

**FINANCING MICHIGAN RETIRED TEACHER  
PENSION AND HEALTH CARE BENEFITS**

**September 2004**

**Report 337**

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**CRC**

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## **Citizens Research Council of Michigan**

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## *Contents*

	<u>Page</u>
In Brief .....	1
Introduction .....	1
Primer on Retirement Benefit Funding .....	2
Health Care Benefits.....	3
Pension Benefit Funding .....	4
Future Changes in Contributions .....	6
Health Care .....	7
Pension Benefits .....	7
Projected Future Contribution Rates.....	7
Combining the Pension and Health Benefit Rates .....	7
Pension .....	7
Health .....	7
Policy Options .....	10
Pension Benefit .....	10
Health Care Benefit .....	10
Conclusion .....	11

## *Tables*

Table 1 – Michigan Public School Employees Retirement System: Unfunded Accrued Liabilities, Health Benefits, FY1985 through FY2003 .....	3
Table 2 – Investment Gains (Losses) Applied in Valuations, Fiscal Years Ending 1998-2003 .....	4
Table 3 – Michigan Public School Employees Retirement System, Actual and Projected Contribution Rates, Regular Pension and Health Benefits, Fiscal Years 1991 through 2015 .....	9

## *Charts*

Chart 1 – Effects of the 2001 and 2002 Stock Markets, Investment Smoothing Calculation, Fiscal Years Used in Each Valuation .....	5
Chart 2 – Level vs Pay-as-you-go Contribution Percentages.....	6
Chart 3 – MPSERS Contribution Rates, Fiscal Years Ending 1991 through 2020 .....	8

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# FINANCING MICHIGAN RETIRED TEACHER PENSION AND HEALTH CARE BENEFITS

## In Brief

Funding pension and health care benefits provided by the Michigan Public School Employees Retirement System (MPERS) will constitute an increasing burden on state finances in coming years. If the actuarial assumptions beyond FY2003 prove accurate, the contribution rate paid by the employers will jump significantly from the 14.87 percent charged by the State for FY2005 to over 20 percent in FY2008. The sharp increase is the combined result of escalating health care costs paid on a pay-as-you-go basis; the very large losses experienced in the stock market in 2001 and 2002; and the postponement of contribution rate increases made possible by the use of reserves, soon to be exhausted.

The effects of escalating pension costs on public school

finance will be dramatic. In FY2005, the increase in MPERS contributions will average approximately \$90 per pupil, an amount greater than the entire per pupil increase in school aid support. In the following three fiscal years, the average per pupil increase in MPERS contributions will exceed \$100 each year. In FY2008, the per pupil costs of MPERS contributions will average about \$1,200.

In a year of moderate economic growth, the increase in school aid revenues on a per pupil basis would likely average no more than \$300. Combining increased costs for MPERS contributions and health benefits for working employees leaves little room for increased spending elsewhere in school budgets, even if the economy improves throughout the period.

## Introduction

Prior to the implementation of Proposal A in 1995, the State of Michigan and public school districts shared in the financing of the employers' shares of contributions to Michigan Public School Employees Retirement System (MPERS) for public school districts.\* Those contributions, expressed as a percentage of active employee payrolls, pre-funded the actuarial costs of the defined benefit plan provided to public school employees plus the costs of health benefits for retirees on a pay-as-you-go basis. After Proposal A was approved, full responsibility for financing the employers' contributions passed to the school districts. Under the new finance system, the level of financial support was intended to provide sufficient resources for local school districts to pay for MPERS contributions.

Since 1995, the contribution rate has fluctuated. The overall contribution rate was actually lower in FY2004

than in FY1995 because for FY2004 the system is using reserves to keep the contribution rates below the actuarially calculated required levels. The use of reserves dedicated for health care will hold the overall contribution requirement for FY2005 to less than one percentage point of payroll higher than it was in FY1995.

Three forces have emerged in recent years that portend large increases in contribution rates in the next several years:

- Effective for 1997, system assets reflected the current market value of investments in the calculation of fund assets resulting in a large reduction in the contribution rate. Prior to 1997, a five-year smoothed market value method was used and that method has been employed since 1997 as well. The savings in employer contributions at the school district level were reflected in the State's decision to provide no increase in the foundation allowance portion of School Aid in the year of the change.
- The stock market declines in 2001 and 2002 created huge losses in retirement fund investments during those years and the losses, in turn, are causing increased contribution rates. Loss effects are mitigated

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\* MPERS provides benefits to employees in 553 local school districts, 57 intermediate school districts, 7 state universities, 28 public community colleges, 58 public school academies, and 10 public library organizations. These entities make contributions supporting the benefits for their employees.

