

## *Office Memorandum*

**Date:** November 7, 2016

**To:** MSRS Board of Directors

**From:** Dave Bergstrom, Executive Director

**Phone:** 651-284-7888 or 1-800-657-5757

**Subject:** **Deferred Augmentation Rates for Former University of Minnesota Hospital Employees (Fairview Hospital)**

### **History**

In 1996, the University of Minnesota Hospital and Clinics (UMHC) was acquired by Fairview Hospital and Healthcare Services, a private, non-profit organization. Many of the University of Minnesota Hospital employees were covered by the MSRS General Employees Retirement Plan (General Plan). As a large private organization, Fairview's employees could not participate in a public retirement plan. Legislation was enacted to ensure that University employees transferring to Fairview employment would receive future retirement benefits under the General Plan commensurate with the contributions made by the University and employees. At the time, the goal was that the pension received from MSRS plus the retirement benefits provided by Fairview would approximate the same benefit that members would have received if they had remained in MSRS covered employment.

To accomplish this goal, the legislation provided an increased deferred augmentation rate to privatizing employees. In 1996, the General Plan provided augmentation for all deferred members of 3% per year until age 55 and 5% per year thereafter. The Fairview Hospital legislation increased the augmentation for privatizing employees by 2.5% to 5.5% per year and 7.5% per year after age 55. In addition to this enhanced augmentation benefit, the legislation maintained *Rule of 90* benefits for members who remained employed at Fairview and clarified that anyone who returns to a position covered by any statewide pension plan would give up the enhanced augmentation.

The enhanced augmentation rates have provided reasonable benefits for retiring employees. However, 20 years of compounding at improved augmentation rates have now grown these benefits to a size which is no longer commensurate with the contributions made to the plan and in most cases exceeds what the member would have been eligible for had they remained in the plan.

The "Great Recession" in 2008 and 2009 lowered the plan's funded ratio from 99% to 68% in the span of two years. Since then, MSRS has reduced benefits in the form of postretirement increase (COLA) reductions and augmentation reductions. MSRS has also increased contributions for all of our members and employers. In 2010 the Board approved a reduction in the deferred augmentation rate from 3% per year before age 55 and 5% per year thereafter to a flat 2% regardless of age. This deferral reduction did not apply

to employees covered by the Fairview Hospital agreement. As a result, this one group of members has been less impacted by the General Plan reforms of the last six years than have the rest of the General Plan membership. (For additional examples of changes to the General Plan, see the table below.)

	1996	Today
<b>Contribution Rates</b>	4.07% of pay	5.5% of pay*
<b>COLA</b>	6.4%	2.0% **
<b>Deferred Augmentation</b>	3% (under 55) / 5% (over 55)	2% per year regardless of age
<b>Life Expectancy</b>	85.5 years old	87.7 years old
<b>Assumed Rate of Return</b>	8.5%	8% ***
<b>Enhanced Augmentation - former UMHC</b>	5.5% under 55 / 7.5% (over 55)	5.5% under 55 / 7.5% (over 55)

\* The Board just approved an increase to 6%

\*\* The Board just approved a decrease to 1.5%

\*\*\* The Board just approved a decrease to 7.5%

## What is Deferred Augmentation?

A deferred member is a former state employee who has left state service, but not yet started to collect a pension benefit. MSRS has approximately 16,700 deferred members (2015 valuation). About 1,280 of those members are former University of Minnesota Hospital and Clinic employees eligible for enhanced deferred augmentation (5.5% or 7.5% per year). The remaining 15,420 deferred members receive regular deferred augmentation (2% per year).

Deferred augmentation increases a benefit by a percentage (currently 2%) for every year that deferred member doesn't start a pension benefit.

For example, a 53-year-old member quits her job with the state to work in the private sector. She decides to wait to collect her benefit until she reaches age 62. At age 53 her benefit was worth \$1,000 per month. With a 2% augmentation rate it will grow to \$1,020 at age 54 and at 55 to \$1,040. By 62-years-old the benefit is worth \$1,195. (For a visual depiction of deferred augmentation, see the graph on page 5)

The policy intent of deferred augmentation is to provide some protection against inflation and an incentive for employees to keep their money in MSRS until they have reached retirement age.

