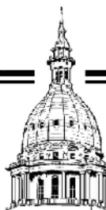
Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536



BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

House Bill 6230 (as enrolled)
Sponsor: Representative Walter DeLange
House Committee: Appropriations
Senate Committee: Appropriations

Date Completed: 12-19-96

CONTENT

The bill would amend the Public School Employees Retirement Act to provide for a defined contribution retirement plan. The bill would provide an option for all new members hired on or after the implementation date to become members of the new Tier 2 (defined contribution) plan or the original Tier 1 (defined benefit plan). All persons who were members of the Public School Employees Retirement System (PSERS) prior to the implementation date 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 PSERS 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.

"Implementation date" would be defined as July 1, 1997, if full actuarial funding of the pension benefits occurred. If full actuarial funding of the pension benefits did not occur before July 1, 1997, implementation date would mean the date established by the retirement board, which would have to be prior to January 1, 1998, if full actuarial funding of the pension benefits occurred. If full actuarial funding of the pension benefits did not occur by January 1, 1998, the Tier 2 retirement plan would not be implemented.

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 the implementation date and who do not elect to become a qualified participant in Tier 2 and new employees hired on or after the implementation date who chose to become members of the Tier 1 plan. Tier 2 members would be defined as those current members who elect to participate in the new defined contribution retirement plan and new employees hired on or after the implementation date who chose to become qualified participants in the Tier 2 plan. The PSERS board could promulgate rules pursuant to the Administrative Procedures Act for Tier 1 retirement plans but not for Tier 2 plans, but could not promulgate rules for the establishment, implementation, administration, operation, investment, or distribution of a Tier 2 retirement plan.

The bill states that for fiscal years beginning on or after the effective date of this legislation, the annual contribution rate for unfunded actuarial accrued liability would be based on and applied to the combined payrolls for members of Tier 1 and qualified participants of Tier 2. (This provision is designed to keep the contribution rate for unfunded accrued liabilities from increasing due to the

decrease in the number of employees of Tier 1.) This provision would be extended, as of March 28, 1996, to the combined payrolls of university employees who were members of PSERS before January 1, 1996, and those who would have been members of PSERS after January 1, 1996, but are not members of PSERS due to its being was closed off to new university hires after January 1, 1996. Universities that are members of PSERS would have their portion of the unfunded actuarial accrued liability amortized over 40 years beginning on October 1, 1996, and ending on September 30, 2036.

Members, or deferred members who first became a member of PSERS after the implementation date, would have their entire monthly premium paid by the retirement system for health care benefits, including dental, vision, and hearing plans if they had completed 30 or more years of credited service. These benefits also would be extended to health insurance beneficiaries or for the benefit of the retirant's or deceased member's retirement allowance beneficiary. If the retirant or deceased member had between 10 and 30 years of credited service, the retirement system would pay a portion of the monthly premiums equal to 3% per year of service. If the retirant or deceased member had less than 30 years of credited service and were less than 60 years of age, his or her health benefit monthly premium would be reduced in the same manner as a retirement allowance is reduced under Section 84(2).

All new employees hired after the implementation date would have to choose to be members in either the Tier 1 or Tier 2 plan. The election would have to be made within 60 days of employment and would be irrevocable. An individual who did not make a written election would automatically become a qualified participant of Tier 2. The PSERS would have to give all members who were members of Tier 1 on the day before the implementation date, the opportunity to elect to terminate membership in Tier 1 and elect membership in the Tier 2 plan. Such an election would be irrevocable. The PSERS would have to accept written elections beginning on the 180th day after the implementation date and ending on the 300th day after the implementation date 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 on the 330th day after the implementation date; 2) become a qualified participant in Tier 2, effective 12:01 a.m. on the 331st day after the implementation date; 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 on the 330th day after the implementation date.

The same provisions would be made for deferred members and nonvested members who returned to work for a public school. 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. The calculation of estimated and actuarial present value of the member's or deferred member's accumulated benefit obligation 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 retirement system as a result of adopting a defined contribution plan over the costs that would have been incurred by the retirement system 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 10 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 amount of premiums paid by the retirement system would be equal to 3% per year of service up to a maximum of 90%. Insurance premium payments would be based on a cash disbursement method. Also, if a former qualified participant of Tier 2 had less than 30 years of credited service and were less than 60 years of age, his or her health benefit payment would be reduced in the same manner as a retirement allowance is reduced under Section 84(2).

In addition, duty and nonduty disability and death benefits would be paid to Tier 2 qualified participants as if they had been a member of Tier 1. Any payments received would be offset by the value of the distribution of the participant's accumulated balance upon his or her becoming a former qualified participant pursuant to the distribution methods described below.

Upon leaving the public school'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 decides, 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 38.1304 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.

In addition, the unfunded accrued liabilities for the Public School Employees Retirement System would remain under control. The bill contains language to head off any anticipated increase in the unfunded accrued liability of the Tier 1 plan. The provision would allow the contribution rate for unfunded accrued liabilities to be based on the combined payrolls of both Tier 1 and Tier 2 employees. Because the payrolls of both Tier 1 and Tier 2 employees would be combined, the Tier 1 plan would effectively have no loss of employees and therefore no loss of salary upon which to determine the contribution rate for unfunded liabilities.

Finally, 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.

Fiscal Analyst: J. Carrasco

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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.