



**S.F. 594**  
(Dahle)

**H.F. 705**  
(Bly)

**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 authorization.  
*Date of Summary:* February 21, 2013

**Specific Proposed Changes**

- Allows a former Northfield Transit Division employee to purchase 43 months of allowable service credit and salary credit to correct for the period of public employment he rendered that was unreported to the Public Employees Retirement Association (PERA) by paying the equivalent member contribution amount, plus interest, and obligating the former employer, the City of Northfield, to pay the balance of the full actuarial value service credit purchase payment amount determined under statute.

**Policy Issues Raised by the Proposed Legislation**

1. Appropriateness of authorizing late refund repayment.
2. Conformity with Commission prior service credit purchase policy principles.
3. Equitable considerations in the purchase.
4. Status as former PERA member when purchasing service credit.
5. Cost of prior service credit purchase for Mr. Hermstad.
6. Failure of PERA to adequately identify unreported public employees.
7. Appropriate allocation of purchase payment.

**Potential Amendments**

No suggested amendments by Commission staff.



TO: Members of the Legislative Commission on Pensions and Retirement  
FROM: Lawrence A. Martin, Executive Director *JLM*  
RE: S.F. 594 (Dahle); H.F. 705 (Bly): PERA-General; Prior Service Credit Purchase for Certain Northfield Employee  
DATE: February 21, 2013

Summary of S.F. 594 (Dahle); H.F. 705 (Bly)

S.F. 594 (Dahle); H.F. 705 (Bly) permits David Hermstad, described as the sole intended member of a class of public employees, to repay a prior member refund and to purchase 43 months of allowable service credit and salary credit from the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) by paying the member contributions that would have been deducted from his compensation during the period, plus compound interest at 8.5%, from the date when the contribution would have been deducted until the date of payment, and with the City of Northfield obligated to pay the balance of the full actuarial value prior service credit purchase payment.

Public Pension Problem of David Hermstad

David Hermstad, a 70-year-old resident of Northfield, Minnesota, was employed by the Transit Division of the City of Northfield in October 2005, was not reported to the Public Employees Retirement Association (PERA) for retirement coverage until April 2009, when Mr. Hermstad reportedly complained about the city's failure to make retirement plan contributions, and was laid off in June 2012. Mr. Hermstad, the City of Northfield, and PERA did not utilize in a timely fashion the existing PERA statutory authority to recover past omitted member contribution deductions and corresponding employer contributions, which have a three-year time limit for commencement. Mr. Hermstad wants PERA General Employees Retirement Plan allowable service credit for the 43 months of employment by the City of Northfield for which no member deductions or employer contributions were made. Because Minnesota Statutes, Section 356.551, Subdivision 1, Paragraph (a), requires that any prior refund of accumulated member contributions and interest be repaid before any prior service credit purchase may be made and because Minnesota Statutes, Section 353.35, Subdivision 1, requires that all refund repayments must be made within six months of PERA-General Plan membership termination, the initial draft special legislation would not resolve Mr. Hermstad's problem.

Discussion and Analysis

S.F. 594 (Dahle); H.F. 705 (Bly) allows David Hermstad, a former Northfield Transit Division employee, to purchase 43 months of allowable service credit and salary credit to correct for the period of public employment he rendered that was unreported to the Public Employees Retirement Association (PERA) by paying the equivalent member contribution amount, plus interest, and obligating the former employer, the City of Northfield, to pay the balance of the full actuarial value service credit purchase payment amount determined under statute.

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

1. Appropriateness of Authorizing Late Refund Repayment. The policy issue is whether or not it is appropriate to permit Mr. Hermstad to repay a previously received refund of accumulated member contributions and interest six months or later than the normal deadline for the repayment of a refund by a terminating plan member. Extending the deadline for Mr. Hermstad would be problematic if his actions caused the circumstance that he could not repay a refund before making the prior service credit purchase. Mr. Hermstad's deadline began to run on August 1, 2012, when he was laid off from his Northfield employment, and not because he made the decision to leave PERA-General coverage and plan membership. Mr. Hermstad's self-help remedy is limited to becoming reemployed by an employer covered by PERA-General, when he could repay his refund once he obtains six months of post-reemployment service credit. The Commission should consider asking Mr. Hermstad to explain why he had not repaid the refund prior to the date that he was laid off.

