

S.F. 2387
(Murphy)

H.F. xxx

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA
Relevant Provisions of Law: Minnesota Statutes, Chapter 353F
General Nature of Proposal: Adding the City of Cannon Falls Hospital to PERA Privatized Employee Chapter
Date of Summary: February 10, 2006

Specific Proposed Changes

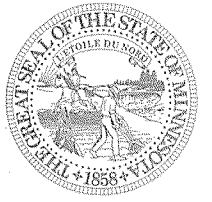
- Includes the City of Cannon Falls Hospital under the provisions of Minnesota Statutes, Chapter 353F (Privatized Public Hospital, PERA Pension Benefits), if the facility is sold or leased to a private sector or a nonprofit sector entity rather than a public entity.

Policy Issues Raised by the Proposed Legislation

1. Implications of using privatization model.
2. Consideration of PERA-General actuarial condition.
3. Actuarial cost of the special benefit provisions and gain/loss issues.
4. Local support/covering cost of actuarial work.

Potential Amendments

S2387-A1 would make the bill effective on the day following final enactment.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director *EB*

RE: S.F. 2387 (Murphy); H.F. xxx: PERA Privatized Employees; Adding The City of Cannon Falls Hospital to PERA Privatized Employee Chapter

DATE: February 8, 2006

Summary of S.F. 2387 (Murphy); H.F. xxx

S.F. 2387 (Murphy); H.F. xxx would include the City of Cannon Falls Hospital under the provisions of Minnesota Statutes, Chapter 353F (Privatized Public Hospital, PERA Pension Benefits), if the facility is privatized (sold or leased to a private sector or a nonprofit sector entity rather than a public entity). The act would apply to those employees covered by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General) who transfer to the new nonprofit corporation or private organization that will be created, and is effective if local approval is provided and if the bill does not create an actuarial loss for PERA-General. The existing or new employer must cover the cost of the actuarial study necessary to make that determination.

Current Employment Situation of City of Cannon Falls Hospital

The City of Cannon Falls Hospital has approximately 110 employees, and most are likely to have met the salary threshold requirement and any other applicable requirements for PERA coverage. PERA-General is a defined benefit retirement plan. The City of Cannon Falls Hospital is expected to transfer from public ownership to a nonprofit, a 501(c)(3) corporation, forming a joint organization with Mayo Health System. It is expected that this change will occur in April 2006. Once the change in ownership occurs, the employees will no longer be public employees, and thus will not be eligible for continued PERA-General coverage as active members under existing law. Commission staff understands that the new employer will provide the privatized employees with a defined benefit retirement program and employees will also have access to a 403(b) plan, which is a form of defined contribution plan.

Treatment under Chapter 353F, PERA Privatized Hospital

S.F. 2387 (Murphy); H.F. xxx would amend law to provide PERA privatization chapter coverage (Chapter 353F) for the existing City of Cannon Falls Hospital employees if that facility is privatized. When the privatization of a PERA-covered employing unit occurs, the employees no longer qualify as public employees and no longer qualify to continue as active PERA-General members. However, if these employees are made eligible under Chapter 353F, they will have certain benefits that differ from the typical treatment of terminated employees. One justification for this different treatment is that the privatized employees did not choose to leave public service and to end public retirement plan coverage. Their employee status changed from public to nonpublic due to an action by the employer (the transfer from public employer to nonprofit corporation or other nonpublic status), rather than by an exercise of free will by the employees.

If a privatization is included under Chapter 353F, those employees who are employed at the time of the transfer to the nonprofit corporation receive the following special coverage provisions:

1. Vested Benefit With Any Service Length. The normal three-year PERA vesting period is waived, so a privatized employee with less than three years of PERA-covered service would be entitled to receive a PERA retirement annuity, notwithstanding general law.
2. Increased Deferred Annuity Augmentation Rate. For the period between the date of privatization and the date of eventual retirement, the privatized employee's deferred PERA retirement annuity will increase at the rate of 5.5 percent rather than three percent until age 55 and at the rate of 7.5 percent rather than five percent after age 54.
3. "Rule of 90" Eligibility with Post-Privatization Service. For privatized employees with actual or potential long service who could have retired early with an unreduced retirement annuity from PERA under the "Rule of 90" (combination of age and total service credit totals 90), the employee will be able to count future privatized service with the hospital for eligibility purposes, but not for benefit computation purposes.

