer-paid amounts used by an employee toward the cost of insurance coverage ... flexible spending accounts..."

After further review of the various agreements, we found that one or two of the agreements also allowed employees to cash out personal days, which the City included in salary reported to PERA. PERA's governing statutes do not allow contributions to be paid or pensions calculated on any unused annual leave. We classify cashed out personal days or annual leave as "unused." And, we found that in at least one of the agreements, a tool allowance had been reported as salary, which is ineligible for PERA purposes, because in our view this represents a reimbursement for expenses that is specifically excluded from PERA's salary definition.

Staff worked with the City of Duluth administrators directing what we would need to make the necessary adjustments to salary and contributions reported and to recalculate monthly benefit amounts being paid that included the invalid salary in the high-five year average salary.

Within six weeks, we then learned that the Western Lake Superior Sanitary District (WLSSD) had been withholding deductions and reporting contributions on the employer contribution to deferred compensation since 1990. The PERA governing statutes, however, weren't amended to specifically reference "employer-paid fringe benefits" as ineligible salary until July 1, 1994. Therefore, we informed the WLSSD that we would only be correcting reporting errors back to that date, because our law did not reference employer-paid fringe benefits as ineligible prior to that time.

We also heard from the City of Virginia in October 2008 that they had also been reporting contributions to PERA on an employer payment to deferred compensation since July 1, 1997. The number of city employees affected by the Virginia error was limited to supervisory personnel, so has affected only a couple dozen, some already retired, however.

After we sent out a special mailing to employers asking them to come forward if they were similarly misreporting salary to PERA, we heard from the City of Backus, affecting two individuals; the Duluth Entertainment Convention Center for one individual and the Duluth School District. PERA is continuing to work through the issue with the school district at this time.

***Internal Revenue Service Consultation re:
Compliance requirements for qualified plans.***

When we learned of the extent of the reporting error by Duluth and WLSSD, our attorney consulted with the tax compliance arm of our actuarial consulting firm, Mercer. We were advised to contact the Internal Revenue Service (IRS) about filing a Voluntary Compliance Program (VCP) application for two reasons:

1. PERA submitted an application to the IRS in May 2008 asking for a new determination letter verifying that our plan is operated in compliance with the requirements set forth by the IRS for qualified plan status.
2. The purpose of this application is to notify the IRS of a significant reporting error that has resulted in a plan operational failure. Anytime the provisions of the plan document (statutes) are not properly followed, a plan operational failure occurs. A significant error is generally one that has not been found within about three years since it began. Filing the VCP application notifies the IRS of the issue and provides a detailed description of how we will correct the failure and is recommended in the event the plan is ever audited by the IRS. If the plan were to be audited and an error of this significance first brought to the Service's attention only then, the plan runs the risk of significant penalties and fines. By submitting the VCP application, the IRS is on notice and has had an opportunity to weigh in and guide the plan on the appropriate action to take to correct the error.

On November 6, 2008, PERA staff and legal advisor had a conference call with the IRS' personnel responsible for overseeing the Employee Plans Compliance Resolution System and specifically the 2008-50 Revenue Procedures guiding the VCP application process and other correction methods authorized by the IRS for qualified retirement plans. We were informed that since our plan document (statutes) did not have a limitation on correcting the reported salary and contributions and benefits paid thereon, we had to make the corrections retroactively to the appropriate dates. We were told that the procedures required the payment of interest on the erroneously reported employee deductions, and that a refund of those erroneous deductions, plus interest, had to be paid to the employer who in turn was to get the refund to the currently active members of the plan. A direct payment to current active members would be considered an in-service distribution which is not allowed for qualified plans. We were also told that the erroneous employer contributions paid on the ineligible salary could not be refunded as

a distribution out of the trust, but would have to be counted against future employer obligations. We were told we were absolutely not to take money out of the trust to refund overpaid employer contributions.