## A Primer on Retirement Benefit Funding

Most public employees are provided, as a part of their compensation packages, benefits designed to enhance their incomes following retirement. These benefits fall into two categories: 1) post-retirement income, or pensions, and 2) other post employment benefits, primarily health care insurance.

**Types of Pension Plans.** Pension benefits are either 1) defined by a formula usually based on employee compensation and length of service (“defined benefit”), or 2) determined by contributions to an employee account that are invested to provide a pool of assets available to the employee following retirement (“defined contribution”). In defined benefit plans, the benefit formula is controlling and the responsibility for assuring payment of the benefit falls on the employer. In defined contribution plans, the benefit is determined by the amounts contributed and the earnings on those contributions with the risk borne by the employee.

**Financing Pension Benefits.** In defined benefit plans, the fiduciary responsibility of the employer is to assure that assets are available to pay the benefits as they come due. One way of doing this is through **cash disbursement funding** (“pay-as-you-go”), in which the benefit is paid to retirees out of current revenues of the governmental unit. While this results in lower initial payments, those payments rise and eventually may make payment of the obligation unaffordable without increased taxes or reductions in other expenditure items. Moreover, pay-as-you-go financing shifts the burden of paying for the benefit forward to future generations, thereby artificially reducing the cost of providing services to those who receive them currently.

To avoid the problems associated with cash disbursement funding, most defined benefit plans use **advance funding** in which the employer makes contributions to a fund based on the future pension liability created as employees work and are paid. Actuarial determinations of the cost of benefits arising from current service (“normal cost”) are based on assumptions about factors that affect liability, such as life expectancy; rates of salary change; rates of departure from the work force before retirement; and patterns of timing of retirement. The contribution rate,

which takes these factors plus the return on investments into account, is computed as a level percent of payroll, which will continue unchanged as long as the assumptions made by the actuary are borne out by actual experience. This makes the annual contribution predictable and facilitates accurate financial planning.

To the extent that actual experience varies from the actuarial assumptions, there may be gains or losses to the pension fund. Frequently, those variances are attributable to ups and downs in the largely unpredictable markets in which the pension funds are invested. In addition, the contribution rate may be affected by such things as early retirement programs or changes in the pension benefit formula. To the extent that the contribution to cover normal costs turns out to be inadequate to cover the projected benefits, the accrued actuarial liability will exceed the assets in the fund, creating an **unfunded accrued liability**. In order to assure that the funds are available to pay benefits when they arise, actuarially determined contributions in addition to those necessary to cover normal costs must be made over a period of years, typically 30 or 40, to amortize the unfunded accrued liability.

The existence of an unfunded accrued liability is not, by itself, an indication of funding problems. The relationship between assets and accrued liabilities, the **funding ratio**, will vary over time and is generally not considered an indication of problems unless it is in long-term decline or is very low. A pension plan with a funding ratio of 70 percent, but growing, may be healthier than a fund with a ratio of 80 percent, but falling.

**Financing Other Postemployment Benefits (OPEB).** While advance funding is the norm for pension benefits, it is not the norm for other postemployment benefits, which are typically paid for on a cash disbursement basis. When first adopted by governmental units, retiree health care benefits amounted to only a few tenths of a percent of payroll and putting them on a pay-as-you-go basis appeared to be a manageable policy. These benefits now rival pension benefits in their cost and their funding is becoming a major fiscal problem. The arguments against cash disbursement financing and in favor of advance funding apply equally to pension and OPEB funding.

through the use of a five-year averaging technique intended to lessen year-to-year fluctuations in contribution requirements. The market decline will have an adverse effect on the contribution rate for pension benefits through FY2008.

- The costs of health care for retirees have risen rapidly, as is the case with group insurance rates for work-

ing employees in all sectors of Michigan's economy. Exacerbating the climb in health care costs is the rapid increase in the number of retirees since 1995, 36 percent in eight years compared with an increase of 11 percent in the number of active employees. From FY1995 through FY2003, the actual contributions for health care benefits for retirees increased at an annual rate of 12.7 percent.

