

MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM (MPSERS) REVISIONS

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Senate Bill 1040 (H-1)

Sponsor: Sen. Roger Kahn

House Committee: Appropriations

Senate Committee: Appropriations

Complete to 5-21-12

A SUMMARY OF SENATE BILL 1040 (H-1)

The bill would amend the Michigan Public School Employees' Retirement System (MPSERS) Act to make the following changes to pension and retiree health care benefits:

- Require all employees (except those in the Hybrid - Pension Plus plan) to choose one of the following options by August 31, 2012 to take effect October 1, 2012:
 - Increase contributions to 4% for the Basic Plan and 7% for the Member Investment Plan (MIP) and maintain a 1.5% pension multiplier.
 - Maintain current contribution rates but freeze existing benefits at a 1.5% multiplier and receive a 1.25% pension multiplier for future years of service.
 - Freeze existing pension benefits and move into a defined contribution (DC), 401(k) style, plan with a flat 4% employer contribution for future service.
- Cap the maximum allowable final average compensation for employees hired after July 1, 2012 at \$100,000, adjusted annually for inflation.
- Increase the retiree health insurance premium contribution of both existing and future retirees to at least 20%, capping the MPSERS's premium share at 80% beginning January 1, 2013.
- Eliminate retiree health insurance for employees hired on or after July 1, 2012, and replace it with a 401(k) or 457 plan with an employer match of up to 2% of compensation plus a lump sum deposit of either \$1,000 or \$2,000 into a Health Reimbursement Account (HRA) upon termination of employment.
- Continue the 3% employee contribution for retiree health but guarantee an employee's individual contributions. Use the 3% contributions toward prefunding future retiree health benefits. Allow existing employees to opt out and choose the 2% matching contribution into a DC plan in lieu of retiree health benefits.
- Shift from paying for retiree health care benefits on a pay-as-you-go method to prefunding with a combination of employee contributions, employer contributions and state funding.

- Cap the employer rate at the equivalent of 24.46% of payroll (the maximum FY 2011-12 rate) after adjusting for changes in employer contributions for unfunded accrued liabilities (see below), and provide School Aid Fund contributions to pay the amount of annual required contribution that exceeds the employer maximum rate.
- Continue to charge the normal cost of pension and health care, meaning the amount necessary to prefund the benefit earned by current employees in any given year, on each employer's MPSERS payroll, but shift the cost of paying unfunded accrued liabilities (UAL) to an employer's cost of operating expenditures (COE).

Pension Changes

Currently employees hired prior to 1990 (those who never transferred into the Member Investment Plan (MIP)), are in a noncontributory plan called the Basic Plan and contribute 0% for their pension benefits. Employees hired since January 1990 but prior to July 2010 (or former Basic members who transferred into the MIP plan) contribute between 3% and 6.4%, depending on their level of compensation and their hire date, for an enhanced benefit compared to the original Basic Plan.

Senate Bill 1040 (H-1) would require that employees currently in either the Basic or MIP pension plan must choose among the following options, which would take effect October 1, 2012:

1. Increase their contribution to 4% for the Basic Plan and 7% for the Member Investment Plan (MIP) and maintain the current 1.5% pension multiplier. Currently MIP contributions are graduated based on income, but Senate Bill 1040 (H-1) would require a flat 7% on all compensation. The bill specifies that the employee contributions could not exceed the normal cost of the pension benefit.

Employees who chose to pay an increased contribution could choose to contribute either until their retirement or until they reach 30 years of service, at which point their contributions would decrease to current levels and their pension multiplier for years of service that exceed 30 would decrease to 1.25%.

2. Maintain current contribution rates, freeze existing benefits at 1.5% multiplier, and receive a 1.25% pension multiplier for future years of service.
3. Freeze existing pension benefits and move into a defined contribution (DC), 401(k) style, plan with a flat 4% employer contribution for future service.

Employees hired since July 2010 are in a hybrid plan called Pension Plus, which has both a diminished pension benefit as well as a defined contribution component. Senate Bill 1040 (H-1) would make no pension contribution changes for existing or future Hybrid plan employees. However, the bill would cap the final average compensation used to calculate a Hybrid plan pension at \$100,000 adjusted annually for inflation.

