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BILL ANALYSIS

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Senate Bills 546 and 547 (as introduced 5-25-07)
Sponsor: Senator Wayne Kuipers
Committee: Education

Date Completed: 5-30-07

CONTENT

Senate Bill 546 would amend the Public School Employees Retirement Act to require the Public School Employees Retirement System (PSERS) to pay 90%, rather than 100%, of health insurance premiums for a retirant who became a member of the system after June 30, 2008; require the retiree to be at least 60 years old; and provide for a reduced payment if the retiree had at least 10 but less than 30 years of service credit.

Senate Bill 547 would amend the Public School Employees Retirement Act to do the following:

- **Increase the required contribution to the Member Investment Plan for a person who first became a member of PSERS on or after July 1, 2008, and who earned over $15,000.**
- **Require all members aged 60 or older to have at least 10 years of credited service before being entitled to a retirement allowance.**
- **Require a person who became a member on or after July 1, 2008, to have 10 years of service after purchasing service credit, before the purchased service could be credited to the member.**
- **Require PSERS to pay 90%, rather than 100%, of health insurance premiums for a retirant who became a member after June 30, 2008, and who was at least 60 and had at least 30 years of service credit (as proposed by Senate Bill 546).**
- **Remove current limitations on the benefit amount that a retirant may receive annually, and instead provide that benefits could not exceed limitations set forth in Section 415 of the Internal Revenue Code (IRC).**
- **Provide that if any section of the Act were held to be invalid or unconstitutional for any reason, the holding would not affect the validity of the remainder of the Act or the Act in its entirety.**

Senate Bill 546 is tie-barred to Senate Bill 547.

The bills are described in detail below.

Senate Bill 546

Under the Act, except as otherwise provided, PSERS must pay the entire monthly premium or membership or subscription fee for hospital, medical-surgical, and sick care benefits for the benefit of a retirant or retirement allowance beneficiary who elects coverage in the plan authorized by the retirement board and the Department of Management and Budget (DMB). This system also must pay up to 90% of the maximum amount payable under these provisions for hospital, medical-surgical, and sick care benefits coverage for each health insurance dependent of a retirant receiving benefits.

In addition, PSERS must pay 90% of the monthly premium or membership or subscription fee for dental, vision, and hearing benefits for the benefit of a retirant or retirement allowance beneficiary who elects coverage in the authorized plan. The system also must pay 90% of the monthly premium or membership or subscription fee for dental, vision, and hearing benefits for the benefit of each health insurance dependent of a retirant receiving those benefits.

Under the bill, these provisions would not apply to a retirant who first became a member of PSERS after June 30, 2008.

Instead, for a member or deferred member who first became a member after June 30, 2008, PSERS would have to pay up to 90% of the monthly premium or membership or subscription fee for the hospital, medical-surgical, and sick care benefits plan, the dental plan, vision plan, or hearing plan, or any combination of the plans for the benefit of the retirant and his or her 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 at least 30 years of service credit or employment with a reporting unit or units under the Act, and the retirant or deceased member were at least 60 years of age at the time of the application for benefits.

If a retirant or deceased member had 10 or more but less than 30 years of service credit or employment with a reporting unit or units and the retirant or deceased member were at least 60 years of age at the time of application for benefits, PSERS would have to pay a portion of the monthly premium or membership or subscription fee for the plans or combination of plans equal to the product of 3% and the retirant's or deceased member's years of service.

The retirement system could not pay the premiums or membership or subscription fees described above until the retirant or beneficiary requested enrollment in the plans or combination of plans in writing in the manner prescribed by PSERS. The above provisions would not apply to a member who received a disability retirement allowance under the Act or to a deceased member's retirement allowance under Section 90.

(That section provides for the payment of benefits to the surviving spouse of a deceased member receiving worker's compensation. The retirement allowance beneficiary's retirement allowance is computed as otherwise provided in the Act, except that the reduction for early retirement does not apply.)

<u>Senate Bill 547</u>

<u>Retirement Plan Contributions</u>

Under the Act, except as otherwise provided, a member of PSERS who first became a member on or after January 1, 1990, must make the following contributions to the Member Investment Plan (MIP) created under the Act:

-- If the member's annual earned compensation for the school fiscal year is not over $5,000, 3% of the member's compensation is payable to MIP.
-- If the member's annual earned compensation for the school fiscal year is over $5,000 but not over $15,000, $150 plus 3.6% of the excess over $5,000 is payable to MIP.
-- If the member's annual earned compensation for the school fiscal year is over $15,000, $510 plus 4.3% of the excess over $15,000 is payable to MIP.