2. Conformity with Commission Prior Service Credit Purchase Policy Principle. The policy issue is whether or not the proposed legislation conforms with the applicable portion of the Commission's Principles of Pension Policy. Principle II.C.10. provides that:

II.C.10. Purchases of Prior Service Credit

- Purchases of public pension plan credit for periods of prior service should be permitted only if it is determined by the Commission:
- that the period to be purchased is public employment or relates substantially to the public employee's career,
- that the purchase payment amount from the member or from a combination of the member and the current or former 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 unless an error or an omission by the pension plan was responsible for the loss of service credit,
- that the purchase payment amount must include a minimum payment by the member of the equivalent member contributions, plus compound interest from the purchase period to the date of payment unless the employer committed a particularly egregious error,
- that the purchase payment is the responsibility of the member, with the current or former employer authorized to pay some or all of the portion of the payment amount in excess of the minimum member payment amount, unless the employer has some culpability in the circumstances giving rise to the purchase and then a mandatory employer contribution may be imposed, and
- that the purchase must not violate notions of equity.

The question of conformity with the equitable requirement is addressed as policy issue #3. The proposed legislation conforms with the other requirements of the principle, since Mr. Hermstad's purchase period was clearly public employment, the full actuarial value payment amount must be paid, payment includes a minimum member equivalent contribution requirement, and the payment amount is allocated in part to the employer assuming that the City of Northfield had culpability in the case (discussed in policy issue #7).

3. Equitable Considerations in the Purchase. The policy issue is whether or not the prior service credit purchase violates notions of equity, especially with respect to Mr. Hermstad as the requester of the special purchase authority. If the public employee involved in the purchase request knew that public pension coverage should have been provided and did not pursue the coverage or failed to attempt to correct the failure of pension coverage in a timely fashion once the error was discovered, it could be argued that permitting a service credit purchase would violate notions of equity. From the information provided to the Commission staff, there does not appear to be an equitable consideration adverse to Mr. Hermstad. The Commission should consider requesting testimony from the City of Northfield to fully determine the equities.
4. Status as Former PERA Member When Purchasing Service Credit. The policy issue is whether or not Mr. Hermstad, as a former Northfield city employee on layoff status, should be eligible to be authorized to purchase prior service credit for a period of service. While not specifically included in the applicable portion of the Commission's Principles of Pension Policy, the Commission in the past has raised an objection to authorizing a service credit purchase when the potential purchaser is no longer an employee in the public sector, although that objection has not always derailed a purchase request. The situation is analogous to a refund repayment, where the repayment of a refund of previously taken accumulated member contributions and interest is only permitted if the refund recipient has again become a Minnesota public pension plan participant. The fact that Mr. Hermstad was laid off, and hence involuntarily discontinued PERA-General retirement plan membership, could argue against a strict application of the general Commission preference against authorizing service credit purchase by former pension plan members.
5. Cost of Prior Service Credit Purchase for Mr. Hermstad. The policy issue is the cost related to Mr. Hermstad for the prior service credit purchase that the proposed legislation would authorize. Because PERA-General is a defined benefit plan, the value of the retirement coverage and the actuarial cost of the coverage to be borne by PERA-General is a function of Mr. Hermstad's age at retirement, his total service credit at the conclusion of his public employment, and his final average salary at retirement rather than the member and employer contributions that should have been made or are made on his behalf. Akin to insurance premiums and any other cost/benefit pooling arrangements, the actuarial liability associated with a period of uncovered service can be either greater or lesser than the member and employer contributions that would have been payable at the time, plus interest over the lag period.

The PERA determination of the prior service credit purchase payment amount indicates that Mr. Hermstad would be obligated to pay about \$5,300 if he is required to pay the unpaid member contributions plus 8.5% interest. The City of Northfield, if obligated to pay the balance of the full actuarial cost of the purchase, would owe about \$9,000.

6. Failure of PERA to Adequately Identify Unreported Public Employees. The policy issue is the potential failure by PERA to adequately monitor governmental subdivision exclusion reports from Northfield in the case of Mr. Hermstad, either causing or contributing to his period of public employment without retirement plan coverage. Because PERA does not include in retirement coverage to very modestly paid regular political subdivision employees, there are more excluded employees from PERA-General coverage than for any other Minnesota public pension plan. A portion of PERA's law, Minnesota Statutes, Section 353.27, Subdivision 10, requires employing units covered by PERA to provide annually an exclusion report listing all employees potentially eligible for PERA-General coverage who were not reported as PERA members. This report is required annually and is required to include all employees in potentially PERA-General eligible positions. As needed, PERA is empowered to conduct field audits to review the payroll records of a governmental subdivision. Of the various general employee retirement plans, PERA has produced the greatest number of prior service credit purchase special legislation requests over the years. Since PERA can administratively collect equivalent deduction and contribution payments for unreported public employees and grant service credit for unreported PERA-General eligible employment within three years of discovery, the Legislature only sees the potential tip of an unreported employee problem in PERA-General. PERA acknowledges that it has not caught reporting errors in connection with past prior service credit purchase special legislation, but it is not clear that PERA has taken effective steps to correct the situation. If PERA is questioned as to its enforcement of its membership provisions and does not present convincing evidence that it is effectively enforcing its membership reporting requirements, the Commission may desire to take that into account in determining the portion of the total purchase payment by Mr. Hermstad. If PERA did not properly review any Northfield payroll abstracts or exclusion reports under Minnesota Statutes, Section 353.27, Subdivision 10, or failed to collect the required employer reporting, an argument could be made that PERA should bear some financial responsibility for the employee portion of the service credit purchase payment for Mr. Hermstad. If PERA was determined by the Commission to have failed to fulfill its duty to monitor exclusion reports and enforce plan coverage requirements and if the penalty imposed on PERA for that apparent failure was the payment of interest on the unpaid member contribution amount, that amount would be approximately \$2,000, reducing Mr. Hermstad's purchase obligation to a little less than \$3,300.
  