## 2016 Legislative Session

Last November, Staff proposed a modification to the enhanced augmentation benefit for former UMHC (Fairview) members. The intent of the proposal was to achieve similar treatment of former UMHC members as other deferred members. The proposal lowered benefits from 5.5% (under age 55) and 7.5% (age 55 and above) to 2% for all members. This proposal was opposed by former UMHC members as well as Council Five of the American Federation of State, County and Municipal Employees (AFSCME). Both groups

argued that the impact of an immediate reduction to 2% would significantly harm members near retirement. Opposing groups also accused MSRS of failing to provide adequate notice of proposed changes.

In response to the opposition, the Legislative Commission on Pensions and Retirement (LCPR) passed a resolution requiring MSRS to work with the LCPR, former UMHC members and other interested parties to produce a report recommending different legislation during the 2017 session.

## **2017 Staff Proposal**

Over the last several months, MSRS staff held meetings with former UMHC members to find an outcome that considered the concerns of all parties by protecting those close to retirement while still limiting the future growth of benefits. The revised proposal is a reduction in deferred augmentation from 5.5% and 7.5% depending on age to 4.5% augmentation effective on January 1, 2021.

This proposal maintains the 2.5% improvement to regular augmentation that was in place in 1996. It will also have no impact on the benefits of those currently within four years of retirement. It saves the fund approximately \$13.7 million.

	<b>2016 Proposal</b>	<b>2017 Proposal</b>
<b>Augmentation Rate</b>	2%	4.5%
<b>Effective Date</b>	2017	2021
<b>Savings</b>	\$53 million	\$13.7 million

## **Comments:**

The former UMHC employees raised several concerns during the last legislative session and in meetings that we have had with them. Here are some of their concerns:

- This additional benefit was promised to them at the time of the merger
- The additional benefit was one of the reasons why they continued to work at Fairview
- When the sale happened, not only did the employees lose retirement coverage, they also lost wages, and other benefits.
- Employees have planned for retirement and reducing the value of their benefits, with this short notice, disrupts planning.
- This change only impacts a small number of employees and isn't going to make a substantial difference in the plan's funding.
- MSRS should have known the impact of the deferred augmentation at the time the law was passed and MSRS was a party to that decision

Here are some responses to the concerns that have been raised:

- Everybody in the plan has had to make sacrifices and are getting less than "promised" when they were hired or retired – we lowered the deferred augmentation to everyone effective on January 1, 2012.
- The goal of the enhanced augmentation was to have the benefit received from MSRS, plus the money in their Fairview pension plan equal to the amount that they would have received had they been allowed to stay in MSRS. In most cases, the employees are going to end up with more than if they had stayed in MSRS.

- MSRS was involved in trying to protect retirement benefits and in no way was involved in making up for other benefits and lower pay.
- Last year's proposal did not give adequate notice, but this year's proposal is much less of a reduction and implementation is delayed until 2021.
- This proposal was never intended to help solve our funding issue – it was based on benefits that have grown out of proportion and to have former UMHC employees share in the funding solution.
- At the time the law was passed, MSRS was 104% funded and the actuaries measured the financial impact. Much has changed since then – we have lowered investment assumptions, lived through the “Great Recession” and have had several mortality changes since then.

Additional details will be presented at the meeting.

# MSRS Proposed Augmentation Reduction for Fairview Members (55 Years Old Today)

Proposal: Reduce Enhanced Augmentation for all Fairview Members to 4.5% starting on January 1, 2021.

Example Fairview Annuity = (High 5 Salary) x (Formula) x (Years of Service) x (Augmentation Rates Compounded Annually)

\$3,333/month x 1.5% x 10 years x (Augmentation Rates Compounded Annually)