## Health Care Benefits

MPSERS provides health, dental, hearing and vision care benefits to retired employees and their eligible dependents. For employees retiring before age 65, health benefits are provided by the system. Once a member of eligible dependent becomes Medicare eligible, the system

becomes secondary and coverage is coordinated with the Medicare program. The benefits are in the form of insurance coverage and the costs are financed by the employers on a pay-as-you-go basis. The contribution rate, as a percentage of active member payrolls, has been rising

**Table 1**

**Michigan Public School Employees Retirement System  
Unfunded Accrued Liabilities  
Health and Pension Benefits  
FY1985 through FY2003**

<b>Fiscal Year</b>	<b>Health Unfunded Accrued Liability (millions)</b>	<b>Pension Unfunded Accrued Liability (millions)</b>	<b>Pension Valuation Assets (millions)</b>	<b>Pension Funded Ratio (Percent)</b>
1985	\$1,488	\$1,928	\$7,559	79.7
1986	1,651	612	9,645	94.0
1987	1,723	310	10,930	97.2
1988	1,982	2,206	11,823	84.3
1989	2,586	1,411	12,791	90.2
1990	2,984	2,020	13,746	87.2
1991	3,787	3,379	14,653	81.3
1992	4,415	4,230	15,333	78.4
1993	5,338	4,700	16,999	78.7
1994	6,014	6,511	18,503	74.0
1995	6,568	6,947	20,455	74.6
1996	6,682	6,042	22,529	78.9
1997	NA	(259)	30,051	100.9
1998	NA	993	31,870	97.0
1999	11,040	253	34,095	99.3
2000	12,517	246	36,893	99.3
2001	13,802	1,375	38,399	96.5
2002	14,378	3,575	38,382	91.5
2003	15,706	6,043	38,726	86.5

NA – Not Available

Source: MPSERS Health Benefit and Pension Actuarial Valuations

steadily to 6.05 percent in FY2004 and will increase to 6.55 percent in FY2005. While pre-funding such benefits is not the norm, the current financing practice virtually insures continuing increases in the percentage into the foreseeable future.

Recently, the Governmental Accounting Standards Board (GASB) issued Statement 43 containing standards to improve post employment benefit plan reporting. The new standards require disclosure of liabilities for such retiree benefits as health insurance. (The State has reported the unfunded liability for MPERS health care for many years.) **Table 1** summarizes the steady rise in the unfunded liability. In FY1985 the unfunded liability totaled \$1.5 billion. At FY2003 year end the unfunded liability had in-

creased to \$15.7 billion and the percentage of payrolls necessary to amortize that liability over 33 years and to pre-fund future benefits was 15.4 percent of member payrolls. **Table 1** also includes data tracking the funding status of the system's pension benefits and the financially strong position resulting from pre-funding the benefits.

Rising health care cost pressure is likely to continue. Expenditures will also increase with the significant increases in the number of retirees receiving the benefits. The growth rate in the number retired will exceed the growth, if any, in the number of active members. It is likely the contribution rate for this component will rise each year and will overtake the basic pension benefit percentage by early in the next decade.

### Pension Benefit Funding

The Michigan Constitution requires that pension benefits be pre-funded and that any unfunded liability arising from adverse actuarial experience or benefit changes such as early retirement programs be amortized. Annual actuarial valuations establish the percentage of payroll necessary to fund the pension benefits. Most of the factors in the actuarial calculations are relatively stable. They include mortality, age patterns of retirement, and projected salary changes for active members. The system is in the process of reducing the amortization period to 30 years from its present 33 years. This change will add to contribution requirements in the next few years.

signed to reduce extreme year-to-year fluctuations in the computed assets used to determine the contribution percentage. The State resumed a five-year smoothing calculation after the 1997 calculation change. **Table 2** summarizes the pattern of smoothed gains and losses for the past six years.

Thus far, the change in the contribution percentage has been tempered by smoothing. In the two-year period FY2001 and FY2002 the market value of MPERS's portfolio dropped about \$10 billion as a result of a two-year market rate of return of minus-22 percent. This is

A factor that is subject to large annual fluctuations is the return on investment. That factor is assumed at 8 percent per year based on long-term trends in investment markets. While this assumption has worked fairly well over the long run, large fluctuations in the stock market can cause the contribution percentage to fluctuate as well, even if the long-term rate assumption is met.

