TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Susan Lenczewski, Executive Director

RE: Update on Bills regarding Fairview Employees: Reduction in the Enhanced Augmentation Rate and Changes to the Exception to Enhanced Augmentation for Return to Public Service

DATE: April 5, 2016

Status Update on Bills relating to the Fairview Employees

H.F. 3716 (O'Driscoll)/S.F. XXXX (formerly LCPR16-016). This bill both reduces the rate of future augmentation and revises the exception from enhanced augmentation for return to public service. This bill was heard by the Pension Commission at its meeting on February 24, 2016. At the meeting, the Commission heard from David Bergstrom, Executive Director of the Minnesota State Retirement System (MSRS), Representative Phyllis Kahn, and several testifiers, including Fairview employees or their spouses, and representatives from AFSCME Council 5. No action was taken. The focus of the testimony and discussion was on the proposed reduction in the future rate of augmentation from 5.5% to 2%. (For Fairview employees who are at least age 55, the reduction in the future rate of augmentation would be from 7.5% to 2%.)

H.F. xxxx (Hornstein/Thissen); S.F. xxxx (Dibble); Revisor #16-6647. This bill only revises the exception from enhanced augmentation for return to public service and mirrors the exception language in H.F. 3716, as to substance. (This bill reflects changes made by the Revisor's Office to clarify the retroactive application of the changes, but these changes are not intended to change the substance of the bill.) This bill was heard by the Pension Commission at its meeting on March 22, 2016. The authors presented the bill and Mr. Bergstrom provided testimony. Amendment #16-6647-1A, which would apply the change to all current and future retirees was distributed. No action was taken on the bill or the amendment.

Commission Meeting on April 5, 2016. The Commission will hear an update from Mr. Bergstrom at the meeting on April 5. The Chair will determine the extent to which the Commission will hear additional testimony from members of the public.

Additional Information for Consideration by the Commission

Communications to Fairview Employees in 1997. In connection with the U of M Hospital/Fairview spin-off transaction at the end of 1996, MSRS provided information to all Fairview employees regarding the supplemental pension benefit package through a mailing and a series of informational meetings. Copies attached for your consideration:

- The mailing starts on page 3 of the packet; and
- The slide presentation used at the informational meetings starts on page 5 of the packet. Page 10, in the slide presentation, explains enhanced augmentation and the exceptions.

Communications to Fairview Employees since 1997. MSRS reports that an informational page was included with benefit estimates prepared as requested by Fairview employees for a period, up to approximately 2013. A copy of that information sheet is at page 13 of the packet.

Beginning in July 2014, benefit estimates for the Fairview employees included an explanation of augmentation and the exception for return to public service. A copy of a benefit estimate begins on page 15 of the packet. See page 17 of the packet for the paragraph on the Fairview benefits.

We understand that annual statements are not customized for this particular group of former employees, for cost reasons because the size of the group is small compared to the total MSRS member population. Therefore, annual statements typically have not specifically addressed enhanced augmentation or the exceptions to receiving it.

Summary of the Fairview Facts and Proposed Changes

- The reduction in the rate of augmentation will result in actuarial savings to MSRS of nearly $60 million, an immediate improvement to MSRS' funding status.

- Deductions from the paychecks of 50,000 current active State employees continue to pay for enhanced benefits to a small group of employees who haven't contributed to MSRS in 20 years.

- Augmentation is a COLA credited every year on a former employee's pension benefit and the increases are cumulative. It is not found at all in private sector pensions and, in the public sector, is unique to the pension plans of Minnesota and South Dakota. While a good case can be made to eliminate it entirely, an even better case can be made to eliminate it in this case, involving substantially higher rates of augmentation to one select group of former employees.

- The proposal reduces the rate of increase only on a prospective basis—the enhanced increases already credited to these members' pensions over the last 20 years are locked in and are not reduced by the proposal. The potential for litigation arises when change is retroactive, which this is not.

- This is true pension plan reform. It is commendable that MSRS is seeking to reform this excess from the past and has moved forward with this initiative, notwithstanding the controversy and additional work it has brought to the executive director and his staff. Were it not firmly grounded in common sense and fairness, MSRS would not have initiated the proposal.

