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BILL ANALYSIS

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House Bill 4701 (Substitute H-6 as passed by the House)
House Bill 4702 (as passed by the House)
Sponsor: Representative Bill Rogers (H.B. 4701)
Representative Chuck Moss (H.B. 4702)
House Committee: Appropriations
Senate Committee: Appropriations

Date Completed: 11-29-11

CONTENT

House Bill 4701 (H-6) would amend the State Employees' Retirement Act to do all of the following:

-- Require a Defined Benefit (DB) member to choose whether to contribute 4% of salary (pre-tax) to remain in the DB system, or whether to not pay the 4% and instead "freeze" his or her compensation and years of service and convert to the Defined Contribution (DC) system for future service. A DB member choosing to pay the 4% would be required to further choose whether to make the contribution until attainment date (30 years of service) or retirement/termination.
-- Within two pay periods after the effective date of the legislation, discontinue the existing 3% contribution all State employees are currently making into the irrevocable trust created in the Public Employee Retirement Health Care Funding Act. Contributions made between November 1, 2010, and the discontinuation date would be refunded on or before May 13, 2012, with interest.
-- Spread the unfunded accrued liability for the pension system across both the DB and DC payrolls, rather than just across the DB payroll.
-- Prohibit deferred or nonvested members who are reemployed on or after January 1, 2012, from rejoining the DB system, and instead place those employees into DC.
-- Require the retirement system to design and implement an automatic enrollment feature for employee contributions into 401k and 457 plans.
-- Allow the State to make matching contributions to a different plan or account than the elective contributions made by an employee.
-- Exclude overtime premium payments, or payments for services in excess of 80 hours in a biweekly period, from the calculation of compensation for the purpose of pension payments, for overtime after January 1, 2012.
-- Allow DC employees hired by the State before January 1, 2012, to choose (between January 3, 2012 and March 2, 2012) to remain in the graded health care subsidy plan for retiree health care or monetize existing years of service and credit that monetization to a 401(k) or 457 plan.
-- Eliminate retiree health insurance coverage from the State for any new employee hired on or after January 1, 2012, or for any existing DC employee choosing to convert to the 401(k) or 457 plan for health care. Instead, the State would make a matching contribution up to 2% of the employee's compensation to an appropriate tax-deferred account, such as a 401(k) or 457. In addition, for employees hired on or after January 1, 2012, the State would deposit into a health reimbursement account $2,000 when the

employee terminated employment after age 60 with at least 10 years of service, or $1,000 upon termination with at least 10 years of service.

-- Require a report from the retirement system by January 1, 2017, providing the projected impact of the $2,000 and $1,000 deposits into health reimbursement accounts with regard to the annual required contribution as used by the Governmental Accounting Standards Board.
-- Appropriate $1.9 million to the Office of Retirement Services for administration of the changes proposed under this bill.

House Bill 4702 would amend the Public Employee Retirement Health Care Funding Act to create individual health reimbursement accounts (HRAs) within the irrevocable health care trusts established under this Act in 2010. The State would deposit into the individual HRAs the $2,000 and $1,000 lump-sum credits for new hires as discussed below. Additional employer and mandatory employee contributions could be deposited into the HRAs as well, but voluntary contributions are not permitted under Federal tax law at this time. Funds deposited into the HRAs could be used for eligible medical expenses in retirement.

The bills are tie-barred to each other.

Pension Changes for Defined Benefit Members

State employees hired before March 31, 1997, who did not choose at that time to convert their service and become members of the State's 401(k)/457 plans, are in the Defined Benefit (DB) plan. A defined benefit plan provides a fixed monthly pension upon eligible retirement from the State based on years of service and final average compensation. At the present time, there is no cost to a DB employee for participating in the DB pension plan.