We later verified with the IRS personnel what should be done if the deductions and contributions paid on ineligible salary that was included in benefit payments were going to be refunded. We were advised that if contribution refunds were paid, but the benefit payments were not going to be corrected and overpayments collected, the employer would have to pay to PERA the actuarial value of the higher benefit payments. But, if contributions were not refunded and benefit payments were allowed to continue with the invalid salary included in the benefit computation, there was no additional financial requirement from the employer.

We were also advised that there is nothing that prohibits a retroactive amendment to our plan document (statutes) as part of the correction process for this error. (Part III, Section 5.01(b) states in part: "... A plan does not have an Operational Failure to the extent the plan is permitted to be amended retroactively...")

Example of the dollars estimated to be involved with these employee deduction and employer contribution overpayments are as follows:

| Name of Employer | Total Employee Contributions (w/o interest) | Total Employer Contribution |
|---|--|------------------------------------|
| City of Duluth | \$1,137,164.73 | \$1,414,340.72 |
| Duluth Airport Authority | \$13,729.98 | \$14,928.55 |
| Western Lake Superior Sanitary District | \$21,184.88 | \$23,160.61 |
| City of Virginia | \$13,386.46 | \$15,917.72 |
| City of Backus | \$915.49 | \$994.14 |
| Total (\$2,655,723.28) | \$1,186,381.54 | \$1,469,341.74 |

| Name of Employer | Number of Active Members | Number of Inactive Members | Number of Benefit Recipients |
|---|---------------------------------|-----------------------------------|-------------------------------------|
| City of Duluth | 742 | 142 | 466 |
| Duluth Airport Authority | 15 | 4 | 15 |
| Duluth Entertainment Convention Center (DECC) | 1 | 0 | 0 |
| Western Lake Superior Sanitary District | 13 | 8 | 8 |
| City of Virginia | 12 | 4 | 4 |
| City of Backus | 2 | 0 | 0 |

Overpaid benefit values are still being calculated.

1.1 moves to amend the delete everything amendment (S0191-DE3) to
1.2 S.F. No. 191; H.F. No. 723, as follows:

1.3 Page 84, after line 7, insert:

1.4 "Sec. 44. CITY OF DULUTH AND DULUTH AIRPORT AUTHORITY;
1.5 CORRECTING ERRONEOUS EMPLOYEE DEDUCTIONS, EMPLOYER
1.6 CONTRIBUTIONS AND ADJUSTING OVERPAID BENEFITS.

1.7 Subdivision 1. Application. Notwithstanding any provisions of sections 10 and 11,
1.8 or Minnesota Statutes 2008, chapter 353 and 356 to the contrary, this section establishes
1.9 the procedures by which the executive director of the Public Employees Retirement
1.10 Association shall adjust erroneous employee deductions and employer contributions
1.11 paid on behalf of active employees and former members by the city of Duluth and by
1.12 the Duluth Airport Authority on amounts determined by the executive director to be
1.13 invalid salary under Minnesota Statutes, section 353.01, subdivision 10, reported between
1.14 January 1, 1997, and October 23, 2008, and for adjusting benefits that were paid to former
1.15 members and their beneficiaries based upon invalid salary amounts.

1.16 Subd. 2. Refunds of employee deductions. (a) The executive director shall refund
1.17 to active employees or former members who are not receiving retirement annuities or
1.18 benefits all erroneous employee deductions identified by the city of Duluth or by the
1.19 Duluth Airport Authority as deductions taken from amounts determined to be invalid
1.20 salary. The refunds must include interest at the rate specified in Minnesota Statutes,
1.21 section 353.34, subdivision 2, from the date each invalid employee deduction was received
1.22 through the date each refund is paid.

1.23 (b) The refund payment for active employees must be sent to the applicable
1.24 governmental subdivision which must pay the refunded employee deductions plus interest
1.25 to the active members who are employees of the city of Duluth or who are employees of
1.26 the Duluth Airport Authority, as applicable.

1.27 (c) Refunds to former members must be mailed by the executive director of the
1.28 Public Employees Retirement Association to the former member's last known address.

