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SCHOOL RETIREES: ADD INSURANCE

House Bill 4433 as enrolled
Second Analysis (11-22-89)
Sponsor: Rep. Justine Barns

House Bill 4466 as enrolled
Third Analysis (11-22-89)
Sponsor: Rep. Wilfred Webb

House Committee: Senior Citizens and Retirement
Senate Committee: Judiciary

THE APPARENT PROBLEM:

Public Act 91 of 1985 virtually overhauled the Public School Employees Retirement System (PSERS), extending to retired school employees many of the benefits enjoyed by retired state employees. There are a number of issues, however, that many believe should now be addressed, particularly issues that relate to the lack of dental, vision, and hearing benefits for retirants and their beneficiaries, the purchase of service credit by members, members' participation in the Member Investment Plan, and the eroding effects of inflation on retirement allowances. These concerns are discussed in more detail below:

Dental, Vision, and Hearing Benefits. PSERS does not pay for dental, vision, and hearing benefits, nor does it offer those benefits at the retirant's own cost. Many older retirees, especially those who have been retired for some time, report that the purchase of these benefits takes up a disproportionately large portion of their income. Some retirees are angry because their "13th checks" are spent on these expenses. Many people believe that dental, vision, and hearing insurance coverage, similar to that provided retired state employees, could be granted to public school retirees.

Purchase of Service Credit. The Public School Employees Retirement Act allows members, under certain circumstances, to purchase service credit for various types of public employment or for periods of time that cause interruptions or delays in public school employment. Members may purchase service credit for time spent in the military, for parental leave, for employment with the federal government, out-of-system public education employment, and sabbatical leave, for example. The formula used to compute member compensation for service credit purchase varies from option to option, but generally members are required to pay into the retirement system, for each year purchased, a specified amount, usually based on the actuarial cost, an amount equal to a certain percentage of the member's full-time compensation for the school fiscal year in which payment is made, or an amount equal to the amount he or she would have contributed under a member contribution schedule. For the purposes of computing payment, the act specifies that the compensation amount used shall not be less than the highest school fiscal year compensation previously received by the member.

While the above formulas would ordinarily present no problems for the average employee, problems have surfaced in the past two years concerning compensation unique to the teaching profession. School teachers can elect to receive their 12-month salary at regular pay periods throughout the year, or during the 10-month school year, in which case they receive their summer pay in a lump sum at the beginning of the summer break. In cases where members have gone from a 12-month pay period in one school year to a 10-month pay period in the next year, however, a member may actually receive 14 month's salary in one year, and this exaggerated salary figure has been used, according to some members, to calculate the amount they must pay to purchase service credit. The problem is that the retirement system has interpreted the act to mean that the compensation amount used to compute service credit payment must include all income received in a school fiscal year, and this interpretation has been upheld by an attorney general opinion, even though the compensation may represent more than one fiscal year of earned income. Some feel that the legislature obviously intended that the compensation amount used to calculate the cost of service credit purchase should be based on a member's school fiscal year salary earned, and not received, in the previous school fiscal year, and that the act should be amended to correct the inequities it imposes.

It has also been suggested that the act promotes a perception that the retirement system is elitist, since the current types of service for which credit may be purchased are used primarily by teaching employees. Further, although additional types of service traditionally have been recognized in response to conditions affecting significant portions of the employee population, the more recent trend has been to allow buy-ins for many other types of service that have only limited application. Also, it is reported that the diverse buy-in provisions have bogged down the retirement system in its efforts to educate members and process service credit purchases. It has been proposed that a nonspecific service credit provision be provided to replace most most of the 27 different types of service for which credit currently may be purchased.

Member Investment Plan. Until 1985, post-retirement increases were made only sporadically. Among the 1985 amendments was the creation of the Member Investment Plan (MIP), which was designed to provide members with reliable cost-of-living increases. Members of the system can make a one-time choice between the MIP and the basic plan. The MIP is funded by employee contributions at a rate of four percent of their annual compensation, although that rate is to be adjusted every three years to equal the percentage needed to fund MIP benefits. Although the two plans have benefits in common — including health insurance for retirants and eligible dependents, duty death benefits, duty and nonduty disability benefits, provision for deferred retirement, and provision for reduced retirement — the MIP offers enhanced benefits, which include earlier

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retirement, larger monthly checks, a yearly increase to help counter inflation, and earlier survivor protection.