Interaction with Other Bills

If S.F. 2387 (Murphy); H.F. xxx were to pass during the 2006 Legislative Session, the Dassel Lakeside Community Home privatized employees might not receive the full increased deferred annuity augmentation rates indicated above. Under a separate bill, S.F. 2378 (Pogemiller), PERA is seeking to revise the deferred annuity augmentation treatment provided to privatized employees under the PERA privatization chapter, for any new privatization where the enacting legislation is due to action by the 2006 or later Legislature. If the PERA proposal is enacted in its current form, the rate to age 55 would be 4.0 percent per year rather than 5.5 percent, and the rate after age 55 would be 6.0 percent per year rather than 7.5 percent.

Background Information on Health Care Facility Privatizations

- a. Privatization Trend. There is a trend among health care facilities to convert from public sector ownership to private sector or quasi-public sector ownership. These conversions have involved selling, leasing, or transferring the facility, along with transferring the existing employees to that reorganized health care facility. The privatization of health care facilities is occurring among both large and small hospitals, clinics, and related health care providers. The privatizations typically increase organizational flexibility and reduce various costs, allowing the privatized organization to be financially competitive. One area of potential savings is the elimination of PERA active member coverage (or coverage by another public pension plan, if applicable), which is eliminated by the privatization.
- b. Privatization Impact on Retirement Coverage. When a privatization occurs and employees no longer qualify as public employees for PERA pension purposes, PERA membership terminates and retirement benefit coverage problems may emerge. Under current PERA law, three years of PERA coverage is required for vesting. For employees who terminate PERA membership without vesting, no deferred retirement annuity right typically is available. The member may elect a refund of accumulated member contributions with six percent interest, or the individual may leave the contributions at PERA, perhaps in the expectation that the individual will change employment in the future and again become a covered public employee. For a vested employee who terminates PERA membership with at least three years of service, there is a choice between a deferred retirement annuity right and a refund. The deferred retirement annuity is augmented by three percent per year under age 55 and five percent per year thereafter until retirement.

When a privatization occurs and employees lose the right to continue coverage by the public plan, all of the employees are impacted. The employee may be terminated from employment at the time of the sale, transfer, or reorganization. Those employees will lose both continued employment and continued retirement coverage. For employees who remain employed after transfer to the newly organized health care facility, the privatization interrupts their benefit coverage. If there is no pension plan established by the privatized health care facility, the employees will suffer a loss of overall benefit coverage other than Social Security coverage. If the new employer does provide a plan, portability problems between the old plan and the new plan are likely.

- c. Evolution of Privatization Treatment. The Legislature has dealt with privatizations on several occasions over the past few decades, primarily health care privatizations. The treatment has evolved over time. At times, in addition to any benefit that the employee may have been eligible for under a public pension plan as a deferred annuitant, the individual was offered an enhanced refund (employee plus employer contributions) plus interest. On a few occasions, the individuals were permitted to remain in PERA-General. The following summarizes treatments used since 1984:
 - In 1984, relating to the privatization of the Owatonna City Hospital, legislation allowed the affected employees to receive a deferred retirement annuity with at least five years of service or to receive a refund of employee and employer contributions, plus interest at six percent, compounded annually.
 - In 1986, relating to the St. Paul Ramsey Medical Center reorganization, legislation allowed only a delayed right to withdraw from PERA and receipt of a refund of only member contributions plus interest at five percent, compounded annually.
 - In 1987, relating to the Albany Community Hospital and the Canby Community Hospital, legislation allowed the affected employees to receive a deferred retirement annuity with a five-year vesting period or to receive a refund of both the employee and employer contributions, plus compound annual interest at six percent.
 - In 1988, relating to the Gillette Children's Hospital employees, legislation continued the membership of the affected employees in the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General), but excluded new employees from public pension plan coverage.