House Bill 4701 (H-6) would provide an election for a DB member to pay, beginning April 1, 2012, 4% of salary to remain in the DB pension plan for future compensation and service credit, or, if the member did not want to pay the 4% to remain in the DB plan for future accruals, then the member's compensation and service credit would be frozen at today's amounts, for the purposes of the member's pension calculation, and the member would be transferred into the State's Defined Contribution (401(k)/457) plan for future service. If the member did choose to pay the 4% and remain in the DB pension plan for future years, the member would have to make a subsequent choice whether to pay the 4% until reaching 30 years of service, called the "attainment date" (at which point he or she would transfer to the DC plan for future service), or to pay the 4% until termination or retirement. As long as a DB employee continued to pay the 4%, the employee's pension calculation would take into account the additional years of service and any changes in compensation. If the employee chose not to pay the 4%, or pay only until the attainment date, years of service and compensation levels would be frozen at those respective times, for pension calculation purposes.

Regarding the purchase of service credit toward calculating a person's pension, the bill would differentiate when and how purchased service credit could be included, based on if and when a DB employee paid the 4% charge. First, if a DB person chose not to pay the 4%, then only service credit purchased under a payment plan in effect by March 31, 2012, could be included in pension calculations. Members choosing to pay 4% until reaching their attainment date would be able to count purchased service credit if purchased under a payment plan in effect as of the attainment date. Members choosing to pay 4% until termination/retirement could count service credit purchased at any point during their time of employment.

The bill also would exclude from the definition of compensation most overtime earned after January 1, 2012. This change would result in lower final average compensation for

employees eligible for, and receiving, overtime payments, which could then result in a lower pension payment for certain future retirees. This change would not affect overtime that occurred before January 1, 2012, which could still be counted in final average compensation as applicable.

The bill would not change the retiree health care plan or coverage available to State employees hired before March 31, 1997, whether those employees are still in the DB system or whether they chose to convert their service to the DC plan in 1997.

Retiree Health Care Changes for Existing DC Employees

State employees first hired on or after March 31, 1997, are in the State's Defined Compensation plan for retirement, and for retiree health care, these employees are in a graded health care subsidy plan. That plan currently provides 30% State retiree health care premium coverage after 10 years of service, with an additional 3% of State coverage earned per year, up to a maximum of 80% or 90%, depending on when the employee was hired. Under current law, if an employee leaves before 10 years of service, the employee will not receive any health care coverage when reaching retirement age.

The bill would provide a choice for existing DC employees either to remain in the graded health care premium, or to "monetize" their service to date, with the entire monetized amount credited to a tax-deferred account, which would include the State's 401(k) and 457 plans, if the employee first terminated from employment after reaching normal retirement age and service guidelines, or one-half of the monetized amount upon termination if the employee had at least 10 years of service. If the employee first terminated State service before attaining 10 years, then the employee would not receive any monetized amount.

The bill includes a formula for the calculation of the monetized amount, based upon an average monthly premium of $1,000, a frozen benefit percent equal to 3% multiplied by the employee's years of service, and a deferred life annuity factor. The formulaic amount would then be calculated to approximate the actuarial present value as of March 31, 2012, and this amount would annually adjust to reflect the change in the medical care component of the United States Consumer Price Index, but not less than 0% or more than 4%. (See Table 1 for examples of monetized credits under various scenarios.) The employee would receive 50% of the adjusted monetized amount if first separating from employment before reaching normal retirement age and service eligibility requirements (age 55 with 30 years, or age 60 with 10), but had worked at least 10 years for the State. The employee would receive 100% of the adjusted monetized amount if the employee worked for the State until reaching age 55 with at least 30 years of service, or age 60 with at least 10 years.

For DC employees who chose to "monetize" their years of service to date, they would forfeit any State premium coverage of health care premiums in retirement. Instead, in addition to the monetized amount described above, these employees would receive State matching funds into a 401(k) or 457 account, up to 2% of an employee's compensation, if the employee contributed 2%. It is the intent of the Office of Retirement Services (ORS) to track both the employee and employer contributions under this provision and identify those amounts as available for retiree health care, but the employee would be free to use those dollars for any purpose allowable under Federal law for a 401(k) or 457 plan.

