Legislative Analysis

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STATE EMPLOYEES' RETIREMENT REVISIONS

Senate Bill 1226 (H-38 as amended)
Sponsor: Sen. Mark Jansen
House Committee: Oversight and Investigations
Senate Committee: Appropriations

Complete to 9-23-10

A SUMMARY OF SENATE BILL 1226 AS PASSED BY THE HOUSE

The bill would amend the State Employees' Retirement Act (MCL 38.11 et al.) to make the following changes to State employees' retirement benefits:

<u>Retirement Incentives for Employees in the Defined Benefit Pension Plan</u>
Currently State employees have to be age 55 and have 30 years of service to be eligible to retire. For employees who retire between November 1, 2010 and January 1, 2011, the bill also would allow employees to retire if their age plus years of service equal at least 80 or if their total years of service were equal to at least 30. This would apply to classified civil service employees, unclassified state employees, legislative branch employees, and judicial branch employees. Employees who wanted to retire as of November 1 would have to apply by October 22, 2010 and would have until October 22, 2010 to withdraw their application. Employees who want to retire after November 1 through January 1 would have to apply by November 5, 2010 and would have until November 5, 2010 to withdraw their application.

In addition, for members who retire by January 1, 2011 the bill provides a 1.6% multiplier in the pension formula for an employee who is eligible to retire under current eligibility and a 1.55% multiplier for members who qualify under either of the early out provisions described above. Currently a member's pension calculation equals their final average compensation (FAC) multiplied by their years of service multiplied by 1.5%. The bill caps the final average compensation to which the additional multiplier is applied at $90,000.

The bill would allow members who are conservation officers or who are eligible for supplemental early retirement as a covered employee (positions in a State correctional facility or center for forensic psychiatry) to retire under the increased multiplier as described above or under the current supplementary provisions but not both.

Employees retiring during this period would forfeit the lump sum payment of their accumulated annual leave, sick leave, and other deferred leave time payouts and would instead receive an equal amount through a supplemental retirement allowance payment over 60 monthly installments beginning January 1, 2011. The bill would prohibit such payments from being used to purchase service credit. This subsection would not apply to banked leave time.

The bill would allow for a department director to request an extension to allow an employee to remain until July 1, 2011. It would require approval by the Director of the Office of the State Employer and the State Budget Director or the Senate Majority Leader, the Speaker of the House, Director or Chair of the Legislative Retirement System, Chair of the Legislative Council, or the Chief Justice, depending where the employee works. Service accumulated during an extension will not be considered to determine which eligibility criteria, and hence which enhanced pension multiplier, the employee may retire under.

The bill would require that the additional costs to the pension system created by early out and the increased multiplier be amortized over a 5-year period.

<u>Contribution into Irrevocable Trusts for Retiree Health Care</u>

Beginning November 1, 2010, the bill would require that all state employees contribute 3% of their compensation into a funding account, which under the bill would mean an irrevocable trust which would be established under Public Act 77 of 2010, the Public Employee Retirement Health Care Funding Act, and would be established and administered under Section 115 of the Internal Revenue Code. Funds deposited in the irrevocable trust could be used to pay for retirement health care benefits for retirees and their eligible dependents now or in the future. The contributions would be required for three fiscal years and would end on September 30, 2013.

<u>Modify Retiree Health Care Benefits</u>

Currently, employees in the Tier 2 defined contribution plan vest in retiree health care benefits including hospitalization, medical, dental, and vision insurance after 10 years of employment. The State pays a portion of the premium for retiree health insurance benefits for Tier 2 retirees in an amount equal to 3% times the number of years of service up to 30 years, not to exceed 90%.

For employees hired prior to April 1, 2010, the bill would revise the State portion to equal the lesser of the amount described above or the portion of health insurance premiums paid for by the State for Tier 1 members under Section 20d, which caps the State premium share for Tier 1 retirees at the same share paid for by the State for classified civil service employees. The State currently pays 90% for classified civil service employees (95% if they choose a health maintenance organization (HMO) option), so the bill would not decrease the State's premium share for Tier 2 retirees directly but would tie it to future changes in the State's premium share for Tier 1 retirees and active civil service employees, who were hired prior to April 1, 2010.

In addition, the bill would cap the State's health insurance premium share for Tier 2 retirees who were originally hired after April 1, 2010 to the lesser of the premium share provided under Section 20d or to the share provided to active civil service employees hired after April 1, 2010. For most civil service employee positions, the State's premium share was recently negotiated to a maximum of 80% (85% if they choose an HMO option).

The bill would also eliminate the current option that allows retirees to elect health insurance coverage other than what is provided by the Civil Service Commission in Section 20d and requires that the retirement system pay an amount equal to the amount of the State's share of the monthly premium directly to the other health insurance plan or medical savings account. After January 1, 2011, the bill would allow only a retiree or dependent who had previously elected alternative coverage to continue doing so at his or her own cost.

<u>Independent Contractors</u>
Currently statute requires that a retiree who is employed by the state either directly or indirectly through a contractual agreement with a third party, must forfeit their retirement benefits while employed. The bill would amend this to include retirees who are employed by the state through an arrangement as an independent contract beginning October 1, 2010. This would not apply to a retiree engaged as an independent contractor on October 1, 2010 as long as he or she remains in the same contract in place on October 1, 2010 without amendment or extension.

The bill would also exempt certain retirees working for the Attorney General from both the current double dipping prohibition as well as the additional restrictions on independent contractors. This would apply to the appointment of a retiree, who was formerly an assistant attorney general, as a special assistant attorney general, if the Attorney General determines that the retiree has a specialized experience and expertise necessary for an appointment and that the appointment would be the most cost-effective option for the State.

