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 (Substitute S-6 as reported)
Sponsor: Senator Jud Gilbert, II
Committee: Appropriations

CONTENT

Senate Bill 1227 (S-6) would enact numerous amendments to the Michigan Public School Employees' Retirement System (MPSERS), including:

-- Increased employee contributions.
-- Capped years of service in defined benefit plan/transfer to new defined contribution plan after 30 years.
-- New hybrid pension plan for employees first hired on or after July 1, 2010.
-- Elimination of dental and vision coverage for members retiring on or after October 1, 2010.
-- Phased retirement option for members retiring after June 30, 2010.
-- A requirement that retirees pay a percentage of salary toward health care costs, if re-hired as a contracted employee, equal to the percentage of their payroll employers contribute toward retiree health costs.

Increased Employee Contributions
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.

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 to MIP, who would have to pay 6.9% of salary).

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, then the employee would not earn service credit during the period of time contributions were made.

Capping Years of Earned Service at 30

Employees first reaching 30 years of earned service credit on or after October 1, 2010, would be prohibited from accumulating more than 30 years of earned service credit toward the calculation of their pension allowance. This would not include purchased service credit, which could be counted toward the pension calculation. After working 30 years, an employee would become a member of the defined contribution (DC), or Tier 2, plan for additional years. The bill would require the retirement system to determine the method and time frame for participation in Tier 2. This section would not apply to employees hired after July 1, 2010.

When an employee reached 30 years, the earned service would be capped at 30 (or, for people with more than 30 on the bill's effective date, the number of years earned at that time), and the employee would be moved into a DC plan for any additional years worked. The employer would contribute 4% of the employee's salary to the employee's Tier 2 account, and would match up to 3% of the employee's contribution to the Tier 2 account. Therefore, the employer could be required to pay a maximum of 7% of salary for this person for as long as the employee worked the additional years past 30 and remained an active employee, if the employee contributed 3% of salary. The employee would have to affirmatively elect not to contribute or to contribute less than 3% of salary for that lesser amount to be effective. The employee would be allowed to contribute more than 3% of salary, but the employer would not match more than 3%, after the initial 4% employer contribution to the Tier 2 account. An employee described here would be immediately vested in both his or her own contributions to the DC account, and in any employer contributions to the account.

The actuary would not reduce the employer contribution rate for these members when they exceeded 30 years of service; rather, these employer contributions would be deposited into a reserve for employer contributions. In other words, the actuary would determine the expected DC contributions and build those costs and capped earned service savings into the overall MPSERS employer contribution rate.

An employee going beyond 30 years of service would be able to count any salary adjustments made during those additional years in his or her computation of final average compensation.

New Hybrid Plan

Employees 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 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. 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.

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%. 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.

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.

Elimination of Vision and Dental Coverage

Currently, retirees under MPSERS have to pay 10% of the monthly premium for dental, vision, and hearing benefits, and the retirement system pays the remaining 90% of the cost. This bill would eliminate all dental, vision, and hearing benefits for anyone retiring on or after October 1, 2010. Therefore, retirees would pay 100% of the cost of vision, dental, and hearing benefits. Employees retiring before October 1, 2010, would receive these benefits, with the State paying 90% of the cost as in current law. Any employee retiring after October 1, 2010, could participate in the dental or vision coverage offered by the retirement system, but at his or her own cost, currently about $35/month for a retiree, or about $70/month for a retiree plus spouse to cover the cost of both plans.

Third-Party Contracted Employees

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 a contracted employee, using a third-party employer. The employer also does not have to pay contributions to the MPSERS system for these employees. This bill would require such contracted employees 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).

Phased Retirement Option

Members retiring after June 30, 2010, who are at least age 60 would be allowed to work up to one-half time and draw a pension at the same time. To be eligible, the retiree would have to have worked at least half of a year in each of the five years before retirement, leave service on or after June 30, 2010, be at least 60 years old, and meet the requirements to earn a retirement allowance. After retirement, the allowable work schedule could be not more than 50% of the previous hours worked, and would have to commence within three months following retirement. The State Superintendent of Public Instruction and the Retirement Board could discontinue these postretirement option positions beginning July 1, 2011. The employer would have the sole discretion to determine if, and the extent to which, a postretirement option position would be made available. Each position would be for a period not to exceed one school fiscal year, but could be renewed annually for up to three years total, at the discretion of the employer. Additional service credit would not be earned during this postretirement period.