Increased Employee Health Care Premium Contributions

Currently retirees hired prior to July 2008 pay between 0% and 10% of their monthly medical care premiums depending on whether they are Medicare-eligible and whether they have dependents. They also pay 10% of their monthly dental and vision benefits. The MPSERS system pays for the balance of costs. Employees hired since July 2008 earn a graded health care premium based on the number of years of service they earn: 30% after 10 years and an additional 4% per year capped at 90%.

Senate Bill 1040 (H-1) would cap the maximum employer contribution for medical, dental and vision benefits at 80% and would require that retirees pay at least 20% of their premium for all existing and future retirees.

Defined Contribution (DC) Health Care Revisions

Senate Bill 1040 (H-1) would eliminate retiree health insurance coverage for employees hired after July 1, 2012 and would replace it with an employer matching contribution of up to 2% of compensation into either a 401(k) or 457 plan.

In addition, these employees would receive a lump sum deposited into a Health Reimbursement Account (HRA) upon termination of employment. The lump sum would equal \$1,000 for an employee who terminates employment prior to reaching age 60 with ten years of service or \$2,000 for an employee who terminates employment after reaching age 60 with ten years of service.

Employer matching contributions provided in lieu of retiree health care could not be used as a basis for a loan from an employee's tax-deferred account.

Continue Mandatory 3% Employee Contribution for Retiree Health Care

Beginning in July 2010, all employees in MPSERS began contributing 3% of their compensation into an irrevocable trust for retiree health care costs. The employee contributions are currently being held in an escrow account pursuant to court order while the legality of the mandatory contributions is litigated. Senate Bill 1040 (H-1) would continue these contributions and use them to begin prefunding retiree health care benefits. If an employee were not eligible for retiree health care upon retirement, he or she would have their contributions returned in equal monthly installments over 5 years after reaching age 60.

Senate Bill 1040 (H-1) would allow existing employees to opt out of the 3% contribution if they agree to forego all retiree health care benefits and take the 2% DC matching contribution in lieu of health care as described above for new employees.

Begin Prefunding Retiree Health Care Obligations

Currently retiree health care benefits are paid on a cash or pay-as-you-go basis. Senate Bill 1040 (H-1) would instead require that retiree health care benefits be prefunded. Prefunding retiree health care benefits requires a significant increase in current contributions but saves

the system in the long term because of the benefit from investment returns on prefunding contributions. The bill would include employee 3% contributions and increased retiree premium share contributions as well as employer and state contributions to pay for prefunding. Prefunding triggers a change in the accounting method used to determine future unfunded liabilities, allowing MPSERS to use an 8% discount rather than a 4% discount rate. This will reduce the UAL, currently calculated at \$27.6 billion, by \$10.8 billion.

Other Rate Changes

The bill would also include a number of other changes to the employer contribution rates:

First, the bill would reamortize the cost of the early retirement program of 2010 from 5 years to 10 years in order to create short term savings to allow additional funding in the short term to be redirected to prefunding retiree health care for greater long-term savings.

Second, the bill would cap the employer rate at the equivalent of 24.46% of payroll, which is the maximum FY 2011-12 rate, after adjusting for changes in employer contributions for unfunded accrued liabilities (described below), with intent to provide School Aid Fund contributions to pay the amount of annual required contribution that exceeds the employer maximum rate.

Third, the bill would continue to charge the normal cost of pension and health care, meaning the amount necessary to prefund the benefit earned by current employees in any given year, on each employer's MPSERS payroll. Rather than continuing to charge the UAL rate on payroll as well, it would redistribute those costs over an employer's cost of operating expenditures (COE). Charging UAL costs on COE better ensures that unfunded liabilities related to previously earned benefits remain with the employer that created the cost. A local school district's COE would include the COE of a public school academy it authorizes after Senate Bill 1040 (H-1) takes effect.

FISCAL IMPACT:

Senate Bill 1040 (H-1) would create both quantifiable short-term savings as well as long-term savings, which cannot be precisely quantified, due to various provisions of the bill, which are summarized in the table below. For FY 2012-13, the bill would cap employer contributions at the equivalent of the FY 2011-12 rate of 24.46%, which would require an estimated \$130 million in School Aid funding to meet the full annual required contribution. The bill would decrease the UAL calculation by a total of \$15.9 billion from \$45.2 billion to \$29.3 billion.