1.29 Subd. 3. Benefit adjustments. (a) For a former member who is receiving a
1.30 retirement annuity or disability benefit, or for a person receiving an optional annuity or
1.31 survivor benefit, the executive director must:

1.32 (1) adjust the annuity or benefit payment to the correct monthly benefit amount
1.33 payable by reducing the average salary under Minnesota Statutes, section 353.01,
1.34 subdivision 17a, by the invalid salary amounts;

2.1 (2) determine the amount of the overpaid benefits paid from the effective date of
 2.2 the annuity or benefit payment to the first of the month in which the monthly benefit
 2.3 amount is corrected;

2.4 (3) calculate the amount of employee deductions taken in error on invalid salary,
 2.5 including interest at the rate specified in Minnesota Statutes, section 353.34, subdivision 2,
 2.6 from the date each invalid employee deduction was received through the date the annuity
 2.7 or benefit is adjusted as provided under clause (1); and

2.8 (4) determine the net amount of overpaid benefits by reducing the amount of the
 2.9 overpaid annuity or benefit as determined in clause (2) by the amount of the erroneous
 2.10 employee deductions with interest determined in clause (3).

2.11 (b) If a former member's erroneous employee deductions plus interest determined
 2.12 under this section exceeds the amount of the person's overpaid benefits, the balance must
 2.13 be refunded to the person to whom the annuity or benefit is being paid.

2.14 (c) The executive director shall recover the net amount of all overpaid annuities or
 2.15 benefits as provided under subdivision 4.

2.16 Subd. 4. **Employer credits and obligations.** (a) The executive director shall
 2.17 provide a credit without interest to the city of Duluth and to the Duluth Airport Authority
 2.18 for the amount of that governmental subdivision's erroneous employer contributions. The
 2.19 credit must first be used to offset the net amount of the overpaid retirement annuities, and
 2.20 the disability and survivor benefits that remains after applying the amount of erroneous
 2.21 employee deductions with interest as provided under subdivision 3, clause (4). The
 2.22 remaining erroneous employer contributions, if any, must be credited against future
 2.23 employer contributions required to be paid by the applicable governmental subdivision. If
 2.24 the overpaid benefits exceed the employer contribution credit, the balance of the overpaid
 2.25 benefits is the obligation of the city of Duluth or the Duluth Airport Authority, whichever
 2.26 is applicable.

2.27 (b) The Public Employees Retirement Association board of trustees shall determine
 2.28 the period of time and manner for the collection of overpaid retirement annuities and
 2.29 benefits, if any, from the city of Duluth and the Duluth Airport Authority.

2.30 **EFFECTIVE DATE.** (a) This section is effective ^{for the city of Duluth} the day after the Duluth city
 2.31 council and the chief clerical officer of the city of Duluth timely complete their compliance
 2.32 with Minnesota Statutes, section 645.021, subdivisions 2 and 3, for members who are, and
 2.33 former members who were, employees of the city of Duluth.

2.34 (b) This section is effective ^{for the DAA} the day after the Duluth Airport Authority and the chief
 2.35 clerical officer of the Duluth Airport Authority timely complete their compliance with

- 3.1 Minnesota Statutes, section 645.021, subdivisions 2 and 3, for members who are, and
- 3.2 former members who were, employees of the Duluth Airport Authority."
- 3.3 Renumber the sections in sequence and correct the internal references
- 3.4 Amend the title accordingly

Minnesota Statutes, Section 353.27, GENERAL EMPLOYEES RETIREMENT FUND.

