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

BILL ANALYSIS

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

House Bill 6229 (Substitute H-5, as passed the House)
Sponsor: Representative Kim Rhead
House Committee: Appropriations
Senate Committee: Appropriations

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CONTENT

The bill would amend the State Employees Retirement Act to provide for a defined contribution retirement plan. The bill would require all new members on or after March 31, 1997, to become members of the Tier 2 (defined contribution) plan. All persons who were members of the State Employees Retirement System (SERS) prior to March 31, 1997, would have the option of remaining in the Tier 1 (defined benefit) plan or elect to become a qualified participant in Tier 2. All members also would be eligible to receive health care benefits as prescribed in the proposed bill. In addition, an early retirement option is provided for certain current State employees who meet the early retirement provision in the proposed bill. Currently, all members of the SERS are members of a defined benefit retirement plan. The defined benefit plan provides a guaranteed lifetime retirement benefit provided the member vests in the system and attains the minimum age and service requirements. The proposed defined contribution retirement plan and the early out provision are outlined below.

Defined Contribution Plan

Under the proposed bill, the current plan would be divided into two types of membership. Tier 1 members would be defined as those employees who are members of the original retirement system prior to March 31, 1997, and who do not elect to become a qualified participant in Tier 2. Tier 2 qualified participants would be defined as Tier 1 members who elect to become qualified participants in Tier 2 and all new employees hired on or after March 31, 1997.

The SERS board could promulgate rules pursuant to the Administrative Procedures Act for Tier 1 retirement plans but not for Tier 2 plans. The SERS board could not promulgate rules for the establishment, implementation, administration, operation, investment, or distribution of a Tier 2 retirement plan.

The SERS would have to give it's current members the opportunity to terminate membership in Tier 1 and become a qualified participant in Tier 2. Such an election would be irrevocable. The SERS would have to accept written elections from January 2, 1998 to April 30, 1998, for members choosing to switch to the Tier 2 retirement plan. An employee who elects to change from a Tier 1 member to a Tier 2 qualified participant would elect to do all of the following:

1. Cease to be a member of Tier 1, effective 12 midnight, May 31, 1998.

2. Become a qualified participant in Tier 2, effective 12:01 a.m., June 1, 1998.

3. Waive all rights to a pension, an annuity, a retirement allowance, an insurance benefit, or any other benefit under Tier 1, effective 12 midnight, May 31, 1998.

These same provisions would be made for deferred members and nonvested members that return to work for the State. However, their election to stay in Tier 1 or change to Tier 2 would have to be submitted to the retirement system in writing within 60 days of their reemployment. The effective dates for these employees would depend on the dates that they are reemployed.

For current, deferred, or former nonvested members that would elect to terminate membership in Tier 1 and become a qualified participant in Tier 2, the retirement system would direct the State Treasurer to transfer a lump sum amount from the appropriate fund to the qualified participant's account in Tier 2. The retirement system would calculate the amount to be transferred based on the actuarial present value of the member's accumulated benefit obligation plus his or her accumulated contributions. The calculation of estimated and actuarial present value of the member's or deferred member's accumulated benefit obligation and personal contributions would be based upon methods adopted by the Department of Management and Budget and the retirement system's actuary in consultation with the retirement board.

After consulting with the retirement system's actuary, the Department of Management and Budget would calculate for each fiscal year any cost savings that would have accrued to the State as a result of adopting a defined contribution plan over the costs that would have been incurred by the State had a defined contribution plan not been implemented. The savings would not be used to decrease the actuarial rate charged by the retirement system, but instead would be deposited in a health insurance fund. The amount deposited in a health fund could not be expended until the actuarial accrued liability for health benefits is 100% funded.

Under the bill, the State Treasurer would be entrusted with the following duties and responsibilities:

* Administer the Tier 2 plan and invest the plan’s assets. The State Treasurer would be the fiduciary and trustee of the Tier 2 plan. The State Treasurer could appoint an advisory board to assist in carrying out duties as fiduciary and trustee.

* Determine the provisions and procedures of Tier 2 in conformity with the act and the Internal Revenue Code.

* Employ or contract with personnel for services that the State Treasurer determines necessary for the proper administration of and investment of the assets of the Tier 2 plan.

The individuals that become qualified participants in the defined contribution plan (Tier 2) would direct the investment of their accumulated employer and employee contributions and earnings to one or more investment choices within the available categories of investment funds provided by the State Treasurer. The administrative costs of the Tier 2 plan would be paid by the qualified participants, former qualified participants, and refund beneficiaries with active accounts.

In the new Tier 2 plan, the State would contribute 4% of a qualified participant's salary to the individual's account. In addition, the participant would be allowed to contribute up to 3% of his or her compensation to his or her account, with the employer making a matching contribution up to a maximum of 3%. The qualified participant could also make additional contributions beyond those mentioned up to the maximum allowed by the State Treasurer and the Internal Revenue Code.

