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STATE EMPLOYEES RETIREMENT CHANGES: EARLY OUT PLAN, HEALTH FUNDING ACCOUNT, DUTY DISABILITY CHANGES

House Bill 5732
Sponsor: Rep. Paul DeWeese
Committee: Senior Health, Security and Retirement

Complete to 2-22-02

A SUMMARY OF HOUSE BILL 5732 AS INTRODUCED 2-21-02

The bill would amend the State Employees' Retirement Act to establish an early retirement plan, create an advance health funding account and provide for prefunding of health benefits when that account was fully funded, revise duty disability provisions, make certain changes concerning the tax exempt status of the retirement system, and change a provision concerning compensation of retirement board members.

Current retirement age requirements. Under current law, a member of the State Employees Retirement System who is a participant in the defined benefit program is entitled to retire with a full retirement benefit upon meeting one of the following age and service requirements:

- At age 60 with 10 or more years of credited service (or five years in certain circumstances); or,

- At age 55 with at least 30 years of service credit.

In addition, a member who is at least 55 years old with 15 to 30 years of service credit may retire, but the retirement allowance is reduced by .5 percent for each month the member is less than 60 years old.

Early retirement option. House Bill 5732 would add language to create an early retirement option that would apply during 2002. Under the bill, a member whose combined age and length of credited service was equal to at least 80 years, as of November 1, 2002 or on the effective date of retirement, whichever was earlier, could retire with a full (unreduced) retirement allowance. There would be no minimum age requirement. An application would have to be filed between April 1 and April 30, 2002, and the member would have to state a retirement date between July 1 and November 1, 2002. A member could withdraw an application until May 15, 2002, but after that date the application would be irrevocable.

Eligibility. To be eligible, a person would have to be employed by the state (or be on layoff status) for the six-month period ending on the effective date of his or her retirement (or have been an employee of the State Judicial Council on September 30, 1996). Members of the classified civil service, employees of the judicial and legislative branches, employees of the governor's office, and unclassified employees would be eligible for the early retirement program. In addition, former members of the retirement system who had previously transferred from the

defined benefit program to the defined contribution program could retire under the early retirement program if they met the "80 and out" requirements.

Members of the retirement system in "covered" positions (certain Corrections Department positions) and conservation officers would not be eligible under the bill.

Enhanced benefit formula. A retirement allowance under the defined benefit program is calculated according to a formula that multiplies the member's number of years of credited service by his or her final average compensation by a factor of 1.5 percent. The benefit formula for a retirement allowance under the bill would instead use a 1.75 percent factor. (The enhanced benefit formula would also apply to those who retired during the July-November period under the existing age 60 with ten years of service option.) Those who are participants in the defined contribution program but who met the "80 and out" requirement could retire under the defined benefit formula with a .25 percent retirement factor (i.e., years of service x final average compensation x .25 percent).

Lump sum payments. Any amount that a member retiring under the bill would otherwise be entitled to receive in a lump sum at retirement on account of unused sick leave would be paid in monthly installments over five years. The bill specifies that payments received under this provision could not be used to purchase service credit under the act. Payments for sick leave would be paid from funds appropriated to the person's employer (e.g., principal department, legislature, judiciary), and not from funds of the retirement system, and would be considered taxable income for purposes of the state income tax. (Note: In an enacting section, the bill specifies that the bill's designation of these payments as taxable income "is intended to clarify the legislative intent and correct misinterpretations surrounding the fact that [the payments] are not made by the retirement system and are not retirement payments exempt from income tax.")

Any amount that a member retiring under the bill was entitled to receive in a lump sum at retirement on account of accumulated annual leave would be paid on or after October 1, 2002.