Subd. 7. **Adjustment for erroneous receipts or disbursements.** (a) Except as provided in paragraph (b), erroneous employee deductions and erroneous employer contributions and additional employer contributions to the general employees retirement plan of the Public Employees Retirement Association or to the public employees police and fire retirement plan for a person who otherwise does not qualify for membership under this chapter, are considered:

(1) valid if the initial erroneous deduction began before January 1, 1990. Upon determination of the error by the association, the person may continue membership in the association while employed in the same position for which erroneous deductions were taken, or file a written election to terminate membership and apply for a refund upon termination of public service or defer an annuity under section 353.34; or

(2) invalid, if the initial erroneous employee deduction began on or after January 1, 1990. Upon determination of the error, the association shall refund all erroneous employee deductions and all erroneous employer contributions as specified in paragraph (e). No person may claim a right to continued or past membership in the association based on erroneous deductions which began on or after January 1, 1990.

(b) Erroneous deductions taken from the salary of a person who did not qualify for membership in the general employees retirement plan of the Public Employees Retirement Association or in the public employees police and fire retirement plan by virtue of concurrent employment before July 1, 1978, which required contributions to another retirement fund or relief association established for the benefit of officers and employees of a governmental subdivision, are invalid. Upon discovery of the error, allowable service credit for all invalid service is forfeited and, upon termination of public service, the association shall refund all erroneous employee deductions to the person, with interest as determined under section 353.34, subdivision 2, and all erroneous employer contributions without interest to the employer. This paragraph has both retroactive and prospective application.

(c) Adjustments to correct employer contributions and employee deductions taken in error from amounts which are not salary under section 353.01, subdivision 10, must be made as specified in paragraph (e). The period of adjustment must be limited to the fiscal year in which the error is discovered by the association and the immediate two preceding fiscal years.

(d) If there is evidence of fraud or other misconduct on the part of the employee or the employer, the board of trustees may authorize adjustments to the account of a member or former member to correct erroneous employee deductions and employer contributions on invalid salary and the recovery of any overpayments for a period longer than provided for under paragraph (c).

(e) Upon discovery of the receipt of erroneous employee deductions and employer contributions under paragraph (a), clause (2), or paragraph (c), the association must require the employer to discontinue the erroneous employee deductions and erroneous employer contributions reported on behalf of a member. Upon discontinuation, the association must:

(1) for a member, provide a refund in the amount of the invalid employee deductions with interest on the invalid employee deductions at the rate specified under section 353.34, subdivision 2, from the received date of each invalid salary transaction through the date the credit or refund is made;

(2) for a former member who:

(i) is not receiving a retirement annuity or benefit, return the erroneous employee deductions to the former member through a refund with interest at the rate specified under section 353.34, subdivision 2, from the received date of each invalid salary transaction through the date the credit or refund is made; or

(ii) is receiving a retirement annuity or disability benefit, or a person who is receiving an optional annuity or survivor benefit, for whom it has been determined an overpayment must be recovered, adjust the payment amount and recover the overpayments as provided under this section; and

(3) return the invalid employer contributions reported on behalf of a member or former member to the employer by providing a credit against future contributions payable by the employer.

(f) In the event that a salary warrant or check from which a deduction for the retirement fund was taken has been canceled or the amount of the warrant or check returned to the funds of the department making the payment, a refund of the sum deducted, or any portion of it that is required to adjust the deductions, must be made to the department or institution.

(g) If the accrual date of any retirement annuity, survivor benefit, or disability benefit is within the limitation period specified in paragraph (c), and an overpayment has resulted by using invalid service or salary, or due to any erroneous calculation procedure, the association must recalculate the annuity or benefit payable and recover any overpayment as provided under subdivision 7b.

(h) Notwithstanding the provisions of this subdivision, the association may apply the Revenue Procedures defined in the federal Internal Revenue Service Employee Plans Compliance Resolution System and not issue a refund of erroneous employee deductions and employer contributions or not

recover a small overpayment of benefits if the cost to correct the error would exceed the amount of the member refund or overpayment.

(i) Any fees or penalties assessed by the federal Internal Revenue Service for any failure by an employer to follow the statutory requirements for reporting eligible members and salary must be paid by the employer.