Employees would immediately vest in their own contributions, and the vesting schedule for employer contributions would follow the existing DC schedule. The schedule for vesting in State contributions would be 50% after two years of service, 75% after three years, and 100% vested in employer contributions after four years of service.

Retiree Health Care Changes for Future Employees

For employees first hired by the State on or after January 1, 2012, the bill would eliminate all State premium coverage for retiree health care, and replace it with employer matching contributions, up to 2% of compensation if an employee contributed 2%, for deposit into a 401(k) or 457 plan. In addition, the State would credit $2,000 to a health reimbursement account for a new hire who worked for the State until age 60 or older and had at least 10 years of service, or $1,000 for a new hire who worked for the State at least 10 years but did not work until age 60. The amount of money a new hire had in retirement for health care would depend on the contributions made and the investment returns on those assets, but the State would not be responsible for any retiree health care policy coverage.

Employees would immediately vest in their own contributions, and the vesting schedule for employer contributions would follow the existing DC schedule. The schedule for vesting in State contributions would be 50% after two years of service, 75% after three years, and 100% vested in employer contributions after four years of service.

Other Changes

The bill includes other changes, including the elimination and refund of the existing 3% all State employees (DB and DC) are currently contributing for retiree health care. The contribution would be eliminated no later than two pay periods after the enactment of this legislation, and the ORS would be required to refund contributions made to date no later than May 13, 2012, with an option for employees to receive the refund in their paycheck or as a deposit into their 401(k) or 457 account.

The bill includes a potentially significant change under which employees would be automatically enrolled in the level of contributions necessary to receive the maximum State matching amounts for the employees' 401(k) or 457 accounts. Currently, employees are not automatically enrolled, but must elect to contribute funds for their postemployment savings. Under the State's DC plan, the State contributes 4% of an employee's compensation into his or her 401(k) or 457 account, and the State matches an employee's contributions, up to an additional 3%. The bill would auto-enroll DC employees with a 3% contribution into their account, thereby triggering the maximum State matching funds. New DC employees and those electing to opt out of health care under this bill also would be auto-enrolled for the additional 2% of matchable contributions. An employee would have to make an election not to contribute the maximum amount, if so desired. At the present time, the average contribution across all existing State workers is 2.4%.

The bill addresses former employees, both those vested and nonvested, who were in the DB plan when working, but return to work on or after January 1, 2012, and those who were in the public school retirement system and begin working for the State on or after January 1, 2012. Under current law, these employees have the option to return under the DB plan, but under the bill, they would be placed into the DC plan and no subsequent years of service would be counted toward pension calculations. Therefore, those State employees who were vested already would be frozen at the years of service and compensation previously earned, and those who were not vested would receive credit for prior service only for the purpose of vesting in the DC plan (but no monetary credit for that service); both the State employees and former school employees would become participants in the DC 401(k)/457 plans.

The bill also includes a requirement that the health liability and unfunded accrued actuarial liability (UAAL) be spread across both the DB and DC payrolls, rather than the current requirement to spread it only over the DB payroll. For FY 2011-12, the UAAL represents 27% of the total State Employees Retirement System (SERS) contribution rate, because it is spread only over DB payroll. If it were spread over both DB and DC payroll, the percentage

dedicated for the UAAL would be 13%. While there would be no net overall cost or savings to making this change, it would remove any adverse consequences to departments when making payroll decisions on DB and DC employees. In other words, from the point this change was made, the DB/DC makeup of a department's personnel would make significantly less difference to departmental payroll costs than under the current system.

The bill includes a $1.9 million appropriation for the ORS to implement the changes included in the legislation. The appropriation would be made from the assets in the pension funds.

MCL 38.1b et al. (H.B. 4701)
38.2731 et al. (H.B. 4702)

FISCAL IMPACT

The bills would produce both short- and long-term savings for the State. The savings are itemized below.