Under the bill, a member who first became a member on or after July 1, 2008, if his or her annual earned compensation for the school fiscal year were over $15,000, the required contribution would be increased to $510 plus 6.4% (rather than 4.3%) of the excess over $15,000.

Currently, a person who first became a member on or before December 31, 1986, but did not perform membership service between that date and January 1, 1990, and who returns to membership service on or after January 1, 1990, also must contribute to MIP as described above.

Under the bill, that provision would apply only to a member who first became a member before July 1, 2008.

<u>Years of Service</u>

Under the Act, a member of the retirement system who is no longer working as a public school employee or in any other capacity for which service credit is allowed under the Act is entitled to a retirement allowance if, among other things, the member is 60 years of age or older and has accumulated 10 or more years of credited service as a public school employee.

For a member who contributes to MIP, the 10 years of credited service is reduced to five years if the member is working as a public school employee and received credited service in each of the five school fiscal years immediately preceding the retirement allowance effective date. Under the bill, this provision would apply only to a member who became a member on or before June 30, 2008.

Purchase of Service Credit

The Act allows a member to purchase up to five years of service credit, less the number of years of service credit purchased under certain other provisions (under which credit had to be purchased before January 31, 1991), upon request and payment to PSERS of the actuarial cost.

Under the bill, service credit purchased under this provision could not be credited to a member who became a member on or after July 1, 2008, unless he or she followed the purchase of service credit with 10 years of reporting unit service under the Act.

In addition, a member who left or leaves service as a public school employee for purposes of maternity or paternity or child rearing, and returns to service as a public school employee, or a person performing out-of-system public education service who leaves that service for maternity, paternity, or childrearing and who subsequently becomes a member of PSERS, without intervening employment of more than 20 hours per week for each week for which service credit is claimed, may purchase service credit for the time period or periods during which he or she was separated from service.

Under the bill, service purchased under this provision could not be credited to a member who became a member on or after July 1, 2008, unless he or she had at least 10 years of reporting unit service under the Act.

Under the Act, a member is not entitled to a retirement allowance based on out-of-system public education service that was performed after July 1, 1974, unless the member purchases service credit for those years by paying into PSERS an amount based on the member's compensation in the preceding school fiscal year, multiplied by the years of service that the member elects to purchase, and unless that service is followed by five years of reporting unit service.

Similar provisions apply to a member purchasing service credit for service performed as an employee in a nonpublic elementary or secondary educational institution or a nonpublic two- or four-year institution of higher education in the State; an employee in a foreign country at a school for U.S. military personnel or U.S. Department of State personnel; a full-time teacher with the Jobs Corps; a teacher in a trust territory or former trust territory of the United States; or a teacher on an Indian reservation in this country.

Under the bill, a member who became a member on or after July 1, 2008, and who purchased service credit under those provisions would have to follow the purchase of service credit by 10 years of reporting service under the Act, rather than five years.

Limitations on Benefits

Currently, unless otherwise provided, employer-financed benefits provided by PSERS may not exceed $10,000 per year for a retirant who has 15 or more years of credited service at retirement.

The benefits may not exceed that limitation unless one of the provisions described below results in a higher limitation. In that case, the employer financed benefits provided by PSERS may not exceed the lesser of the following:

1) One of the following amounts as applicable to the member:

-- If a member retires at age 62 or older, $90,000 or the amount adjusted for increases in cost of living.
-- If a member retires at or after age 55 but before age 62, the actuarially reduced amount of the limit provided above (calculated with an interest rate of 5% per year compounded annually) although the limitation may not be reduced actuarially below $75,000.
-- If a member retires before the age of 55, the actuarially reduced amount of the preceding limit (calculated with an interest rate of 5% per year compounded annually).

2) 100% of the member's average compensation for the high three years as described in Section 415(b)(3) of the IRC.

(The IRC limits a recipient's compensation to 100% of the recipient's average compensation for his or her high three years, which means a period of not more than three consecutive calendar years during which the participant was an active participant in the plan and had the greatest aggregate compensation from the employer.)

The Act provides that the higher limitation under these provisions applies to employer-financed benefits provided by PSERS, and, for the purposes of Section 415(b) of the IRC, applies to aggregated benefits received from all qualified pensions plans administered by the Office of Retirement Systems in the DMB. These provisions must be administered using the limitations applicable to each calendar year as adjusted by the Secretary of the Treasury or his or her delegate under Section 415(d) of the IRC. The retirement system must adjust the benefits subject to the limitation each year to conform with the adjusted limitation. (Section 415 of the IRC provides limits on benefits and contributions under qualified retirement plans. Section 415(d) provides for annual cost-of-living adjustments to those limitations. Section 415(b) specifically deals with limitations for defined benefit plans.)