Subd. 7a. Deductions or contributions transmitted by error. (a) If employee deductions and employer contributions under this section, section 353.50, 353.65, or 353E.03 were erroneously transmitted to the association, but should have been transmitted to a plan covered by chapter 352D, 353D, 354B, or 354D, the executive director shall transfer the erroneous employee deductions and employer contributions to the appropriate retirement fund or individual account, as applicable. The time limitations specified in subdivisions 7 and 12 do not apply. The transfer to the applicable defined contribution plan account must include interest at the rate of 0.71 percent per month, compounded annually, from the first day of the month following the month in which coverage should have commenced in the defined contribution plan until the end of the month in which the transfer occurs.

(b) A potential transfer under paragraph (a) that is reasonably determined to cause the plan to fail to be a qualified plan under section 401(a) of the federal Internal Revenue Code, as amended, must not be made by the executive director of the association. Within 30 days after being notified by the Public Employees Retirement Association of an unmade potential transfer under this paragraph, the employer of the affected person must transmit an amount representing the applicable salary deductions and employer contributions, without interest, to the retirement fund of the appropriate Minnesota public pension plan, or to the applicable individual account if the proper coverage is by a defined contribution plan. The association must provide the employing unit a credit for the amount of the erroneous salary deductions and employer contributions against future contributions from the employer. If the employing unit receives a credit under this paragraph, the employing unit is responsible for refunding to the applicable employee any amount that had been erroneously deducted from the person's salary.

(c) If erroneous employee deductions and employer contributions reflect a plan coverage error involving any Public Employees Retirement Association plan specified in section 356.99 and any other plan specified in that section, section 356.99 applies.

Subd. 7b. Recovery of overpayments. (a) In the event the executive director determines that an overpaid annuity or benefit from the general employees retirement plan of the Public Employees Retirement Association, the public employees police and fire retirement plan, or the local government correctional employees retirement plan is the result of invalid salary included in the average salary used to calculate the payment amount must be recovered, the association must determine the amount of the employee deductions taken in error on the invalid salary, with interest determined in the manner provided for a former member under subdivision 7, paragraph (e), clause (2), item (i), and must subtract that amount from the total annuity or benefit overpayment, and the remaining balance of the overpaid annuity or benefit, if any, must be recovered.

(b) If the invalid employee deductions plus interest exceed the amount of the overpaid benefits, the balance must be refunded to the person to whom the benefit or annuity is being paid.

(c) Any invalid employer contributions reported on the invalid salary must be credited to the employer as provided in subdivision 7, paragraph (e).

(d) If a member or former member, who is receiving a retirement annuity or disability benefit for which an overpayment is being recovered, dies before recovery of the overpayment is completed and a joint and survivor optional annuity is payable, the remaining balance of the overpaid annuity or benefit must continue to be recovered from the payment to the optional annuity beneficiary.

(e) If the association finds that a refund has been overpaid to a former member, beneficiary or other person, the amount of the overpayment must be recovered for the benefit of the respective retirement fund or account.

(f) The board of trustees shall adopt policies directing the period of time and manner for the collection of any overpaid retirement or optional annuity, and survivor or disability benefit, or a refund that the executive director determines must be recovered as provided under this section.

Minnesota Statutes, Section 353.01, DEFINITIONS.

Subd. 10. **Salary.** (a) Subject to the limitations of section 356.611, "salary" means:

(1) the periodic compensation of a public employee, before deductions for deferred compensation, supplemental retirement plans, or other voluntary salary reduction programs, and also means "wages" and includes net income from fees;

(2) for a public employee who is covered by a supplemental retirement plan under section 356.24, subdivision 1, clause (8), (9), or (10), which require all plan contributions be made by the employer, the contribution to the applicable supplemental retirement plan when an agreement between the parties establishes that the contribution will either result in a mandatory reduction of employees' wages through payroll withholdings, or be made in lieu of an amount that would otherwise be paid as wages; and

(3) for a public employee who has prior service covered by a local police or firefighters relief association that has consolidated with the Public Employees Retirement Association or to which section 353.665 applies and who has elected coverage either under the public employees police and fire fund benefit plan under section 353A.08 following the consolidation or under section 353.665, subdivision 4, the rate of salary upon which member contributions to the special fund of the relief association were made prior to the effective date of the consolidation as specified by law and by bylaw provisions governing the relief association on the date of the initiation of the consolidation procedure and the actual periodic compensation of the public employee after the effective date of consolidation.

