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BILL ANALYSIS

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Senate Bill 1021 (as introduced 2-25-04)
Sponsor: Senator Cameron S. Brown
Committee: Appropriations

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CONTENT

The bill would amend the State Police Retirement Act to allow the banked leave time and furlough hours for State Police employees to count as full credited service for the purpose of determining an employee's retirement benefit. The bill also would include in the definition of "compensation" the furloughed and banked leave time hours. The bill would eliminate the current annual retirement benefit limit of $90,000 and instead limit an annual retirement benefit to the limitations set forth under current Internal Revenue Service (IRS) regulations. Finally, the bill would implement a deferred retirement option plan (DROP) for State Police officers.

The bill would define "banked leave time program" as the Part B annual leave hours within the annual and sick leave program for State employees approved by the IRS on September 5, 2003, in which a pay reduction or other concessions are applied to a member or qualified participant in exchange for additional Part B annual leave hours (Part B annual leave is the banked leave time program). The bill also would define "furlough hours" as the unworked hours incurred in conjunction with the banked leave time program.

Currently, payment for accrued annual leave at separation in excess of 240 hours is not included in the determination of final average compensation (FAC). The bill would extend this prohibition to the payment for banked leave time hours. However, beginning October 1, 2003, the bill would allow the computation of an employee's FAC to include the value of any unpaid furlough hours and the value of any unpaid hours exchanged for Part B annual leave hours calculated at the member's then-current hourly rate of pay. Additionally, the current law defines the "last 2 years of service" as the two-year period immediately preceding the member's last day of service, or in the case of a duty disability, the period of two consecutive years of service with the Department of State Police immediately preceding the date of the duty disability. The bill would add to the definition the two-year period immediately preceding participation in DROP.

The bill would define "officer", as a nonexclusively represented member of the retirement system.

The bill also would create the Health Advance Funding Subaccount for the purpose of receiving deposits in years when the assets for normal retirement benefits are funded at 100% or more. In those years, employer contributions could be deposited into the new subaccount. Funds from the subaccount could not be spent until the actuarial liability for health benefits was fully funded. Also, the Department of Management and Budget would be permitted to transfer amounts from the Health Advance Funding Subaccount to the reserve for employer contributions (the fund set aside for pensions of future retirees) to cover any underfunding that might arise for normal retirement costs.

Also, the bill would require any benefits that are paid from an arrangement and fund account to be paid from a portion of the employer contributions. The retirement board would have to determine the amount of the employer contributions or other eligible funds that would be allocated to the arrangement and fund account and deposit that amount in that account before it deposited any remaining employer contributions or other eligible funds in the pension fund.

Under current law, a retirement benefit is limited to the lesser of $90,000 per year or 100% of the member's highest three-year average compensation as described in Section 415(b)(3) of the Internal Revenue Code (IRC). The bill would delete the $90,000 maximum retirement benefit that may be received by a member and instead provide that the benefit limitation would be solely limited by Section 415 of the IRC. Current IRS regulations set the limit at $160,000 per year.

Additionally, the bill would make several technical changes to bring the State Police Retirement Act into compliance with changes in Federal regulations.

The bill would add a new language creating the DROP program. The program would be developed within the existing defined benefit plan and administered by the Office of Retirement Services. The plan would allow an officer with 25 or more years of credited service to participate in the DROP program. The DROP program would allow a participant to defer his or her retirement for up to six years but continue to be an employee of the State Police. The participant would remain an active employee and would be eligible to receive any applicable wage changes and benefits, would be subject to Civil Service rules and regulations, and would be subject to removal in the same manner as if he or she had not elected to participate in the DROP program.