<u>Provide Supplemental Appropriation for the Office of Retirement Services.</u> The bill would provide $1.6 million for FY 2009-10 for the Office of Retirement Services, which is in the Department of Technology, Management, and Budget, for administering the changes required under the bill. The appropriation would be designated a work project and the funds could be carried forward for use in FY 2010-11.

FISCAL IMPACT:

<u>Retirement Incentives</u>
Increasing the pension calculation multiplier 1.5% to either 1.55% or 1.6% and allowing for early retirement for those with a combined 80 years in age and service and those with 30 years of service will cost approximately $386.6 million. The costs will be distributed over the next 7 years, but will be offset by an estimated $406.1 million in savings from replacing only 2 out of every 3 employees, thus allowing the state to reduce it's workforce sooner than it otherwise would have experienced through attrition. This assumes retirement rates based on the State's experience with PA 75 of 2010, the recent retirement reforms enacted for the Michigan Public School Employees' Retirement System.

Employee Contribution into Irrevocable Trusts for Retiree Health Care

Requiring state employees to contribute a percentage of their salary equal to 3% for FYs 2010-11 through 2012-13 for retirement health care would allow for a reduction in the employer contribution paid by the State. Estimated savings would be approximately $75.2 million for FY 2010-11 and could total $239.2 million over ten years.

Modify Retiree Health Care Benefits

The fiscal impact of reducing the State's premium share in the Tier 2 defined contribution plan for future employees to the maximum share provided to civil service employees is indeterminate. Savings will not be achieved for a minimum of 10 years before employees hired after April 1, 2010 are vested in any health insurance benefit, and it will be many years before this change applies to a significant proportion of State retirees. The savings will depend on future health care costs and on the portion of premium paid by the State for civil service employees in the future.

Ten Year Net Savings/Costs

See the attached table for a ten-year analysis of projected net savings/costs of the proposed bill. While the bill could create net savings in FY 2010-11 of approximately $205.1 million Gross ($79.6 million GF/GP), the savings will drop somewhat as the added costs of the retirement incentives are not borne by the State until the third year. Over ten years, the net savings could total approximately $258.7 million Gross ($100.4 million GF/GP).

ORS Appropriation

Finally, the bill would appropriate $1.6 million for FY 2009-10 for the Office of Retirement Services for implementation costs.

Fiscal Analyst: Bethany Wicksall

Estimated Fiscal Impact of SB 1226 - AS PASSED BY THE HOUSE

(in millions)

	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	**Cumulative 10 Year Total**
Employee Contributions for Retiree Health Care											
3% per year for 3 years	$75.2	$82.0	$82.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	**$239.2**
subtotal	**$75.2**	**$82.0**	**$82.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$239.2**
Additional banked leave costs	**($10.6)**	**($5.7)**	**($5.7)**	**($5.7)**	**($5.7)**	**$6.7**	**$6.7**	**$6.7**	**$6.7**	**$6.6**	**$0.0**
One Time Replacement Savings	$68.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	**$68.0**
Ongoing Replacement Savings	$101.2	$109.9	$76.1	$42.3	$8.5	$0.0	$0.0	$0.0	$0.0	$0.0	**$338.1**
subtotal	**$158.6**	**$104.2**	**$70.4**	**$36.6**	**$2.8**	**$6.7**	**$6.7**	**$6.7**	**$6.7**	**$6.6**	**$406.1**
Retirement Incentive: Current Eligibles											
Increase Multiplier to 1.60% and Early Pension	$0.0	$0.0	($35.2)	($35.2)	($35.2)	($35.2)	($35.2)	$0.0	$0.0	$0.0	**($176.0)**
Increased Retiree Health Costs	($19.2)	($25.6)	($25.6)	($6.4)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	**($76.8)**
subtotal	**($19.2)**	**($25.6)**	**($60.8)**	**($41.6)**	**($35.2)**	**($35.2)**	**($35.2)**	**$0.0**	**$0.0**	**$0.0**	**($252.8)**
Retirement Incentive: Combined 80 and Out or 30 YOS and out											
Increase Multiplier to 1.55% and Early Pension	$0.0	$0.0	($16.6)	($16.6)	($16.6)	($16.6)	($16.6)	$0.0	$0.0	$0.0	**($83.0)**
Increased Retiree Health Costs	($9.5)	($12.7)	($12.7)	($12.7)	($3.2)	$0.0	$0.0	$0.0	$0.0	$0.0	**($50.8)**
subtotal	**($9.5)**	**($12.7)**	**($29.3)**	**($29.3)**	**($19.8)**	**($16.6)**	**($16.6)**	**$0.0**	**$0.0**	**$0.0**	**($133.8)**
Gross	**$205.1**	**$147.9**	**$62.3**	**($34.3)**	**($52.2)**	**($45.1)**	**($45.1)**	**$6.7**	**$6.7**	**$6.6**	**$258.7**
GF/GP	$79.6	$57.4	$24.2	($13.3)	($20.3)	($17.5)	($17.5)	$2.6	$2.6	$2.6	$100.4

Notes:

1. 6,400 employees are currently eligible and another 6,050 would be eligible under an early retirement with either an 80 and out or a minimum 30 years of service.
2. Assumes partcipation rates as experienced under SB 1227 - the MPSERS Plan: 36.9% for current eligibles and 16.4% for both the 80 and out and 30 YOS.
3. Assumes 2:3 replacement ratios.
4. Tapers replacement savings down over 4 years to assume those retirements would have happened over the next 4 years regardless.
5. Assumes that banked leave time payouts would be paid sooner than they would have otherwise, but would net to zero over the entire period.
6. Assumes Retirement Effective Date of January 1.
7. Employee Retirement Health Contributions beginning November 1.