(b) Salary does not mean:

(1) the fees paid to district court reporters, unused annual vacation or sick leave payments, in lump-sum or periodic payments, severance payments, reimbursement of expenses, lump-sum settlements not attached to a specific earnings period, or workers' compensation payments;

(2) employer-paid amounts used by an employee toward the cost of insurance coverage, employer-paid fringe benefits, flexible spending accounts, cafeteria plans, health care expense accounts, day care expenses, or any payments in lieu of any employer-paid group insurance coverage, including the difference between single and family rates that may be paid to a member with single coverage and certain amounts determined by the executive director to be ineligible;

(3) the amount equal to that which the employing governmental subdivision would otherwise pay toward single or family insurance coverage for a covered employee when, through a contract or agreement with some but not all employees, the employer:

(i) discontinues, or for new hires does not provide, payment toward the cost of the employee's selected insurance coverages under a group plan offered by the employer;

(ii) makes the employee solely responsible for all contributions toward the cost of the employee's selected insurance coverages under a group plan offered by the employer, including any amount the employer makes toward other employees' selected insurance coverages under a group plan offered by the employer; and

(iii) provides increased salary rates for employees who do not have any employer-paid group insurance coverages;

(4) except as provided in section 353.86 or 353.87, compensation of any kind paid to volunteer ambulance service personnel or volunteer firefighters, as defined in subdivision 35 or 36;

(5) the amount of compensation that exceeds the limitation provided in section 356.611; and

(6) amounts paid by a federal or state grant for which the grant specifically prohibits grant proceeds from being used to make pension plan contributions, unless the contributions to the plan are made from sources other than the federal or state grant.

(c) Amounts provided to an employee by the employer through a grievance proceeding or a legal settlement are salary only if the settlement is reviewed by the executive director and the amounts are determined by the executive director to be consistent with paragraph (a) and prior determinations.

1.1 moves to amend H.F. No. 1668; S.F. No., as follows:

1.2 Page 3, line 6, delete "city of Duluth and the Duluth Airport Authority" and insert "
1.3 applicable government subdivision" and after the period insert "The procedure developed
1.4 by the Public Employees Retirement Association board of trustees must be designed to
1.5 minimize negative financial impact on the retirement funds of the association, to the
1.6 extent permitted under this section, and must include interest at the preretirement rate
1.7 specified in Minnesota Statutes, section 356.215, subdivision 8, for the applicable Public
1.8 Employees Retirement Association plan."

1.1 moves to amend H.F. No. 1668; S.F. No., as follows:

1.2 Page 1, line 6, delete "CITY OF DULUTH AND DULUTH AIRPORT
1.3 AUTHORITY;"

1.4 Page 1, line 18, after "amounts" insert ", and for making similar adjustments for
1.5 active employees, former employees, and adjusting benefits related to erroneous employee
1.6 deductions and employer contributions identified prior to March 1, 2009, for other
1.7 government subdivisions specified in subdivision 6"

1.8 Page 1, line 20, after "members" insert "of the applicable government subdivision"

1.9 Page 1, line 21, delete everything after "identified"

1.10 Page 1, line 22, delete "Duluth Airport Authority"

1.11 Page 2, line 4, delete "city of Duluth or who are employees of the Duluth Airport"

1.12 Page 2, line 5, delete "Authority, whichever is" and after "applicable" insert "
1.13 government subdivision"

1.14 Page 2, line 15, delete "July 1, 2009" and insert "the date that prospective annuity or
1.15 benefit amounts are corrected"

1.16 Page 2, line 30, delete "city of Duluth and to the Duluth Airport Authority" and
1.17 insert "applicable government subdivision"