In 1997, following several years of strong investment performance, the State reset the valuation assets in the system to current market value. This permitted capturing the strong market performance in the form of reduced contributions and an increase in the funding ratios of the system. Prior to 1997, the valuation assets were computed using a five-year smoothing calculation recognizing market values and deviations from the assumed rate of return (8 percent). The smoothing method was de-

**Table 2**

**Investment Gains (Losses) Applied in Valuations\***  
**Fiscal Years Ending 1998-2003**  
 (Dollars in Millions)

<u>Market Year</u>	<u>Investment Gains (Losses)</u>
1998	(\$ 5)
1999	497
2000	409
2001	(1,502)
2002	(1,384)
2003	296

\* One-fifth of Gains (Losses) in Each Year

Source: MPERS Actuarial Valuations

# FINANCING MICHIGAN RETIRED TEACHER PENSION AND HEALTH CARE BENEFITS

in contrast to the assumed increase of 8 percent per year from investments. The computed contribution rate for FY2004 reflects both FY2001 and FY2002 in the five-year average. This is the second year that both years of significant losses are reflected in the computed contribu-

tion rate. Since FY2001, the computed contribution rate has climbed from 6.48 percent of payroll to 9.74 percent. **Chart 1** indicates that the effects of the market downturn will continue to enter into the calculations through FY2008.

**Chart 1**

**Effects of the 2001 and 2002 Stock Markets  
Investment Smoothing Calculation  
Fiscal Years Used in Each Valuation**

Fiscal Year Contribution Rate Affected	Year of Market Performance				
	2001	2000	1999	1998	1997
2003	2001	2000	1999	1998	NA
2004	2002	2001	2000	1999	1998
2005	2003	2002	2001	2000	1999
2006	2004	2003	2002	2001	2000
2007	2005	2004	2003	2002	2001
2008	2006	2005	2004	2003	2002
2009	2007	2006	2005	2004	2003

<b>Losses</b>
<b>Gains</b>
<b>Future Years</b>

NA – Not Applicable

## Future Changes in Contributions

In order to assess future changes in contribution rates, it is necessary to separate health care from the basic pension benefits and make assumptions regarding each component of the rate. The key assumptions are as follows:

- Health care will continue to be financed on a pay-as-you-go basis. Savings resulting from changes in the health benefit plan approved by the MPSERS Board are expected to permit the FY2005 contribution rate of 6.55 percent to continue in FY2006.
- Although in principle the changes in Medicare benefits are likely to generate some savings for the system, no estimates are available at this time. While savings resulting from the changes will lower the contribution rates, the path of the increases in the contribution rate is not likely to be materially affected.
- After FY2006, total health care costs for existing and new retirees will continue to increase at approximately the annual rate of the last eight years (nearly 13 percent) through FY2008. These cost increases will be driven by increases in the number of retirees of about 3.5 percent per year and increases in the costs of insurance premiums averaging about 9.5 percent per year. After FY2008, it is assumed that the increases in premium costs will moderate to about a 7.5 percent rate.
- The investment portfolio will meet the actuarial assumption of 8 percent market value return on investments.
- All other actuarial assumptions will be met. Importantly, increases in the number retiring each year will add directly to health care costs.

### Health Care

If health care were pre-funded from FY2005 forward and the unfunded accrued liability amortized, the contribu-

tion rate would need to be more than 15 percent of payroll. The contribution rate on a pay-as-you-go basis has more than doubled since 1991. The rise will continue from the FY2005 and FY2006 percentages of 6.55 until the rate reaches 20 percent or more at the end of the next decade. **Chart 2** compares funding percentages under level versus pay-as-you-go calculations. The budgetary savings achieved by postponing contributions into the future may place future benefits at risk.

