Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1227 (S-11 as reported by the Committee of the Whole)*(as passed by the Senate)*
Sponsor: Senator Jud Gilbert, II
Committee: Appropriations

CONTENT

Senate Bill 1227 (S-11) would enact numerous amendments to the Michigan Public School Employees' Retirement System (MPSERS), including:

-- Increased employee contributions.
-- New hybrid pension plan for employees first hired on or after July 1, 2010.
-- A requirement that retirees pay a percentage of salary toward health care costs, if re-hired as contractual employees, equal to the percentage of their payroll employers contribute toward retiree health costs.

Increased Employee Contributions
Employees in the Basic Plan (hired before January 1, 1990) currently pay nothing for retirement; employees hired before January 1, 1990, who switched to the Member Investment Plan (MIP) currently pay 3.9% of salary toward their retirement; employees hired after July 1, 1990, and before July 1, 2008, currently pay $510 annually plus 4.3% of salary above $15,000; and employees hired after July 1, 2008, currently pay $510 annually plus 6.4% of salary above $15,000.

Effective with the first pay date after July 1, 2010, this bill would increase employee contributions to the retirement system by three percentage points, except for those hired after July 1, 2008, whose contribution would increase by 0.9 percentage point. As a result, all Basic Plan members would pay 3% of salary, and all other employees would pay $510 annually plus 7.3% of salary above $15,000 (except those who switched from the Basic Plan to MIP, who would have to pay 6.9% of salary).

The bill specifies that the required contributions would have to be used to fund benefits for service credit earned after October 1, 2010, and could not be used to fund unfunded liability for accrued benefits earned by members before October 1, 2010. In addition, if an employee did not make the required contributions or if the payments made by an employee were subsequently refunded (e.g., by a court order), then the employee would not earn service credit during the period of time contributions were made.

New Hybrid Plan
Employees hired on or after July 1, 2010, would be placed in a new "hybrid" pension plan, with a blending of defined benefit (DB) and defined contribution (Tier 2) components. A person under this plan would not be able to receive pension payments until age 60, and would be required to have worked at least 10 years as a public school employee. The purchase of service credit by these employees would be prohibited. The employee would have to contribute $510 annually plus 7.3% of salary above $15,000, in addition to the Tier 2 contributions described below.

An employee under this plan would have to contribute 2% of salary to his or her Tier 2 account, unless affirmatively electing not to contribute or to contribute a lesser amount. The employer would have to match 50% of the employee's first 2% of salary contribution, for a maximum total employer payment of 1% of salary deposited into the Tier 2 account. This would be in addition to the employer cost for the DB pension of this employee. The employee would be allowed to contribute more than 2% of salary, but the employer would not match more than 1%. An employee described here would be immediately vested in his or her own contributions, and would vest in employer contributions as follows: 25% after two years of service, 75% after three years of service, and 100% after four years of service.

The DB side of this hybrid plan would use a nine-year period on which to calculate the final average compensation (FAC), likely generating a lower FAC than is in current law. (For Basic Plan members, the time frame is five years; for MIP members, the time frame is three years.) Also, under this plan, the actuary would be required to assume a 7% rate of return on the investments in the portfolio (rather than the 8% rate under current law). The actuary could determine a different employer contribution rate for these members.

<u>Third-Party Contracted Employees</u>
Currently, members who retire and begin drawing pensions but then return to work can avoid the earnings limitations in statute if they return to work as contractual employees, using a third-party employer. The employer also does not have to pay contributions to the MPSERS system for these employees. This bill would require such contractual employees to pay a portion of their salary to MPSERS equal to the percentage paid by the employer for retiree health care (currently 7.25% of pay).

<u>Other Changes</u>
The bill proposes numerous other changes, including:

-- Setting the interest rate of return on the DB portion of the hybrid between 0% and 7%.
-- Changing the reporting of contributions from monthly to a schedule and manner determined by the retirement system, and providing for penalties for intentional errors made or unintentional errors not corrected.
-- Providing for the drawing of Tier 2 accumulated balances, and providing that DC distributions would be exempt from State, county, municipal, or other local tax.
-- Setting the MPSERS employer contribution rate at no more than 17.08% for FY 2010-11.
-- Appropriating $2.0 million to the Office of Retirement Services for administration of the changes outlined in this legislation. The appropriation would be a work project, with an estimated completion date of September 30, 2011.

MCL 38.1304 et al.

<u>FISCAL IMPACT</u>

The State Budget Office (SBO) analysis indicates that increasing employee contributions would provide local savings to employers of $207.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $2.4 billion. The SBO analysis indicates the new hybrid DB/DC pension plan would provide local savings to employers of $3.9 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $410.6 million. However, the numbers are likely to be revised downward due to lowering the pension-drawing age to 60 from the originally-proposed 65 years.

The only way these savings could be achieved for employers (K-12 districts, intermediate school districts, community colleges, and participating universities, charter schools, and libraries) in FY 2010-11 would be to lower the already-published employer contribution rate from 19.41% to a rate that would reflect the increased employee contributions and hybrid plan for new employees. Therefore, the bill also would require the employer contribution rate to be no more than 17.08% in FY 2010-11. In future years, the reforms would reduce the MPSERS employer contribution rate that otherwise will occur, though in the near term the rate likely would continue to increase due to relatively recent investment losses in the stock market.

Combined, the changes in the legislation are estimated to save employers $211.0 million in FY 2010-11, and after 10 years, the estimated savings total $2.8 billion.

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