The bill would remove those provisions. Instead, employer-financed benefits provided by PSERS could not exceed the applicable limitations set forth in Section 415, as adjusted by the Commissioner of Internal Revenue to reflect cost-of-living increases, and PSERS would have to adjust the benefits subject to the limitation each calendar year to conform with the adjusted limitation.

For the purposes of Section 415(b) of the IRC, the applicable limitation would apply to aggregated benefits received from all qualified pension plans for which the Office of Retirement Services coordinated administration of that limitation.

As currently required, PSERS would have to be administered in compliance with the provisions of Section 415 of the Internal Revenue Code and regulations under that section that are applicable to governmental plans.

MCL 38.1391 (S.B. 546)
38.1343a et al. (S.B. 547)

Legislative Analyst: Curtis Walker

FISCAL IMPACT

Senate Bill 546

State: The bill would have a small fiscal impact on the State. The Office of Retirement Services (ORS) already administers PSERS, but could need to increase staff or responsibilities associated with implementing the changes in this bill.

Local: Under the graded premium program provision in this bill, local districts eventually would see significant savings due to lower PSERS contribution rates for retiree health benefits. However, there would be no savings in the first 10 years of the program. Savings gradually would increase over the course of 30 to 40 years, when all retirees would be covered under the graded premium program. The ORS estimates that in the long term, districts could save up to 43% of total health care costs once all retirees fell under the plan and subsequently retired.

If this program had been in place over the past 40 years, the State's health care expenses for PSERS retirees would have been $433.2 million in FY 2005-06 rather than the $760.0 million actually incurred, savings of $326.8 million. Health benefit expenses have been increasing in recent years and are likely to continue to increase. Accordingly, the amount of savings generated by a 43% reduction in costs also would increase by the time the plan was fully developed and implemented.

The provision in this bill that would place an age requirement on health care benefits also would produce savings for districts in the long term. There would be no savings in the first 10 years of the program, since the earliest any newly hired employee could retire with benefits would be after 10 years of service when he or she was at least 60 years old. After 10 years, there would be gradually increasing savings for the next 20 to 25 years. Like the graded premium program, full savings would not be realized for 30 to 40 years, when all retirees fell under the plan and subsequently retired. It is difficult to project savings that far into the future, but in the current fiscal year approximately $119 million will be paid for PSERS retirees who are under 60 years old.

Again, the actual savings likely would be higher due to increasing health care costs.

Senate Bill 547

State: The bill could have a small fiscal impact on the State. The Office of Retirement Services could need to increase staff or responsibilities associated with implementing the changes in this bill.

Local: Increasing the member contribution rate from 4.3% of salary over $15,000 to 6.4% would produce savings for reporting units of PSERS. The member contributions are credited against what a district owes to PSERS for the normal cost portion of the retirement rate. Therefore, increasing member contribution would decrease the amount required from the district. Assuming 10,000 new public school employees are hired per year with an average starting salary of $35,000, this provision would generate savings of $7.35 million in the first year, with a similar additional cumulative amount in the following years.

The provision eliminating the "60 and 5" retirement provision also would create savings for districts. This provision allows a member to retire at age 60 with five years of service, provided the person worked through his or her 60th birthday and worked in each of the last five years. The total number of people falling under this age/service category is 3,345 out of a system with over 157,000 retirees, or about 2%. An estimate of cost savings is unavailable at this time. However, since the number of retirees who fall under this age/service category is a small percentage of the total, savings are likely to be small.

The provision in this bill requiring 10 years of service for purchased service credit would not generate savings for local districts. Under this bill, two different criteria would determine when a member could retire with full benefits. First, Member Investment Plan (MIP) members may retire as soon as they have 30 years of credited service. The proposed change would not affect this group. A second group may retire at 60 with 10 years of service. Under current law, purchased years of credit cannot count toward the 10-year service requirement, so this group would not be affected by the proposed change.

Under the graded premium program provision in this bill, local districts eventually would see significant savings due to lower PSERS contribution rates for retiree health benefits. However, there would be no savings in the first 10 years of the program. Savings gradually would increase over the course of 30 to 40 years, when all retirees would be covered under the graded premium program. The ORS estimates that in the long term, districts could save up to 43% of total health care costs once all retirees fell under the plan and subsequently retired.

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Fiscal Analyst: Kirk Sanderson