



**H.F. 2386**

(Olin)

**S.F. xxxx**

## **Executive Summary of Commission Staff Materials**

*Affected Pension Plan(s):* Public Employees Retirement Association (PERA)  
*Relevant Provisions of Law:* Minnesota Statutes, Section 353F.02, Subdivision 4  
*General Nature of Proposal:* Adding Oakland Park Nursing Home in Pennington County to PERA privatization chapter  
*Date of Summary:* April 23, 2007

### **Specific Proposed Changes**

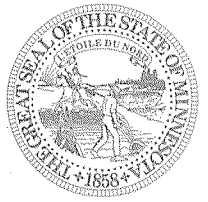
- Adding Oakland Park Nursing Home in Pennington County to the PERA privatization chapter.

### **Policy Issues Raised by the Proposed Legislation**

1. Implication of using privatization chapter. PERA privatization chapter treatment will result in less gain to PERA than simply treating privatized employees as terminated members under PERA-General law.
2. Local Support. The issue is whether the current or prospective employer is willing to pay for an actuarial study required to determine whether PERA will obtain at least some gain by this privatization.

### **Potential Amendments**

No Commission staff amendments.



TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director *EB*

RE: H.F. 2386 (Olin); S.F. xxxx: PERA; Adding Oakland Park Nursing Home in Pennington County to the PERA Privatized Employee Chapter

DATE: April 5, 2007

#### Summary of H.F. 2386 (Olin)

H.F. 2386 (Olin); S.F. xxxx would include the Oakland Park Nursing Home in Pennington County and any related facilities under the Public Employees Retirement Association (PERA) privatization chapter (Minnesota Statutes, Chapter 353F) if the facility is privatized. The provision requires local approval and an actuarial review finding that the bill does not create an actuarial loss for the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General). The date of the required actuarial cost analysis must be within one year of the date that the Oakland Park Nursing Home is sold or leased. Pennington County or the new employer must cover the cost of the actuarial study necessary to make that determination.

#### Current Employment Situation of Oakland Park Nursing Home

The Oakland Park Nursing Home is a public facility with employees covered by the General Employee Retirement Plan of the Public Employees Retirement Association (PERA-General). PERA-General is a public defined benefit retirement plan. The facility is likely to be sold or leased to a non-public employer. If that change occurs, the employees will no longer be public employees, and thus will not be eligible for continued PERA-General coverage as active members. 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 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.
- b. Defined Benefit Plans. 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: Privatized Public Hospital, PERA Pension Benefits

H.F. 2386 (Olin); S.F. xxxx would amend law to provide PERA privatization chapter coverage (Chapter 353F) for the existing Oakland Park Nursing 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 4.0 percent rather than three percent until age 55 and at the rate of 6.0 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.

#### 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