Office of Retirement Services Appropriation

Senate Bill 1040 (H-1) would also appropriate \$4.7 million for FY 2011-12 for the Office of Retirement Services to administer the changes proposed in the bill.

Fiscal Analyst:

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent

Michigan Public School Employees' Retirement System (MPSERS) Proposed Reforms

Employer Contribution Rates:
 FY 2011-12: 24.46%
 FY 2012-13: 27.37%
 FY 2013-14: 31.21%

Unfunded Liabilities:
 Pension: \$17.6 billion
 Health: \$27.6 billion

SB 1040 (H-1) Provisions	Current Law Provisions	Year 1 Savings/(Cost)	Impact on Unfunded Accrued Liability (UAL)
<p>1. Employees choose among the following:</p> <ul style="list-style-type: none"> • Increase employee pension contributions as follows: Basic: 4% MIP: 7% • Continue paying current contribution rates and have a decreased pension multiplier of 1.25%, instead of 1.5%, for future service • Freeze their pension and move into a 4% flat defined contribution (DC) plan for future service. 	<p>Currently employees contribute varying rates depending on plan and hire date:</p> <p>Basic: 0% MIP: graduated rate with top rate between 3.9% and 6.4% depending on hire date</p>	<p>Reduces the Employer contribution rate by 2.07% of payroll.</p> <p>Increases Employee contributions by \$265 million in Year 1.</p>	<p>Reduces the UAL by \$1.56 billion.</p>

SB 1040 (H-1) Provisions	Current Law Provisions	Year 1 Savings/(Cost)	Impact on Unfunded Accrued Liability (UAL)
2. Increase retiree share of health care premiums to 20% for existing and future retirees.	Retirees currently pay between 0% and 10% of health care premiums depending on age and dependents.	Reduces the Employer contribution rate by 1.00% of payroll. Increases retiree contributions by \$90 million in Year 1.	Reduces the UAL by \$1.9 billion.
3. 2% Matching DC Plan Contribution in lieu of retirement health care for new hires	Employees receive between 30% and 100% of their retiree health care premiums depending on hire date and number of years of services.	Minimal cost increases due to required match, which will grow over time.	Avoids added unfunded liabilities for new employees.
4. Continue 3% Employee contributions for retirement health and use funds to prefund their future benefits. Guarantees each employees' individual contributions and refund them if the employee does not qualify for retiree health care upon reaching age 60.	Currently employees pay 3% of their compensation for retiree health care, intended for use toward current retiree health care costs.		Reduces the UAL by \$5.5 billion.
5. Begin prefunding retiree health care using both employee 3% contributions mentioned above as well as employer and state contributions.	Currently retiree health care is paid on a pay-as-you-go, cash basis each year, paying the annual cost of providing health care for current retirees.	Increases employer/state costs equal to 3.55% of payroll (6.13% total with 2.58% from employee 3% contributions) Creates long-term as prefunding amounts are invested and used to pay future costs.	Reduces the UAL by \$5.3 billion.

SB 1040 (H-1) Provisions	Current Law Provisions	Year 1 Savings/(Cost)	Impact on Unfunded Accrued Liability (UAL)
6. Cap the Employer contribution rate at the FY 2011-12 level and shift future increases related to prefunding to the School Aid Fund.	Total retirement costs were shifted to employers in 1995.	Caps employer rate at the equivalent of 24.46% (see below). State costs would equal \$130 million in first year and grow as cost of prefunding grows.	No change
7. Redistribute "stranded" unfunded liability costs over employer current operating expenditures (COE) rather than payroll.	Currently both the normal costs and unfunded liabilities are charged to employers based on a percent of payroll. However payroll is declining disproportionately across the system, which shifts the cost of unfunded liabilities to those districts with a higher proportion of payroll.	Continue to charge 3.41% of normal costs on payroll. Convert the remaining UAL rate of 21.05% of payroll to 11.76% of COE.	No change

Total Impact of Proposal

	Under Current Provisions	Under SB 1040 (H-1)
FY 2012-13 Employer Contribution Rate	27.37% of payroll	3.41% of payroll plus 11.76% of current operating expenditures (Equivalent: 24.46% of payroll)
Long-Term Unfunded Liability: Pension	\$17.6 billion	\$16.0 billion
Long-Term Unfunded Liability: Health Care	\$27.6 billion	\$13.3 billion
Long-Term Unfunded Liability: Total	\$45.2 billion	\$29.3 billion
Additional state funding needed for FY 2012-13	\$0	\$130 million