A qualified participant would be immediately 100% vested in his or her personal contributions into a Tier 2 plan. The individual would become vested in the employer's contributions as follows:

2 years of credited service	50%
3 years of credited service	75%
4 years of credited service	100%

A qualified Tier 2 participant would become vested in health insurance coverage after completing 10 years of service as a qualified participant and was not a member, deferred member, or former nonvested member in Tier 1. If a member, deferred member, or former nonvested member was a participant in Tier 1 and elects to participate in Tier 2, then that participant would have to meet the service requirements that he or she would have been required to meet under Tier 1 in order to vest in health benefits. Qualified participants who were members, deferred members, or former nonvested member of Tier 1 who elect to participate in Tier 2 would be credited with the years of service accrued under Tier 1 for the purposes of meeting the vesting requirements of Tier 2. Health insurance coverage would be available to vested qualified participants and their eligible dependents. The amount of premium paid by the retirement system for qualified participants who were not a member, deferred member, or former nonvested member of Tier 1 would be equal to 3% per year of service up to a maximum of 90%. For qualified participants who were members, deferred members, or former nonvested members of Tier 1and elected to become qualified participants of Tier 2, the State would pay a portion of the health insurance premium equivalent to the premium amounts paid on behalf of retirants of Tier 1. All insurance premium payments would be based on a cash disbursement method.

In addition, duty and non-duty disability and death benefits would be paid to Tier 2 qualified participants as if they had been a member of Tier 1. Any payments received would be offset by the value of the distribution of his or her accumulated balance upon becoming a former qualified participant pursuant to the distribution methods described below.

Upon leaving the State's employment, a former qualified participant would be eligible to receive distribution of his or her accumulated balance in their defined contribution account. Upon death of a qualified participant, the accumulated balance in the deceased participant's account would be paid to the refund beneficiary, or if none is stated, to the legal representative or the deceased participant's estate.

A former qualified participant or refund beneficiary could elect one or a combination of several of the following methods of distribution:

(a) Lump sum.
(b) Lump sum direct rollover to another qualified plan.
(c) Periodic distributions as authorized by the State Treasurer.
(d) No distribution, balance remains in the account until person decides, to the extent allowed by Federal law.

In addition, all disbursements of employer contributions (the mandatory 4%) and the earnings on those contributions, plus the employee and matched employer contributions (up to a maximum of 6%) and the earnings on those contributions, would be exempt from State, county, municipal, or other local tax. Any contributions made by the employee beyond the first 3% would be subject to all taxes.

Finally, if the Department of Management and Budget receives notification from the IRS that a section or a portion of a section of the law for each retirement system would cause the retirement system to be disqualified for tax purposes under the Internal Revenue Code, then the portion that would cause disqualification would not apply.

FISCAL IMPACT

The exact fiscal impact of the Tier 2 plan is indeterminable. Any cost savings that would arise would be placed into the health insurance fund of the retirement system. The bill contains a provision stating that any cost savings would not be used to decrease the actuarial rate charged by the retirement system, but instead would be deposited in a health insurance fund. Because health insurance costs may continue to rise, so too would the contribution rate for health insurance for the remaining Tier 1 plan. However, in the future when the health insurance fund contains sufficient funds to cover the actuarial accrued liability for health benefits, the contribution rate for health insurance for the Tier 1 plan would decrease.

Additionally, the administrative costs for the defined contribution plan would be paid by the qualified participants, former qualified participants, and refund beneficiaries from the earnings on their investments.

Early Retirement Plan

House Bill 6229, which amends the State Employees Retirement Act, contains a special provision that provides an early retirement option for certain State and legislative employees. Corrections and Conservation Officers would be excluded from this early retirement option. Full retirement benefits would be granted to employees who meet one of the following criteria:

* Member must be at least 60 years of age and have completed 10 years of service.

* Member must be at least 55 years of age and have completed 15 years of service.

* Member must be at least 50 years of age and have completed 25 years of service.

To be eligible to retire under the above stated criteria, the member would have to have been employed by the State or Legislature for the 6-month period ending on the effective date of his or her retirement. A member who is restored to service or who is on layoff status during that 6-month period would be considered to have met the 6-month employment requirement. An eligible employee would also include a person who was an employee of the State Judicial Council on September 30, 1996.

The early retirement window would be from April 1, 1997 to June 1, 1997, for State employees, and from February 1, 1997 to June 1, 1997, for legislative employees. A member would have to file a written application with the retirement board at least 30 days prior to the date on which the member would elect to retire. However, the director of a principal department could request that the effective date of retirement for a State employee member employed by that department be extended to a date not later than June 1, 1998. To get this extension, the director would have to submit a written request along with the written concurrence of the member to the Department of Management and Budget on or before April 30, 1997. This provision would not apply to legislative employees.

In addition, any employee taking an early retirement under the provisions in this bill would be prohibited from becoming a contractual employee for this State for two years after separation from employment.

Members that would choose to retire under this provision would receive a retirement benefit equal to the member's number of years and fraction of a year of credited service multiplied by 1.75% of his or her final average compensation. Members less than 60 years of age with less than 30 years of credited service receiving benefits under the proposed early retirement provision would not be subject to the reductions in their benefits for early retirement as specified in the Act. Also, a retirant under this early retirement provision who is owed a lump sum payment for accumulated sick leave would have that payment paid in 60 equal monthly installments.

Fiscal Impact of Early Retirement

There are currently an estimated 7,000 State employees that are eligible for early retirement under the proposed provision. It is further estimated that about half of those eligible would retire early under the provision. Because the plan would be implemented half way through the first year, the first year cost savings are estimated to be $12.1 million Gross, $4.5 million GF/GP. The savings are expected to double in the second and subsequent years to an estimated average of $25 million Gross and $9 million GF/GP.

MCL 38.1e et al. Fiscal Analyst: J. Carrasco

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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.