1.18 Page 3, line 2, delete "city of Duluth or the Duluth Airport"

1.19 Page 3, line 3, delete "Authority, whichever is" and after "applicable" insert "
1.20 government subdivision"

1.21 Page 3, line 6, delete "city of Duluth and the Duluth Airport Authority" and insert "
1.22 applicable government subdivision"

1.23 Page 3, line 8, delete "city of Duluth or the Duluth Airport Authority, as" and delete
1.24 the comma and insert "government subdivision"

1.25 Page 3, delete lines 18 to 26 and insert:

1.26 "Subd. 6. **Scope.** (a) This section applies to the following government subdivisions:

1.27 (1) the city of Duluth;

2.1 (2) the Duluth Airport Authority;

2.2 (3) the Western Lake Superior Sanitary District;

2.3 (4) the city of Virginia; and

2.4 (5) the city of Backus.

2.5 (b) This section should not be interpreted as authorizing revision of any completed
2.6 corrective actions.

2.7 **EFFECTIVE DATE.** This section is effective for a government subdivision
2.8 specified in subdivision 6 after the governing body of that government subdivision and the
2.9 applicable chief clerical officer timely complete their compliance with Minnesota Statutes,
2.10 section 645.021, subdivisions 2 and 3, for members who are, and former members who
2.11 were, employees of the applicable government subdivision."

2.12 Amend the title accordingly

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State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-SEVENTH
SESSION

HOUSE FILE No. 1668

May 5, 2011

Authored by Murphy, M.

The bill was read for the first time and referred to the Committee on Government Operations and Elections

1.1 A bill for an act
1.2 relating to retirement; Public Employees Retirement Association; optional
1.3 correction of erroneous employee deductions and employer contributions
1.4 provision for city of Duluth and Duluth Airport Authority.

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

1.6 Section 1. **CITY OF DULUTH AND DULUTH AIRPORT AUTHORITY;**
1.7 **CORRECTING ERRONEOUS EMPLOYEE DEDUCTIONS, EMPLOYER**
1.8 **CONTRIBUTIONS, AND ADJUSTING OVERPAID BENEFITS.**

1.9 Subdivision 1. **Application.** Notwithstanding any provisions of Minnesota Statutes,
1.10 section 353.27, subdivisions 7 and 7b, or Minnesota Statutes 2010, chapters 353 and 356,
1.11 to the contrary, this section establishes the procedures by which the executive director of
1.12 the Public Employees Retirement Association shall adjust erroneous employee deductions
1.13 and employer contributions paid on behalf of active employees and former members
1.14 by the city of Duluth and by the Duluth Airport Authority on amounts determined by
1.15 the executive director to be invalid salary under Minnesota Statutes, section 353.01,
1.16 subdivision 10, reported between January 1, 1997, and October 23, 2008, and for
1.17 adjusting benefits that were paid to former members and their beneficiaries based upon
1.18 invalid salary amounts.

1.19 Subd. 2. **Refunds of employee deductions.** (a) The executive director shall refund
1.20 to active employees or former members who are not receiving retirement annuities or
1.21 benefits all erroneous employee deductions identified by the city of Duluth or by the
1.22 Duluth Airport Authority as deductions taken from amounts determined to be invalid
1.23 salary. The refunds must include interest at the rate specified in Minnesota Statutes,

2.1 section 353.34, subdivision 2, from the date each invalid employee deduction was received
 2.2 through the date each refund is paid.

2.3 (b) The refund payment for active employees must be sent to the applicable members
 2.4 who are employees of the city of Duluth or who are employees of the Duluth Airport
 2.5 Authority, whichever is applicable.

2.6 (c) Refunds to former members must be mailed by the executive director of the
 2.7 Public Employees Retirement Association to the former member's last known address.