MPSERS Impact on Funding Worksheet

PRELIMINARY AND DRAFT

5/4/2012

If the system were fully pre-funding Retiree Health Care like we do pension, the Unfunded Accrued Liability (UAL) could be calculated using an 8% discount rate. The current pay-as-you-go system calculates the UAL using a 4% discount rate. Partial pre-funding of Retiree Health Care allows the actuary to calculate the UAL with a discount rate between 4% and 8%, dependent on the level of pre-funding.

	Pension Funding (\$ in billions)	Health Care Funding (\$ in billions)
Illustrative Impact on 2013 Rate (for employees hired since 7/1/2010)	Unfunded Accrued Liability	Unfunded Accrued Liability (Full Funding)
Today's (As-Is) Funding Requirements	27.37% \$	17.600 \$
Positive health experience in FY 2011 Revised UAL	-0.70%	\$ (1.600) \$ 26.000
1 Reduce liability by establishing a maximum subsidy of 80% for retiree health care Revised UAL	-1.00%	\$ (1.900) \$ 24.100
2 New employees will receive a Personal Healthcare Fund (2% matching contribution + \$2,000/\$1000 upon termination) Revised UAL		Eliminates the growth of the liability for new employees \$ 24.100
3 Partially fund retiree health care liability using 3% member contributions. Revised UAL	-2.58%	\$ (5.500) \$ 18.600
4 Fully prefund health care Revised UAL	6.13%	\$ (5.300) \$ 13.300
5 Pension Choice Revised UAL	-2.07%	\$ (1.560) \$ 16.040
6a Reamortize early retirement incentive program	-1.30%	
6b Preliminary budgetary adjustment projection	-1.39%	
New retirement rate	24.46%	
Overall reduction in liabilities:	\$1.56 Billion (Pension)	\$14.3 Billion (Health)
	\$15.86 Billion (Overall)	

MPSERS
Projected Employer Contributions for Pension and Retiree Health Benefits
Effects of Proposed Provisions
(Draft - 05/04/2012)

Projected Employer Contribution Rates

Estimated employer contribution rates, as percentages of MPSERS active member payroll, are displayed in the chart below. Tabular values are provided as well.

Two alternative projections are shown:

1. Current Plan Provisions – Baseline Scenario

Current plan provisions are continued for both the pension and retiree health plans. New employees are covered by the Hybrid Plan (Pension Plus Plan) and receive graded coverage in the retiree health plan.

2. Proposed Provisions – Full Funding – 10 Year Amortization of ERIP Scenario

Proposed Pension Provisions:

Basic employees contribute 4% of pay to the pension plan, while MIP employees contribute 7% of pay to the pension plan.

Proposed Retiree Health Provisions:

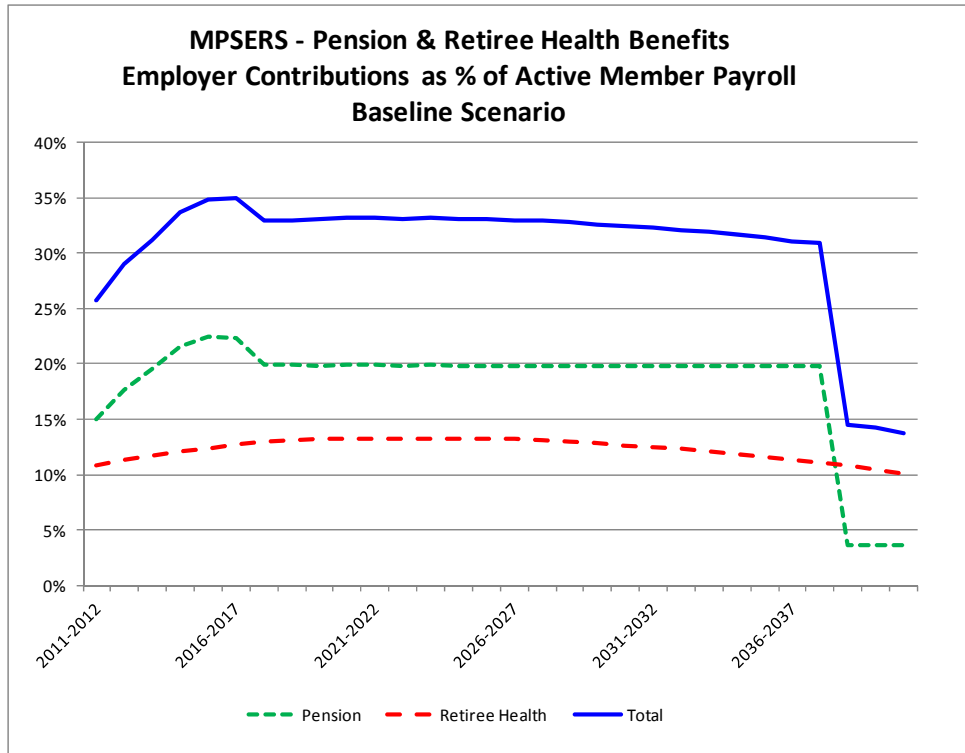
80%/20% (employer/employee) cost share for all participants (active, deferred, and retired), 3% active member contributions to the health plan for current actives, new employees are covered by a 2% DC arrangement.

