

TO: Members of the Legislative Commission on Pensions and Retirement

FROM: Ed Burek, Deputy Director

RE: S.F. 1963 (Betzold); H.F. xxx: Privatized Water and Wastewater Facility Employees Coverage Elimination

DATE: April 4, 2005

Summary of S.F. 1963 (Betzold); H.F. xxx

S.F. 1963 (Betzold); H.F. xxx amends a water or waste water treatment facility privatization provision by terminating the privatized employees from active membership in General Employees Retirement Plan of the Public Employees Retirement Association (PERA-General) following a privatization rather than continuing to permit them to remain as active members with an annual election to terminate from further coverage.

Background Information on Privatizations

- A. Water and Wastewater Treatment Privatizations. Chapter 471A currently includes a provision, which is being amended by this bill, to permit the existing employees in water and wastewater treatment facilities to remain in the public plan following a privatization. That practice was placed in law in 1986. More recently, the Legislature has dealt with privatizations, primarily in the healthcare area, by terminating the employees from continued plan coverage, but allowing the employees to be placed in a privatized employees chapter, if it is demonstrated that this will not eliminate all gain to the public plan, which extends certain benefits not offered to other terminated employees.
- B. More Recent Treatment of Privatized Employees. When a privatization occurs, the usual recent practice is to terminate the privatized employees from continued active membership in the public plan, because the employees no longer qualify as public employees for Public Employees Retirement Association (PERA) pension purposes, or as state employees for purposes of the General State Employees Retirement Plan of the Minnesota State Retirement System (MSRS-General). The primary reason for this treatment is concern about retaining plan qualification. Federal law requirements indicate that public plans should not provide coverage for private employees. Private employees covered by a public plan, except for de minimis portions, could jeopardize plan qualification.
- C. Privatization Impact on Retirement Coverage. When membership terminates retirement benefit coverage, problems may emerge. Under current PERA and MSRS law, three years of plan coverage is required for vesting. For employees who terminate plan 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 with the plan, 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 or MSRS membership with at least three years of service, there is a choice between a deferred retirement annuity right and 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 privatized facility, the privatization interrupts their benefit coverage. If there is no pension plan established by the privatized 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.

- D. Evolution of Privatization Treatment. The Legislature has dealt with privatizations on several occasions over the past few decades, primarily healthcare 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 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.
- 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 Loge, Kanabec Hospital, RenVilla Nursing Home, and the St. Peter Community Health Care Center.

Treatment Under Chapter 353F, PERA Privatized Hospital

If a bill is introduced to place a group of privatized employees in the privatization chapter and that bill is enacted, those privatized employees 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.

Discussion

S.F. 1963 (Betzold); H.F. xxx raises the following pension and related public policy issues:

1. Need for Change. The policy issue is whether the water and wastewater privatization policy needs to be changed. The Legislative Commission on Pensions and Retirement may wish to hear brief testimony from Mary Vanek, PERA Executive Director, on this matter. The general argument that has been made recently to support terminating privatized employees from active public plan membership is concern about retaining plan qualification. Federal law requirements indicate that public plans should not provide coverage for private employees. Private employees covered by a public plan, except for de minimis portions, could jeopardize plan qualification.
2. Treatment After Privatization. The issue is what treatment shall be provided to the privatized employees once they are no longer public employees. Quite recently, Ms. Vanek has indicated that changes are needed in the PERA privatized employee chapter, and she requested that no further bills to place employees in the privatization chapter should pass until the Commission and Legislature decide on appropriate revisions to that chapter. Thus, the current bill will create considerable uncertainty by terminating the privatized employees from PERA-General without a model in place ready to accept them as privatized employees.
3. Bill Interpretation. The issue is whether the bill is intended to apply to past water and wastewater privatizations or just to privatizations that occur after the bill is enacted.

Amendments

LCPR05-217 helps to clarify the bill by more clearly indicating that those individuals who were PERA-General members due to the employment will no longer be active members following a privatization. The amendment also adds an effective date provision and specifies that the bill is intended to apply to privatizations that occur after the effective date. If the intention is to have retroactive application, LCPR05-218 will be needed.

LCPR05-218 amends the previous amendment (LCPR05-217) to give the bill retroactive application, but allows individuals who were privatized in the past to have service credit up to the effective date of the bill. If this amendment is used, the Commission may wish to consider that this treatment terminates an existing law benefit right.