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BILL ANALYSIS

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House Bill 6206 (Substitute H-1 as reported without amendment)
Sponsor: Representative Barbara Dobb
House Committee: Appropriations
Senate Committee: Appropriations

CONTENT

The bill would amend the Michigan Legislative Retirement System Act to provide for a defined contribution retirement plan. The bill would require all new members on or after March 31, 1997, to become members of the Tier 2 (defined contribution) plan. All persons who were members of the Legislative Retirement System (LRS) prior to March 31, 1997, would have the option of remaining in the Tier 1 (defined benefit) plan or electing to become a qualified participant in Tier 2. In addition, all members would be eligible to receive health care benefits as prescribed in the bill. Currently, all members of the LRS are members of a defined benefit retirement plan. The defined benefit plan provides a guaranteed lifetime retirement benefit provided the member vests in the system and attains the minimum age and service requirements. The proposed defined contribution retirement plan is outlined below.

Under the bill, the current plan would be divided into two types of membership. Tier 1 members would be defined as those employees who are members of the original retirement system prior to March 31, 1997, and who do not elect to become a member of Tier 2. Tier 2 members would be defined as Tier 1 members who elect to become qualified participants in Tier 2 and all new employees hired on or after March 31, 1997. The LRS board could promulgate rules pursuant to the Administrative Procedures Act for Tier 1 retirement plans, but could not promulgate rules for the establishment, implementation, administration, operation, investment, or distribution of a Tier 2 retirement plan.

The LRS would have to give its current members the opportunity to terminate membership in Tier 1 and become a qualified participant in Tier 2. Such an election would be irrevocable. The LRS would have to accept written elections from January 2, 1998, to April 30, 1998, for members choosing to switch to the Tier 2 retirement plan. An employee who changed from a Tier 1 member to a Tier 2 member would elect to do all of the following: 1) cease to be a member of Tier 1, effective midnight, May 31, 1998; 2) become a qualified participant in Tier 2, effective 12:01 a.m., June 1, 1998; and 3) waive all rights to a pension, an annuity, a retirement allowance, an insurance benefit, or any other benefit under Tier 1, effective midnight, May 31, 1998.

The same provisions would be made for deferred members and nonvested members who returned to the Legislature as legislators or Lieutenant Governor. However, their election to stay in Tier 1 or change to Tier 2 would have to be submitted to the retirement system in writing within 60 days of their reemployment. The effective dates for these employees would depend on the dates that they were reemployed.

For current, deferred, or former nonvested members who elected to terminate membership in Tier 1 and become a qualified participant in Tier 2, the retirement system would direct the State Treasurer to transfer a lump sum amount from the appropriate fund to the qualified participant's account in Tier 2. The retirement system would calculate the amount to be transferred based on the actuarial present value of the member's accumulated benefit obligation plus his or her

accumulated contributions. The calculation of estimated and actuarial present value of the member's or deferred member's accumulated benefit obligation and personal contributions would be based upon methods adopted by the Department of Management and Budget (DMB) and the retirement system's actuary in consultation with the retirement board.

After consulting with the retirement system's actuary, the DMB would calculate for each fiscal year any cost savings that accrued to the State as a result of adopting a defined contribution plan over the costs that would have been incurred by the State had a defined contribution plan not been implemented. The savings would not be used to decrease the actuarial rate charged by the retirement system, but instead would be deposited in a health insurance fund. The amount deposited in a health fund could not be spent until the actuarial accrued liability for health benefits was 100% funded.

Under the bill, the State Treasurer would have the following duties and responsibilities:

-- Administer the Tier 2 plan and invest the plan's assets. The State Treasurer would be the fiduciary and trustee of the Tier 2 plan. The State Treasurer could appoint an advisory board to assist in carrying out duties as fiduciary and trustee.
-- Determine the provisions and procedures of Tier 2 in conformity with the Act and the Internal Revenue Code.
-- Employ or contract with personnel for services that the State Treasurer determined necessary for the proper administration of and investment of the assets of the Tier 2 plan.