Extended retirement date. The bill would allow an extension, until no later than February 1, 2004, of the retirement date of members eligible to retire under the bill's provisions, upon the request of a department director or upon designation by the legislature or the judiciary. For executive branch employees, a request by a department director would have to be submitted to the Office of the State Employer and the state budget office by May 31, 2002, and that request would have to be approved by the Office of the State Employer and by the budget office. For legislative and judicial employees, such an extension would require the approval of the legislative leaders or the chief justice, as applicable. Extensions for legislative and judicial employees would have to be submitted to the Office of Retirement Systems by May 31, 2002.

Retirement dates, generally. Several provisions of the act require that applications for retirement (generally, and not just for the early retirement program) must specify a retirement date that is at least 30 days but less than 90 days after the filing of the application. The bill would delete these requirements.

Health advance funding subaccount. The bill would create a new health advance funding subaccount in the retirement system. Under the bill, in years in which the pension system was fully funded (for payment of basic retirement benefits), employer contributions could be

deposited into the health advance funding subaccount, rather than into the other accounts dedicated to funding basic retirement benefits. In those years, the requirements for an annual comparison and reconciliation of actual and budgeted amounts of needed employer contributions would not apply.

Assets and any earnings on the assets in the health advance funding subaccount could not be treated as pension assets for any purpose. Further, assets and earnings in the subaccount could not be expended until the actuarial accrued liability for health benefits was fully funded. At that point, money in the subaccount would be used to pay for health care benefits of retirees. Also at that time, the contribution rate for health care benefits would be computed using an individual projected benefit entry age normal cost method of valuation (i.e., health benefits would be "pre-funded", meaning that the benefits earned in a given year would be funded for the future in that year), instead of using a cash disbursement method (a "pay as you go" method of funding from year to year).

Under current law, the Department of Management and Budget is required to annually calculate the amount of cost savings to the state as a result of the implementation of the new defined contribution retirement plan (adopted in 1996, and mandatory for all employees hired after March 1, 1997), and that amount must be included as part of the executive budget recommendations for the next fiscal year, for appropriation into the health insurance reserve fund. The bill would amend this provision to delete this requirement, and specify instead that in years in which employer contributions were not deposited into the health advance funding subaccount (i.e., employer contributions were needed to fund pension benefits), the department could deposit all or part of the cost savings due to the 1996 legislation into the health advance funding subaccount by reducing contributions for pension benefits and increasing contributions for health care by the same amount (but not to the extent that the funds dedicated to pay pension benefits were funded at less than 100 percent).

In addition, the bill would require that any savings in *health premium* costs attributable to *changes in health benefits* payable to defined contribution plan participants under the 1996 legislation would be deposited into the health advance funding subaccount.

Duty disability provisions. Under current law, a member of the retirement system is eligible for a duty disability retirement if he or she becomes totally incapacitated for duty "without willful negligence" on his or her part, because of a personal injury or disease that occurred as the natural and proximate result of the member's employment. There is no minimum service requirement for a duty disability retirement. To receive a duty disability retirement, a person must be examined by the system's medical advisor, the advisor must certify that the member is mentally or physically totally incapacitated for further performance of duty and that the incapacity is likely to be permanent, and the board must approve the retirement. The maximum benefit payable on a duty disability pension is $6,000 per year (and may be less); at age 60 the pension is recalculated based on the regular pension formula, with service credit given for the time the member was receiving a duty disability pension. (Note: According to the "Retirement Guidelines" published by the retirement system, application for a duty disability pension must be made within two years of separation from state service; however, this does not appear to be a statutory requirement.)

The bill would rewrite these provisions in substantially the same manner, making one substantive change. Under the bill, an application for a duty disability retirement would have to be filed no later than one year after termination of the member's state employment. However, the bill would specify that, upon appeal to the retirement board, the board could accept ("for good cause") an application for a disability retirement allowance not later than two years after termination of the member's state employment.