Fiscal Impact from Changes for Defined Benefit Members

First, the most straightforward and immediate impact from the legislation is the requirement to charge DB members 4% of compensation to remain in the DB plan. This would generate an estimated $56.0 million Gross (of which an estimated $28.0 million would be General Fund/General Purpose revenue) on a full-year basis, if all employees chose to remain in the DB plan. However, since this charge would not begin until April 1, 2012, on a half-year basis, this would generate an estimated $28.0 million Gross, of which $14.0 million would be GF/GP revenue. Savings would continue as long as there are DB members to pay the 4%, with estimated savings over the next 15 to 20 years of $300.0 million to $350.0 million.

To the extent DB members did not choose to remain in the DB plan but chose instead to "freeze" compensation and service credit to date and transfer to DC for future service, the immediate savings from the 4% would decline. However, additional long-term savings would accrue to the State since the DC State "normal cost" is lower than the DB "normal cost" for SERS employees, but again, the amount would depend upon the extent to which DB members chose this option. If all DB members chose to freeze their DB service and move to DC, the first-year savings would be around $50.0 million, and long-term liabilities would be decreased by around $500.0 million.

Second, regarding the exclusion of overtime from the definition of compensation, this would likely result in State savings by decreasing pension costs, but to an unknown degree.

Fiscal Impact from Changes for Existing Defined Contribution Members

Current members of the DC system would be offered a choice to remain in the graded health care subsidy plan for retiree health care, or to monetize existing years of service for deposit into a 401(k) or 457 plan. If all existing employees chose to monetize, then the Annual Required Contribution (ARC) for FY 2011-12 would fall from the current $743.0 million to $713.0 million. If all DC members remained in the graded health care plan, then the ARC would remain at $743.0 million. Therefore, it is likely that some level in between the two extremes would be the result.

The ARC is an important figure because it is the annual level of funding necessary for the State to be considered "prefunding" its health care system for retirees. If the State prefunds its retiree health care every year, then today's SERS retiree health liability is calculated at $9.4 billion; if the State pays on a cash basis, then the current liability is calculated at $15.1 billion. Table 4 at the end of the analysis illustrates the differences in long-term estimated

costs between paying retiree health care on a cash basis or prefunding the system, which can be cheaper in the long run because assets set aside and invested have the opportunity to earn market returns, assumed to be 8% annually. Over the next 40 years, the estimated cash costs of retiree health are $43.5 billion, while the estimated prefunding costs of retiree health are $36.6 billion.

The Administration and the Legislature have made a commitment to begin prefunding the State employees' retiree health care system, requiring at least $743.0 million in FY 2011-12 as the first payment toward prefunded status. Again, then, if all DC members chose to monetize, the ARC would fall by around $30.0 million, which would mean $30.0 million in State savings for FY 2011-12 to meet prefunded eligibility.

Fiscal Impact from Changes for New Defined Contribution Employees

For future employees hired on or after January 1, 2012, the maximum State cost for these retirees' "health care" would be 2% of compensation per year. This compares to the current "normal" cost of retiree health care of 4.7% of compensation. Clearly, there would be significant long-term State savings from eliminating the graded premium health care currently in place and replacing it with a maximum 2% State contribution to an employee's 401(k) or 457 account in lieu of health care benefits. The Office of Retirement Services estimates that this plan, when combined with the assumption that 25% of existing DC employees would choose to monetize their existing service and convert to "DC health", would save nearly $5.8 billion over the next 40 years, with approximately one-half of that total accruing to the General Fund (the difference between the $36.6 billion in estimated costs of prefunding the existing retiree health care system and the $30.8 billion in estimated costs of prefunding the retiree health care system proposed under H.B. 4701 (H-6)).

Table 4 depicts these savings over the long run. As mentioned above, significant savings can occur simply by prefunding the existing system, compared to paying for retiree health on a cash, or pay-as-you-go basis. Additional savings under this legislation will occur once existing liabilities have been paid off, because the proposed maximum State cost of 2% of pay for retiree health (placed into an employee's 401k or 457 plan) is less than the projected 4.7% of pay normal cost for retiree graded premium health care under current law. On a yearly basis, the long-run difference between the 4.7% of pay and the 2% of pay is estimated to save the State on average around $200.0 million.