The Retirement Bureau reports, however, that the MIP was selected by only 52 percent of the employees required to choose between the plans by the end of 1986, and that participation in the MIP by new members has been a disappointing 31 percent. The four percent contribution rate was based upon 100 percent participation, according to the actuarial study that preceded the plan's creation. Further, some believe that an inequity exists in the plan's funding: While Public Act 91 of 1985 provided for enhanced benefits for all employees who choose the MIP and then retire, even if they retire only one year later, current and future MIP participants are paying for the enhanced benefits for those retirees as well as for themselves. The Retirement Bureau also cites the frustration and anger of employees who have chosen the basic plan through ignorance, indifference, or uncertainty, and then find themselves unable to change plans; the difficulty of educating 40,000 new employees annually about the plans; and the need of future retirees to obtain more and more of their retirement income from sources other than Social Security.

THE CONTENT OF THE BILLS:

House Bill 4433. Under the Public School Employees Retirement Act, the retirement system currently pays the entire premium or fee for medical benefits for all retirees (minus the amount they would have to pay for Medicare if they were of Medicare age). The retirement system also pays 90 percent of the premiums for dependents' health care coverage. The bill would amend the act to require the retirement system to provide, in addition, dental, optical and hearing benefits. The retirement system would be required to pay 90 percent of the monthly premium, membership, or subscription fees for these services for persons entitled to benefits under the act.

House Bill 4433 is tie-barred to House Bill 4466.

MCL 38.1304 et al.

House Bill 4466. The bill would make the following amendments to the Public School Employees Retirement Act: Purchase of Service Credit. The bill would amend the act to permit a member to purchase up to five years of service credit, minus the years of service credit purchased under the current act, upon request and payment to the retirement system of the actuarial cost. Purchased service credit could not be used to satisfy the minimum of ten years of service credit required to receive a retirement allowance under the act, nor to satisfy the service credit requirements for a retirement allowance paid before age 46. The bill would also amend the act to repeal, as of January 31, 1991, provisions for purchase of service credit for the following:

- Employment with the federal government as a teacher in a foreign country teaching students who are not U.S. citizens, or as a teacher with the Merchant Marines.
- Employment with a county mental health program, or as an employee in a day care or day training program for handicappers.
- Service with the Red Cross on a military base during armed conflict.
- Duty with the Michigan National Guard or the U.S. Armed Forces Reserve.
- Full-time service in the VISTA program, the Peace Corps, or in alternative service to active duty military service.
- Employment with a municipal recreation department.

Under the bill, January 31, 1991, would also be the deadline for the purchase of service credit for service performed as a teacher in a foreign country at a school for U.S. military or State Department personnel or their dependents; with the Job Corps; in a trust territory or former trust territory of the U.S.; on an Indian reservation in this country; at a U.S. armed forces military base in this country or overseas; in a nonpublic elementary or secondary school, 2-year, or 4-year institution of higher education in the United States; for employment or out-of-system public education service performed while a graduate student. The total service credited could not exceed five years. The deadline would also apply to a person who had been excluded from membership but who later became a member. In addition, the bill would repeal that provision of the act which requires service credit to be granted for the time period that a member is absent from service and receives a duty disability retirement allowance (this provision is already covered in another section of the act).

Under the bill, service credit for specific service and for the proposed "generic" five years would be purchased upon payment to the retirement system of the actuarial cost. The cost of purchasing service credit for military service and for out-of-system public education service, however, would remain at the current rates.