- The changes to one of the two exceptions to receiving enhanced augmentation alleviate the adverse impact of the exception that has become a disincentive to Fairview employees wishing to return to public employment. Coincidentally, two constituents have also asked their respective legislators for this relief.

MSRS

IMPORTANT INFORMATION

FOR UNIVERSITY HOSPITAL AND CLINIC EMPLOYEES

WHO WILL BE INTEGRATED IN THE FAIRVIEW SYSTEM

Your University of Minnesota employment covered by the Minnesota State Retirement System (MSRS) ends with the integration of the University's hospital and clinics into Fairview hospital.

You have two choices with regard to your retirement account. You may leave your retirement deductions with MSRS and receive a lifetime monthly annuity when you retire; or you may apply for a refund of those deductions *following termination of University employment.*

Retirement Annuity

Special legislation for University hospital employees assures full value of your MSRS' deductions toward future retirement benefits. This legislation passed during the 1996 session. You are not covered by MSRS' General Employees' Retirement Plan once you end University hospital employment; however, the legislation generates a more substantial annuity than does the normal General Plan. *The legislation is applicable, if you are employed by the University hospital and clinics on the day before the integration, and if you are paid on a biweekly payroll.*

You are eligible for a lifetime monthly annuity at retirement, regardless of your length of service. This monthly benefit is calculated from your length of service and your five high-year average monthly salary. If your service is fewer than five years, we figure your benefit from the average of all salary earned from MSRS-covered employment.

The 1996 law provides additional benefit rights to University hospital employees who become Fairview hospital employees through this merger. If you leave your contributions with MSRS and apply later for monthly benefits, your payment amount is increased at a rate of 5.5 percent each year until the Jan. 1 after you turn age 55. Then the rate increases to 7.5 until the time you begin to draw monthly benefits. This law change is intended to maintain the value of your monthly benefit earned while you were a University employee. These percentages apply if you:

- are not employed in a position covered by another Minnesota public retirement plan
- do not receive the pension while you are still employed by Fairview

Your service with Fairview Hospital counts toward eligibility for the early-retirement benefit called the *Rule of 90,* if your Minnesota public employment began before July 1, 1989.

Example:
Your University employment ends after 28 years of service and you are age 58, you could work two years with Fairview and qualify for the Rule of 90. Then, you'll be age 60, and your service with the University and Fairview hospitals will be 30 years. You may retire from Fairview and receive an MSRS annuity with no early-retirement reduction.

(over)

Your annuity's computation is based on your 28 years of service and your five high-year average salary with the University. The percentage increase applies.

Call MSRS and request an estimate, if you qualify for the Rule of 90 before age 63.

Survivor's Benefit

If you have three years of service credit, leave your money with the retirement fund, and die before your annuity payments begin, your spouse may choose either a:

- lifetime monthly annuity, beginning when you would have been age 55
- refund of your MSRS deductions plus 6-percent interest

Your spouse's payment may begin immediately, if you are over age 55 at the time of death. Your beneficiary receives your retirement-deduction refund plus interest, if you have fewer than three years of service or are unmarried and die.

Refund

Instead of leaving your retirement deduction with MSRS for a lifetime annuity, you have another choice. You may apply for a refund of those deductions and 6-percent interest.

If you request a refund, you may transfer your funds—through a roll over—to another retirement-account trustee, or you may take the lump sum directly. You may roll over your refund to an independent retirement account or your new employer's retirement plan. If you decide to use the roll over, we mail you a check that is payable to you and the trustee. You must endorse the check and deliver it to the trustee. If you request the lump sum directly and bypass a trustee, we send the money to you. The lump-sum refund includes interest less the required 20-percent federal withholding. In addition, a 10-percent federal-tax penalty is applied when you withdraw your lump-sum refund.

A refund application is available from MSRS. You may apply for a refund after termination from University employment.

Consider carefully the advantages of receiving a monthly annuity. If you accept the refund, you forfeit all rights to a lifetime annuity and survivor benefits.

For Further Information

If you have questions, call the Minnesota State Retirement System at (612) 296-2761 or 1 (800) 657-5757; or write to MSRS at MidAmerica Bank Building, Suite 300, 175 W. Lafayette Road, St. Paul, MN 55107-1425.