Other Fiscal Impacts – Refund of 3%, Maximum Auto-Enrollment

The 3% currently being contributed by State employees was estimated to bring in nearly $82.0 million per fiscal year (of which $33.0 million was estimated to be GF/GP revenue), which would have been counted by the State as savings in retiree health care costs. The contribution was implemented on a partial-year basis for FY 2010-11, and a full-year basis for FY 2011-12 and FY 2012-13, with a sunset after that point. Because the 3% has been the subject of a continuing lawsuit, these savings were not assumed in the FY 2011-12 budget; therefore, the refund of the amount collected so far, and the elimination of future contributions, would not have an impact on the enacted FY 2011-12 budget.

Regarding the auto-enrollment for DC contributions, the ORS has indicated its plan to implement this only for new hires, not for existing employees, although the language in the legislation is unclear on this point. If the auto-enrollment were implemented only for new hires, the actuary estimates the additional cost to be $1.0 million in the first year. However, if the auto-enrollment were implemented for all existing DC employees as well, and if those employees did not elect to reduce their contribution from the maximum, the additional State costs for the first year would be estimated at $8.5 million.

Attachments

Attached to the analysis are three tables. Table 1 provides examples of how a person's monetized DC credit could grow over time, based on number of years left until retirement and an assumed 4% growth per year. Table 2 is a detailed grid illustrating a number of potential groups within SERS (DB, DC, deferred vested DB, deferred non-vested DB, etc.), and the impacts of the proposed legislation on the various groups. Table 3 is a high-level summary of the impacts on broad groups of employees, but is not all-inclusive. Finally, Table 4 is a graph depicting three long-range estimates of costs under the current pay-as-you-go health care system, the estimated costs under a prefunding system (with no changes to retiree health), and the estimated costs under a prefunding system with the changes proposed under H.B. 4701 (H-6). These estimated costs are shown as a percentage of State payroll.

Fiscal Analyst: Kathryn Summers

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.

Table 1: House Bill 4701 (H-6) as Passed by the House
Sample Impacts of Monetarization Proposal

Current Age	Current Years of Service	Frozen Accrual Percent	Estimated Retirement Age[1)]	Lump Sum Present Value (in 2011)[2)]	Lump Sum at Retirement[2,3)]
25	5	15%	55	$8,506	$27,588
25	5	15%	62	8,506	36,304
25	5	15%	70	8,506	49,685
35	5	15%	60	9,089	24,230
35	13	39%	62	32,928	94,944
35	13	39%	70	32,928	129,937
45	5	15%	60	13,582	24,460
45	13	39%	62	35,312	68,784
45	13	39%	70	35,312	94,136
55	5	15%	60	20,556	25,010
55	13	39%	65	53,445	79,112
55	13	39%	70	53,445	96,251
60	5	15%	65	17,619	21,436
60	13	39%	65	66,642	81,080
60	13	39%	70	66,642	98,646

1) Future service is used to determine the normal retirement age. Normal retirement age for all members is the earlier of age 55 with 30 years of service, or age 60 with 10 years of service. Special retirement conditions for Corrections Officers and Conservation Officers are not considered.
2) Lump sum is available upon separation from the State at 50% if separating prior to normal retirement age or 100% at normal retirement age, but the table assumes employment with the State until normal retirement age.
3) Lump sum at normal retirement age depends on actual annual interest credits, which will equal the annual increases in the medical care component of the Consumer Price Index, with a minimum annual credit of 0% and a maximum annual credit of 4%. The maximum annual 4% interest credit is shown in the examples above.

Notes: 1. The monthly single life premium at normal retirement age is assumed to be $1,000. The interest discount for all future years is 4% per year (designed to reflect an assumed 8% investment rate of return and a 4% health insurance premium increase assumption). 2. The mortality table used is a 50% - 50% Male/Female blend of the 1994 Group Annuity Mortality Table set forward one year for both males and females.

