State of Minnesota | LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

H.F. 1667
(Shimanski)

S.F. 1299
(Dille)

Executive Summary of Commission Staff Materials

Affected Pension Plan(s): PERA
Relevant Provisions of Law: Minnesota Statutes, Section 353F.04, Subdivision 1
General Nature of Proposal: Extension of 1/1/2007 Exemption to 1/1/2008
Date of Summary: March 29, 2007

Specific Proposed Changes

- Extends to 2008 a current 2007 exemption from 2006 modifications in the PERA Privatization Coverage law deferred annuities augmentation rate for pending privatizations for Hutchinson Area Health Care.

Policy Issues Raised by the Proposed Legislation

1. Equitable argument for requested special time extension.
2. Obligation of fairness of affected employees.
3. Viability of actuarial work underlying Hutchinson Area Health Care privatization.
4. Precedent.

Potential Amendments

None

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Lawrence A. Martin, Executive Director

RE: H.F. 1667 (Shimanski); S.F. 1299 (Dille): PERA; Hutchinson Area Health Care Privatization; Clarify Effective Date

DATE: March 26, 2007

Summary of H.F. 1667 (Shimanski); S.F. 1299 (Dille)

H.F. 1667 (Shimanski); S.F. 1299 (Dille) amends Minnesota Statutes, Section 353F.04, Subdivision 1, the enhanced deferred annuities augmentation rate provision of the Public Employees Retirement Association (PERA) Privatization Benefits Chapter, to extend the current exemption until January 1, 2007, from a reduction in the special enhanced deferred annuity augmentation rate generally applicable to privatizations pending in 2006 for Hutchinson Area Health Care until January 1, 2008.

Hutchinson Area Health Care Pension Privatization Process

Hutchinson Area Health Care has been in the process of becoming privatized since 2005, was unable to complete its privatization before the special privatization deferred annuity augmentation rate was reduced for future privatizations in 2006, and had the applicable deadline extended in 2006, but still has delays in its privatization that carried beyond January 1, 2007, the current date relating to the grandparented higher privatization deferred annuity augmentation rate. The health care facility would like an extension to 2008.

Background Information on Defined Contribution and Defined Benefit Pension Plans

Background information on defined contribution pension plan coverage and on defined benefit pension plan coverage is set forth in Attachment A.

Background Information Health Care Facility Privatizations

Background information on handling past pension plan coverage as part of health care facility privatizations is set forth in Attachment B.

Discussion and Analysis

H.F. 1667 (Shimanski); S.F. 1299 (Dille) permits Hutchinson Area Health Care, until January 1, 2008, rather than January 1, 2007, to privatize the health care facility and avail themselves of the Public Employees Retirement Association (PERA) privatization pension coverage under Minnesota Statutes, Chapter 353F.

The proposed pension legislation will raise several pension and related public policy issues for potential Legislative Commission on Pensions and Retirement consideration and discussion, as follows:

1. Equitable Argument for the Requested Special Time Extension. The policy issue is the persuasiveness of the equitable arguments likely to be forwarded on behalf of Hutchinson Area Health Care to justify the proposed extension of the hold harmless period from the privatization special deferred annuities augmentation rate reduction of January 1, 2007, to January 1, 2008, when the Public Employees Retirement Association (PERA) recommended, in 2006, to reduce the special deferred annuities augmentation rate under its privation law, Minnesota Statutes, Chapter 353F, because of concerns that the actuarial cost of the enhanced augmentation rate exceeded the actuarial gain of the discontinuation of future pension plan coverage, the augmentation rate reduction was imposed solely on future privatizations and not on then-pending privatizations. The timing of any privatization for Hutchinson Area Health Care lies with Hutchinson and if the privatization will be further delayed, representatives of the health care facility or of the likely successor in interest should be available to discuss the reasons for the delay and the reasonableness of the delay.