Non-duty disability provisions. Under current law, a member of the retirement system is eligible for a non-duty disability retirement if he or she has at least 10 years of service credit, becomes totally and permanently incapacitated for duty as the result of a cause not related to state employment, the system's medical advisor certifies that the person is mentally or physically incapacitated for duty and that the incapacity is likely to be permanent, and the retirement board approves the retirement. A nonduty disability pension is calculated under the same formula used for determining standard retirement benefits. (Note: As noted above, according to the "Retirement Guidelines" published by the retirement system, application for a nonduty disability pension must be made within two years of separation from state service; however, this does not appear to be a statutory requirement.)

The bill would rewrite these provisions in a similar manner. Under the bill, the incapacity would have to be because of a "personal injury or disease that is not the natural and proximate result" of the member's employment. Further, the bill would require that an application for a nonduty disability retirement be filed no later than one year after termination of the member's state employment. However, it would specify that, upon appeal to the retirement board, the board could accept ("for good cause") an application for a disability retirement allowance not later than two years after termination of the member's state employment.

Continuing medical examinations for disability retirees; restoration of employment. Under current law, the retirement board may require any disability retiree under age 60 to undergo a medical examination once each year during the first five years following retirement, and at least once every three years thereafter. The retiree may also request and must be granted such a medical examination. A retiree who refuses the exam (and continues the refusal for one year) may lose his or her disability pension. If the medical advisor reports, and the board concurs, that the retiree is physically able and capable of resuming employment, the statute requires that the retiree be restored to state employment and that the disability retirement allowance be ended. The bill would amend this provision to delete the specific requirement for medical exams, and specify instead that the retirement board could require a person to be examined. Further, the bill would delete the requirement that a disability retiree who is found to be physically able to resume employment be restored to state employment, and specify instead that upon that finding, the disability retirement allowance would end after six months. (This provision applies to both duty and non-duty disability retirees.)

Internal Revenue Code provisions. The retirement act contains several provisions required under federal law in order to maintain the tax-exempt status of the retirement system. The bill would amend several of these provisions, as follows.

• The definition of "compensation" would be amended to delete language referring to the compensation limit established in the federal Internal Revenue Code; however, the bill would add language stating that, notwithstanding any other provision of the act, the compensation of a

member of the retirement system would be taken into account for any year under the retirement system only to the extent that it does not exceed the compensation limit established in the IRC code, as adjusted by the commissioner of revenue. The new provision would apply to any person who first becomes a member of the retirement system on or after October 1, 1996.

• The bill would add language specifying that, notwithstanding any other provision of the act, contributions, benefits, and service credit with respect to qualified military service will be provided under the retirement system in accordance with the Internal Revenue Code. This provision would apply to all qualified military service on or after December 12, 1994.

• Beginning January 1, 2002, the definition of "eligible retirement plan" (for purposes of rollover distribution of eligible distributions of employee contributions) would be amended to include annuity contracts described in section 403(b) of the IRC, or an eligible plan under section 457(b) of the IRC that is maintained by a state or local government, so long as amounts transferred into eligible retirement plans from the State Employees' Retirement System are separately accounted for by the plan provider.

• Further, beginning January 1, 2002, with regard to an "eligible rollover distribution", the bill specifies that if a portion of a distribution that is not included in federal gross income is paid to an individual retirement account or annuity described in sections 408(a) or 408(b) of the IRC or a qualified defined contribution plan described in section 401(a) or 403(a) of the IRC, and the plan providers agree to separately account for amounts paid, the portion of distribution that is not includable in federal gross income would be an eligible distribution under the State Employees' Retirement Act.

Retirement board member compensation. The retirement board has nine members, of which two are retirees. The act states that the members of the board are to serve without compensation, but must be reimbursed for actual necessary expenses incurred in performance of board duties. The act also states that notwithstanding this provision, the retired state employee member [sic] is to receive $35 per diem as fixed by the board. The bill would delete the specific dollar amount and specify that the member would receive the per diem compensation established annually by the legislature for the performance of official board duties.

MCL 38.1 et al.

Analyst: D. Martens

■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.