MEMORANDUM

HOUSE FISCAL AGENCY

DATE: 2/17/2010

TO: Members of the Michigan House of Representatives

FROM: Bethany Wicksall, Senior Fiscal Analyst

RE: Executive Proposed Reforms for **Michigan School Employees' Retirement System (MPSERS)**

As part of her FY 2010-11 budget recommendations, the Governor proposed a number of reforms to pensions for school employees. The Executive proposal includes a small pension incentive to retire, as well as a number of proposals that would serve both as an immediate disincentive for those eligible to remain employed and as long term methods to reduce the employer costs for retiree pensions and benefits. However, the bulk of the savings would be generated through reducing the number of public school employees by replacing an average of only 90% of those who retire. It is important to note that any savings derived would be experienced by the local school district, and there would be no fiscal impact for the State.

The details of the plan as presented thus far are summarized below. A draft bill has not yet been released, so the details may change. The cost/savings estimates below are from the State Budget Office and the Office of Retirement Services. A table summarizing the Executive's estimates over the next ten fiscal years is attached. The overall savings fluctuate as the cost of new retirees work their way through the period. The Executive's estimated net savings to school districts for Year 1 total $701.1 million.

Proposed Timeline

The Governor has proposed the following timeline in 2010:

April 1:	Required legislation completed by the Legislature
April 15 - May 15:	Applications for retirement due
May 16 - May 31:	Opportunity to rescind retirement applications
July 1 - August 31:	Window for retirement

This timeline would require that the retirements take place prior to the start of the next school year in order to maximize any potential savings for FY 2010-11.

Michigan Public School Employees' Retirement System (MPSERS) Reform Proposals

There are approximately 32,300 employees currently eligible to retire and another 6,300 who would be eligible with the purchase of service credits. Of these 38,600 potential retirees, the Executive proposal assumes that 75%, or 28,900, will opt to retire under the plan's provisions, which are described in more detail below.

- **Increased Pension Multiplier**: The proposal would create an incentive for state employees to retire by providing an increase in the pension multiplier from 1.5% to 1.6% for employees who are eligible to retire and leave between July 1, 2010 and August 31, 2010. In effect this would provide a 6.7% increase in an employee's pension. As an example, for an employee with a final average compensation of $50,000 and 30 years of service, the increased multiplier would increase his/her annual pension from $22,500 to $24,000, or by $125 per month.

Cost: The proposal would amoritize the cost of the increased multiplier over 5 years. The Executive estimates an annual cost of approximately $285 million beginning in FY 2012 and continuing through FY 2016.

Increasing the number of retirees over the number that otherwise would have been expected to retire also initially increases retiree health care costs. The Executive estimates an annual cost of $292.5 million for each of the first 3 years for retiree health care cost increases.

- **30 Year Cap on Years of Service:** The proposal would cap the maximum number of years of service at 30 as of October 1 and transfer an employee into a defined contribution plan for any additional years of service accrued subsequent to October 1. Employees currently exceeding 30 years of service credit would retain all service credits accrued prior to the transfer date. The cap would apply only to actual years of service and not to the additional 5 years of service credit which may be purchased by an employee. The defined contribution plan would be identical to the State Employee plan, where the employer would contribute 4% of an employee's salary and then match up to an additional 3% of employee contributions. Employees transferred into the defined contribution plan would be immediately vested.

  Savings: The Executive estimates for savings are $41.0 million in Year 1 and would increase to $56 million by Year 10.

- **3% Employee Contribution:** The proposal would require that all public school employees contribute an additional 3% of their salary toward their pension, except employees hired after July 1, 2008 who would pay an additional 0.9%. This contribution would not be required after an employee reached 30 years of service and was transferred to the defined contribution plan.

MPSERS Employee Contribution Rates				
Plan	**Hire Date**	**Current Contribution**	**Proposed Contribution**	**Increase**
Basic	< Jan. 1, 1990	0.0%	3.0%	3.0%
MIP Fixed	< Jan. 1, 1990	3.9%	6.9%	3.0%
MIP Graded	Jan. 1, 1990 < July 1, 2008	Top Tier = 4.3%	Top Tier = 7.3%	3.0%
MIP Plus	> July 1, 2008	Top Tier = 6.4%	Top Tier = 7.3%	0.9%

Savings: The Executive estimates for savings range from $207.0 million in year 1 of implementation to $282.2 million by year 10.

