S.F. 2443
(Dille)

H.F. xxx
(Urdahl)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s):	PERA
Relevant Provisions of Law:	Minnesota Statutes, Chapter 353F
General Nature of Proposal:	Adding Dassel Lakeside Community Home to the PERA Privatized Employee Chapter
Date of Summary:	February 10, 2006

Specific Proposed Changes

- Includes Dassel Lakeside Community Home 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

No Commission amendments.

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director EB

RE: S.F. 2443 (Dille); H.F. xxx (Urdahl): PERA; Adding Dassel Lakeside Community Home to the PERA Privatized Employee Chapter

DATE: February 8, 2006

Summary of S.F. 2443 (Dille); H.F. xxx (Urdahl)

S.F. 2443 (Dille); H.F. xxx (Urdahl) would include Dassel Lakeside Community Home 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 city or new employer must cover the cost of the actuarial study necessary to make that determination.

Current Employment Situation of Dassel Lakeside Community Home

The Dassel Lakeside Community Home is owned by the city of Dassel, and has approximately 85 employees, of which about 65 are members of PERA-General having met the salary threshold requirement and any other applicable requirements for PERA coverage. PERA-General is a defined benefit retirement plan. Dassel Lakeside Community Home is expected to transfer from city ownership to a nonprofit or for-profit organization. It is expected that this change will occur in the spring or summer of 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. The new employer may provide the employees with some other form of retirement coverage for their ongoing employment at the facilities. That coverage might be some form of defined benefit plan like PERA-General, or a defined contribution plan.

Background Information on Defined Contribution Pension Plans and Defined Benefit Pension Plans

A defined contribution plan is a pension plan where the funding for the pension plan is fixed as a dollar amount or as a percentage of payroll. Fixing this element leaves a variable element, which is the benefit amount that is ultimately payable. Under a defined contribution plan, the plan member bears the inflation and investment risks. If there is poor investment performance, the plan member's pension assets will be depressed. High inflation is another risk, since inflation lowers the real value of the investment returns and the assets in the account. The plan member's benefit will be less adequate in meeting the person's pre-retirement standard of living. With a defined contribution plan, the employee generally owns the assets in the account. Those assets move with the employee if the employee changes employment. A defined contribution plan favors employees who are very employment mobile, where employment changes beyond a single employer or a multiple-employer group. It also favors short-term employees in comparison to defined benefit plans. It also favors employees with very stable and modestly increasing salary histories and employees who work considerably beyond the plan's normal retirement age.

The other general plan type is a defined benefit plan. A defined benefit plan is a pension plan where the pension benefit amount that is ultimately payable is pre-determinable or fixed using a formula. Fixing the benefit amount leaves a variable element, which is the funding required to provide that benefit. Because PERA-General is a defined benefit plan, employing units paying into the plan, rather than the employee, bear the inflation and investment risks. If the investment return on plan assets is poor or if inflation produces ever-increasing final salaries and benefit payouts, that risk is borne by the plan and its associated employers. The member has the turnover risks. If a plan member terminates at an early age, or with modest service, the member will receive either no benefit or an inadequate benefit. A defined benefit plan favors long-term or long-service employees. It also favors employees who receive regular promotions and sizable salary increases throughout their careers or who achieve substantial salary increases in their compensation at the end of their career. It also favors employees who retire at or before the plan's normal retirement age.

Defined contribution pension plans predominate in the private sector, while defined benefit pension plans predominate in the public sector. The U.S. Department of Labor, in a study by the Bureau of Labor Statistics entitled National Compensation Survey: Employee Benefits in Private Industry in the United States, 2002, indicates that 36 percent of all private sector employees are covered by a defined contribution plan and that only 18 percent of private sector employees are covered by a defined benefit plan. In a study entitled Employee Benefits in State and Local Governments, 1998, the Bureau of Labor Statistics reports that 90 percent of public employees are covered by a defined benefit plan and only 14 percent of public employees are covered by a defined contribution plan.

Treatment Under Chapter 353F, PERA Privatized Hospital

S.F. 2443 (Dille); H.F. xxx (Urdahl) would amend law to provide PERA privatization chapter coverage (Chapter 353F) for the existing Dassel Lakeside Community Home 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. 2443 (Dille); H.F. xxx (Urdahl) 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 or 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. 2443 (Dille); H.F. xxx (Urdahl) would include the Dassel Lakeside Community Home under Minnesota Statutes, Chapter 353F, if the facility is privatized. The act would apply to PERA-General-covered employees 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 city or new employer must cover the cost of the actuarial study necessary to make that determination.