2. Obligation of Fairness of Affected Employees. The policy issue is whether or not the proposed legislation is a necessity because of a legal or perceived moral obligation to provide fairness to the affected employees of Hutchinson Area Health Care. The privatization provisions arose out of a

concern for the impact that a privatization has on the longer service or older public employees of the privatizing employer and the existing (until January 2007) grandparenting of the higher augmentation rate for pending privatizations arose out of a concern not to change the terms of the program after employee expectations were raised as part of a pending privatization. Neither action is a fulfillment of a legal obligation of the State, which is a third party to most or all privatizations. Although the privatization provisions make the affected employees more whole than they would be otherwise in the event of a privatization, there is a limit to how durable that motivation is or should be. The privatizing employer has the greatest moral or legal obligation to its employees. If the delays in privatization are a result of factors in the control of that employer and if the grandparenting of a higher augmentation rate will have or may have an adverse actuarial impact on the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General), any perception of an obligation to the affected employees that motivated past actions may not continue to be sufficient to justify additional legislative intervention into a situation that could have been resolved in a more timely way locally.

3. Viability of the Actuarial Work Underlying the Proposed Hutchinson Area Health Care Privatization. The policy issue is whether or not the actuarial work previously undertaken with respect to the privatization of Hutchinson Area Health Care remains a valid and reliable indicator of the impact of the inclusion of Hutchinson Area Health Care into the privatization law, Minnesota Statutes, Chapter 353F. The actuarial work was not performed before the Legislative Commission on Pensions and Retirement considered the Hutchinson Area Health Care privatization legislation in 2005, but it was completed in early May 2005. The May 6, 2005, actuarial valuation covered 555 of the 648 Hutchinson Area Health Care employees and indicated a relatively narrow net actuarial gain to the General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) under the most enhanced augmentation rate privatization provisions. As the time period since the actuarial work was prepared and as the Hutchinson Area Health Care workforce changes, with terminations and new hires, the validity of the 2005 actuarial work as a reliable predictor of the actuarial impact of the privatization becomes less and less clear. With a continuation of the privatization under the most favorable terms to the employee group until 2008, as proposed, it may be appropriate to also require Hutchinson Area Health Care to obtain updated actuarial work.

4. Precedent. The policy issue is whether or not a precedent exists for the proposed legislation and whether or not the proposed legislation may likely become a precedent for future proposed legislation. Aside from the legislation recommended by the Legislative Commission on Pensions and Retirement to grandparent in the higher privatization chapter deferred annuities augmentation rate for pending privations in 2006, the Commission staff is unaware of any prior precedent for the proposed legislation. Because the number of pending 2006 privatizations was small, it is unlikely that this proposed legislation will constitute a direct precedent for future legislation, but could be argued to be precedent for analogous or perceived comparable legislation.

Attachment A

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.

Attachment B

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.

d. Treatment Under Chapter 353F, PERA Privatized Hospital. 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 Minnesota Statutes, 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, but that 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 Minnesota Statutes, 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.

State of Minnesota
HOUSE OF REPRESENTATIVES

EIGHTY-FIFTH
SESSION

HOUSE FILE NO. 1667

March 5, 2007
Authored by Shimanski, Urdahl, Brod and Koenen
The bill was read for the first time and referred to the Committee on Governmental Operations, Reform, Technology and Elections

A bill for an act

relating to retirement; general employees retirement plan of the Public Employees Retirement Association; clarifying the effective date of a privatization by Hutchinson Area Health Care; amending Minnesota Statutes 2006, section 353F.04, subdivision 1.

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

Section 1. Minnesota Statutes 2006, section 353F.04, subdivision 1, is amended to read:

Subdivision 1. **Enhanced augmentation rates.** (a) The deferred annuity of a terminated medical facility or other public employing unit employee is subject to augmentation under section 353.71, subdivision 2, of the edition of Minnesota Statutes published in the year in which the privatization occurred, except that the rate of augmentation is as specified in paragraph (b) or (c), whichever is applicable.

(b) This paragraph applies if the legislation adding the medical facility or other employing unit to section 353F.02, subdivision 4 or 5, as applicable, was enacted before July 26, 2005, and became effective before <u>January 1, 2008, for the Hutchinson Area Health Care or before</u> January 1, 2007<u>, for all other medical facilities and all other employing units</u>. For a terminated medical facility or other public employing unit employee, the augmentation rate is 5.5 percent compounded annually until January 1 following the year in which the person attains age 55. From that date to the effective date of retirement, the augmentation rate is 7.5 percent compounded annually.

(c) If paragraph (b) is not applicable, the augmentation rate is four percent compounded annually until January 1, following the year in which the person attains age 55. From that date to the effective date of retirement, the augmentation rate is six percent compounded annually.

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