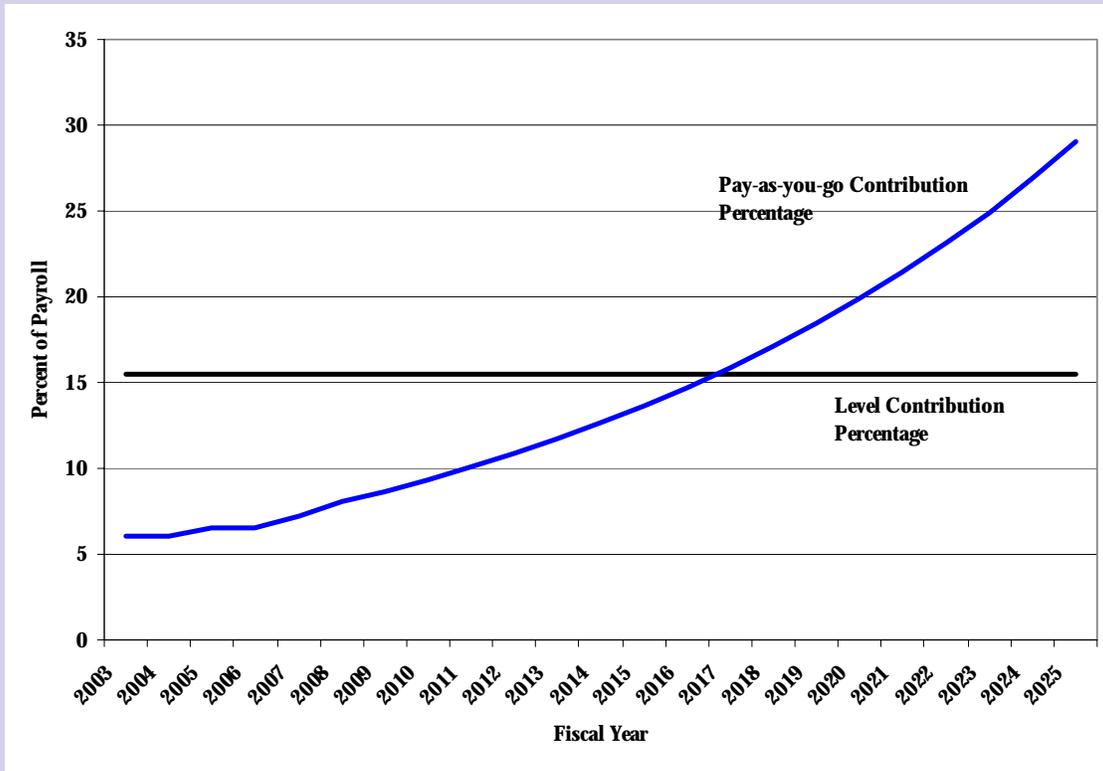
### Pension Benefits

If investments are assumed to generate market value returns of 8 percent each year, it will take several years before the portfolio returns to its pre market-downturn value, adjusted for other factors such as contributions and benefit payments. Even after a good market in 2003, the portfolio value is less than it was in 1999. The effects of the two bad market years will continue to adversely affect the contribution rate charged through FY2008.

### Projected Future Contribution Rates

Projecting contribution rates into the future carries some risk. Actuarial assumptions are just that: assumptions. Most of the assumptions involve factors that change gradually, such as life expectancy and the average age of employees who retire. But factors such as the performance of investments and benefit changes introduce more volatility into the calculations. Nonetheless, it is important to gauge the future changes in this important financial requirement affecting the budgets of all organizations whose employees are members of the system. Since the State has used reserves in the stabilization sub-account of the pension fund to postpone increases in the contributions, it is especially important to forecast the timing of increases that are already calculated and known, in addition to projecting future changes that will occur, assuming actuarial assumptions are achieved.

**Chart 2**  
**Retiree Health Care Benefits**  
**Level vs Pay-as-you-go Contribution Percentages**



## Combining the Pension and Health Benefit Rates

### Pension

In FY2004, the health and pension charge to employers has been 12.99 percent of payroll; 6.05 percent for health and 6.94 for pension. The planned contribution rate for FY2004-05 is 14.87; 6.55 percent for health and 8.32 percent for pension. In both years the rate charged reflects the use of reserves to hold the rate below the calculated level. About \$50 million of reserves will remain after FY2005. Use of those reserves in FY2006 could permit the contribution rate to be reduced for one year only by about .5 percent of payroll.

If the remaining reserves are used in FY2006, in FY2007 the pension rate will rise to the unsubsidized level and fully reflect the 2001 and 2002 investment performance

by FY2008. The unsubsidized rate for FY2005 will be about 10.1 percent of payroll, 1.7 percentage points above the rate that will be charged that year. In addition, the rate will climb in FY2006 through FY2008 as the stock market effects play themselves out.

