



**House
Legislative
Analysis
Section**

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MERS: MEMBER CONTRIBUTIONS

**House Bill 5375 (Substitute H-2)
First Analysis (3-9-92)**

**Sponsor: Rep. Clark Harder
Committee: Senior Citizens
and Retirement**

THE APPARENT PROBLEM:

The administrators of the Municipal Employees Retirement System (MERS) have proposed changes to the Municipal Employees Retirement Act, based on the need to conform to federal requirements for qualified governmental pension plans, and to keep the system current with changing trends in retirement systems. Public Act 427 of 1984 recodified the old Municipal Employees Retirement Act to simplify provisions of the act, to make the act conform with applicable provisions of federal law, and to provide flexibility to participating municipalities or courts (the act was later amended by Public Act 500 of 1988 to include certain court employees under MERS) with regard to optional retirement plans and member contribution programs. Public Act 427 also introduced benefit program P, which, when adopted by a municipality, allows federal income taxes to be deferred on members' contributions. According to the Retirement Bureau, this provision needs to be amended to give current members the option of participating in the program or not. In addition, Public Act 99 of 1990 added language to the act that was intended to assure compliance between the act and Internal Revenue Service (IRS) requirements for tax exempt public retirement plans. The language was drafted in haste to meet an IRS imposed deadline, and now needs to be amended to conform to the drafting standards of the Legislative Service Bureau. Other amendments to the act are needed to assure members greater portability in their retirement pensions, and to correct various inequities in the act.

THE CONTENT OF THE BILL:

House Bill 5375 would amend the Municipal Employees Retirement Act to require that participating municipalities and courts allow members of the Municipal Employees Retirement System (MERS) the option of participating in contribution program "P" or not; to extend the

break-in-service requirements for members, and to permit an extension of the repayment period for accumulated contributions by members who wish to be reinstated in the retirement system; to permit a retiree to return to work without interruption of benefits until he or she earns \$5,000 during a calendar year; to permit the payment of pro rata interest on refunds of member contributions; to delete the requirement that certain officials join MERS within 60 days; and to amend provisions of the act regarding benefit limitations, in order to achieve compliance with United States Internal Revenue Service (IRS) rules.

Contribution Program "P." Currently, the act requires that a municipality or court that adopts contribution program P must pick up mandatory member contributions. The contributions are then treated as municipality or court contributions when determining tax treatment under the Internal Revenue Code. House Bill 5375 would amend these provisions of the act to give current members the option of participating in the program, and to require the following:

--Those municipalities or courts that required member contributions on account of compensation earned as of the effective date of the bill would be required to adopt -- by resolution or administrative order -- contribution program P before July 1, 1992.

--Within 30 days of the date of the resolution or administrative order, the municipality or court would allow each member to decide whether or not the municipality or court should pick up that member's required contributions on account of compensation earned.

--For each member who elected to have his or her contributions picked up under contribution program P, the program would become effective on the date

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of the resolution or administrative order, or on the date the retirement system received approval from the IRS, whichever came later. Members who chose not to participate would not be required to do so.

--A member who was employed by the participating municipality or court after the date of the resolution or administrative order would have his or her required contributions picked up under contribution program P.

--Those municipalities or courts that required member contributions on account of compensation earned after the effective date of the bill would be required to adopt contribution program P -- by resolution or administrative order -- to pick up member contributions required on account of compensation earned after the effective date of the program. The program would be effective on the date of the resolution or administrative order, or on the date the retirement system received approval from the IRS, whichever occurred later.

--The participating municipality or court would pay contributions picked up under contribution program P from the same source of funds that are used to pay compensation to the member. Member contributions would be picked up by a reduction in the member's cash salary, or an offset against a future salary increase, or both, and designated as employer contributions in lieu of employee contributions. Members would not have the option of receiving the contributed amounts directly, instead of having those amounts paid to the retirement system.

Break In Service/Repayment of Accumulated Contributions. Currently, under the act, an member who is not "vested" in the system forfeits his or her retirement service credit if the break in membership lasts for more than 60 consecutive months (5 years). The bill would increase the allowable length of the break in service to 15 years. The act also provides for reinstatement of credit for a member who returns to service with the same municipality within 15 years, provided that, among other things, the member has been credited with at least 60 consecutive months of service subsequent to the break in service that caused the forfeiture, and the member pays back any refunded contributions. The bill would delete this provision. The act also permits credited service that is forfeited for a reason other than a break in service of more than

60 consecutive months to be reinstated, provided that the member acquired the forfeited service while he or she was employed by the same participating municipality or court, and the member was rehired by that municipality or court and repaid all accumulated contributions within five years. The bill would permit a municipality or court to adopt a resolution or administrative order establishing a written policy to extend the period for payment beyond five years. The policy would be uniformly applicable to all members.