The actuarial cost would be defined as the product of the following three items:

a) A percentage, determined by the retirement board and the Department of Management and Budget, which when multiplied by a member's compensation, as determined below, resulted in the average actuarial present value of the additional benefits resulting from the crediting of one additional year of service. The percentage could vary because of age, credited service, or benefit coverage. An increase or decrease in the percentage under this subdivision would not become effective until the expiration of six months or more after the board notified the reporting units of the increase or decrease.

b) A member's compensation, which would be the member's full-time or equated full-time compensation earned in the school fiscal year immediately before the school fiscal year in which the application to purchase and payment for the service were made. The compensation amount used could not be less that the highest compensation previously earned by the member.

c) The number of years, including any fraction of a year, of credited service a member elected to purchase, up to the maximum allowed.

Should the compensation amount used to compute payment exceed a member's final average compensation determined at the time of retirement, the payment would have to be recomputed using the member's final average compensation, and a refund would be made based on the recomputation.

The bill would also amend the act to revise the method used to compute the cost of purchasing credit. Should the compensation amount used to compute payment for purchase of service credit for certain service before the

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bill's effective date exceed the full-time or equated full-time compensation earned in the school fiscal year used in the computation, the payment for that purchase would be recomputed using the greater of the full-time or equated full-time compensation amount earned for the school fiscal year in which payment was made, or the highest school fiscal year compensation previously earned by the member, and a refund would be made. The refund would be made only to a member, deferred member, or retirant who made written application to the board in a form determined by the board. Should a member who had made a service credit purchase payment die without designating a retirement allowance beneficiary, or withdraw from service before his or her retirement became effective, the payment would be refunded to the member or to his or her refund beneficiary upon request.

Member Investment Plan. Currently, the act requires an MIP contribution rate of 4 percent of a member's annual compensation, with the percentage to be adjusted every three years beginning October 1, 1990. Under the bill, until December 31, 1989, the contribution rate would be four percent for a person who first became a member on or before that date, and who elected on or before that date to contribute to the MIP. Beginning January 1, 1990, the person's rate would be 3.9 percent. Those who first became members on or after January 1, 1987, but before January 1, 1990, would have 30 days from their first date of employment to irrevocably elect to make these contributions.

Under the bill, those who first became members on or after January 1, 1990, would be required to contribute the amounts listed below, based on the member's annual school fiscal year earned compensation. These rates would also apply to those who first became members on or before December 31, 1986, but who did not perform membership service between that date and January 1, 1990, and returned to membership service on or after January 1, 1990.

Member's Annual School Fiscal Year Earned Compensation	Amount Payable To The Member Investment Plan
Not over $5,000	3 percent of Member's Compensation
Over $5,000, but not over $15,000	$150, plus 3.6 percent of the excess over $15,000
Over $15,000	$510, plus 4.3 percent of the excess over $15,000

Members subject to the above rates could elect irrevocably to discontinue contributions to MIP after the end of three school fiscal years following the date they first contributed to the plan, or after the end of four school fiscal years following the date of their first contribution. They would then receive a refund of those contributions, plus interest, as determined by the retirement board, payable within six months after the date of notification by the reporting unit, but would not be entitled to the benefits afforded MIP members. The bill would require that MIP members be given advance notice of the opportunity to elect to discontinue contributions. (The above provisions would not apply until the department received notice from the Internal Revenue Service that the retirement system would not be disqualified for tax purposes under the Internal Revenue Code.

Allowance Increase. The bill would amend the act to delete previous provisions for retirement allowance increases. Under the bill, each retirement allowance that was effective before October 1, 1981 would be increased effective January 1, 1990. The amount of the increase would be a percentage of the retirement allowance payable as of January 1, 1990 without this provision. The percentage increase would range from one percent for those who retired between October 1, 1980, and September 30, 1981, to twenty- two percent for those who retired before October 1, 1960. The bill would also provide for an annual increase, beginning October 1, 1990, for each retirement allowance that was effective on or before January 1, 1987. The amount of the increase would be equal to three percent of the allowance that would be payable without this provision.

