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BILL ANALYSIS



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Senate Bill 1227 (Substitutes S-11 and H-9)
Sponsor: Senator Jud Gilbert, II
Senate Committee: Appropriations
House Committee: Oversight and Investigations

Date Completed: 4-28-10

CONTENT

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

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, or age 60 with 10 years of service to be eligible to retire, or they may retire at any age with 30 years of service if they are in the Member Investment Plan. A member's pension is calculated by multiplying years of service by the pension multiplier by the final average compensation (FAC). The current pension multiplier is 1.5%.

Senate: The Senate substitute does not include a retirement incentive.

House: The bill also would allow employees to be eligible to retire if they have a combined age and years of service totaling 80, 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 person retiring with a 1.7% multiplier would see a 13.3% increase in his or her 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.

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 proposed 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.

New Hybrid Plan

Senate: 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 (DC or 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. 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%. The employee 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, 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 substitute does not include a hybrid plan for new employees.

Third-Party Contracted Employees

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.

Senate: The Senate substitute would require such contractual employees (who have retired and returned to work under contract) 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 substitute 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 a member of MPSERS. This would mean that the reporting unit would have to pay the contribution rate on the wages of all people 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 substitute would require that retirees who return to work at a reporting unit remit the entire MPSERS contribution rate multiplied by their wages, deducted from their pension allowance.

Phased Retirement Option

Senate: The Senate substitute does not include a phased retirement option.

House: The House substitute includes an option for retirees to retire, draw their pension, and return to work part-time without financial penalty. An employee using 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.

Retirement Rate Charged to Employers

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

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

House: The House substitute does not include a MPSERS rate.

Reporting Unit Requirements

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 people employed with salary, service, and contributions.

Senate and House: The reporting would change from monthly to a manner determined by the retirement system. The quarterly affidavits would be required every pay period. A fee of not less than \$25 and interest charges of not less than 6% would be imposed if errors were not corrected before discovery by the retirement system, or were found to be intentional.

Appropriations to Office of Retirement Services:

Senate: Appropriates \$2.0 million to ORS for implementing the statutory changes.

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

Tie-Bar

House: Tie-barred the bill to House Bill 4073, the proposed Public Employee Retirement Health Care Funding Act.

MCL 38.1304 et al.

SENATE FISCAL AGENCY ESTIMATES OF FISCAL IMPACT

Senate: See attached table. 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 SBO analysis indicates the new hybrid DB/DC pension plan would provide local savings to employers of \$3.9 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save \$410.6 million. However, the numbers are likely to be revised downward due to lowering the pension-drawing age to 60 from the originally proposed 65 years.

The only way these savings 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 and hybrid plan for new employees. Therefore, the Senate substitute also would require the employer contribution rate to be no more than 17.08% in FY 2010-11. 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.

Combined, the changes in the legislation are estimated to save employers \$211.0 million in FY 2010-11, and after 10 years, the estimated savings total \$2.8 billion.

House: See attached table. The House substitute includes an increase in the pension multiplier from 1.5% to 1.7%, and would allow an "early out" for people with a combined age and years of service equal to 80. At an assumed participation rate of 70%, the estimated cost of these provisions is \$5.1 billion, distributed over the next six years, but would be partially offset by wage and replacement savings of an estimated \$2.9 billion, leaving a net cost of \$2.2 billion. This analysis assumes that 70% of eligible employees would take the incentive and retire at the 1.7% multiplier (rather than waiting and retiring with the 1.6% multiplier), that 90% of employees would be replaced (compared with 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 could create savings for employers, but only if the increased employee contributions were used to reduce the employer contribution rate instead of "locking up" the employee contributions as a means to begin prefunding retiree health care. The attached table assumes that the employee contributions would result in employer savings, but this is not guaranteed. The estimated employee contributions total \$300.0 million/year, or \$3.0 billion over 10 years.

Requiring employers to pay the MPSERS contribution rate on wages paid to third-party contracted employees would increase costs for employers that have a significant portion of wages in contracted services (including charter schools, for example), but likely would create statewide savings to all employers by adding funds to the pension system and potentially reducing the retirement contribution rate.

Senate and House: Requiring retirees who came back as contracted employees to pay a portion of their wages into the retirement system would create savings (relatively small) to the system as a whole.

Senate and House: The Senate substitute would appropriate \$2.0 million to the Office of Retirement Services for implementation; the House substitute would appropriate \$4.5 million.

Fiscal Analyst: Kathryn Summers

**School Employee Pension Reforms: SFA Analysis of 10-Year Savings Estimates in Senate-Passed Version of SB 1227
(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	\$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
Gross Savings	\$210.9	\$227.1	\$242.3	\$257.6	\$273.3	\$289.7	\$306.6	\$325.0	\$343.8	\$362.8	\$2,839.1

Source: Senate Fiscal Agency

**School Employee Pension Reforms: SFA Analysis of 10-Year Savings Estimates in House-Passed Version of SB 1227
(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
3% employee contribution retiree health care	\$300.0	\$300.0	\$300.0	\$300.0	\$300.0	\$300.0	\$300.0	\$300.0	\$300.0	\$300.0	\$3,000.0
Retirement incentive – pension cost	\$0.0	(\$707.0)	(\$707.0)	(\$707.0)	(\$707.0)	(\$707.0)	\$0.0	\$0.0	\$0.0	\$0.0	(\$3,535.0)
Increased health care costs on pension system	(\$413.0)	(\$413.0)	(\$413.0)	(\$413.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$1,652.0)
Wage and replacement savings	\$881.4	\$786.2	\$687.6	\$585.5	\$0	\$0	\$0	\$0	\$0	\$0	\$2,940.7
Gross Savings	\$768.4	(\$33.8)	(\$132.4)	(\$234.5)	(\$407.0)	(\$407.0)	\$300.0	\$300.0	\$300.0	\$300.0	\$753.7

Source: Senate Fiscal Agency

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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.