Employment of Retirees. Currently a retiree may return to work at the municipality from which he or she retired for a period of 60 days per year. The member's retirement allowance is suspended after the 60 days until the period of employment ends. The bill would delete the 60-day restriction. Under the bill, a retiree would be permitted to return to work with the same municipality or court until he or she earned \$5,000 in gross compensation during a calendar year. Payment of the member's normal retirement allowance would resume on the first day of the next calendar month after the period of employment ended, or on the January 1 following suspension of the allowance, if the reemployment were not terminated.

Refund of Member Contributions. Currently, the act requires that the retirement system allocate undistributed investment income to the reserve accounts for employee and employer contributions and for retired benefit payments and excess casualty experience.

The act also requires that the retirement system refund the accumulated contributions of a member who has been laid off, or who incurs a break in service. The bill would amend the act to permit the retirement system, before the contributions were paid, to allocate to those investment earnings attributable to the accumulated contributions, and to permit this to be done for each month between the time that the investment earnings were allocated and the date the contributions are paid.

60-day Limitation for Elected Officials. The act currently lists certain employees who may not be classified as "municipal employees" for purposes of membership in the retirement system. The list includes the mayor, village president, or a member of the governing body of a participating municipality, unless these individuals apply for membership within 60 days from the date the individual last qualified for the position, or the date

the municipality became a participating municipality, whichever was later. The bill would delete this requirement, and would permit these employees to become MERS members by filing a written membership application with the retirement system.

Benefit Limitations. At present, the Municipal Employees Retirement Act specifies that it conforms to the applicable provisions of federal law for qualified governmental pension plans, and that the trust is intended to be an exempt organization under the federal Internal Revenue Code. In conformance with the code, the act provides that employer-financed benefits provided by MERS may not exceed \$50,000 per year for police, fire or public safety members with 15 or more years of credited service, or \$10,000 per year for all other members. However, if application of the following guidelines produces a higher limitation, then the higher limitation applies: for members retiring at age 62 or older, the upper limit is \$90,000, or the member's three-year highest average earnings, whichever is less; for members retiring before age 62, the upper limit is \$90,000, actuarially reduced to reflect payments made before age 62, but not less than \$75,000; for members retiring before age 55, the limitation is calculated from a limitation of \$75,000 at age 55.

The act also specifies that the \$50,000 and \$90,000 limitations be adjusted by the IRS to reflect cost of living increases.

House Bill 5375 would amend the guidelines under which exceptions to the \$50,000 and \$10,000 limitations are calculated to comply with applicable provisions of the Internal Revenue Code for governmental plans. Under the bill, employer-financed benefits could not exceed the lesser of 100 percent of the member's three-year highest average compensation, as prescribed under the code, or one of the following:

- a) For members retiring at age 62 or older, the upper limit would be \$90,000 or the amount that results when this figure is adjusted annually to reflect increases in cost of living.
- b) For members retiring at, or after, age 55, but before age 62, the actuarially reduced amount of the above \$90,000 limitation, using a five percent annual interest rate, compounded annually, but not less than \$75,000.

- c) For members retiring before age 55, the actuarially reduced amount of the above \$75,000 limitation, using a five percent annual interest rate, compounded annually.

The bill would delete the requirement that the \$50,000 and \$90,000 limitation be adjusted annually by the IRS. Under the bill, the secretary of the treasury would be required to adjust these limitations, as prescribed under the Internal Revenue Code, and the Retirement Bureau in the Department of Management and Budget would administer the retirement system.

MCL 38.1504 et al.

FISCAL IMPLICATIONS:

According to the Retirement Bureau in the Department of Management and Budget, the bill would have no impact on state funds. Local municipalities would incur costs initially to implement the reporting requirements of contribution program P. (3-5-92)

ARGUMENTS:

For:

The bill would amend current provisions in the act concerning contribution program P to conform to Internal Revenue Service rules. Under the act, municipalities or courts that adopt contribution program P pick up the member contributions that are required of members on account of compensation earned (as opposed to contributions based on a fixed percentage of the member's compensation). The verb phrase "pick up" is borrowed from the Internal Revenue Code, and is intended to allow members to treat the contribution as deferred income and thus to defer the payment of taxes on the contribution. The contributions are then treated as municipality or court contributions when determining tax treatment under the code. Member contributions are picked up from funds in the retirement deduction account that would otherwise have been designated as member contributions and paid to the retirement system.