This information can be made available in an alternative format, such as large print, Braille or cassette tape. Teletypewriter users and telecommunication-device-for-the-deaf users call the Minnesota Relay Service at (612) 297-5353 or 1 (800) 627-3529, and ask to be connected to MSRS at 296-2761.

HANDOUT AT
SLIDE SHOW

ANNUITY AMOUNT

determined by

1. Average Salary
2. Length of Service
3. Age When Payment Begins
4. Form of Payout Selected

AVERAGE SALARY

1. Average of 5 high successive years.
2. Normally is last 5 years, up to and including last day worked.
3. Includes all salary earned in 5 high period (i.e. overtime, shift differential, etc.) except;
   a. Unused vacation paid in lump sum upon termination.
   b. Unused sick leave (severance pay) paid upon retirement.
4. Deferred Compensation has no effect.

ALLOWABLE SERVICE

- Months in which deductions taken.
- Leave of absence with workers' compensation.
- Leave of absence paid.
- Refunds repaid.
- Part time may be prorated.

ALLOWABLE SERVICE FACTORS

Step Formula:

- 1% for each of first 10 years (.083% for each month).
- 1.5% for each year after 10 years (.125% for each month).
- If 20 years of service,

10	@ 1.0% =	10.0%
10	@ 1.5% =	15.0%
20		25%

Level Formula:

- 1.5% for each year (.125% for each month).
- If 20 years of service.

  20 @ 1.5% = 30%

NORMAL RETIREMENT AGE

IF FIRST COVERED BY RETIREMENT AFTER 6/30/89.

YEAR OF BIRTH	NORMAL RETIREMENT AGE	YEAR OF BIRTH	NORMAL RETIREMENT AGE
1937	65	1955	66-2
1938	65-2	1956	66-4
1939	65-4	1957	66-6
1940	65-6	1958	66-8
1941	65-8	1959	66-10
1942	65-10	1960 AND LATER	67
1943-1954	66		

REDUCTION FOR EARLY RETIREMENT

If Step Formula:

* No reduction if age plus service equals 90.
* If over 30 years of service, reduction is 3% for each year under age 62 (1/4% per month).
* If under 30 years of service, reduction is 3% for each year under age 65.

IF LEVEL FORMULA:

* No reduction if age 65 or over.
* Actuarial reduction (averages 5¼% per year) for each month under normal retirement age.

	STEP	LEVEL
FORMULA	1% for 1st 10 years 1.5% thereafter.	1.5% for all years.
NORMAL RETIREMENT AGE	62 or 65 or Rule of 90	Social Security normal retirement age; 65 or 65+
EARLY RETIREMENT REDUCTION	3% per year.	Actuarial reduction.

POST-RETIREMENT ADJUSTMENT FORMULA

- Cost of Living Component
  Up to 3.5% per year, based on CPI

- Investment Component
  Based on investment earnings - measured by increase in market value of the fund
  Increase spread over five-year period

University of Minnesota Hospital and Clinics Integration with Fairview Hospital and Health-Care Services

To be eligible:

* You must be employed on the day before integration.
* You must be paid on a biweekly-payroll basis.

Deferred Annuity Computation

Computation Method	Example
Average Monthly Salary	$2,200 *
Service-Credit Percent	x 7.5%
	$ 165.00
Augmentation Factor	x 2.4273 Salary value [illegible]
Early-Retirement Reduction	x .5231 [illegible] 55 Value [illegible] year to early [illegible]
	$ 209 at age 55

* The example assumes :

* an average monthly salary of $2,200
* termination at age 25 with five years of service
* an annuity payment that begins at age 55

MSRS' Special Benefits to Transferring Employees

- Immediate vesting
- *Rule of 90* eligibility
- Augmentation at 5.5 percent to Jan. 1. after age 55, and at 7.5 percent thereafter

Limitations on MSRS' Special Benefits

- Special augmentation rates do not apply if you start your annuity while employed by Fairview. Also, an earnings limitation exists on an MSRS annuity if you work for Fairview after beginning to receive an annuity.
- Special augmentation rates stop the day you become covered, again, by another public-retirement plan in Minnesota.

