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EARLY RETIREMENT FOR LEGISLATIVE EMPLOYEES

House Bill 4605 as enrolled
Public Act 743 of 2002
First Analysis (1-21-03)

Sponsor: Rep. Sandra Caul
House Committee: Senior Health, Security and Retirement (discharged)
Senate Committee: none

THE APPARENT PROBLEM:

One way that governments (and other employers) can reduce their operating costs is to offer incentives for more senior, highly paid employees to retire earlier, and then replace them (or some of them) with entry-level, lower paid workers. As part of the executive budget proposal for fiscal year 2002-2003, in which there was an estimated $970 million shortfall, one of the measures that was proposed to cut spending was an "early out" retirement plan for state employees. This plan was enacted by the legislature as Public Act 93 of 2002. About 7,900 state workers retired under the plan, which was offered to workers whose age and years of service totaled at least 80 years. As an incentive to retire early, the early retirement plan contained an increased "multiplier" of 1.75 percent (rather than 1.5 percent) in the pension formula, and waived the minimum age requirement.

(Under normal circumstances, members of the State Employees Retirement System who are participants in the defined benefit program [generally, those hired before March 1997] are eligible to retire at age 60 with 10 years of service, or at age 55 with 30 years of service, or may retire at 55 with fewer than 30 years but with a reduced retirement allowance. Pensions are calculated based on a formula that multiplies a person's years of service credit by his or her final average compensation and then by a factor of 1.5 percent.)

In continuing to deal with budget shortfalls of increasing severity, and in recognition that term limits have resulted in wholesale turnover among legislators, including the election of 54 new representatives and 29 new senators in 2002, another early retirement plan has been proposed for state employees who are employees of the legislature. The plan is also offered to employees of the office of the governor, employees of the judicial system, and unclassified employees within the state civil service (typically, the highest ranking executive branch employees). The rationale offered is that these employees serve at the pleasure of the elected officials for whom they work, and do not enjoy the relatively more secure employment status of the classified civil service workforce.

In a related matter, Public Act 93 of 2002 also established a new health advance funding subaccount to the retirement system and added language to the act requiring that excess employer contributions (e.g., employer contributions made in years in which the pension system was already fully funded for payment of basic pension benefits) be placed in that subaccount and dedicated toward payment of future health care costs. This was considered a first step toward "prefunding" health care benefits. (Basic pension benefits are prefunded, that is, the employer prepays an amount which, together with investment income, is sufficient to pay for the *future* costs being incurred on behalf of current employees and retirees. Health care benefits currently are not prefunded, but rather are paid on a year-to-year basis.) At the time that Public Act 93 was being considered, the unfunded accrued liability for health care benefits was estimated at $6.6 billion. The health advance subaccount mechanism was enacted as a means of making a down payment on that future cost. As of September 30, 2000, the State Employees Retirement System was funded at a rate of 109.1 percent. That is, it was overfunded by 9.1 percent. Thus, for fiscal year 2002-2003, employer contributions of about $112 million were directed into the new health advance funding subaccount as provided under Public Act 93. However, by the end of 2002, the governor and the legislature were forced to make a number of spending reductions and executive order cuts in order to balance the budget. As part of those budget-balancing actions, it was proposed that the SERS act be amended to allow the transfer of a portion of these funds to the general fund, to meet current budgetary needs.

Finally, under the defined benefit provisions of the State Employees' Retirement Act, Department of Corrections employees working in certain specified positions requiring supervision or custody of prisoners are considered to be in "covered" service for purposes of the retirement system. Members with "covered" service may be eligible for earlier retirement and supplementary benefits. One of the requirements for receiving a supplemental retirement allowance is that the member's final three years of employment must be in a "covered" position. Some advocate making an exception to this requirement for a member who was employed in a "covered" position in a corrections center and whose "covered" position was terminated due to the closing of the corrections center, resulting in the employee's transfer to a non-covered position. It has been argued that, in such a case, a person should be considered to be in a "covered" position (and thus eligible for a supplemental retirement allowance) if the person either continued in a non-covered position until retirement, or transferred to a covered position but whose last three years of credited service were a combination of covered and non-covered service due to the termination of the covered position by the closing of a corrections center. While earlier versions of the legislation would have enacted this policy change, due to budgetary concerns it has been proposed that this idea be subjected to further study and perhaps be considered again by the legislature at a future time.

THE CONTENT OF THE BILL:

Under current law, a member of the State Employees Retirement System who is a participant in the defined benefit program is entitled to retire with a full retirement benefit upon meeting one of the following age and service requirements:

- At age 60 with 10 or more years of credited service (or five years in certain circumstances); or,

- At age 55 with at least 30 years of service credit.

In addition, a member who is at least 55 years old with 15 to 30 years of service credit may retire, but the retirement allowance is reduced by .5 percent for each month the member is less than 60 years old.

House Bill 4605 would add language to create an early retirement option for employees of the legislature, employees of the office of the governor, and unclassified civil service employees. The program would apply during December, 2002 and would be offered to members whose combined age and length of credited service was equal to at least 75 years, and to members with at least 20 years of service credit whose combined age and length of credited service was equal to at least 65 years, as of December 31, 2002 or on the effective date of retirement, whichever was earlier. Those qualifying could retire with a full (unreduced) retirement allowance. There would be no minimum age requirement. To be eligible, a person would have to be employed by the state or the legislature (or be on layoff status) for the 30-month period ending on December 1, 2002. An application would have to be filed between December 1 and December 31, 2002, and the member would have to state a retirement date on or after January 1, 2003 and no later than February 1, 2003. A member could withdraw an application until January 15, 2003, but after that date the application would be irrevocable.