House Bill 5375 would amend the act to make the program optional for current members of MERS and mandatory for future members. The adoption of this additional benefit program would enable members of MERS to remain competitive with surrounding communities who are not members of MERS.

For:

The bill would correct current inequities and inconsistencies in the act, such as the requirement that certain members of a municipality's governing body, such as a mayor or village president, have the option of being included in the membership of MERS or not. Currently, these employees may not be covered under MERS unless they apply for membership within 60 days after the date they last qualified for the position or the date the municipality became a participating municipality. However, under new federal regulations, all state and local governmental employees must belong to either a pension system or the social security system, and some officials who missed the 60-day deadline need an opportunity to opt into the system. Also, under MERS, a member who leaves employment with one governmental unit for employment with another may receive credit for the previous employment if the break in service is no longer than fifteen years. However, a member who is not vested in the system (or, who has not earned enough credited service to receive a retirement allowance) loses all retirement service credit if he or she leaves a participating municipality for more than five years. Further, if a member returns to service with the same employer, he or she must work an additional 5 years before credited service is reinstated. These latter requirements discriminate against those employees who work part time, including many mothers who leave work from time to time to raise families. The bill would rectify this inequity by deleting these two requirements, and by extending the break in service provision to 15 years. This would bring the act into conformity with the recent national trend toward portability in retirement benefits.

For:

The bill would provide more flexibility for employees by changing the current provision that requires repayment within five years of any refunded contributions of forfeited credited service. Under the bill, a municipality could extend the period of repayment. Often, employees who return to work after a period of absence need to reestablish themselves financially before they can afford to pay out what could be a large sum of money. The bill would enable members to do this without losing their right to regain forfeited service credits. In addition, the bill would require that the retirement system calculate a portion of investment earnings and add this amount to the accumulated contributions for forfeited credited service that are

paid to an employee who has been laid off, or who incurs a break in service. Currently, the act only requires that the retirement system return these accumulated contributions, together with compound interest, and the retirement system calculates the amount that is to be credited to the individual balances in the reserve for employee contributions once per year. Under the bill, the retirement system would be required to calculate the amount owed the employee for each month between the date the earnings were allocated and the date the contributions were paid. Further, the bill would make it easier for retirees to return to part-time work at the municipality or court from which they retired. Currently, retirees may only work for a period of 60 days per year before their retirement allowance is suspended. Reportedly, the average MERS retirement benefit is \$4,000 per year, so most retirees need to supplement their income. The bill would eliminate the 60-day limitation and would permit retirees to work until they earned \$5,000. This provision would make it easier for retirees who only wished to work on a part-time basis. It would also safeguard against the possibility of "double-dipping," since it would still require retirement allowances to be suspended if a retiree earned more than \$5,000.

Against:

The bill could impose financial hardships on municipalities and courts. Currently, the act saves municipalities the costs involved in reinstatement of service credits that have been forfeited due to a break in service by requiring the repayment of refunded contributions within five years after a member rejoins the retirement system. The longer a member waits to apply for reinstatement, the more costly it is to the municipality or court involved, since reinstatement involves the repayment of contributions that have been refunded, and the employer's contribution is higher than the employee's. Members should be required to apply for reinstatement within a specific time period to reduce the cost to employers.

Response:

The bill does not impose a mandatory requirement that municipalities or courts extend the period for repayment of refunded contributions. The bill merely provides a municipality or court with the option of adopting a resolution or an administrative order to establish a written policy on this question.

Against:

It is unclear whether the bill actually enhances the concept of portability in retirement benefits. The bill does delete the act's current requirement that a member who is not vested must acquire an additional 60 consecutive months of service after a break in service. The bill also provides for a break in membership of 15, rather than 5, years. However, as written, the bill now provides for reinstatement of service credit that has been forfeited only for a reason other than a break in membership.

POSITIONS:

The Retirement Bureau in the Department of Management and Budget supports the bill. (3-5-92)

The Michigan Townships Association has no position on the bill. (3-4-92)