Legislative Analysis

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PUBLIC SCHOOL RETIREMENT INCENTIVE

House Bill 4285
Sponsor: Rep. Fred Miller
Committee: Education

Complete to 2-24-09

A SUMMARY OF HOUSE BILL 4285 AS INTRODUCED 2-17-09

House Bill 4285 would amend the Public School Employees Retirement Act (MCL 38.1384) to increase the multiplier used to calculate a member's retirement allowance from 1.5 percent to 2.0 percent for members who retire on or before June 30, 2010. (For an individual working in learning disciplines having a shortage of teachers, the deadline would be pushed back one year, to June 30, 2011). The bill does not change who is eligible to retire.

To qualify, a retirement system member would have to file a written application with the retirement board and the reporting unit between April 1, 2009 and March 31, 2010, requesting a retirement allowance effective date that was at least 30 days after the date on the written application and no later than June 30, 2010. A member could withdraw a written application on or before March 15, 2010. After that date, an application would be irrevocable.

The bill would limit the number of employees who could retire in order to cap at $1.5 billion the aggregate liability to the retirement system of the present value of future benefits attributable to the increased multiplier and incurred in the applicable plan year.

Members would be selected according to age and years of actual service, with those having the greatest number of actual years of service receiving first preference and the earliest dated applications receiving first preference.

All determinations concerning the aggregate liability to the retirement system, and the members permitted to retire, would be made by the retirement system. The aggregate liability cap would be applicable on a school-year basis so that a member who was not permitted to retire as of June 30, 2009 could reapply for consideration to retire not later than June 30, 2010. (If a member was not permitted to retire, the member's written application would be considered to be withdrawn in a timely manner.)

The bill increases the amount of the retirement allowance. Currently a school employee's pension is determined by multiplying three factors: final average compensation (FAC), years of service (YOS), and a multiplier of 1.5 percent. The proposal would increase the multiplier from 1.5 percent to 2.0 percent (which increases a retiree's annual pension by 33 percent). "Final average compensation" is defined to mean the average of the member's highest 36 consecutive calendar months (three years) of compensation if they contribute to the retirement plan, and the highest 60 consecutive months (five years) if they don't.

If a member retires under the bill and is rehired by the public school system as an independent contractor, either as an individual or through an employment agency, then the member's pension would be suspended for the period of employment.

FISCAL IMPACT:

The total annual net costs of the proposed legislation, summarized in Table 2, would range from $501.7 million to $657.9 million. Further details follow.

Examples of Impact on School Employees

Table 1 provides examples of how the proposal would affect the pension allowance of various hypothetical school employees.

Table 1: Personal Pension Increase Scenarios

Employee	FAC	YOS	Current Multiplier	Current Pension	Proposed Multiplier	Proposed Pension	Annual Increase
#1	$40,000	15	1.5%	$9,000	2.0%	$12,000	$3,000
#2	$70,000	30	1.5%	$31,500	2.0%	$42,000	$11,500
#3	$150,000	30	1.5%	$67,500	2.0%	$90,000	$22,500

Participation

According to the Office of Retirement Services (ORS), approximately 55,000 school employees would be immediately eligible to retire and an additional 7,000 would be eligible to purchase the time required to retire. When the State offered an increased pension multiplier incentive for state employees in 2002, 60% of eligible state employees retired. Since that package raised the multiplier from 1.5% to 1.75%, it is reasonable to expect that a higher percentage of school employees would apply for retirement with a 2.0% multiplier. It should be pointed out, given some public misperception, that this proposal includes all school employees that are part of the Michigan Public School Employees' Retirement System (MPSERS), including those of community colleges and certain university employees, and is not limited to just teachers.

The bill would cap participation by limiting the present value of the total added cost of the unfunded accrued actuarial liability (UAAL) of the pension to $1.5 billion for each of the two school years in which employees could retire. Applications to retire under this proposal would be given preference based on age and the most years of experience as well as the earliest application date. On average, depending on salary, this would cap the number of retirees to approximately 14,750 retirees for both school years 2008-2009 and 2009-2010, for a total of approximately 29,500. According to the ORS, approximately 9,000 of the eligible retirees would have retired absent the proposal for each of the two school years, and it would be reasonable to assume an equal proportion of the balance would have retired over the following three years, such that all of them would have retired absent the proposal within five years. See Table 2 for a distribution of estimated retirees attributable to the proposal over the next five years based on these assumptions.