Discussion with a representative from the Dassel Lakeside Community Home suggests less than full support for privatization legislation at this time. Any action to privatize the facility is in an early stage. No specific buyer has been identified, and at the current time the city is interested in having legislation enacted to include the Dassel Lakeside Community Home employees under the privatization chapter to maintain that option. PERA told the city that the actuarial review, which would be performed by The Segal Company, the actuary jointly retained by the larger pension fund administrations, might cost between $8,000 and $10,000. The city wants to give some thought to whether it is worthwhile to undertake that study given that cost. An option that was mentioned is that the city might choose to not approve the legislation locally and instead spend $10,000 providing some form of lump sum payment to the privatized employees.

S.F. 2443 (Dille); H.F. xxx (Urdahl) 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. 2443 (Dille); H.F. xxx (Urdahl) should be recommended to pass given PERA-General's current funding problems. PERA would be marginally harmed by the proposed legislation because it would reduce the gain that PERA would otherwise receive. The treatment under Chapter 353F, the privatization chapter, shares some of that gain with these employees by providing enhanced deferred annuities and "Rule of 90" rights where applicable. 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, indicate 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
Membership		
Active Members		142,303
Service Retirees		48,147
Disabilitants		1,853
Survivors		6,650
Deferred Retirees		35,768
Nonvested Former Members		100,369
Total Membership		335,090
Funded Status		
Accrued Liability		$15,892,554,615
Current Assets		$11,843,935,692
Unfunded Accrued Liability		$4,048,618,923
Funding Ratio	74.53%	
Financing Requirements		
Covered Payroll		$4,530,882,628
Benefits Payable		$715,043,179
Normal Cost	7.79%	$352,964,350
Administrative Expenses	0.22%	$9,967,942
Normal Cost & Expense	8.01%	$362,932,292
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Amortization	4.73%	$214,310,748
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	0.00%	$0
Total Contributions	11.07%	$501,893,998
Total Requirements	12.74%	$577,243,040
Total Contributions	11.07%	$501,893,998
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 received a gain due to the privatization. A specific actuarial review of implications of this privatization has yet occurred. S.F. 2443 (Dille); H.F. xxx (Urdahl) 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. The Commission staff's current understanding is that the city is interested in S.F. 2443 (Dille); H.F. xxx (Urdahl) in order to have of option of including the Dassel Lakeside Community Home in the PERA privatization chapter. The city is not, as of this writing, fully committed to providing local approval. The city is considering several options, including dividing the cost of the study (approx. $8,000 to $10,000) among the privatized employees, rather than undertaking and paying for the study. Discussion between the city and PERA may help clarify these matters by time the Commission hears the bill.

A bill for an act

relating to retirement; providing for certain pension benefits upon privatization of the Dassel Lakeside Community Home; amending Minnesota Statutes 2005 Supplement, section 353F.02, subdivision 4.

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

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

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

(1) Bridges Medical Services;

(2) the Dassel Lakeside Community Home;

(3) the Fair Oaks Lodge, Wadena;

~~(3)~~ (4) the Glencoe Area Health Center;

~~(4)~~ (5) the Hutchinson Area Health Care;

~~(5)~~ (6) the Kanabec Hospital;

~~(6)~~ (7) the Luverne Public Hospital;

~~(7)~~ (8) the Northfield Hospital;

~~(8)~~ (9) the RenVilla Nursing Home;

~~(9)~~ (10) the Renville County Hospital in Olivia;

~~(10)~~ (11) the St. Peter Community Healthcare Center; and

~~(11)~~ (12) the Waconia-Ridgeview Medical Center.

Sec. 2. **EFFECTIVE DATE.**

Section 1 is effective upon the latter of:

(1) the day after the governing body of the city of Dassel and its chief clerical officer timely complete compliance with Minnesota Statutes, section 345.021, subdivisions 2 and 3; and

(2) the first day of the month next following certification to the Dassel City Council by the executive director of the Public Employees Retirement Association that the actuarial accrued liability of the special benefit coverage proposed for extension to the privatized Dassel Lakeside Community Home employees under section 1 does not exceed the actuarial gain otherwise to be accrued by the Public Employees Retirement Association, as calculated by the consulting actuary retained under Minnesota Statutes, section 356.214. The cost of the actuarial calculations must be borne by the city of Dassel or by the entity which is the employer following the privatization.