



H.F. 2393
(Hamilton)

S.F. 2175
(Vickerman)

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 Lakefield Nursing Home to PERA privatization chapter
Date of Summary: April 23, 2007

Specific Proposed Changes

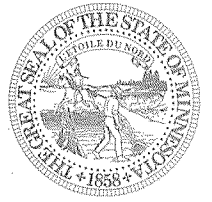
- Adding Lakefield Nursing Home to the PERA privatization chapter.

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. 2393 (Hamilton); S.F. 2175 (Vickerman): PERA; Adding Lakefield Nursing Home to the PERA Privatized Employee Chapter
DATE: April 5, 2007

Summary of H.F. 2393 (Hamilton); S.F. 2175 (Vickerman)

H.F. 2393 (Hamilton); S.F. 2175 (Vickerman) would include the Lakefield Nursing Home in Lakefield 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 Lakefield Nursing Home is sold or leased. The City of Lakefield or the new employer must cover the cost of the actuarial study necessary to make that determination.

Current Employment Situation of Lakefield Nursing Home

The Lakefield Nursing Home is a public facility with employees covered by 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. 2393 (Hamilton); S.F. 2175 (Vickerman) would amend law to provide PERA privatization chapter coverage (Chapter 353F) for the existing Lakefield 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 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 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 and 2006, the Legislature returned to the use of a single model, approving three more additions to the PERA privatization chapter in 2005 (Bridges Medical Center, Hutchinson Area Health Care, and Northfield Hospital), and in 2006 (City of Cannon Falls Hospital, Clearwater County Health Services, and Dassel Lakeside Community Home), 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

H.F. 2393 (Hamilton); S.F. 2175 (Vickerman) would include the Lakefield Nursing Home and any related facilities under the PERA privatization chapter upon privatization. The bill raises the following pension and related public policy issues:

1. Consistency with Established Policy. The requirements in the bill and the treatment of the employees are consistent with bills which have recently passed.
2. 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.
3. Consideration of PERA-General Actuarial Condition. The issue is whether the proposed legislation should be recommended to pass given PERA-General's current funding situation. 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 in 2005 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, 2006, PERA-General actuarial valuation, summarized below, indicate that PERA-General had contributions that were 1.14 percent of covered payroll, \$53 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 75 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 adequate to fully address those problems.

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|----------------------------|------------------|
| <u>Membership</u> | |
| Active Members | 144,244 |
| Service Retirees | 50,320 |
| Disabilitants | 1,940 |
| Survivors | 6,818 |
| Deferred Retirees | 37,476 |
| Nonvested Former Members | 105,590 |
| Total Membership | 346,388 |
| <u>Funded Status</u> | |
| Accrued Liability | \$16,737,756,758 |
| Current Assets | \$12,495,207,148 |
| Unfunded Accrued Liability | \$4,242,549,610 |
| Funding Ratio | 74.65% |

PERA-General
2006

| <u>Financing Requirements</u> | | |
|-------------------------------|---------------|----------------------|
| Covered Payroll | | \$4,703,895,104 |
| Benefits Payable | | \$748,390,506 |
| Normal Cost | 7.78% | \$366,059,040 |
| Administrative Expenses | <u>0.20%</u> | <u>\$9,407,790</u> |
| Normal Cost & Expense | 7.98% | \$375,466,830 |
| Normal Cost & Expense | 7.98% | \$375,466,830 |
| Amortization | <u>4.92%</u> | <u>\$231,431,639</u> |
| Total Requirements | 12.90% | \$606,898,469 |
| Employee Contributions | 5.63% | \$264,931,649 |
| Employer Contributions | 6.13% | \$288,515,428 |
| 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 | 11.76% | \$553,447,077 |
| Total Requirements | 12.90% | \$606,898,469 |
| Total Contributions | <u>11.76%</u> | <u>\$553,447,077</u> |
| Deficiency (Surplus) | 1.14% | \$53,451,392 |

4. Local Support/Covering Cost of Actuarial Work. The issue is whether the city or prospective new employer are willing to pay the cost of the actuarial study. The Commission may wish to determine that through testimony. If they are not willing to cover that cost, there is little reason for the Commission to further consider the bill.

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State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-FIFTH
SESSION

HOUSE FILE No. **2393**

March 29, 2007

Authored by Hamilton

The bill was read for the first time and referred to the Committee on Governmental Operations, Reform, Technology and Elections

1.1 A bill for an act
1.2 relating to retirement; providing for certain pension benefits upon privatization
1.3 of the Lakefield Nursing Home; amending Minnesota Statutes 2006, section
1.4 353F.02, subdivision 4.

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

1.6 Section 1. Minnesota Statutes 2006, section 353F.02, subdivision 4, is amended to read:

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

1.8 (1) Bridges Medical Services;

1.9 (2) the City of Cannon Falls Hospital;

1.10 (3) Clearwater County Memorial Hospital doing business as Clearwater Health
1.11 Services in Bagley;

1.12 (4) the Dassel Lakeside Community Home;

1.13 (5) the Fair Oaks Lodge, Wadena;

1.14 (6) the Glencoe Area Health Center;

1.15 (7) the Hutchinson Area Health Care;

1.16 (8) the Kanabec Hospital;

1.17 (9) the Lakefield Nursing Home;

1.18 (10) the Luverne Public Hospital;

1.19 ~~(10)~~ (11) the Northfield Hospital;

1.20 ~~(11)~~ (12) the RenVilla Nursing Home;

1.21 ~~(12)~~ (13) the Renville County Hospital in Olivia;

1.22 ~~(13)~~ (14) the St. Peter Community Healthcare Center; and

1.23 ~~(14)~~ (15) the Waconia-Ridgeview Medical Center.

2.1 Sec. 2. **EFFECTIVE DATE.**

2.2 Section 1 is effective upon the latter of:

2.3 (1) the day after the governing body of the city of Lakefield and its chief clerical
2.4 officer timely comply with Minnesota Statutes, section 645.021, subdivisions 2 and 3; and

2.5 (2) the first day of the month next following certification to the Lakefield City
2.6 Council by the executive director of the Public Employees Retirement Association that
2.7 the actuarial accrued liability of the special benefit coverage proposed for extension to
2.8 the privatized Lakefield Nursing Home employees under section 1 does not exceed the
2.9 actuarial gain otherwise to be accrued by the Public Employees Retirement Association, as
2.10 calculated by the consulting actuary retained under Minnesota Statutes, section 356.214.
2.11 The cost of the actuarial calculations must be borne by the current employer or by the entity
2.12 which is the employer following the privatization, and the date of the actuarial calculations
2.13 must be within one year of the date the Lakefield Nursing Home is sold or leased.