Taking a Refund?

If you decide to take a refund, it will include:

* your contributions
* 6-percent interest, that is compounded annually on fiscal year-end balances

Tax Consequences if You Take a Refund

If you take a refund, it is:

* taxable as ordinary income
* subject to a 10-percent excise tax, if you are fewer than 59½ years
* subject to a 20-percent withholding tax, if it is paid directly to you
* able to be rolled over to another qualified plan or retirement account, such as an IRA, without an income-tax or excise-tax penalty

MSRS' Survivor's Benefit

The survivor's benefit entails these particulars:

* The surviving spouse's benefit may begin as early as when the deceased employee would have been age 55.
* The usual reduction for early retirement applies after age 55. One-half the reduction applies before age 55.
* The survivor may choose a lifetime benefit or certain period amounts.

MSRS Minnesota State Retirement System
Your Foundation for Retirement

U of M Fairview Hospital
Deferred Benefit Estimate Explained

Enclosed is an estimate of your deferred benefit from the Minnesota State Retirement System (MSRS).

The benefit is based on the amount of allowable service and your high-five average monthly salary. The benefit increases at the rate of 5.5 percent per year from January 1, 1997, until the month benefit payments begin. If you begin the benefit after age 55, the amount increases at the rate of 7.5 percent per year beginning the January following your 55th birthday. The percent increases are included in the estimated benefit amounts. The increased rates do not apply if you again become covered by another public retirement plan in Minnesota.

1. Retirement Date

The estimate(s) assumes you start receiving your benefit on this date(s).

2. Estimated Single-Life Monthly Benefit

This is the highest monthly benefit you can receive based on your allowable service and high-five salary. After your death payment stops. If your death occurs before you receive your total retirement contributions, MSRS will refund the balance to your beneficiary.

3. Allowable Service

Allowable service is the number of years and months you have been covered by MSRS during your career. The estimate is based on this amount of service.

4. Service Percentage Factor

Your amount of allowable service converts to this percent of your high-five salary.

5. Estimated Average Monthly Salary

This is based on your highest-five consecutive years of salary. If your allowable service is fewer than five years, all your earnings are included in calculating the average.

6. Early Retirement Reduction

If your benefit payment begins before you reach normal retirement age, the Single-Life benefit, as explained in number 2, has been reduced by this percent.

7. Joint-and-Survivor Benefit

You can select one of three Joint-and-Survivor benefit options. The 100 percent, 75 percent or 50 percent option provides for a survivor benefit after your death. If your survivor predeceases you, your benefit bounces back to the Single-Life benefit amount beginning the first of the month after your survivor's death. If you choose an option, MSRS needs a photocopy of your survivor's birth record.

Other Information

Your Fairview benefit is in addition to your MSRS benefit. To be eligible to receive your MSRS benefit, you must terminate Fairview employment.

If death occurs before your benefit starts, your benefit application may be voided. If death occurs before the benefit begins, there may be a monthly benefit payable to your spouse.

Your Social Security retirement benefit is in addition to your MSRS benefit. Call Social Security for an estimate at 1-800-772-1213.

MSRS
60 Empire Drive | Suite 300 | St. Paul, MN 55103-3000
Telephone: 651-296-2761 | Toll-free: 1-800-657-5757 | Fax: 651-297-5238
www.msrs.state.mn.us

Teletypewriter users and telecommunications-device-for-the-deaf (TDD) users call the Minnesota Relay Service at 1-800-627-3529 and ask to be connected to MSRS at 651-296-2761.

About MSRS

MSRS administers 10 different retirement plans that provide retirement, survivor, and disability benefit coverage for Minnesota state employees as well as employees of Metropolitan Council and many non-faculty members of the University of Minnesota, and Minnesota State Colleges and Universities (MNSCU).

MSRS also administers the **Minnesota Deferred Compensation Plan (MNDCP)** – a voluntary tax-deferred savings plan, and the **Health Care Savings Plan (HCSP)** – a tax-free medical expense and premium savings plan.

Core securities, when offered, are offered through GWFS Equities, Inc. and/or other broker dealers.

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