Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1227 (S-11), (H-9), and (CR-1)
Sponsor: Senator Jud Gilbert, II
Committee: Appropriations

CONTENT

The following information summarizes what was contained in the Senate- and House-passed versions of Senate Bill 1227, and what is contained in the Conference Report.

Senate Bill 1227 would enact numerous amendments to the Michigan Public School Employees' Retirement System (MPSERS), as outlined below.

Retirement Incentive for MPSERS Employees
Background: Currently, MPSERS employees have to be age 55 with 30 years of service, age 60 with 10 years of service to be eligible to retire, or may retire at any age with 30 years of service for persons in the Member Investment Plan. Under current law, the pension multiplier is 1.5%.

Senate: The Senate did not include a retirement incentive.

House: In addition to currently-eligible employees, the House bill also would allow employees to be eligible to retire if they had a combined age and years of service totaling 80 (as of August 31, 2010), if they retire between June 15 and October 1, 2010.

House: The bill would provide a 1.7% multiplier in the pension formula for a person who retires between June 15 and July 1, 2010, and a 1.6% multiplier for a person who retires after July 1 but by October 1, 2010. A member's pension is calculated by multiplying years of service by the pension multiplier by the final average compensation (FAC). Under the House bill, a person retiring with a 1.7% multiplier would see a 13.3% increase in their pension, and a person retiring with a 1.6% multiplier would see a 6.7% increase. The bill also would cap the FAC of any member retiring under the incentives at $114,000.

House: The bill would allow for extensions to be requested, for an employee to remain working until July 1, 2011. The extensions would have to be approved by the State Superintendent of Public Instruction. Also, the bill would require the additional costs to the pension system created by the increased multiplier and early out to be amortized over a five-year period.

Conference: The Conference Report provides a 1.6% multiplier for employees currently eligible to retire, and a 1.55% multiplier for employees who have a combined age and years of service totaling 80, if they retire between July 1 and September 1, 2010, and would be eligible to retire by August 31, 2010. The Final Average Compensation would be capped at $90,000 under the enhanced multipliers; any higher FAC would be part of the pension calculation, but at the 1.5% multiplier.

One extension (for a retirement date no later than September 1, 2011) per reporting unit would be allowed, if requested by the employer and employee, and another 2,500 of retiring employees could be granted an extension, with the ORS distributing the additional 2,500 extensions on a pro-rata basis. Pension costs would be amortized over a five-year period.

Increased Employee Contributions

Background: Employees in the Basic Plan (hired before January 1, 1990) currently pay nothing for retirement; employees hired before January 1, 1990, who switched to the Member Investment Plan (MIP) currently pay 3.9% of salary toward their retirement; employees hired after July 1, 1990, and before July 1, 2008, currently pay $510 annually plus 4.3% of salary above $15,000; and employees hired after July 1, 2008, currently pay $510 annually plus 6.4% of salary above $15,000.

Senate: Effective with the first pay date after July 1, 2010, this bill would increase employee contributions to the retirement system by three percentage points, except for those hired after July 1, 2008, whose contribution would increase by 0.9 percentage point. As a result, all Basic Plan members would pay 3% of salary, and all other employees would pay $510 annually plus 7.3% of salary above $15,000 (except those who switched from the Basic Plan to MIP, who would have to pay 6.9% of salary).

Senate: The bill specifies that the required contributions would have to be used to fund benefits for service credit earned after October 1, 2010, and could not be used to fund unfunded liability for accrued benefits earned by members before October 1, 2010. In addition, if an employee did not make the required contributions or if the payments made by an employee were subsequently refunded (e.g., by a court order), then the employee would not earn service credit during the period of time contributions were made.

House: Beginning October 1, 2010, the bill would require all MPSERS employees to contribute 3% of their compensation into a funding account, specified as an irrevocable trust established under House Bill 4073 (the Public Employee Retirement Health Care Funding Act). Funds deposited into the irrevocable trust could be used to pay for retirement health care benefits for retirees and their eligible dependents now or in the future. The bill would determine and credit regular interest for employee contributions paid into the trust in the same manner as interest amounts for the MIP.

Conference: Starting on July 1, 2010, all employees in MPSERS will contribute 3% of salary (in addition to any pre-existing pension contributions) into a funding account, defined as an appropriate irrevocable trust established under House Bill 4073. However, employees who worked and made less than $18,000 in 2009-10 or new employees who are expected to make less than $18,000 in the 2010-11 school year will contribute 1.5%, rather than 3% during that school year, increasing to 3% yearly thereafter.

Hybrid Plan for New Employees

Senate: Employees first hired on or after July 1, 2010, would be placed in a new "hybrid" pension plan, with a blending of defined benefit (DB) and defined contribution (Tier 2) components. A person under this plan would not be able to receive pension payments until age 60, and would be required to have worked at least 10 years as a public school employee. The purchase of service credit by these employees would be prohibited, and cost of living adjustments to the pension would not be provided. The employee would have to contribute $510 annually plus 7.3% of salary above $15,000, in addition to the Tier 2 contributions described below.

