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BILL ANALYSIS

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Senate Bill 635 (as introduced 6-22-05)
Sponsor: Senator Wayne Kuipers
Committee: Education

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CONTENT

The bill would amend the Public School Employees Retirement Act to provide for a defined contribution retirement plan. The bill would require all new members hired on or after the implementation date (July 31, 2005) to become members of the new Tier 2 (defined contribution) plan. All individuals who were members of the Michigan Public School Employees Retirement System (MPSERS) before the implementation date would have the option of remaining in the Tier 1 (defined benefit) plan or becoming a qualified participant in Tier 2. In addition, all members would be eligible to receive health care benefits as prescribed in the proposed bill.

Currently, all members of the MPSERS 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 before the implementation date and who do not elect to become a qualified participant in Tier 2. 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.

The MPSERS board could promulgate rules pursuant to the Administrative Procedures Act for Tier 1 retirement plans but not for Tier 2 plans. In addition, the board could not promulgate rules for the establishment, implementation, administration, operation, investment, or distribution of a Tier 2 retirement plan.

For fiscal years beginning on or after the bill's effective date, 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.)

Members, or deferred members who first became a member of MPSERS 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 to a retirant's or deceased member's retirement allowance beneficiary. If the retirant or deceased member had between 20 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 under 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) (for a member

having less than 30 years of service who retires before his or her 60th birthday).

All new employees hired after the implementation date would have to become members of the Tier 2 plan. In addition, the MPSERS 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 MPSERS would have to accept written elections beginning on September 30, 2005 and ending on December 31, 2005, for members choosing to switch to the Tier 2 retirement plan. An employee who elected to change 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 12 midnight on December 31, 2005.

2. Become a qualified participant in Tier 2, effective 12:01 a.m. on January 1, 2006.

3. Waive all rights to a pension, an annuity, a retirement allowance, an insurance benefit, or any other benefit under Tier 1, effective 12 midnight on December 31, 2005.

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 would have 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 could not be used to decrease the actuarial rate charged by the retirement system to reporting units.

The State Treasurer and the DMB would have the following duties and responsibilities:

* The State Treasurer would 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 its duties as fiduciary and trustee.

* The DMB would determine the provisions and procedures of Tier 2 in conformity with the Act and the Internal Revenue Code.

* The DMB would 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 become 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 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 premium 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 non-duty disability and death benefits would be paid to a Tier 2 qualified participant as if he or she 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 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 his or her accumulated balance in the person's defined contribution account. Upon the 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 of 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.
-- 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 those contributions, plus the employee and matched employer contributions (up to a maximum of 6%) and the earnings on those contributions, 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 Department of Management and Budget 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 the portion that would cause disqualification would not apply.

MCL 38.1304 et al.

FISCAL IMPACT

The exact fiscal impact of the Tier 2 plan is indeterminate. The bill contains a provision that any cost savings would not be used to decrease the actuarial rate charged by the retirement system.

Second, the unfunded accrued liabilities for the Public School Employees Retirement

System would remain under control. The bill contains specific language to head off any unanticipated 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.

An actuarial valuation would be required in order to get a sense of the potential savings that could be realized if the system switched from a defined benefit plan to a defined contribution plan. Any potential savings would be several years down the road because all current and near-future retirees still would be defined benefit (DB) retirees. The only real immediate savings would come in the employers' (schools') contributions to the system.

Currently, employers (schools) pay 14.87% of an employee's salary into the retirement system to pay for retirement benefit costs. The new defined contribution (DC) plan would require schools to pay a mandatory 4% of an employee's salary into his or her DC account. In addition, the DC plan would allow the first 3% paid by the employee to be matched by the employer.

The experience data from the current State Employees Retirement System show that, on average, DC members contribute 6% of their salary to the DC plan, meaning that the State contributes an additional 3% for an average total of 7% being paid by the State for each State employee who is a DC member. In addition, the State pays the same contribution rate for health benefits for DC members as it does for DB members. If it is assumed that the same would happen in the MPSERS if the bill were enacted, using an average teacher salary of $55,000, the difference between the current payment of 14.87% of salary versus a maximum of 7% for retirement and 6.55% for health benefits under a DC plan school, districts would save on average an estimated $726 per new hire (or existing employee who chose to switch from the DB plan to the new DC plan).

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.

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