It is important to note that favorable investment performance relative to the assumed 8 percent market return would lessen the increase in the contribution rate in the future and could cause it to decline. While returns such as those achieved in the later half of the 1990s are not likely, if the investments out-performed the assumption by 2 percentage points per year on average through the next eight years, the contribution rate could be as much as 2 percentage points lower.

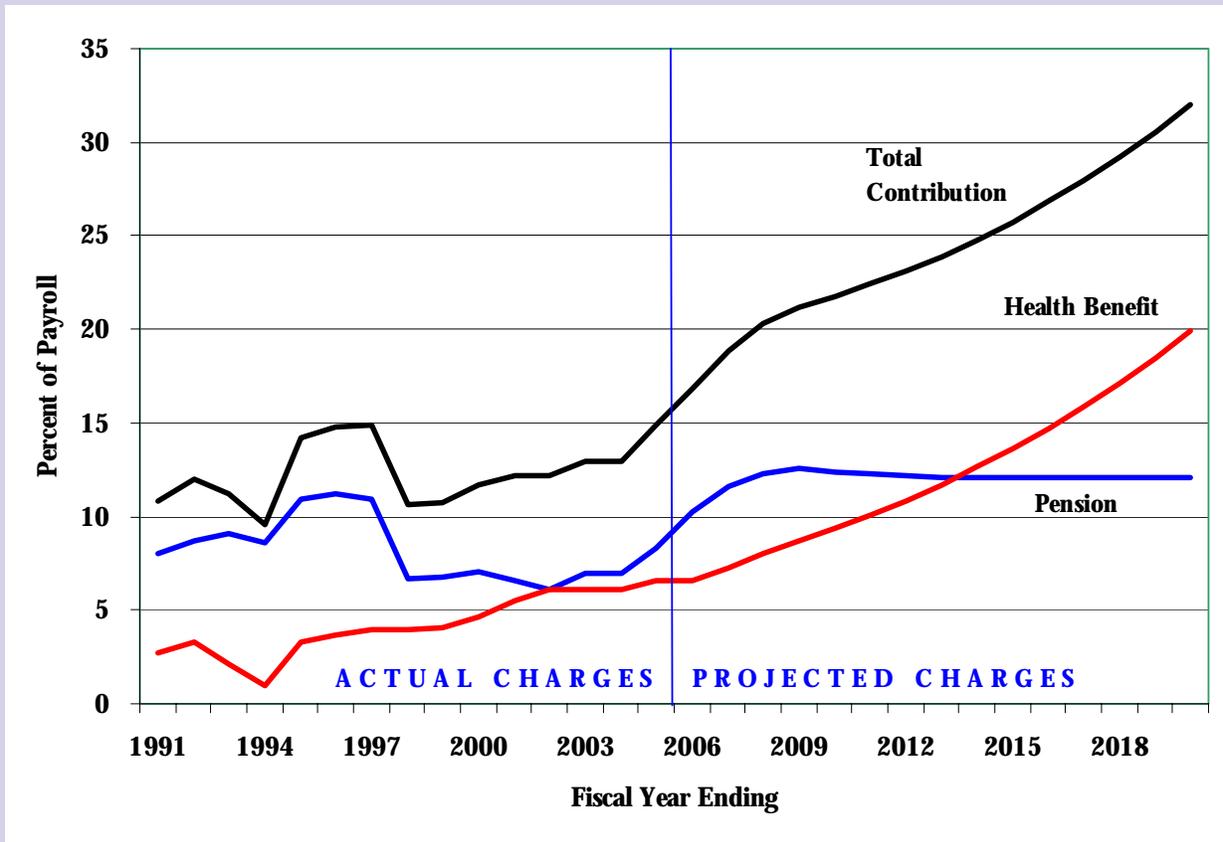
**Health**

Health benefit contributions will continue to increase well into the future under the current pay-as-you-go policy. If the annual rate of increase in total payments since 1995 persists, annual increases in the contribution rate will approach 1 percentage point of payroll by FY2015. Extending that trend beyond that timeframe assumes that the explosion in health care costs will not evoke a response at the national level to moderate the increases. But even with a lessening of the increases in health care costs, the numbers of new

retirees into the MPSERS will continue to drive expenditures higher. Beyond FY2008, an annual increase in total retiree health care expenditures is assumed to be 11 percent, adding roughly 0.7 percentage point each year to the contribution rate initially and building up in the future.