Table 2: Groups Affected by Proposed Changes

Group	Impact on Retirement if currently working	Impact on Health if currently working	Impact on Retirement if they are not currently working for the State and they return in the future	Impact on Health if they are not currently working for the State and they return in the future	Impact on Retirement if they are not currently working for the State and they do not return	Impact on Health if they are not currently working for the state and they do not return	Change in status from current
DB retirant	Come back as DC, Pension suspended	No impact	Come back as DC, Pension suspended	No impact	No impact	No impact	No
DB active who elects to pay 4% with less than 10 years	Gets New Service and Comp for duration elected	No impact	N/A	N/A	N/A	N/A	Yes
DB active who elects to pay 4% with 10 or more years.	Gets New Service and Comp for duration elected	No impact	N/A	N/A	N/A	N/A	Yes
DB active who elects not to pay 4% with less than 10 years.	Join DC plan, pension is frozen, continue to accrue service credit towards eligibility & vesting	No impact	N/A	N/A	N/A	N/A	Yes
DB active who elects not to pay 4% with 10 or more yrs.	Join DC plan, pension is frozen, continue to accrue service credit towards eligibility	No impact	N/A	N/A	N/A	N/A	Yes
DB Deferred vested member	NA - not currently working	NA - not currently working	Come back as DC, pension is frozen, continue to accrue service toward eligibility	No impact	No impact	No impact	Yes
DB former non-vested member	NA - not currently working	NA - not currently working	Come back as DC with DB time counting as vesting credit in DC	$2000 or $1000 lump sum at termination if at least 10 yrs. plus a 2% matching employer contribution	No impact (they get nothing)	No impact (they get nothing)	Yes
Deferred MPSERS	NA - not currently working	NA - not currently working	Come back as DC	$2000 or $1,000 lump sum at termination if at least 10 yrs. plus a 2% matching employer contribution	No impact	No impact	Yes
Former qualified participants currently "retired" & getting a health benefit	No impact	No impact	No impact	No impact	No impact	No impact	No
DC qualified participants who switched from DB	No impact (they are DC)	No impact	N/A	N/A	N/A	N/A	No
DC active qualified participants who started as DC with 10 years or more	No impact	Election to opt out of graded premium & receive monetized amount and 2% matching contribution, if at least 10 yrs.	NA - currently working	NA - currently working	NA - currently working	NA - currently working	Yes
DC active qualified participants who started as DC with 4-10 years	No impact	Election to opt out of graded premium & receive monetized amount and 2% matching contribution, if at least 10 yrs.	NA - currently working	NA - currently working	NA - currently working	NA - currently working	Yes
DC active qualified participants who started as DC with less than 4 years	No impact	Election to opt out of graded premium & receive monetized amount and 2% matching contribution, if at least 10 yrs.	NA - currently working	NA - currently working	NA - currently working	NA - currently working	Yes
Former qualified partici-pants with 10 or more yrs. who have not begun drawing a health benefit	NA - not currently working	NA - not currently working	No impact	Monetized health care, if at least 10 yrs. plus a 2% matching employer contribution	No impact	No impact	Yes
Former qualified participants with 4-10 yrs.	NA - not currently working	NA - not currently working	No impact	$2000 or $1000 lump sum at termination if at least 10 yrs. plus a 2% matching employer contribution	No impact	No impact (no benefit)	Yes
Former qualified participants with less than 4 yrs.	NA - not currently working	NA - not currently working	No impact	$2000 or $1000 lump sum at termination if at least 10 yrs. plus a 2% matching employer contribution	No impact	No impact (no benefit)	Yes
New hires	N/A	N/A	No impact	$2000 or $1000 lump sum at termination if at least 10 yrs. plus a 2% matching employer contribution	N/A - would never have worked for the State	N/A - would never have worked for the State	Yes

Source: Office of Retirement Services

Table 3: State Employees' Retirement System (SERS) OPEB Proposals

- OPEB (Other Post-Employment Benefits) = Retiree Health Care

- OPEB accrued liability measures the value of retiree health care benefits earned by retirees and active employees to date – in other words, what has been promised/earned

- SERS = State employees only – does not include public school employees, State police, judges, or legislators, but does include corrections officers and conservation officers

Current System

- State employees hired on or after March 31, 1997 are in a 401k plan for retirement, and are in a graded premium plan for retiree health care, earning 30% State coverage after 10 years of service and 3% for each year of service thereafter, capped at 80% or 90%. Employees must work at least 10 years before receiving any benefit, and they receive State coverage at age 55 with at least 30 years of service or age 60 with at least 10 years.