- In 1994, relating to the St. Paul Ramsey Medical Center again, legislation continued the PERA membership of existing employees who were PERA members unless the employee elected to terminate PERA membership before July 1, 1995.
- In 1995 through 1998, the approach used for PERA privatizations during this period required PERA coverage to end for all employees at the time of the transfer of the health care facility to the new ownership. The new health care entity was urged but not required to provide a “PERA-like” plan for individuals who are transferred with the facility and remain as employees of the new entity. For individuals who are terminated at the time of the transfer, and who were not vested in PERA, the city was authorized to match any refund with interest that the individual received from PERA. This model was used with the Olmsted County Medical Center privatization (1995), the Itasca County Medical Center (1995 and 1996), Jackson Medical Center, Melrose Hospital, Pine Villa Nursing Home, and the Tracy Municipal Hospital and Clinic (1997), and the Luverne Community Hospital (1998) privatizations.
- In 1996, a different approach was used for the University of Minnesota Hospital-Fairview merger, a procedure which was coded as Chapter 352F. Prior to the privatization, the University employees were covered by a public plan comparable to PERA-General, the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General). This is the model upon which the PERA privatization chapter, Chapter 353F, which was enacted in 1999, is based. In this model, termination of coverage by the public plan occurs at the time of the privatization, but the employees who terminated coverage (even those who were not vested) were permitted deferred annuities from the public plan with an augmentation rate that exceeded that used under general law, and the employees were allowed to use service with the new organization to meet age/service requirements for qualifying for the “Rule of 90” under the public plan. The legislation that included specific privatizations in the in the PERA privatization chapter are contingent upon local approval and a finding by the actuary that the inclusion is not expected to create a loss for PERA.
- In 2004, two different approaches were used. A few groups wished to remain as active PERA members, the new employers were willing to provide that treatment and to cover the resulting PERA-General employer contribution requirements, and PERA did not oppose that proposed treatment. This treatment, allowing the employees to remain as active PERA members following privatization, was extended to Anoka County Achieve Program employees and to Government Training Office employees, despite the changed status of these individuals from public sector to private sector. The chief reservation against this treatment is a federal requirement that public plans should not provide coverage to private sector employees, under threat of losing its qualified status and making contributions subject to immediate taxation. However, public plans are permitted to cover a small percentage of private sector employees, providing the percentage is minimal. While the dividing line between an acceptable minimal percentage and an unacceptable percentage is unclear, it was safe to assume that the small number of individuals involved in these two privatizations would not cause a plan qualification problem. Plan qualification concerns may be an issue in the future if this treatment is proposed for other privatizations, causing the percentage of private employees in PERA to grow.

The other model used in 2004 was the model specified in the PERA privatized employee chapter. This approach was used for Fair Oaks Lodge, Kanabec Hospital, RenVilla Nursing Home, and the St. Peter Community Health Care Center.
- In 2005, the Legislature returned to the use of a single model, approving three more additions to the PERA privatization chapter, with the inclusion of Bridges Medical Center, Hutchinson Area Health Care, and Northfield Hospital, all contingent upon local approval and a find by the actuary that inclusion under the chapter would not create a loss for PERA.

Discussion and Analysis

S.F. 2387 (Murphy); H.F. xxx would include the City of Cannon Falls Hospital under the provisions of Minnesota Statutes, Chapter 353F, if the facility is privatized (sold or leased to a private sector or a nonprofit sector entity rather than a public entity). The act would apply to those employees covered by the PERA-General who transfer to the new nonprofit corporation or private organization that will be created, and is effective if local approval is provided and if the bill does not create an actuarial loss for PERA-General. The existing or new employer must cover the cost of the actuarial study necessary to make that determination.

S.F. 2387 (Murphy); H.F. xxx raises the following pension and related public policy issues:

1. Implications of Using Privatization Model. If privatization occurs, the privatized employees would be better off if the bill were to be enacted because, under Chapter 353F, they receive the enhanced vesting right, enhanced deferred annuity augmentation, and the ability to use service with the new employer to qualify for the “Rule of 90.” In recent years, bills such as the current one were passed by the Legislature without much controversy. However, it follows that if the bill would make the privatized employees better off, it makes PERA worse off, because PERA will receive less of a gain from the privatization.
2. Consideration of PERA-General Actuarial Condition. The issue is whether S.F. 2387 (Murphy); H.F. xxx should be recommended to pass given PERA-General’s current funding problems. The impact from

any single privatization, however, is miniscule. Also, legislation was enacted last session which addressed PERA-General's contribution needs by phasing in by 2010 significant increases in employee and employer contributions that should be more than adequate to place PERA on the path to fully retiring its unfunded obligations. The results from the July 1, 2005, PERA-General actuarial valuation, summarized below, indicates that PERA-General had contributions that were 1.67 percent of covered payroll, \$75.3 million below what is needed to cover ongoing costs and retire all unfunded liability by the full funding date. The funding ratio (ratio of assets to liabilities) was 74.5 percent. However, as just indicated, increases in contribution rates that began phasing in on January 1, 2006, and are scheduled to fully phase in by 2010 should be more than adequate to fully address those problems.