2.8 Subd. 3. **Benefit adjustments.** (a) For a former member who is receiving a
 2.9 retirement annuity or disability benefit, or for a person receiving an optional annuity or
 2.10 survivor benefit, the executive director must:

2.11 (1) adjust the annuity or benefit payment to the correct monthly benefit amount
 2.12 payable by reducing the average salary under Minnesota Statutes, section 353.01,
 2.13 subdivision 17a, by the invalid salary amounts;

2.14 (2) determine the amount of the overpaid benefits paid from the effective date of the
 2.15 annuity or benefit payment to July 1, 2009;

2.16 (3) calculate the amount of employee deductions taken in error on invalid salary,
 2.17 including interest at the rate specified in Minnesota Statutes, section 353.34, subdivision
 2.18 2, from the date each invalid employee deduction was received through the first day of the
 2.19 month in which the refund under paragraph (b), or action to recover net overpayments
 2.20 under subdivision 4, occurs; and

2.21 (4) determine the net amount of overpaid benefits by reducing the amount of the
 2.22 overpaid annuity or benefit as determined in clause (2) by the amount of the erroneous
 2.23 employee deductions with interest determined in clause (3).

2.24 (b) If a former member's erroneous employee deductions plus interest determined
 2.25 under this section exceeds the amount of the person's overpaid benefits, the balance must
 2.26 be refunded to the person to whom the annuity or benefit is being paid.

2.27 (c) The executive director shall recover the net amount of all overpaid annuities or
 2.28 benefits as provided under subdivision 4.

2.29 Subd. 4. **Employer credits and obligations.** (a) The executive director shall
 2.30 provide a credit without interest to the city of Duluth and to the Duluth Airport Authority
 2.31 for the amount of that governmental subdivision's erroneous employer contributions. The
 2.32 credit must first be used to offset the net amount of the overpaid retirement annuities and
 2.33 the disability and survivor benefits that remain after applying the amount of erroneous
 2.34 employee deductions with interest as provided under subdivision 3, paragraph (a),
 2.35 clause (4). The remaining erroneous employer contributions, if any, must be credited
 2.36 against future employer contributions required to be paid by the applicable governmental

3.1 subdivision. If the overpaid benefits exceed the employer contribution credit, the balance
 3.2 of the overpaid benefits is the obligation of the city of Duluth or the Duluth Airport
 3.3 Authority, whichever is applicable.

3.4 (b) The Public Employees Retirement Association board of trustees shall determine
 3.5 the period of time and manner for the collection of overpaid retirement annuities and
 3.6 benefits, if any, from the city of Duluth and the Duluth Airport Authority.

3.7 Subd. 5. **Treatment of invalid salary amounts in process.** (a) The governing body
 3.8 of the city of Duluth or the Duluth Airport Authority, as applicable, may elect to limit the
 3.9 period of adjustment for amounts determined to be invalid salary to apply to the fiscal
 3.10 year in which the error was reported to, and the salary determined to be invalid by, the
 3.11 Public Employees Retirement Association, and the immediate two preceding fiscal years,
 3.12 by a resolution of the applicable governing body transmitted to the Public Employees
 3.13 Retirement Association executive director within 30 days following the effective date
 3.14 of this section.

3.15 (b) If the governing body of the applicable governmental subdivision declines the
 3.16 treatment permitted under paragraph (a) or fails to submit a resolution in a timely manner,
 3.17 the statute of limitations specified in paragraph (a) does not apply.

3.18 **EFFECTIVE DATE.** (a) This section is effective for the city of Duluth the day after
 3.19 the Duluth city council and the chief clerical officer of the city of Duluth timely complete
 3.20 their compliance with Minnesota Statutes, section 645.021, subdivisions 2 and 3, for
 3.21 members who are, and former members who were, employees of the city of Duluth.

3.22 (b) This section is effective for the Duluth Airport Authority the day after the Duluth
 3.23 Airport Authority board of directors and the chief clerical officer of the Duluth Airport
 3.24 Authority timely complete their compliance with Minnesota Statutes, section 645.021,
 3.25 subdivisions 2 and 3, for members who are, and former members who were, employees
 3.26 of the Duluth Airport Authority.