- **Eliminate Retiree Dental/Vision Coverage:** Currently statute provides that school districts pay 90% of the premium for dental and vision coverage for MPSERS retirees. Under the proposal, school districts would no longer pay for dental or vision premiums for state employees who retire after October 1. School employees who retire after that date would be allowed to purchase coverage through the MPSERS dental and vision plans. While the current premium costs vary for employee-only to full-family coverage, the typical cost of dental and vision coverage for an employee plus a spouse is approximately $69 per month.

  Savings: This proposal would create increasing savings over time as the proportion of retirees who qualify for paid dental/vision insurance diminishes. Executive estimates of savings begin at $1.0 million in the first year and grow to $42.8 million by year 10. Full savings would not be achieved until all retirees no longer qualify for benefits between 30 and 40 years from now.

- **Phased Retirement Option:** The proposal would also include an option for retirees who are 60 years of age or older under which the employee could retire and draw their pension while still working part time. They would have to reduce the number of hours worked by 50% and work no more than 1,040 hours. The option could be renewed annually at management discretion but could not exceed a total of 3 years. This would be optional by district and employee eligibility would be determined by management discretion.

  Cost: Because this option will be left up to district management discretion, the Executive proposal does not include an estimate. The option might initially decrease some of the estimated savings, but the number of phased retirements granted is expected to be small.

- **New Hybrid Plan:** The proposal would move all newly hired school employees into a hybrid pension and defined contribution system. The pension would be similar to the existing plan with the following changes:
  - Increase final average compensation from 3 years to 9 years.
  - Eliminate any cost of living adjustments (COLA)
  - Increase the minimum retirement age to 65 (currently minimum age for Basic plan is 55 and the MIP plan has no minimum age requirement with 30 years of service.

  The added defined contribution benefit would provide a 50% employer match on a maximum employee contribution of 2% of salary. This proposal would reduce the employer normal cost of the pension plan from 4.2% to 1.8% with an additional 1% possible for the defined contribution match. It would also significantly reduce the employer contribution for retiree health care costs by pushing the retirement age to 65.

  Savings: The Executive proposal estimates a Year 1 savings of $3.9 million and a Year 10 savings of $80.6 million. These savings would continue to increase as the proportion of school employees in the new plan increases and would be fully realized after approximately 40 years.

<u>Proposed Reductions in the State Workforce</u>

As mentioned above, the significant savings associated with this proposal are generated through the assumed reduction in the number of school employees. The Executive assumes this would be accomplished by replacing only 90% of employees staff positions. Given the Executive's estimated 28,900 new retirees, this would mean replacing 26,000 employees for a net reduction of almost 3,000 positions. In addition to savings from reduced positions, the State Budget Office estimates a savings of $20,000 per employee in salary differential for new employee replacements.

Savings: The Executive estimates a savings of $740.7 million in the first year which would diminish annually to $241.6 million by year 10.

Executive Proposed School Employee Pension Reforms
Estimated Savings
(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**
Increase Multiplier to 1.6%	$0.0	($285.0)	($285.0)	($285.0)	($285.0)	($285.0)	$0.0	$0.0	$0.0	$0.0	**($1,425.0)**
Increased Retiree Health Costs	($292.5)	($292.5)	($292.5)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	**($877.5)**
Years of Service 30yr Cap	$41.0	$42.0	$44.0	$45.0	$47.0	$48.0	$50.0	$52.0	$54.0	$56.0	**$479.0**
3% Employee Contribution	$207.0	$214.3	$221.8	$229.5	$237.5	$245.9	$254.4	$263.3	$272.6	$282.2	**$2,428.5**
Eliminate Retiree Dental/Vision	$1.0	$5.0	$8.9	$13.1	$17.3	$22.1	$26.9	$32.0	$37.3	$42.8	**$206.4**
Hybrid Plan for New Employees	$3.9	$12.8	$20.5	$28.1	$35.8	$43.8	$52.2	$61.7	$71.2	$80.6	**$410.6**
Replacement Savings	$740.7	$699.5	$651.6	$646.2	$548.4	$492.8	$434.6	$373.4	$309.1	$241.6	**$5,137.9**
GROSS SAVINGS	**$701.1**	**$396.1**	**$369.3**	**$676.9**	**$601.0**	**$567.6**	**$818.1**	**$782.4**	**$744.2**	**$703.2**	**$6,359.9**

Source: All estimates are those of the State Budget Office and Office of Retirement Services.