Postretirement Service. Currently, under the act, a retirant who — on account of age or years of service — receives a retirement allowance other than a disability allowance, and then becomes employed by a reporting unit, is not entitled to a new final average compensation or additional service credit unless an additional five or more years of service credit are performed. Under the bill, the member would be entitled to a new final average compensation or additional service credit if he or she had contributed the equivalent of three or more years of service credit to MIP. The bill would also revise the computation of the repayment that a retirant must make before a retirement allowance may be recomputed. The act also requires that a retirant's allowance be reduced by the amount that his or her earnings exceed the amount permitted under the Social Security Act. Under the bill, the allowance would be reduced by either the Social Security limitation, or one-third of the member's final average compensation, whichever was less. For the purpose of computing allowable earnings, the final average compensation would be increased by five percent for each full year of retirement.

Other Provisions.

- Retirement allowances would be paid in equal monthly installments.

- The state treasurer would be added to the retirement board, which currently consists of the superintendent of public instruction and seven members appointed by the governor with the advice and consent of the Senate.

- A member whose reporting unit service consisted of library or museum service and whose employment there was terminated when the reporting unit became a participating municipality in a district library agreement, or a member who was a former employee of a reporting unit that became a participating municipality to a district library agreement would be considered a public school employee under the act if the member was subsequently employed by the district library, and the library adopted a resolution providing that it would make the required payments to the board.

- The reserve for retired benefit payments would be the account from which all retirement allowances, and refunds made when retirement allowance payments terminated before a retirant's accumulated contributions had been paid, would be paid. After receiving each annual actuarial valuation, the balance in the reserve would be brought into balance with the actuarial present value of retirement allowances that were to be paid after the end of the fiscal

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year to retirants and retirement allowance beneficiaries receiving retirement allowances at the end of the fiscal year, by a transfer between the reserve for employer contributions (currently called the pension accumulation fund) and the reserve for retired benefit payments.

- The reserve for undistributed investment income would be the account which would be credited with all income received by the system from the investment of assets, all gifts and bequests received by the retirement system, and all other money whose disposition was not specifically provided for. The board would be required to transfer from this reserve all amounts necessary to credit the interest required under the act to the reserve for employee contributions, the reserve for employer contributions, the reserve for MIP, the reserve for retired benefit payments, and the reserve for health benefits, and to fund the reserve for administrative expenses (currently called the expense fund).

- The 10-year amortization period for the value of benefits attributable to members who opt for early retirement (when their combined age and length of service totals at least 80 years) would instead be amortized over 50 years, which is the amortization period for other unfunded liabilities.

FISCAL IMPLICATIONS:

According to the Retirement Bureau in the Department of Management and Budget, the cost to the state of the proposed benefits would be as follows:

	Percentage of Payroll	First Year ($ Millions)
Change in actuarial methods to reflect value of 13th check:		
- present MIP members	0.24	$ 14.00
- new Basic members	0.16	9.00
MIP changes:		
Set voluntary MIP rate at 4 percent	9.19	11.00
Mandatory MIP for new members (4 percent)	(0.54)	(32.00)
3.9 percent contribution rate for present MIP members	0.05	3.00
Graduated contribution scale for new members ($ amounts not indexed)	(0.16)	(9.00)
Allow new members to opt out after 3 years of MIP contributions; refund in about 9 months; no forfeiture of credited service	0.15	9.00
Eliminate 13th check for new Basic members	(0.16)	(9.00)
Dental, vision, hearing (90 percent premium subsidy)	0.49	28.00
Adopt 9.8 percent-8.0 percent investment return assumption	(0.32)	(18.00)
Extend "early-out window" amortization period to 50 years	(0.11)	(6.00)
Permanent 1-22 percent increases for pre-October 1, 1981, retirees	0.07	4.00
Non-specific service credit buy-in at full actuarial cost	0.00	0.00
Savings from Medicare Catastrophic Insurance (Parts A and B)	(0.05)	(3.00)
Total Increase in Computed State Contributions	0.01%	$ 1.00

ARGUMENTS:

For:

The bill's provision for dental, hearing and vision benefits would help those who need help most. According to the Retirement Bureau's latest pension payroll report, the average pension received by PSERS members is around $7,500 per year, out of which the retiree must pay for dental, hearing, and vision care. While many of these retirees have incomes augmented by Social Security, Michigan public schools did not come under the Social Security Program until 1955, and many who retired twenty-five or thirty years ago are not eligible for those benefits. The costs of dental work, eye examinations and glasses, and treatment for hearing problems unfortunately increase as one ages. Many who have been retired for some time, and who do not have the financial resources to take care of these medical needs when they arise, often delay seeking medical help, and the problems get worse.