Other Changes

The bill proposes numerous other changes, including:

-- Setting the interest rate of return on the DB portion of the hybrid between 0% and 7%.

-- Changing the reporting of contributions from monthly to a schedule and manner determined by the retirement system, and providing for penalties for intentional errors made or unintentional errors not corrected.

-- Providing for the drawing of Tier 2 accumulated balances, and providing that DC distributions would be exempt from State, county, municipal, or other local tax.

-- Appropriating $4.5 million to the Office of Retirement Services for administration of the changes outlined in this legislation. The appropriation would be a work project, with an estimated completion date of September 30, 2011.

MCL 38.1304 et al.

FISCAL IMPACT

The proposed long-term reforms would have the following fiscal impact:

MPSERS Proposals for Existing Employees

- **Increase Employee Contribution to Pension.** The State Budget Office (SBO) analysis indicates that increasing employee contributions would provide local savings to employers of $207.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $2.4 billion. The Senate Fiscal Agency (SFA) analysis uses the figures estimated by the SBO for this portion of the proposal.

  For this proposal and the two described below, the only way the savings estimated by the SBO could be achieved for employers (K-12 districts, intermediate school districts, community colleges, and participating universities, charter schools, and libraries) in FY 2010-11 would be to lower the already-published employer contribution rate from 19.41% to a rate that would reflect the increased employee contributions. In future years, the reforms would reduce the MPSERS employer contribution rate that otherwise will occur, though in the near term the rate likely would continue to increase due to relatively recent investment losses in the stock market.

- **Cap Years of Service in Pension System at 30/Transfer to DC Plan Thereafter.** The SBO analysis indicates this would provide local savings to employers of $41.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $479.0 million. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

- **Eliminate Retiree Dental/Vision Savings.** The SBO analysis indicates this would provide local savings to employers of $1.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $206.4 million. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

MPSERS Proposals for New Hires

The bill would make substantial changes for members first hired after July 1, 2010, in addition to the elimination of dental and vision care and the capping of service credit at 30 years, detailed above. The proposal includes:

- **Hybrid Defined Benefit/Defined Contribution for New Hires.** The SBO analysis indicates this would provide local savings to schools of $3.9 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $410.6 million. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal; however, the numbers are likely to be revised downward due to lowering the pension drawing age to 60 from the original 65 years.

TOTAL LONG-TERM SAVINGS FROM REFORMS

The SBO estimates that the long-term reforms would produce FY 2010-11 savings of $252.9 million and 10-year savings that total $3.5 billion. The SFA analysis would concur with these estimates produced by the Budget Office in conjunction with the State's actuary.

The table on the following page illustrates the components of the analysis.

School Employee Pension Reforms: 10-Year Savings Estimates of S.B. 1227 (S-6)
(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
Eliminate retiree dental/vision savings	$1.0	$5.0	$8.9	$13.1	$17.3	$22.1	$26.9	$32.0	$37.3	$42.8	$206.4
Increase employee contribution rate savings	207.0	214.3	221.8	229.5	237.5	245.9	254.4	263.3	272.6	282.2	2,428.5
Hybrid plan for new employees savings	3.9	12.8	20.5	28.1	35.8	43.8	52.2	61.7	71.2	80.6	410.6
Cap DB enrollment at 30 yrs - savings	41.0	42.0	44.0	45.0	47.0	48.0	50.0	52.0	54.0	56.0	479.0
Gross Savings	**$252.9**	**$274.1**	**$295.2**	**$315.7**	**$337.6**	**$359.8**	**$383.5**	**$409.0**	**$435.1**	**$461.6**	**$3,524.5**

Date Completed: 3-25-10 Fiscal Analyst: Kathryn Summers