If a member met all of the above requirements except the requirement of being employed by the state or the legislature for the 30-month period ending December 1, 2002, he or she could still retire under the bill with an unreduced retirement allowance, but would not be eligible for the enhanced benefit formula (see below). These members would be subject to the regular benefit formula that uses a 1.5 percent multiplier.

The bill specifies that conservation officers and members in "covered" positions (certain Corrections Department positions) would not be eligible for the early retirement program proposed in the bill.

Enhanced benefit formula. A retirement allowance under the defined benefit program is calculated according to a formula that multiplies the member's number of years of credited service by his or her final average compensation and then by a factor of 1.5 percent. Those eligible to retire under the bill would receive, instead, an unreduced retirement allowance calculated using 1.75 percent factor. Those who are participants in the defined contribution program but who otherwise met the eligibility requirements (age and service equal to 75 years, or 65 years with 20 years of service credit) could retire under the defined benefit formula with a .25 percent retirement factor (i.e., years of service x final average compensation x .25 percent).

Payments for sick leave. Any amount that a member retiring under the bill would otherwise be entitled to receive in a lump sum at retirement on account of unused sick leave would be paid in monthly installments over five years beginning on or after February 1, 2003. The bill specifies that payments received under this provision could not be used to purchase service credit under the act. Payments for sick leave would be paid from funds appropriated to the appointing authority, and not from funds of the retirement system. Payments for sick leave would be taxable income.

Re-employment with the state. An employee who retired under the bill's early retirement provisions could not be hired under contract by the state for a period of two years after the date of separation from state service.

Further, the bill specifies that *any* retiree (whether he or she retired under the bill's early retirement plan or otherwise) who was rehired by the state and entered on the state payroll on or after December 1, 2002, would no longer be a member of the defined benefit program, but would instead be a new member of the defined contribution program.

Transfer of funds from health advance subaccount to general fund. Under the bill, for fiscal year 2002-2003 only, the general fund portion of all amounts received in the health advance funding subaccount as of October 1, 2002 (and accumulated earnings on those amounts) would be transferred to the general fund. [According to the Senate Fiscal Agency, this is estimated to be about $60 million.]

"Covered" positions. Under the bill, the retirement board would be required to report to the House and Senate Appropriations Committees, by June 30, 2003, on the cost of transferring persons to noncovered positions if they were in covered positions with corrections centers before their positions were terminated due to the closure of the corrections centers between August 1, 1999 and August 1, 2000, if these persons continued in noncovered positions until retiring as supplemental members, or if they transferred to covered positions but whose last three years of service were a combination of covered and noncovered service due to the termination of covered positions by the closure of a corrections center. (See *The Apparent Problem*.)

MCL 38.11 et al.

BACKGROUND INFORMATION:

Previous "early out" legislation. The legislature has enacted several early retirement programs for state employees. As noted, Public Act 93 of 2002 offered an "80 and out" plan with no minimum age requirement, and was the first such plan to include an increase in the multiplier used in the pension formula. Reportedly, nearly 8,000 state employees retired under the plan between July 1 and November 1, 2002. Public Act 93 also was the first such plan to offer an equivalent incentive for DC plan members.

In addition, in 1984 and 1987, state employees were offered "80 and out" programs, and in 1991 and 1992, there were "70 and out" provisions for limited periods of time. Then, in 1996, another early retirement program was offered in conjunction with legislation that created a new defined contribution retirement program, which was mandatory for all new employees. Generally, these programs have reduced the required age and/or years of service, increased the pension formula multiplier, or both. Most of the previous early retirement plans (except the 2002 legislation) have required participants to be at least 50 years old.

Defined contribution program. The 1996 legislation created the defined contribution program, in which all employees hired after March 1997 are participants. (Retirement systems for state employees, legislators, and judges were amended to implement the new plan.) Employees who were currently covered under the defined benefit program were offered an opportunity to convert their retirement assets into the new DC plan during a four-month "window" in 1998.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the early retirement program would result in actuarial costs to the retirement system of $150,000 to $200,000 per year, an amount that is considered to be actuarially insignificant. The program is estimated to result in gross general fund savings of about $6 million per year, less health insurance costs of about $2 million, resulting in a net savings of $3.5 million to $4 million per year. (1-17-03)

ARGUMENTS:

For:

The early retirement plan is expected to save the state up to $4 million per year, and is needed to balance the budgets of the legislative agencies. It is more humane to address the budget difficulties by providing some workers with a choice of retiring early, rather than having to lay off employees to cut costs. The plan is very similar to the earlier plan offered to state employees. It differs in that its eligibility is broader; more unclassified employees qualify under this plan than would have under the earlier “80 and out” plan. The rationale for offering a broader early retirement plan for staff who work for elected officials is that these workers enjoy considerably less job security than do those state workers who are in civil service positions.

Against:

The plan has been criticized as being overly generous, a “sweetheart deal” to reward those who are close to legislators and other elected officials. Some believe that the cost cutting rationale is very thin.

For:

A provision in the bill would allow for the transfer of about $60 million to the general fund to help shore up the state’s general fund, which is woefully short of funds to support state programs. The money comes from “excess” contributions not needed at the present time to fund retirement benefits.

Against:

Under Public Act 93 of 2002, a policy change was implemented to begin using these “excess” funds to help pay for the future costs of retirees’ health care benefits. Concern was raised at the time that this policy change would have the negative effect of “locking in” all future surpluses for this purpose, leaving nothing to fund benefit increases (as has been done from time to time). It was argued at the time that the system’s $863 million in overfunding should be used, instead, to enhance benefits for current retirees. And, there was fear that the legislation left open the possibility that the new health subaccount could be “raided” for other uses. Less than a year later, the prediction is coming true! Money in the pension fund, including employer contributions and investment earnings, should be used for the benefit of retirees, not to balance the state’s budget.

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.