For:

Allowing "generic" purchase of service credit buy-ins would eliminate the proliferation of buy-ins that currently plague the system, and would provide consistent and equitable treatment of all members regardless of their educational service or employment background. Until the recent past, additional types of service were recognized, in large part, in response to conditions affecting a significant portion of the employee population. For instance, public employment in other states was recognized partly to attract teachers to Michigan following World War II. More recently, credit became available for maternity, paternity, and childrearing purposes, in recognition of the large number of individuals who interrupt a career to devote time to raising a family. The more recent trend, however, has been to recognize all manner of service, with no regard to its limited application. This has served to whet the appetite of others with career interruptions not directly related to the many types of service for which credit is now available. As a result, there are ever-increasing demands for more and more buy-ins to attempt to provide equity among a dramatically diverse population.

For:

The "generic" buy-in would simplify the administration of service credit purchases and would enable the retirement system to fulfill its mission of providing retirement benefits for public school employees without the complex effort now required to provide complete information and administer the purchase process. With the addition of each new type of creditable service, the process of educating the membership becomes lengthier and more complex. Moreover, the current trend of earlier retirement and living longer indicates the need to concentrate the system's attention and resources on these areas.

For:

House Bill 4466 would correct an unfair situation that requires PSERS members to purchase service credit based on a formula that reflects a higher salary level than their actual compensation. Most members are unaware of this problem until they actually make the request to purchase the service credit, at which time they cannot retroactively correct the situation.

Against:

Allowing PSERS members to purchase service credit for up to five years, for any reason, could result in more buy-ins and increased processing of payments as a greater number of members purchase additional credit. Further, there would be no specific performance of service required in order to purchase credit; current law at least requires a member to have been employed in some particular way for the purchase of credit.

Response: House Bill 4466 contains safeguards to prevent this provision from being abused. First, a person could not double-dip by purchasing generic service credit for the years for which credit was purchased under an existing buy-in; second, a person could not purchase generic service credit in order to retire at an artificially low age.

For:

By requiring all employees hired after January 1, 1990, to contribute to the Member Investment Plan, House Bill 4466 would address the concern that individuals do not consider retirement planning when they are first hired, and would give the PSERS three years to educate them about the differences between the MIP and the basic plan, and the advantages of the MIP. Generally, new employees are required to make a decision at the very time in life and career when retirement planning is of least interest, and many select the basic plan through ignorance, indifference, or uncertainty, and then experience frustration and anger whey they are unable to change plans and find that the decision not to choose the MIP is irreversible. Although saving for retirement can be a relatively painless process if started at the beginning of a career, especially if savings are tax-deferred, research reportedly has shown that two-thirds of school employees fail to take advantage of tax- deferred investments, and those who do typically delay participation until their 30s. Under the bill, members would enjoy security, because the MIP is a defined benefit plan whose payout is protected by the state constitution, and would also achieve a maximum return on their investment because of the advantages of participating in the system's professionally managed fund.

Response: Joining the MIP would not truly be mandatory, since members could drop out during their fourth year of participation.

Against:

Noncareer employees historically have preferred improvements in pay levels while working over inclusion in the membership of a retirement plan. Other employees would prefer to forego the MIP contribution deduction from their pay despite the earning of market interest rates, the availability of refunds at termination, or the ability to roll over savings into other tax-deferred plans. Members should continue to have the ability to make this decision from the start.

For:

A retirement allowance increase based on a percentage of a member's retirement allowance would be beneficial to career employees. These retirees are less advantaged by the thirteenth check, which is of more benefit to those who have been retired the longest and have the lowest allowances. These changes also would give PSERS members parity with members of the State Employees Retirement System.