This scenario assumes that employers and members are fully funding the retiree health ARC each year. Additionally, it is assumed that the employer fully funds the early retirement incentive over 10 years (starting with the 2012-2013 fiscal year, rather than over 5 years as currently scheduled).

All results in this illustration are based on September 30, 2010 valuation results. In all cases, FY 2010-2011 payroll is estimated to total \$9.5 billion, consistent with the payroll estimated in the September 30, 2010 actuarial valuation. As of September 30, 2010, school employers had not yet completed their planned replacement of employees who retired under the 2010 Early Retirement Incentive Program, so that reported active member payroll dropped significantly. However, reported payroll began to increase after September 30, 2010. The actuary and the Office of Retirement Services estimated that actual payroll would be around \$9.5 billion in FY 2010-2011.

None of the projected employer contribution rates include reconciliation payments. The projected pension employer contribution rates include the 2-year delay in the budgeting process beginning with the 2012-2013 fiscal year. (That is, the September 30, 2010 valuation was used to budget fiscal years ending 2012 and 2013. The September 30, 2011 valuation is used to budget fiscal year 2014.) For retiree health projected employer contribution rates, no delay was incorporated in the full funding scenario.

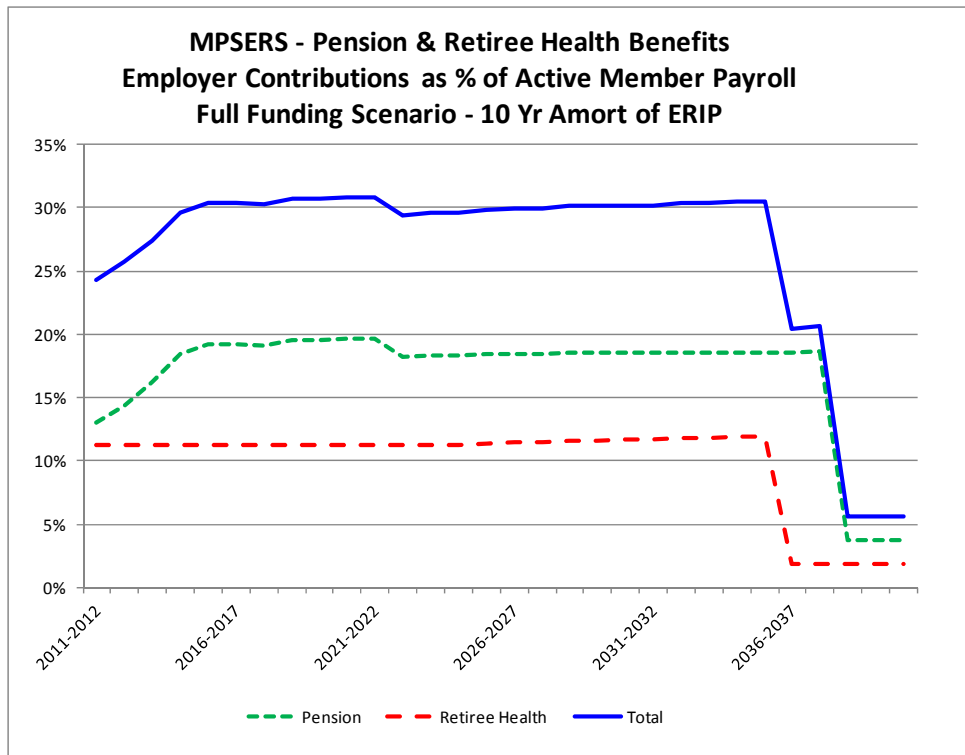
BASELINE SCENARIO (Draft - 05/04/2012)