PERA-General

		2005
<u>Membership</u>		
Active Members		142,303
Service Retirees		48,147
Disabilitants		1,853
Survivors		6,650
Deferred Retirees		35,768
Nonvested Former Members		<u>100,369</u>
Total Membership		335,090
<u>Funded Status</u>		
Accrued Liability		\$15,892,554,615
Current Assets		<u>\$11,843,935,692</u>
Unfunded Accrued Liability		\$4,048,618,923
Funding Ratio	74.53%	
<u>Financing Requirements</u>		
Covered Payroll		\$4,530,882,628
Benefits Payable		\$715,043,179
Normal Cost	7.79%	\$352,964,350
Administrative Expenses	<u>0.22%</u>	<u>\$9,967,942</u>
Normal Cost & Expense	8.01%	\$362,932,292
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Amortization	<u>4.73%</u>	<u>\$214,310,748</u>
Total Requirements	12.74%	\$577,243,040
Employee Contributions	5.30%	\$240,262,784
Employer Contributions	5.77%	\$261,631,214
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	11.07%	\$501,893,998
Total Requirements	12.74%	\$577,243,040
Total Contributions	<u>11.07%</u>	<u>\$501,893,998</u>
Deficiency (Surplus)	1.67%	\$75,349,042

3. Actuarial Cost of the Special Benefit Provisions and Gain/Loss Issues. The Commission's general practice in recent years has been to approve the proposed treatment, providing that PERA did not suffer a loss due to the privatization legislation. A specific actuarial review of implications of this privatization has not yet occurred. S.F. 2387 (Murphy); H.F. xxx is consistent with Commission practice by including language in the effective date making the legislation conditional upon the receipt of actuarial work, and certification by PERA that the analysis indicates that at least some net gain to the fund is expected.
4. Local Support/Covering Cost of Actuarial Work. The issue is whether there is sufficient local support and willingness to pay for the actuarial study to warrant spending Commission time on this matter. Commission staff's impression is that there is willingness to cover those costs, but that should be verified through testimony by the author or a city or hospital representative.

Potential Amendment for Commission Consideration

Amendment S2387-A1 would make the bill effective on the day following final enactment. As of this writing, the necessary actuarial work has not been performed. However, if by the time of the Commission hearing the actuarial study has occurred and the hospital, city, or new employing unit has paid for that work, and if the Commission concludes based on that work that PERA is not likely to suffer a loss due to the privatization, the Commission may wish to consider revising the effective date provision. If the actuarial work has occurred and been paid for the local approval clause is not needed, and the Commission will have decided whether or not PERA is likely to suffer a loss, eliminating the need for the effective date provision in the bill as drafted.

1.1 moves to amend S.F. No. 2387; H.F., as follows:

1.2 Page 1, line 22, delete "upon the latter of:" and insert "on the day following final
1.3 enactment."

1.4 Page 2, delete lines 1 to 11

1.1 A bill for an act
 1.2 relating to retirement; providing for certain pension benefits upon privatization
 1.3 of the city of Cannon Falls Hospital; amending Minnesota Statutes 2005
 1.4 Supplement, section 353F.02, subdivision 4.

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

1.6 Section 1. Minnesota Statutes 2005 Supplement, section 353F.02, subdivision 4,
 1.7 is amended to read:

1.8 Subd. 4. **Medical facility.** "Medical facility" means:

- 1.9 (1) Bridges Medical Services;
- 1.10 (2) the city of Cannon Falls Hospital;
- 1.11 (3) the Fair Oaks Lodge, Wadena;
- 1.12 ~~(3)~~ (4) the Glencoe Area Health Center;
- 1.13 ~~(4)~~ (5) the Hutchinson Area Health Care;
- 1.14 ~~(5)~~ (6) the Kanabec Hospital;
- 1.15 ~~(6)~~ (7) the Luverne Public Hospital;
- 1.16 ~~(7)~~ (8) the Northfield Hospital;
- 1.17 ~~(8)~~ (9) the RenVilla Nursing Home;
- 1.18 ~~(9)~~ (10) the Renville County Hospital in Olivia;
- 1.19 ~~(10)~~ (11) the St. Peter Community Healthcare Center; and
- 1.20 ~~(11)~~ (12) the Waconia-Ridgeview Medical Center.

1.21 Sec. 2. **EFFECTIVE DATE.**

1.22 Section 1 is effective upon the latter of:

2.1 (1) the day after the governing body of the Cannon Falls Hospital District and its
2.2 chief clerical officer meet the requirements under Minnesota Statutes, section 645.021,
2.3 subdivisions 2 and 3; and

2.4 (2) the first day of the month following certification to the Cannon Falls Hospital
2.5 District by the executive director of the Public Employees Retirement Association that the
2.6 actuarial accrued liability of the special benefit coverage proposed for extension to the
2.7 privatized city of Cannon Falls Hospital employees under section 1 does not exceed the
2.8 actuarial gain otherwise to be accrued by the Public Employees Retirement Association, as
2.9 calculated by the consulting actuary retained under Minnesota Statutes, section 356.214.
2.10 The cost of the actuarial calculations must be borne by the current employer or by the
2.11 entity which is the employer following the privatization.