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RETIREMENT PAYMENT OPTIONS; GENERIC BUY-IN

House Bill 4173 as enrolled
Public Act 205 of 1998
Sponsor: Rep. Kim Rhead

House Bill 4897 as enrolled
Public Act 213 of 1998
Sponsor: Rep. Eileen DeHart

Third Analysis (7-6-98)
House Committee: Public Retirement
Senate Committee: Appropriations

THE APPARENT PROBLEM:

Under both the Public School Employee Retirement System and the defined benefit provisions of the State Employees Retirement System, a member may retire with a regular retirement allowance payable throughout his or her life, or may receive the actuarial equivalent of that amount in a reduced retirement allowance payable throughout the lives of the retiree and his or her beneficiary (generally, a spouse). (This is intended to provide a continuing retirement benefit for the retiree's spouse if the retiree predeceases the spouse. If the spouse predeceases the retiree, however, the retirement allowance reverts ["pops-up"] to the regular retirement allowance amount.) Currently, the retiree chooses among several options for the reduced retirement allowance, including a continuation of retirement benefits at the same rate as paid before the retiree's death, or ½ of the reduced benefit to be payable to the beneficiary after the retiree's death, or "equated" versions of both of those, which allow a retiree to coordinate benefits with the onset of Social Security payments. (All options are based on the actuarial equivalent of the regular retirement allowance.) It has been suggested that some couples would prefer a third option that would provide for 3/4 of the reduced allowance to continue after the retiree's death.

In addition, the State Employees Retirement System Act allows members to purchase service credit for time spent in other types of public employment, for military service, for parental leave, and for other specific circumstances listed in the act that cause interruption or delays in state employment. Typically, the act requires that the member present evidence to substantiate such time and to pay to the retirement

system an amount that will "pay" for the added benefits the additional service credit will produce; the member is said to "purchase" service credit at "actuarial cost". The list of allowable reasons for purchasing service credit has steadily grown, and with it the complexity of administering the transaction. Additionally, it is sometimes very difficult for a member to produce evidence of employment that took place decades earlier, and for the retirement board to verify such service. It's been suggested that a "generic" buy-in provision be added to the act, as was done in the Public School Employees Retirement System several years ago.

Finally, several amendments to the State Employees Retirement Act have been proposed that can be considered to be technical in nature. The retirement system's actuary reportedly has suggested amending the statute's definition of "actuarial cost" (used to calculate the cost to members to purchase service credit) to more closely reflect the actual cost to the system of providing the additional benefits that result. And, though certain employees have qualified for five-year vesting in the system since 1987, not all references in the act were updated to reflect that change.

THE CONTENT OF THE BILLS:

House Bill 4173 would amend the State Employees Retirement Act (MCL 38.1a et al.) in the following ways.

- The bill would add a new option for payment of the reduced retirement allowance that would provide for

3/4 of the reduced retirement allowance to continue to be paid to the beneficiary after the retiree's death. This option would be available beginning January 1, 2000.

- Currently, the act allows for the purchase of service credit for certain specified reasons (VISTA or Peace Corps service, maternity or paternity leave, local government service, service as a federal employee or employee of another state, among others). A member may purchase up to five years service credit for any of those specified reasons, for a combined maximum of 10 years of purchased service credit. The bill would provide for a "generic" purchase of service credit; members could purchase up to five years of service credit (minus any service credit purchased for service at a Department of State branch office, VISTA or Peace Corps, or for time on an approved medical leave; these provisions would be repealed) at actuarial cost without meeting the criteria for the specific buy-ins listed in the act. As in the existing buy-in provisions, purchased service credit could not be used to satisfy the minimum number of years of service needed to receive a retirement allowance (to become "vested" in the system). If a member who had purchased service credit under this provision died or left state service before becoming vested, the payment would be refunded to the member or his or her estate. As under current law, a maximum of 10 years of service credit could be purchased.

- The bill would revise the definition of "actuarial cost" used in the calculation of the cost of purchasing service credit. (Actuarial cost is generally a percentage that, when multiplied by a person's annual compensation, results in the average actuarial present value of the additional benefits that the person would receive at retirement due to the additional year of service credit being purchased.) The act sets the percentage at 9 percent for purchases of service credit made before December 31, 1990, and specifies that beginning on that date and every three years thereafter, the percentage "shall be computed based upon actual experience". Under the bill, the retirement board would calculate the percentage used to determine actuarial value, which could vary because of age, credited service, or benefit coverage. The bill would also specify that a member's compensation used in this calculation would be the compensation earned in the fiscal year immediately preceding the year in which the purchase of service was made, and that it would be no less than the highest compensation previously earned by the member.

- The bill would amend the provision that establishes the criteria for receiving a regular (unreduced) retirement allowance. This provision requires a person to be age 60 and have 10 or more years of credited service. The bill would add language clarifying that those members who are vested in the system after five years under other provisions in the act (elected officers, unclassified executive or legislative branch employees, and certain former employees of the state accident fund and the former Department of Mental Health) may retire with a regular retirement allowance at age 60 with five years of service.

- House Bill 4173 would take effect August 1, 1998 (but the provision adding the 75 percent survivor payment option would not be available until January 1, 2000).

House Bill 4897 would amend the Public School Employees Retirement Act (MCL 38.1343c et al.) to add a third option for payment of the reduced retirement allowance, which would provide for 3/4 of the reduced retirement allowance to continue to be paid to the beneficiary after the retiree's death. This option would be available beginning January 1, 2000.

Tie-bar. House Bills 4173 and 4897 are tie-barred to each other.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bills are expected to be actuarially neutral. (1-26-98)

The Bureau of Retirement Systems in the Department of Management and Budget has estimated the first-year administrative costs associated with implementation of the 75 percent payment option at \$150,000. (1-22-98)

ARGUMENTS:

For:

The bills would add to the two major retirement systems a middle ground option for the payment of the reduced retirement allowance, used to protect a spouse after the death of the retiree. A new 75 percent option would allow a couple to receive a higher benefit while both are living than does the 100 percent survivor option, and would provide greater protection for the widowed spouse than the 50 percent option. This

would benefit those couples where the spouse of the SERS or PSERS retiree has a smaller pension, but not enough to live on after the death the retiree.

For:

The "generic" purchase of service credit provision in House Bill 4173 would streamline administrative procedures for both members and the retirement bureau, and would make the state employees system more consistent with the public school employees system, which already includes such an option.

Analyst: D. Martens

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.