Costs

According to the ORS, the increased multiplier would increase the present value of the UAAL of the pension system by approximately $101,600 per participating person. For FY 2008-09 districts are charged 4.56% of their payroll to pay for the UAAL that as of Sept. 30, 2007 equaled approximately $5.8 billion. So if the present value of the additional UAAL would be $3.0 billion and were amortized over the same 29 year period as is currently used, the additional costs would equal about $232 million per year, and the district contribution rate for the UAAL would increase by 2.36 percentage points. However, the Office of Retirement Services has suggested that in order to decrease the total costs of the package, districts should pay the added UAAL costs over the same 5-year period in which districts would benefit from the salary savings. While paying for the costs up front would decrease the total costs, it would considerably increase the required contributions from districts for those five years. The annual costs for those five years would be approximately $710 million and would increase contribution rates by approximately 7.2 percentage points.

In addition to the added UAAL costs, increasing the number of retirees would increase retiree health care costs for each year that the retiree would have worked absent the incentive. FY 2007-08 retiree health care costs totaled $734.5 million for 167,265 eligible retirees, averaging $4,391 per person. Table 2 summarizes the annual costs which vary from $12.6 million to $50.5 million based on the number of added retirees attributed to the proposal for each of the next five years. Retiree health care costs are charged to districts as a percent of payroll, and the added costs would increase contribution rates between 0.1 and 0.5 percentage points depending on the year.

Table 2: Estimated Costs of HB 4285
(in millions)

	FY 10	FY 11	FY 12	FY 13	FY 14
Cumulative # retirees under the proposal	14,750	29,500	29,500	29,500	29,500
Cumulative est. # of retirees absent the proposal	9,000	18,000	20,875	23,750	26,625
Est. # of additional retirees attributable to proposal	5,750	11,500	8,625	5,750	2,875
Additional UAAL costs	$710.0	$710.0	$710.0	$710.0	$710.0
Additional retiree health care costs	$25.2	$50.5	$37.9	$25.2	$12.6
Payroll savings	($129.4)	($258.7)	($194.1)	($129.4)	($64.7)
Total net costs	$605.9	$501.7	$553.8	$605.9	$657.9

Savings

The proposal would create payroll savings by either allowing districts to replace senior staff with younger, cheaper employees or by allowing districts to reduce staff through retirements as opposed to layoffs. Using data from the most recently available actuarial information (for the fiscal year ending Sept. 30, 2007), the average salary of those eligible to retire would be approximately $52,500, and the starting salary of a new employee would be approximately $30,000. If, on average, districts saved approximately $22,500 per new retiree attributed to the proposal, the savings would range from $64.7 million to $258.7 million depending on the year. These savings would increase if districts chose not to replace some or all retirees but would decrease for each employee allowed to retire at a later date under the critical shortage discipline provision or for each employee hired back as an independent contractor if not at a reduced salary.

District Equity

The proposal's costs and savings would not be evenly distributed among school districts. Districts that have a high seniority staff may experience high participation rates and thus would see higher payroll savings. Districts that recently offered their own self-funded retirement incentives or who have a young staff would not see significant payroll savings from such a proposal. The costs, however, are distributed through increased retirement contribution rates on all districts.

Conclusion

The proposed retirement incentive would increase individual pension allowances by 33%. Based on past State experience, it is reasonable to expect that all of the estimated 29,500 eligible employees allowed to retire under this proposal would retire. While the added costs associated with the increased multiplier would apply to all 29,500 retirees, the added retiree health care costs and added salary savings would apply only to the additional retirees attributed to the proposal over each of the next five years. The added UAAL costs would outweigh any estimated salary savings. Total annual net costs, summarized in Table 2, would range from $501.7 million to $657.9 million.

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