

DATE: 2/17/2010
TO: Members of the Michigan House of Representatives
FROM: Bethany Wicksall, Senior Fiscal Analyst
RE: Executive Proposed Reforms for **State Employees' Retirement System (SERS)**

As part of her FY 2010-11 budget recommendations, the Governor proposed a number of reforms to pensions for state 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 state workforce by replacing an average of only 2 out of 3 retirees.

The details of the plan are summarized below. 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 for Year 1 total \$253.0 million Gross and \$98.2 million GF/GP.

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 - September 30:	Window for retirement

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

State Employees' Retirement System (SERS) Reform Proposals

There are approximately 7,100 employees currently eligible to retire and the Executive proposal estimates another 300 would purchase service credit to be eligible. Of these 7,400 potential retirees, the Executive proposal assumes that 85%, or 6,300, 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 September 30, 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.

The incentive would be available only to employees occupying positions subject to the new State Health Plan PPO/HMO for new employees hired after April 1, 2010. To date, all but two unions have agreed to the new State Health Plan.

(Employees in covered positions in the Departments of Corrections, Community Health and Human Services would be eligible for the increased multiplier but would have to choose to retire under either the current supplemental early retirement option, which provides a multiplier of 2.0% until age 62, or the proposed permanent increase to 1.6%, but would not qualify for both.)

Cost: The proposal would amortize the cost of the increased multiplier over 5 years. The Executive estimates an annual cost of approximately \$115 million beginning in FY 2013 and continuing through FY 2017.

Increasing the number of retirees over the number that otherwise would have been expected to retire also initially increases terminal leave payments and retiree health care costs. The proposal would defer leave payouts over 5 years as opposed to paying a lump sum on retirement. The Executive estimates an annual cost of \$28.4 million for each of the first 5 years for terminal leave payments and \$85 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 the state 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. Employees transferred into the defined contribution plan would be immediately vested.

Savings: The Executive estimates for savings are \$2.2 million in Year 1 and diminish to an ongoing annual savings of \$1.1 million by Year 7.

- **3% Employee Contribution:** The proposal would require that all state employees remaining in the pension plan (those hired prior to March 31, 1997) contribute 3% of their salary toward their pension. Employees had to contribute 3% toward their pension from 1954-1974; currently there is no employee contribution required. This contribution would not be required after an employee reached 30 years of service and was transferred to the defined contribution plan.

Savings: The Executive estimates for savings range from \$23.6 million in year 1 of implementation to \$39.7 million for full implementation in year 2, and then diminish over time to \$18.5 million by year 10 as the proportion of State employees left in the pension plan decreases. These savings will then decrease further to \$0 over time as the balance of state employees in the pension system retire.

- **Eliminate Retiree Dental/Vision Coverage:** Currently statute provides that the State pays 90% of the premium for dental and vision coverage for SERS retirees. Under the proposal, the State would no longer pay for dental or vision premiums for state employees who retire after October 1. State employees who retire after that date would be allowed to purchase coverage through the State 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 \$96 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 \$0.5 million in the first year and grow to \$9.8 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 agency and employee eligibility would be determined by management discretion.

Cost: Because this option will be left up to 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.

Proposed Reductions in the State Workforce

As mentioned above, the significant savings associated with this proposal are generated through the assumed reduction in the number of state employees. This would be accomplished by replacing only 1 out of every 2 employees other than direct care/client staff positions, which would be replaced at a rate of 1:1, for a statewide average replacement rate of 68.5% or approximately 2:3. Given the Executive's estimated 6,300 new retirees, this would mean replacing 4,300 employees for a net reduction of 2,000 positions. In addition to savings from reduced positions, the State Budget Office estimates a 10% savings in replacement salaries and a \$2,000 per-employee savings associated with moving new hires into the new State health care plan, which among other things would require that new employees pay 20% of their health care premiums rather than the 10% currently required.

Savings: The Executive estimates a savings of \$340.1 million in the first year prior to full replacement, and annual savings of \$247.9 million in following years.

**Executive Proposed State 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	\$0.0	(\$114.8)	(\$114.8)	(\$114.8)	(\$114.8)	(\$114.8)	\$0.0	\$0.0	\$0.0	(\$574.0)
Terminal Leave Deferral	(\$28.4)	(\$28.4)	(\$28.4)	(\$28.4)	(\$28.4)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$142.0)
Increased Retiree Health Costs	(\$85.0)	(\$85.0)	(\$85.0)	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$255.0)
Years of Service 30yr Cap	\$2.2	\$2.0	\$1.8	\$1.6	\$1.5	\$1.3	\$1.1	\$1.1	\$1.1	\$1.1	\$14.8
3% Employee Contribution	\$23.6	\$39.7	\$36.9	\$35.1	\$32.3	\$29.6	\$26.8	\$24.9	\$22.2	\$18.5	\$289.6
Eliminate Retiree Dental/Vision	\$0.5	\$1.5	\$2.5	\$3.4	\$4.4	\$5.4	\$6.4	\$7.4	\$8.3	\$9.8	\$49.6
Replacement Savings	\$340.1	\$247.9	\$247.9	\$247.9	\$247.9	\$247.9	\$247.9	\$247.9	\$247.9	\$247.9	\$2,571.2
GROSS SAVINGS	\$253.0	\$177.7	\$60.9	\$144.8	\$142.9	\$169.4	\$167.4	\$281.3	\$279.5	\$277.3	\$1,954.2
GF/GP SAVINGS	\$98.2	\$68.9	\$23.6	\$56.2	\$55.4	\$65.7	\$65.0	\$109.1	\$108.4	\$107.6	\$758.1

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

**Employees Eligible for Retirement by Department
(as of 9/30/10)**

	Number of Employees	W/O purchase of service credit		W/ purchase of Service Credit	
		Currently Eligible	% of Total Employees	Total Eligible	% of Total Employees
Agriculture	478	77	16.11%	91	19.04%
Attorney General	529	103	19.47%	112	21.17%
Auditor General	132	10	7.58%	11	8.33%
Civil Rights	125	34	27.20%	35	28.00%
Civil Service Commission	532	131	24.62%	139	26.13%
Community Health	4,435	821	18.51%	927	20.90%
Corrections	16,504	603	3.65%	655	3.97%
Education	348	77	22.13%	85	24.43%
Environmental Quality	1,351	243	17.99%	275	20.36%
Executive Office	57	2	3.51%	2	3.51%
History Arts and Libraries	175	40	22.86%	43	24.57%
House of Representatives	667	15	2.25%	16	2.40%
Human Services	10,848	2,114	19.49%	2,357	21.73%
Information Technology	1,811	283	15.63%	305	16.84%
Judiciary	489	52	10.63%	58	11.86%
Energy, Labor and Economic Growth	4,387	783	17.85%	868	19.79%
Legislative Service Bureau	131	17	12.98%	21	16.03%
Management and Budget	1,019	215	21.10%	238	23.36%
Military Affairs	896	109	12.17%	131	14.62%
Natural Resources	1,265	211	16.68%	240	18.97%
Senate	434	19	4.38%	24	5.53%
Senate Fiscal Agency	30	6	20.00%	8	26.67%
State	1,309	293	22.38%	338	25.82%
State Police	897	114	12.71%	129	14.38%
Strategic Fund	193	36	18.65%	38	19.69%
Transportation	2,931	433	14.77%	474	16.17%
Treasury	1,594	253	15.87%	277	17.38%
TOTAL	53,567	7,094	13.24%	7,897	14.74%

Source: State Budget Office and Office of Retirement Services