Senate: An employee under this plan would have to contribute 2% of salary to his or her Tier 2 account, unless affirmatively electing not to contribute or to contribute a lesser amount. The employer would have to match 50% of the employee's first 2% of salary contribution, for a maximum total employer payment of 1% of salary deposited into the Tier 2 account. This would be in addition to the employer cost for the DB pension of this employee. The employee would be allowed to contribute more than 2% of salary, but the employer would not match more than 1%, unless choosing to do so under a locally negotiated agreement. An employee described here would be immediately vested in his or her own contributions, and would vest in employer contributions as follows: 25% after two years of service, 75% after three years of service, and 100% after four years of service.

Senate: The DB side of this hybrid plan would use a nine-year period on which to calculate the final average compensation (FAC), likely generating a lower FAC than is in current law. (For Basic Plan members, the time frame is five years; for MIP members, the time frame is three years.) Also, under this plan, the actuary would be required to assume a 7% rate of return on the investments in the portfolio (rather than the 8% rate under current law). The actuary could determine a different employer contribution rate for these members.

House: The House did not include a hybrid plan for new employees.

Conference: The Conference Report concurred with the Senate's version of the hybrid plan, except a five-year period will be used on which to calculate the FAC, rather than the Senate's nine-year period. Employees in the hybrid (hired on or after July 1, 2010) will contribute $510 annually plus 6.4% of salary above $15,000, in addition to the Tier 2 contributions, in addition to the 3% contributions to the health care trust fund. Any entity receiving full or partial, direct or indirect funding from the School Aid Fund, and not participating in MPSERS, may opt into the hybrid retirement plan for its employees, upon approval by the Internal Revenue Service. In addition, existing MPSERS employees hired before July 1, 2010 (i.e., not part of the hybrid plan) may opt into DC component of the hybrid plan without an employer match. Hybrid plan employees may contribute more than 2%, and employers may locally negotiate higher matches than the required 1%, not to exceed a total match of 3% (for an employee contribution of 6%). However, any additional employer match beyond 1% is at the discretion of the employer, and is decided annually. An employer or may negotiate matches for non-hybrid employee contributions

<u>Third-Party Contracted Employees</u>
Background: Currently, members who retire and begin drawing pensions but then return to work can avoid the earnings limitations in statute if they return to work as contractual employees, using a third-party employer. The employer also does not have to pay contributions to the MPSERS system for these employees. In addition, current law does not require charter schools or any third-party contracted employees to be part of MPSERS.

Senate: The Senate bill would require employees who have retired and returned to work under contract by a third party to pay a portion of their salary to MPSERS equal to the percentage paid by the employer for retiree health care (currently 7.25% of pay).

House: The House bill would require charter schools to become part of MPSERS. Also, anyone working in a reporting unit or employer who is employed by a third party would become an employee of MPSERS. This would mean that the reporting unit would have to pay the contribution rate on the wages of all persons working in a reporting unit, even if they are employed by a third party, except in certain limited circumstances. However, this would not include a charter school employee who receives retirement benefits under the Optional Retirement Act.

House: The House bill would require that a retiree who returns to work at a reporting unit remit the entire MPSERS contribution rate multiplied by their wages, deducted from their pension allowance.

Conference: Charter schools will not be required to join MPSERS. New retirees who draw a pension and return to work directly for a MPSERS reporting unit will remain subject to the current earnings limitation cap (roughly 1/3 of final average compensation), meaning they can draw a pension and health care and earn a salary equal to roughly 1/3 of their FAC. However, if a retiree working directly for a reporting unit exceeds that earnings cap, then the retiree shall forfeit pension and retiree health care, until the retiree ceases employment. New retirees that return to work indirectly (either via a 3rd party or as an independent contractor) would have their pension and retiree health care suspended (i.e., not provided) for the period of time they are performing core services.

<u>Phased Retirement Option</u>
Senate: The Senate did not include a phased retirement option.

House: The House bill includes an option for retirees at least age 60 to retire, draw their pension, and return to work part-time without financial penalty. An employee utilizing this provision would have to reduce the number of hours worked by 50% and work no more than 1,040 hours. The option could be renewed annually, but could not exceed three years, and would have to be approved by the employer.

Conference: The Conference Report did not include a phased retirement option.

<u>Retirement Rate Charged to Employers</u>
Background: The fiscal year 2009-10 rate that employers have to pay to the MPSERS is 16.94% of total payroll. The Governor's proposed K-12 budget for fiscal year 2010-11 included a MPSERS rate of 19.41%, along with language stating that the rate may decline if retirement reforms are enacted.

Senate: The Senate bill mandated the FY 2010-11 MPSERS rate charged to employers to be no more than 17.08%.

House: The House did not include a MPSERS rate.

Conference: The Conference Report does not include an FY 2010-11 MPSERS rate. The rate will depend upon the actual dollars coming in from the 3% employee contributions for retiree health, and on the number of employees who retire with an incentive under this legislation, since the additional retirees will generate extra retiree health and pension costs, and the payroll base will be smaller due to the retirements.