Projected Payroll and Employer Contributions for Pension and Retiree Health Benefits (in millions)

Fiscal Year	Projected Payroll	Pension		Retiree Health		Total	
		Dollars	% of Pay	Dollars	% of Pay	Dollars	% of Pay
2011-2012	\$9,833	\$1,471	15.0%	\$1,063	10.8%	\$2,534	25.8%
2012-2013	\$10,177	\$1,801	17.7%	\$1,147	11.3%	\$2,948	29.0%
2013-2014	\$10,533	\$2,054	19.5%	\$1,231	11.7%	\$3,285	31.2%
2014-2015	\$10,902	\$2,355	21.6%	\$1,317	12.1%	\$3,672	33.7%
2015-2016	\$11,284	\$2,528	22.4%	\$1,403	12.4%	\$3,931	34.8%
2016-2017	\$11,679	\$2,604	22.3%	\$1,485	12.7%	\$4,089	35.0%
2017-2018	\$12,088	\$2,406	19.9%	\$1,566	13.0%	\$3,972	32.9%
2018-2019	\$12,511	\$2,490	19.9%	\$1,644	13.1%	\$4,134	33.0%
2019-2020	\$12,949	\$2,564	19.8%	\$1,717	13.3%	\$4,281	33.1%
2020-2021	\$13,402	\$2,667	19.9%	\$1,786	13.3%	\$4,453	33.2%
2021-2022	\$13,871	\$2,760	19.9%	\$1,850	13.3%	\$4,610	33.2%
2022-2023	\$14,356	\$2,842	19.8%	\$1,915	13.3%	\$4,757	33.1%
2023-2024	\$14,858	\$2,957	19.9%	\$1,982	13.3%	\$4,939	33.2%
2024-2025	\$15,378	\$3,045	19.8%	\$2,049	13.3%	\$5,094	33.1%
2025-2026	\$15,916	\$3,151	19.8%	\$2,115	13.3%	\$5,266	33.1%
2026-2027	\$16,473	\$3,262	19.8%	\$2,178	13.2%	\$5,440	33.0%
2027-2028	\$17,050	\$3,376	19.8%	\$2,238	13.1%	\$5,614	32.9%
2028-2029	\$17,647	\$3,494	19.8%	\$2,291	13.0%	\$5,785	32.8%
2029-2030	\$18,265	\$3,616	19.8%	\$2,340	12.8%	\$5,956	32.6%
2030-2031	\$18,904	\$3,743	19.8%	\$2,389	12.6%	\$6,132	32.4%
2031-2032	\$19,566	\$3,874	19.8%	\$2,442	12.5%	\$6,316	32.3%
2032-2033	\$20,251	\$4,010	19.8%	\$2,491	12.3%	\$6,501	32.1%
2033-2034	\$20,960	\$4,150	19.8%	\$2,535	12.1%	\$6,685	31.9%
2034-2035	\$21,694	\$4,295	19.8%	\$2,573	11.9%	\$6,868	31.7%
2035-2036	\$22,453	\$4,446	19.8%	\$2,605	11.6%	\$7,051	31.4%
2036-2037	\$23,239	\$4,601	19.8%	\$2,634	11.3%	\$7,235	31.1%
2037-2038	\$24,052	\$4,762	19.8%	\$2,661	11.1%	\$7,423	30.9%
2038-2039	\$24,894	\$921	3.7%	\$2,682	10.8%	\$3,603	14.5%
2039-2040	\$25,765	\$953	3.7%	\$2,696	10.5%	\$3,649	14.2%
2040-2041	\$26,667	\$987	3.7%	\$2,704	10.1%	\$3,691	13.8%

PROPOSED PROVISIONS – FULL FUNDING SCENARIO (Draft - 05/04/2012)



