Background Information on Privatization of University of Minnesota Hospitals and Continuing MSRS-General Benefit Coverage

In 1996-1997, the University of Minnesota transferred its hospitals to Fairview Hospital and Healthcare Services. That transfer shifted the employees from the public sector to the private sector and, for subsequent service, the employees were transferred from the Minnesota State Retirement System General Plan (MSRS-General) to the Fairview Hospital pension plan.

Although the transferred employees were no longer active MSRS-General members for purposes of the continued employment, the 1996 Legislature (Laws 1996, Ch. 460, Art. 1) provided for the enhancement of certain MSRS-General pension benefit rights for the transferred University of Minnesota Hospital employees. The provisions, coded as Minnesota Statutes, Chapter 352F, University Hospital Employee Retirement, included the following:

1. Elimination of Vesting Requirement. The MSRS-General vesting requirement then in law (three years) was eliminated for the transferred employees, so that transferred employees are eligible for an MSRS-General retirement annuity with any length of prior state service.

2. Increased Deferred Annuity Augmentation. For transferred employees who do not take an MSRS-General refund, the deferred retirement annuity is augmented at the rate of 5.5% per year instead of 3.0% for the period until age 55 and at the rate of 7.5% instead of 5.0% for the period after age 55. Given these deferred annuity enhancements, a transferred employee with service and salary credit creating a computed $100 current monthly retirement amount at age 45 will be eligible to receive a future $352 monthly retirement annuity at eventual retirement at age 65 under the proposed legislation, rather than a $218.91 monthly retirement annuity at age 65 under then current law.

3. Recognition of Fairview Hospital Service for Rule of 90 Eligibility. For transferred employees who continue in Fairview Hospital service, service with Fairview Hospital can be added to the prior MSRS-General service credit for purposes of qualifying for the MSRS-General Rule of 90. The Fairview Hospital related service credit is utilized for benefit eligibility only, and not for benefit amount computation purposes.

4. Clarified Eligibility for Refund Following Transfer. Terminated employees are eligible for a refund at any time after the transfer of employment to Fairview.

A few different proposals were initially proposed for handling the privatization including permitting the employees to remain as active MSRS-General covered employees. However, the legislation that was enacted in 1996 terminated their active status in MSRS-General while enhancing benefits as described above. That premature termination produced an additional turnover gain for MSRS-General, not predicted by the plan's withdrawal actuarial assumptions, by releasing considerably more actuarial accrued liability than the value of a deferred retirement annuity or a refund of past member contributions. However, most of that turnover gain was eliminated by the increased benefit coverage rights in MSRS-General provided to these transferred employees under the 1996 legislation.

In debating the legislation, the Commission and Legislature relied on the actuarial firm Mercer, Inc., the MSRS-retained actuary, to provide information on the impact that the proposal would have on MSRS, although Deloitte, the actuary retained by the University of Minnesota, also provided estimates. The following summarizes those actuarial cost impact estimates:

Experience Gain/Liability Increase	Deloitte Estimate	Mercer, Inc. Estimate
(1) Current actuarial liability of MSRS-General or transferred University Hospital and Clinic employees	$150,100,000	$150,100,000
(2) 7/1/1995 funded portion of liability (MSRS-General funding ratio for active lives)	85%, or $128,800,000	85.8%, or $128,800,000
(3) Present value of current MSRS-General benefits upon group termination	$85,600,000	$88,900,000
(4) Experience gain from transferred University Hospital and Clinic employees (before 1996 legislation)	$43,200,000	$39,900,000
(5) Additional liability related to the recognition of future service for Rule of 90 purposes and vesting change	($5,800,000)	($6,700,000)
(6) Additional liability related to increasing the deferred annuity augmentation rate for affected group (3%/5% to 5%/7%)	($30,500,000)	($24,600,000)
(7) Additional liability related to further 0.5% increase in the deferred annuity augmentation rate for affected group (to 5.5%/7.5%)	N/A	($7,600,000)
(8) New gain (loss) from the 1996 legislation	N/A	$1,000,000

Under the Mercer estimates, the transfer of the University Hospital and Clinics employees to Fairview Hospital and Healthcare Services and their termination of future MSRS-General active membership produced an actuarial gain to MSRS-General of $39.9 million if the benefit provisions in law were left unchanged. However, the expansion of MSRS-General benefit coverage for these transferred employees under the 1996 legislation produced an actuarial liability increase of $38.9 million, for a net total actuarial experience gain to MSRS-General from the 1996 legislation of $1 million. The initial actuarial work assumed an increase in deferred annuity augmentation from 3% per year to 5% per year until age 55 and at a rate of 7% per year rather than 5% thereafter until retirement. This is somewhat less than the deferred annuity augmentation enhancements in the final legislation. The expected liability increase from that 5%/7% change, an additional $24.6 million in liability, is shown as item (6) in the above table. However, the impacted employees argued that this left MSRS with too large a remaining windfall. Under further negotiations the deferred annuity augmentation rates in the enacted legislation were increased an additional 0.5%. This is shown as item (7) above, which was estimated to add an additional $7.6 million in liability, leaving MSRS-General with a final estimated net gain of $1 million.

Minnesota Statutes, Chapter 352F, University Hospital Employee Retirement, has been revised several times after 1996, as follows:

- In 1997 (Laws 1997, Ch. 241, Art. 7) the chapter was revised by providing the same treatment to another University of Minnesota health care employee group, employees of the Academic Health Center.

- In 2001 (1st Spec. Sess. Laws 2001, Ch. 10, Art. 9, Sec. 1) disability benefit eligibility was clarified. If an individual develops a total and permanent disability after the privatization date, and the individual had a medically documented preexisting condition of the disability before the merger date, the individual may apply for MSRS-General disability benefits.

- In 2004 (Laws 2004, Ch. 267, Art. 9, Sec. 15), the application of MSRS-General surviving spouse and dependent child rights to privatized employees were clarified by indicating that the law in effect at the time of the privatization applies.

- In 2006 (Laws 2006, Ch. 271, Art. 5, Sec. 1) deferred annuity augmentation rates were reduced for any new MSRS privatizations that occur and are added to the chapter after June 2, 2006. The new rates are 4.0% rather than 5.5% through age 55, and 6.0% rather than 7.5% per year thereafter until retirement. However, no new MSRS privatizations have occurred or been added to the chapter.

- In 2010 (Laws 2010, Ch. 359, Art. 1, Sec. 22), the interest rate on refunds under this privatization chapter was revised to be the same as that provided under to any terminated MSRS-General employee who wants a refund. This interest rate change was from 6.0% to 4%. The refund interest rate change was part of the changes enacted as the 2010 Financial Sustainability Provisions, changes proposed by plan administrators to reduce pension plan liabilities due to the impact of the 2008-2009 market crash on plan assets. Those changes included reductions in deferred annuity augmentation for all members of MSRS plans, including those who were already in deferred status, except the MSRS privatization chapter, University Hospital Employee Retirement. The justification for the exclusion is unclear.