<u>Reporting Unit Requirements</u>
Background: Currently, each reporting unit or employer is required to forward both employer and employee contributions to MPSERS monthly. Also, current law requires quarterly affidavits certifying aggregate reportable compensation, sources of contributions, and Federal wages, along with annual reports listing persons employed with salary, service, and contributions.

Senate and House: The reporting would change from monthly to a manner determined by the retirement system. The employer reports would be required every pay period. A fee of not less than $25 and interest charges of not less than 6% if errors weren't corrected prior to discovery by the retirement system, or found to be intentional.

Conference: The Conference Report includes the language found in the Senate and House versions of SB 1227.

<u>Appropriations to Office of Retirement Services:</u>
Senate: Appropriated $2.0 million to ORS for implementing the statutory changes.
House: Appropriated $4.5 million to ORS for implementing the statutory changes.

Conference: Appropriates $4.5 million to ORS for implementing the statutory changes.

<u>Tie-Bar</u>
House: tie-barred the bill to House Bill 4073, the Public Employee Retirement Health Care Funding Act.

Conference: tie-bars the bill to House Bill 4073, the Public Employee Retirement Health Care Funding Act.

MCL 38.1304 et al.

HOUSE AND SENATE FISCAL AGENCIES ESTIMATE OF FISCAL IMPACT OF CONFERENCE REPORT

See attached table. The Conference Report includes an increase in the pension multiplier from 1.5% to 1.6% for people already eligible to retire, and allows an "early out" for people with a combined age and years of service equal to 80, with a pension multiplier of 1.55%. At an assumed participation rate of 50%, the estimated cost of these provisions is $2.2 billion, distributed over the next six years, but would be partially offset by wage and replacement savings of an estimated $1.7 billion, leaving a net cost of the incentive estimated at $500 million over 10 years. This analysis assumes that 50% of eligible employees would take the incentive and retire with the enhanced multipliers, that 90% of employees would be replaced (compared to the current 95% average replacement), and that wage savings would accrue during the years these people otherwise would have worked.

Requiring all employees to pay 3% of salary toward retirement health care will create savings for employers, because these employee contributions will be used to help pay for current-year retiree health care costs, and will reduce the employer contribution rate compared to what it otherwise would have been. The estimated employee contributions total $300.0 million in the first year, and $3.5 billion over 10 years.

The revised hybrid plan is estimated to save $1.2 million in the first year, and $129.4 million over 10 years.

The combined effects of the three components described above (3% employee contributions to support current retiree health care costs, pension incentive, and hybrid plan for new employees) are estimated to save schools and other MPSERS reporting units $679.6 million in the aggregate for FY 2010-11, totaling an estimated $3.15 billion over 10 years. These savings will vary from employer to employer, and will depend upon the number of additional people who retire because of the incentive, and the wage and replacement decisions made by schools. At the extreme ends of the scale, a school with no retirees could see additional costs during the first six years (which would pay for the enhanced incentives provided to retirees), while a school with large numbers of retirees who aren't replaced could see substantial savings, even after netting out the extra cost of the incentives.

Local savings in the initial years will not be effected via a lower MPSERS contribution rate, because the pension system will have to pay for the enhanced multiplier and the early out. In fact, the contribution rate likely will increase in the short term, above what it otherwise would have been. Instead, the local savings in the initial years will be driven entirely by local decisions: employees retiring (or not) and the wage and replacement decisions made by the employer. Once the costs of the enhanced multiplier and early out have been paid for (by FY 2016-17), the MPSERS contribution rate should be around three percentage points lower than what otherwise would have occurred, without these changes in law. This occurs because of the increased employee contributions to the system, and the introduction of the hybrid plan for new hires, both of which lower the cost to employers, via the MPSERS contribution rate.

Date Completed: 5-13-10 Fiscal Analyst: Kathryn Summers

School Employee Pension Reforms: 10-Year Estimated Savings Analysis of S.B. 1227 (CR-1)
(in millions)

	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20	Cumulative Savings TOTAL
Increase employee contribution rate savings	$300.0	$310.6	$321.4	$332.6	$344.2	$356.4	$368.7	$381.6	$395.1	$409.1	$3,519.7
Revised hybrid plan for new employees savings	1.2	4.0	6.5	8.9	11.3	13.8	16.5	19.4	22.4	25.4	129.4
Retirement incentive – pension cost	0.0	(251.5)	(251.5)	(251.5)	(251.5)	(251.5)	0.0	0.0	0.0	0.0	(1,257.5)
Increased health care costs on pension system	(295.0)	(295.0)	(295.0)	(100.0)	0.0	0.0	0.0	0.0	0.0	0.0	(985.0)
Wage savings	673.4	530.6	375.8	163.6	0.0	0.0	0.0	0.0	0.0	0.0	1,743.4
Estimated Gross Savings	**$679.6**	**$298.7**	**$157.2**	**$153.6**	**$104.0**	**$118.7**	**$385.2**	**$401.0**	**$417.5**	**$434.5**	**$3,150.0**

Source: House and Senate Fiscal Agencies

Assumptions:
--50% participation rate
--90% replacement rate
--Wage savings accrue only during years retirees otherwise would have remained working

Floor\sb1227 (S-11)
This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.