**Chart 3** and **Table 3** combine the projections for both the pension and health portions of the employer contribution rate. In the short term, the rate can be expected to rise from the 12.99 percent paid in FY2004 to more than 20 percent by FY2008.

**Chart 3**  
**MPSERS Contribution Rates**  
**Fiscal Years Ending 1991 through 2020**



# FINANCING MICHIGAN RETIRED TEACHER PENSION AND HEALTH CARE BENEFITS

**Table 3**

**Michigan Public School Employees Retirement System  
Actual and Projected Contribution Rates  
Regular Pension and Health Benefits  
Fiscal Years 1991 Through 2015**

	<u>Fiscal Year Ending</u>	<u>Regular Pension</u>	<u>Health Benefit</u>	<u>Total Percentage</u>
A C T U A L  C H A R G E S	1991	8.06	2.73	10.79
	1992	8.69	3.32	12.01
	1993	9.06	2.11	11.17
	1994	8.62	0.92	9.54
	1995	10.91	3.33	14.24
	1996	11.21	3.63	14.84
	1997	10.97	3.95	14.92
	1998	6.70	3.98	10.68
	1999	6.73	4.04	10.77
	2000	7.06	4.60	11.66
	2001	6.61	5.55	12.16
	2002	6.12	6.05	12.17
	2003	6.94	6.05	12.99
	2004	6.94*	6.05	12.99
	2005	8.32*	6.55	14.87
P R O J E C T E D  C H A R G E S	2006	10.2	6.6	16.8
	2007	11.6	7.3	18.9
	2008	12.3	8.0	20.3
	2009	12.5	8.7	21.2
	2010	12.4	9.3	21.7
	2011	12.3	10.1	22.4
	2012	12.2	10.9	23.1
	2013	12.1	11.7	23.9
	2014	12.1	12.6	24.8
	2015	12.1	13.6	25.8
	2016	12.1	14.7	26.8
	2017	12.1	15.9	28.0
	2018	12.1	17.1	29.2
	2019	12.1	18.4	30.6
	2020	12.1	19.9	32.0

Sources: Actual Rates: Through FY 2005, Michigan Public School Employees Retirement System

Projected Rates: After FY2005, CRC Calculations

\* Reflects subsidization from pension reserves. Unsubsidized rates would have been 8.37% in FY2004 and 10.1% in FY2005.

## Policy Options

### Pension Benefit

Michigan's Constitution provides that the pension benefits are a contractual obligation "which shall not be diminished or impaired." While the State has no options relative to paying for the pension benefits for current working and retired school employees, the system could be changed prospectively to a defined contribution plan for new employees. The State made this change for state employees beginning work on or after March 31, 1997 and offered employees working before the time of conversion the opportunity to transfer their defined benefit assets to the new defined contribution plan. Unlike a defined benefit plan where the employer has the obligation to provide a benefit, which is typically based on a formula related to the individual's compensation while working and the length of employment, a defined contribution plan typically is based on employer and often employee contributions that are usually calculated as a percentage of wages or salaries. Decisions on investment of the contributions are usually the responsibility of the employee and the investment assets are usually portable with ownership moving with the individual when job changes occur. The added flexibility for employees making employment changes carries with it the added risk of adverse investment performance, while the risk is borne by the employer in a defined benefit plan.

If annual contributions to a defined contribution plan are equivalent to those in a defined benefit plan, the assets available to pay benefits at the end of a typical 30-40 year teaching career will be unlikely to support an equivalent retirement income. The reasons for this are that: 1) a defined benefit plan can count on a certain number of employees leaving the system having earned little or no retirement income, yet having had contributions made on their behalf, while defined contribution assets are portable; and 2) investment decisions by employees tend to be more risk-averse. As a result, returns over a long period tend to be lower than those invested by a retirement system.

Other options that could be considered to reduce pension costs include:

- Lower the benefit itself for future employees. Retirees receive a benefit of 1.5 percent of their final aver-

age compensation times the number of years of service. The multiplier of 1.5 percent could be lowered for future employees thereby lowering costs. It should be noted, however, that a multiplier of 1.5 percent is relatively low when compared to municipal retirement systems.