- State has historically paid OPEB on a cash basis, or pay-as-you-go basis. The current-year cost is $497.0 million to pay for today's retired State employees' health care.

- Accrued OPEB liability when paying on a cash basis = $15.2 billion.

- Budget negotiations already set aside $700.0 million in FY 2011-12 to begin prefunding, though a newer estimate shows prefunding in FY 2011-12 will actually cost $743.0 million.

- If the State prefunds, the OPEB liability declines from $15.2 billion to $9.4 billion due to assumed future investment earnings, and will be paid off in 26 years if actuarial assumptions are accurate.

- The OPEB liability declines by nearly $6.0 billion even if no change in retiree health care is made; this decline is purely a result of prefunding the retiree health care system rather than using pay-as-you-go.

Proposed Changes for State Employees

- The HB 4701 (H-6) proposal for retiree health care would allow current DC employees who were first hired on or after March 31, 1997 to choose to convert from a graded premium subsidy to a 401k plan to save for retiree health. This 401k plan would be mandatory for new hires (first hired on or after January 1, 2012).

- All employees hired before March 31, 1997 would not be affected by the retiree health care proposals, but those employees still in the Defined Benefit plan would have to either begin paying 4% of pay in order to continue earning years of service for pension calculations or freeze pension accrued to date and switch to DC.

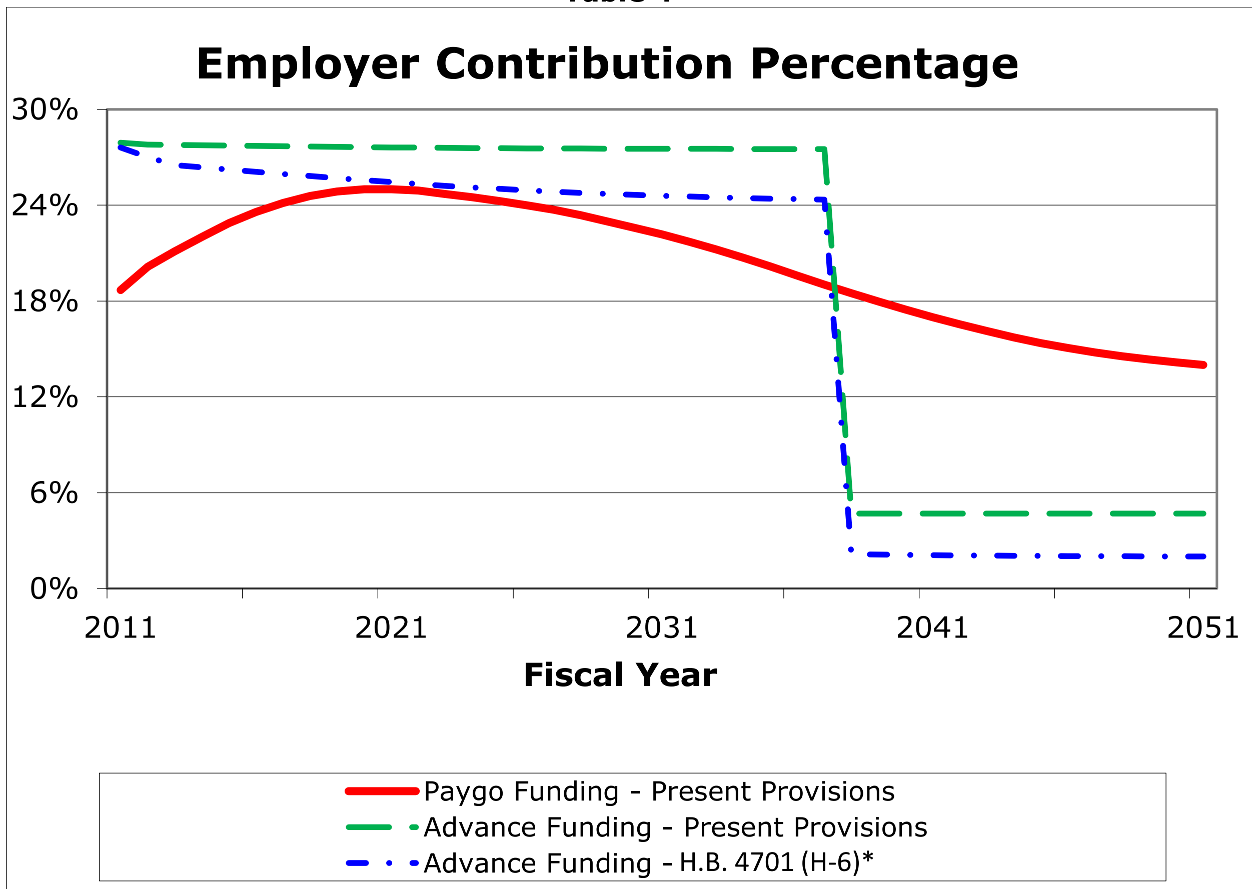
- The bill would rescind and refund the existing 3% employee contribution for retiree health care that is currently being reviewed by the Supreme Court.