Once a member elected to become a DROP participant, a DROP account would have to be created for the deposit of the deferred retirement benefits. The amounts deposited into the DROP account would earn interest at the rate of 3% per year, prorated for any fraction of a year. The DROP account of a DROP participant would have to be credited with the following percentage of his or her monthly retirement allowance as calculated as if he or she had retired on the day prior to becoming a DROP participant:

A. 100% if the officer remained in the DROP program for 6 years.
B. 90% for 5 years but less than 6 years.
C. 80% for 4 years but less than 5 years.
D. 70% for 3 years but less than 4 years.
E. 60% for 2 years but less than 3 years.
F. 50% for 1 year but less than 2 years.
G. 30% for less than 1 year.

A DROP participant could not receive a monthly retirement benefit allowance until termination of his or her participation in the DROP program and commencement of retirement. A DROP participant also would not have any claim to any funds in his or her DROP account until he or she retired. Upon termination of DROP program participation, the former DROP participant could receive funds from his or her DROP account in a lump-sum distribution, a partial lump-sum distribution, or a lump-sum direct rollover to another qualified plan; or the funds could be maintained in the account. However, all funds would have to be removed from the DROP account by April 1 following the calendar year in which the DROP participant attained age 70 years, 6 months of age, or the calendar year in which the DROP participant retired, whichever was later.

If a current or former DROP participant died before removing all funds from his or her DROP account, the remaining funds would have to be paid to the participant's designated beneficiary. If no beneficiary were named, the funds would be paid to the participant's estate. In addition, if a DROP participant became disabled, his or her participation in the DROP program would cease and the member would be retired.

The DROP program would have to be administered in compliance with Section 415 of the Internal Revenue Code (IRC). The bill also would provide for a DROP participant's payment for sick leave, annual leave, and longevity pay, as well as the accrual of sick leave, annual leave, and compensatory time. Participants in DROP would have to pay the health insurance premiums that would have been payable under Section 42 as if they had retired on the day prior to becoming a DROP participant. Finally, if the IRS notified the State that any section of the DROP program disqualified the retirement system for tax purposes, then that section would not apply.

MCL 38.1603 et al.

FISCAL IMPACT

The banked leave time program and furlough hours portion of the bill would have no fiscal impact on State or local resources. The banked leave time and the furlough days are days and work hours that would have been accumulated anyway, and thus are already accounted for in all actuarial assumptions.

For the DROP program, the bill could result in projected annual GF/GP savings for the Department of State Police of $3.3 million. The bill would provide an opportunity for the Department's enlisted employees who have served sufficient State service to qualify for retirement (at least 25 years), to volunteer to continue working for six additional years under the DROP program. To the extent that eligible employees opted for the plan, savings to the annual Department budget would result. The Department would be responsible for paying only for the salary costs of the those employees and not employee-related costs for insurance and retirement; that burden would be assumed by the State Police retirement system, which is fully funded to do so. This would result in annual savings of between 30% and 40% of the total cost of an employee, or an average of $42,800 per Command officer and $33,000 per Trooper and Sergeant. The total savings for the Department would depend upon the number of eligible employees who signed up for the DROP program. Currently, 125 employees would qualify (52 Command officers, 73 Troopers and Sergeants). In July 2004, another 80 employees would become eligible for the program, but following that, it would not be until 2007 that another group of enlisted employees would become eligible.

It is estimated that among the 52 Command officers eligible for the DROP program, nearly all would choose to sign up. However, it is not known how many of the 73 eligible Troopers and Sergeants would join the plan. Should 50 of the Command officers join the plan, annual savings of $2,138,800 would result, and if 35 (approximately half) of the Troopers and Sergeants joined the plan, annual savings of $1,115,000 would be gained, for total annual savings for the Department of $3,293,800.

Of immediate concern to the State budget is the fact that Executive Order 2003-23 reduced GF/GP appropriations for Uniform Services by $1.3 million in anticipation of six months of savings from a DROP program being operative for Command officers by April 1, 2004, with 70 officers participating. Should the bill be enacted in time to allow for those eligible and predicted to join the DROP program beginning April 1, 2004, a six month saving of $1,646,900 GF/GP would result, an amount sufficient to meet the reduction assumptions set forth in the FY 2003-04 budget reduction agreement.

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