Projected Payroll and Employer Contributions for Pension and Retiree Health Benefits (in millions)

Fiscal Year	Projected Payroll	Pension		Retiree Health		Total		School District Rate	School Aid Rate
		Dollars	% of Pay	Dollars	% of Pay	Dollars	% of Pay		
2011-2012	\$9,833	\$1,275	13.0%	\$1,114	11.3%	\$2,389	24.3%		
2012-2013	\$10,177	\$1,465	14.4%	\$1,147	11.3%	\$2,612	25.7%	24.5%	1.2%
2013-2014	\$10,533	\$1,706	16.2%	\$1,183	11.2%	\$2,889	27.4%	24.5%	2.9%
2014-2015	\$10,902	\$2,006	18.4%	\$1,221	11.2%	\$3,227	29.6%	24.5%	5.1%
2015-2016	\$11,284	\$2,167	19.2%	\$1,261	11.2%	\$3,428	30.4%	24.5%	5.9%
2016-2017	\$11,679	\$2,242	19.2%	\$1,303	11.2%	\$3,545	30.4%	24.5%	5.9%
2017-2018	\$12,088	\$2,309	19.1%	\$1,348	11.2%	\$3,657	30.3%	24.5%	5.8%
2018-2019	\$12,511	\$2,440	19.5%	\$1,395	11.2%	\$3,835	30.7%	24.5%	6.2%
2019-2020	\$12,949	\$2,525	19.5%	\$1,445	11.2%	\$3,970	30.7%	24.5%	6.2%
2020-2021	\$13,402	\$2,627	19.6%	\$1,498	11.2%	\$4,125	30.8%	24.5%	6.3%
2021-2022	\$13,871	\$2,719	19.6%	\$1,555	11.2%	\$4,274	30.8%	24.5%	6.3%
2022-2023	\$14,356	\$2,613	18.2%	\$1,614	11.2%	\$4,227	29.4%	24.5%	4.9%
2023-2024	\$14,858	\$2,719	18.3%	\$1,677	11.3%	\$4,396	29.6%	24.5%	5.1%
2024-2025	\$15,378	\$2,814	18.3%	\$1,743	11.3%	\$4,557	29.6%	24.5%	5.1%
2025-2026	\$15,916	\$2,929	18.4%	\$1,813	11.4%	\$4,742	29.8%	24.5%	5.3%
2026-2027	\$16,473	\$3,031	18.4%	\$1,887	11.5%	\$4,918	29.9%	24.5%	5.4%
2027-2028	\$17,050	\$3,137	18.4%	\$1,964	11.5%	\$5,101	29.9%	24.5%	5.4%
2028-2029	\$17,647	\$3,265	18.5%	\$2,043	11.6%	\$5,308	30.1%	24.5%	5.6%
2029-2030	\$18,265	\$3,379	18.5%	\$2,123	11.6%	\$5,502	30.1%	24.5%	5.6%
2030-2031	\$18,904	\$3,497	18.5%	\$2,206	11.7%	\$5,703	30.2%	24.5%	5.7%
2031-2032	\$19,566	\$3,620	18.5%	\$2,292	11.7%	\$5,912	30.2%	24.5%	5.7%
2032-2033	\$20,251	\$3,767	18.6%	\$2,383	11.8%	\$6,150	30.4%	24.5%	5.9%
2033-2034	\$20,960	\$3,899	18.6%	\$2,476	11.8%	\$6,375	30.4%	24.5%	5.9%
2034-2035	\$21,694	\$4,035	18.6%	\$2,572	11.9%	\$6,607	30.5%	24.5%	6.0%
2035-2036	\$22,453	\$4,176	18.6%	\$2,671	11.9%	\$6,847	30.5%	24.5%	6.0%
2036-2037	\$23,239	\$4,322	18.6%	\$430	1.9%	\$4,752	20.4%		
2037-2038	\$24,052	\$4,498	18.7%	\$453	1.9%	\$4,951	20.6%		
2038-2039	\$24,894	\$921	3.7%	\$475	1.9%	\$1,396	5.6%		
2039-2040	\$25,765	\$953	3.7%	\$497	1.9%	\$1,450	5.6%		
2040-2041	\$26,667	\$987	3.7%	\$519	1.9%	\$1,506	5.6%		