- OPEB liability likely remains near $9.4 billion, but would depend upon the number of existing employees choosing to convert to DC-health and away from the graded premium health care subsidy.

- The proposed plan would cost more up front compared to paying for existing coverage on a cash basis, although less than the cost of prefunding the existing system without changes, but would reduce long-term liability. This is because the exposure to health care cost risks would be borne by employees and paid for out of their 401k assets rather than borne by the State and paid for out of the State's subsidy for premium coverage.

Current Law and Retiree Health Care Proposal for State Employees		
	Current Law	**House Bill 4701 (H-6) Summary**
Current DB Employees	State premium coverage equals percentage of coverage active State employees receive	No change for retiree health. New 4% contribution required to remain in DB, or "freeze" current service and compensation levels for pension calculations, and transfer to DC for future service.
Current DB Employees Who Switched to DC	State premium coverage equals percentage of coverage active State employees receive	No change for retiree health.
Existing DC Employees hired on or after March 31, 1997 and before January 1, 2012	Graded Health Care Premium Subsidy – 30% State coverage after 10 years; additional 3% per year after, cap of 80%/90% depending on hire date.	**Optional** to remain with current law graded health care premium subsidy, or choose "DC health", which is: -- Monetize graded health care subsidy earned to date; deposit 100% into 401k/457 upon reaching normal retirement eligibility (age 55 with at least 30 years of service or age 60 with at least 10 years of service). However, 50% of monetized amount would be provided if not retiring from the State but at least 10 years of service. Monetized amount forfeited if terminating employment before 10 years of service. Plus, for future years of service: -- 2% of pay State matching for retiree health care into existing 401k/457; fully vested and portable in future contributions.
New Hires	Graded Health Care Premium Subsidy	-- 2% State matching for retiree health care into existing 401k/457; fully vested and portable after four years. Plus: --$2,000 contribution into 401k upon retirement from the State, or $1,000 contribution into 401k upon separation after 10 years of service.
FY 2011-12 ARC	**$743 million**	**$713 million-$743 million**

Table 4



* Assuming 25% of DC choose monetization.

Notes

1. The draft estimated projections are based on assumptions consistent with the September 30, 2010 annual actuarial valuation.
2. After the unfunded accrued liabilities are fully funded (FY 2037-38 and later years), the advance funding employer contribution decreases to the normal cost, which includes any defined contribution-type employer contributions.
3. The Paygo Funding estimates shown in Table 4 should not be used for short-term budgeting purposes.