7. Appropriate Allocation of Purchase Payment. The policy issue is the question of what is the appropriate portion of the prior service credit purchase payment amount that should be paid by Mr. Hermstad. The Commission's Pension Policy Principles provide for a member payment of the entire full actuarial value purchase obligation for a service credit purchase unless the employer acknowledges an error that led to the service credit loss or is determined to have made an error. The draft proposed legislation was prepared assuming employer responsibility for the service credit loss that Mr. Hermstad suffered. The Commission's Pension Policy Principles also provide for the reduction in or elimination of the member contribution portion of the payment if the employer committed a particularly egregious error. If Northfield was very specifically and particularly responsible for Mr. Hermstad's service credit loss and failed to attempt to correct the situation or did anything else that could argue for a further diminishment in Mr. Hermstad's share of the purchase payment, the Commission should consider requesting Mr. Hermstad to provide any supporting documentation.



SENATE  
STATE OF MINNESOTA  
EIGHTY-EIGHTH LEGISLATURE

S.F. No. 594

(SENATE AUTHORS: DAHLE)

DATE	D-PG	OFFICIAL STATUS
02/21/2013		Introduction and first reading Referred to State and Local Government

1.1 A bill for an act  
 1.2 relating to retirement; Public Employees Retirement Association general  
 1.3 employees retirement plan; authorizing a purchase of prior service credit for  
 1.4 certain Northfield employees.

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

1.6 Section 1. PERA-GENERAL; PURCHASE OF CERTAIN PRIOR NORTHFIELD  
 1.7 SERVICE CREDIT.

1.8 (a) Notwithstanding any provision of Minnesota Statutes, chapter 353, to the  
 1.9 contrary, an eligible person described in paragraph (b) is entitled to repay any prior refund  
 1.10 as provided in paragraph (c) and is entitled to purchase service credit as provided in  
 1.11 paragraph (d).

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

1.13 (1) was born on July 10, 1942;

1.14 (2) was employed by the city of Northfield on October 5, 2005;

1.15 (3) became a member of the general employees retirement plan of the Public  
 1.16 Employees Retirement Association on April 5, 2009;

1.17 (4) was employed by the transit division of the city of Northfield until June 29,  
 1.18 2012; and

1.19 (5) was eligible for PERA general employees retirement plan membership on  
 1.20 October 5, 2005, but was not reported to PERA for membership in a timely fashion.

1.21 (c) The eligible person may repay to the general employees retirement fund of  
 1.22 the Public Employees Retirement Association any refund of accumulated member  
 1.23 contributions and interest previously received, plus interest at an annual rate of 8.5 percent

2.1 compounded annually from the date on which the refund was paid until the date on which  
2.2 the refund is repaid.

2.3 (d) If the eligible person repays all prior refunds under paragraph (c), the eligible  
2.4 person may purchase 43 months of allowable service credit and salary credit from the  
2.5 general employees retirement plan of the Public Employees Retirement Association by  
2.6 making a payment equal to the unpaid member contributions during the period October 5,  
2.7 2005, until April 5, 2009, plus 8.5 percent interest from the date that each contribution  
2.8 would have been transmitted to the Public Employees Retirement Association until the  
2.9 date that the payment under this paragraph is made.

2.10 (e) If the eligible person makes the payment required under paragraph (c) in a timely  
2.11 fashion, within 30 days following notification of that fact by the executive director of the  
2.12 Public Employees Retirement Association, the city of Northfield shall pay the balance  
2.13 of the prior service credit purchase payment amount required under Minnesota Statutes,  
2.14 section 356.551. If the payment by the city of Northfield is not paid in a timely fashion,  
2.15 the executive director shall collect the unpaid amount as provided under Minnesota  
2.16 Statutes, section 353.28, subdivision 6.

2.17 (f) Authority to repay a refund and to make a prior service credit purchase payment  
2.18 under this section expires on December 31, 2014.

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