- Exclude purchased service in determination of early retirement eligibility. Employees with 30 years of credited service may retire at age 55 with full pension and health benefits. Members participating in the Member Investment Plan (MIP) may retire at age 46 with 30 years of service. The 30 year service requirement may be met in part by purchasing years of service based on the actuarial cost of each year of purchased service. The number of years of service determining eligibility for early retirement could be increased to more than 30 years generating savings to the system.
- Raise employee contributions for pension. MIP participants make contributions to the system in exchange for enhanced benefits including cost of living adjustments during retirement. Contributions could be required for new employees for a portion of basic pension benefits thereby reducing employer costs.

### Health Care Benefit

Unlike the pension benefit, the health benefit apparently does not carry with it the same degree of legal protection provided in the Michigan Constitution. In February, 2004 the Michigan Court of Appeals found in *Alberta Studier v Michigan Public School Employees Retirement Board* that increases in prescription drug co-payments and deductibles were permissible. The Court specifically stated it could not rule that health benefits constitute "accrued financial benefits" under the Michigan Constitution "which shall not be diminished or impaired."

There are many ways, in theory, to reduce the future costs of health care coverage. One approach would be to shift from employer contributions to premiums paid by retirees. Employer costs could also be reduced by increasing co-pays for the insured and narrowing the array of covered benefits.

Another approach that has been considered in the past, but not implemented, involves the determination of eligibility for the health benefit. Currently, state law permits a public school employee to work as few as five full years to qualify for the full health benefit upon retirement. This is a very generous plan, since a short-time employee or a part-time employee can qualify for a benefit often worth more than the basic pension. In 1997, the State changed the determination of retiree health coverage for state employees so it is earned in increments of 3 percentage points per year of service for a retiree vested in the system. The employee must accumulate at least ten years of service to vest the health benefit. The result is that an employee working the full-time equivalent of ten years would receive a premium subsidy of 30 percent and a 30-year employee a subsidy of 90 percent. Basing the benefit on years of service would not only save money in the long run, but bring the health benefit into concert with the basic pension which rewards career service more than short-time employment. It is likely that a change like this would need to be prospective for new employees because of potential contractual considerations regarding present employees.

Finally, there are other approaches that could be used to address the future funding crisis in retiree health care:

- Begin pre-funding a portion of the benefit and allocate any excess contributions to pre-funding. Larger current contributions will lessen the contribution requirements in the future. If favorable experience occurs in system financing, the overall contribution rate could be maintained with any resulting savings dedicated to health care pre-funding.

- Fund part or all of the future costs through pension obligation bonds that would permit investing bond proceeds in equities earning long-term rates exceeding interest rates on the bonds. Over a period of years, the system could sell bonds and invest the proceeds in equity investments earning greater returns than the bond rates. This approach could make significant inroads in the unfunded liability over a period of many years. There are risks involved, however. Although equities have out-performed bonds over the long run in the past, there is no guarantee that they will out-perform bonds in the future.
- Require active employees to make a contribution for a portion of retiree health care. The contributions could be earmarked to finance the costs of benefits for future retirees.
- Require that the cost of any years of service purchased by active employees include the future cost of health care. Currently, when an employee retires early, additional health benefit costs are created. When purchased service credit is used to reach the minimum years of service, the purchased credit could be calculated to include the added health costs.

The financial difficulties caused by health care coverage in MPERS are symptomatic of the health care finance crisis in the country. As the costs of health care claim larger and larger shares of the economic activity in the country, pressures for national health care are building in some quarters. It is possible that a national response to this issue may occur before the MPERS contribution rate for health care becomes unaffordable.

## Conclusion

The outlook for MPERS contributions and the effect on school district budgets is decidedly gloomy. Employer contributions for pension and retiree health benefits were roughly 9 percent of local school district budgets in FY2003. In that year, the contribution rate was 12.99 percent of payroll. If the projections in this report materialize, the contribution rate in FY2008 will be over 50 percent higher (20 percent of payroll) than in FY2003 and FY2004. Even if the economy grows enough to gen-

erate 4 percent increases in School Aid Fund revenues in FY2006 through FY2008 (about \$500 million per year), the increase in MPERS contributions will claim about 40 percent of the increased revenues. This amounts to about \$200 million per year and about \$125 per pupil each year. Combining this projection with the likely continuing significant pressure on health insurance premiums leaves little room for growth elsewhere in school budgets.