The individuals who became qualified participants in the defined contribution plan (Tier 2) would direct the investment of their accumulated employer and employee contributions and earnings to one or more investment choices within the available categories of investment funds provided by the State Treasurer. The administrative costs of the Tier 2 plan would be paid by the qualified participants, former qualified participants, and refund beneficiaries with active accounts.

In the new Tier 2 plan, the State would contribute 4% of a qualified participant's salary to the individual's account. In addition, the participant would be allowed to contribute up to 3% of his or her compensation to his or her account, with the employer making a matching contribution up to a maximum of 3%. The qualified participant also could make additional contributions beyond those mentioned up to the maximum allowed by the State Treasurer and the Internal Revenue Code.

A qualified participant would be immediately 100% vested in his or her personal contributions into a Tier 2 plan. The individual would become vested in the employer's contributions as follows:

2 years of credited service	50%
3 years of credited service	75%
4 years of credited service	100%

A qualified Tier 2 participant would become vested in health insurance coverage after completing four years of service as a qualified participant if he or she were not a member, deferred member, or former nonvested member in Tier 1. If a member, deferred member, or former nonvested member of Tier 1 elected to participate in Tier 2, then that participant would have to meet the service requirements that he or she would have been required to meet under Tier 1 in order to vest in health benefits. Qualified participants who were members, deferred members, or former nonvested member of Tier 1 who elected to participate in Tier 2 would be credited with the years of service accrued under Tier 1 for the purposes of meeting the vesting requirements of Tier 2. Health insurance coverage would be available to vested qualified participants and their eligible dependents. The State would pay the following amounts of the health insurance premium for

former qualified participants who were not members, deferred vested members, or nonvested members of Tier 1: 50% for four years of credited service; 75% for five years of credited service; and 90% for six years of credited service. These former qualified participants would be required to pay to the retirement system the portion of the premium not paid by the State.

Former qualified participants who were members of Tier 1 and elected to become qualified participants in Tier 2 would receive the same portion for their health insurance premiums paid by the State as Tier 1 members.

All insurance premium payments would be based on a cash disbursement method.

Upon leaving the State's employment, a former qualified participant would be eligible to receive distribution of the accumulated balance in his or her defined contribution account. Upon death of a qualified participant, the accumulated balance in the deceased participant's account would be paid to the refund beneficiary, or if none were stated, to the legal representative or the deceased participant's estate.

A former qualified participant or refund beneficiary could elect one or a combination of several of the following methods of distribution: lump sum; lump sum direct rollover to another qualified plan; periodic distributions as authorized by the State Treasurer; and/or no distribution, with the balance remaining in the account until person decided, to the extent allowed by Federal law.

In addition, all disbursements of employer contributions (the mandatory 4%) and the earnings on them, plus the employee and matched employer contributions (up to a maximum of 6%) and the earnings on them, would be exempt from State, county, municipal, or other local tax. Any contributions made by the employee beyond the first 3% would be subject to all taxes.

Finally, if the DMB received notification from the IRS that a section or a portion of a section of the law for each retirement system would cause the retirement system to be disqualified for tax purposes under the Internal Revenue Code, then that portion would not apply.

MCL 38.1006 et al.

FISCAL IMPACT

The exact fiscal impact of the Tier 2 plan is indeterminable. Any cost savings that would arise would be placed into the health insurance fund of the retirement system. The bill contains a provision stating that any cost savings would not be used to decrease the actuarial rate charged by the retirement system, but instead would be deposited in a health insurance fund. Because health insurance costs may continue to rise, so too would the contribution rate for health insurance for the remaining Tier 1 plan. However, in the future when the health insurance fund contained sufficient funds to cover the actuarial accrued liability for health benefits, the contribution rate for health insurance for the Tier 1 plan would decrease.

Additionally, the administrative costs for the defined contribution plan would be paid by the qualified participants, former qualified participants, and refund beneficiaries from the earnings on their investments.

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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.