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ALLOW PUBLIC SCHOOL EMPLOYEES IN DEFINED CONTRIBUTION PLAN TO JOIN PENSION PLUS 2

House Bill 6060 (H-2) as passed by the House
Sponsor: Rep. Matt Koleszar
Committee: Labor
Complete to 1-27-25

SUMMARY:

House Bill 6060 would amend the Public School Employees Retirement Act to allow current employees in the state's defined contribution (DC) plan to join the act's Pension Plus 2 plan. The bill would also remove the 50% employee cost sharing requirement for both normal costs and unfunded actuarial accrued liability costs, allow certain employees to purchase up to five years of service credit, and modify provisions related to the retirement age.

The Public School Employees Retirement Act establishes and governs the Michigan Public School Employees Retirement System (MPSERS), the retirement system for Michigan's public school teachers and other public school employees. MPSERS consists of two options, Tier 1 and Tier 2, with hybrid plans available.

Generally speaking, Tier 1 is a defined benefit (DB) plan, and Tier 2 is a defined contribution (DC) plan. An employee's hire date determines which retirement plans they are eligible for (see **Background**, below). As of July 1, 2024, new hires default to being members in the Pension Plus 2 plan, meaning they are both Tier 1 members and Tier 2 qualified participants, if they do not choose otherwise within the 75 days following their employment. Previously, however, new hires defaulted to participation in Tier 2 only after the 75-day election window.

<u>Contribution cost-sharing</u>
The Pension Plus 2 plan, a hybrid plan with a DB and DC component for employees hired on or after February 1, 2018, currently requires a 50/50 contribution share between employers and employees for normal and unfunded actuarial accrued liability (UAAL) costs. (An employee's cost must not be based on an unfunded liability caused by an employer's failure to make a required contribution. Additionally, after the determination of the cost-sharing basis, the employer rate is subject to a floor, which generally cannot be less than the rate for the previous state fiscal year.[1])

HB 6060 would delete these provisions and instead require employers to be responsible for 100% of the normal and UAAL costs.

[1] The floor is permanent for the normal cost but only apples to the UAAL rate until the UAAL has been fully paid, except that for FY 2024-25, the UAAL contribution must equal the actuarially determined contribution rather than having to equal or exceed the FY 2023-24 contribution. Beginning in FY 2025-26, the floor will not apply to the normal cost contribution rate for retiree health benefits.

Tier 1 election

The bill would require MPSERS to provide either of the following groups with, presumably, an opportunity to become members of the Tier 1 retirement plan:[2]

- A qualified participant who elected to become only a qualified participant in Tier 2 before July 1, 2025.
- A qualified participant who was hired between February 1, 2018, and July 1, 2024, and defaulted to becoming only a Tier 2 qualified participant because they did not elect otherwise during the election period.

The one-time election period would have to end by August 1, 2025, and the changeover date would be August 30, 2025.

Beginning August 30, 2025, a qualified participant who affirmatively makes a timely election in accordance with the process established by MPSERS would remain a qualified participant in Tier 2 and would be eligible to accrue service credit or qualify for a pension under Tier 1. Only service credited and compensation earned after August 30, 2025, could be used to determine the employee's retirement allowance.

An employee would have to contribute their normal cost and UAAL contribution amount[3] on a post-tax basis until the United States Internal Revenue Service (IRS) notifies the Department of Technology, Management, and Budget (DTMB) that these contributions can be picked up (paid) by a public school employer and will not be included as gross income until they are distributed or made available to the employee or their beneficiary.

Additionally, House Bill 6060 would remove a provision that closes the Pension Plus 2 Plan to new employees if the actuarial funded ratio falls below 85% for two consecutive years and provides that those employees can only become qualified participants in the Tier 2 DC plan.

Service credit

The bill would allow a Tier 1 member who has completed ten years of service, including service earned while only a qualified participant in Tier 2, to purchase up to five years of service credit upon paying MPSERS the full actuarial cost.[4] (Service credit purchased for certain service before January 31, 1991, would count towards those five years.)

In calculating full actuarial cost, the retirement board and DTMB would use normal cost and UAAL determined as of the fiscal year ending immediately before the date of purchase. Any payment made in a manner other than a lump sum would have to include additional interest at the same rate used to determine actuarial cost.

Service credit purchased in accordance with these provisions could not be used to satisfy the 30-year service credit requirement for a pension paid before age 56 to a member of the Member

[2] House Bill 6060 does not specify what exactly MPSERS must provide to these qualified participants. For purposes of this analysis, it is assumed that they would have an opportunity to elect to join Tier 1 (Pension Plus 2).
[3] Employees would have no required normal cost or UAAL contributions under the provisions of HB 6060.
[4] The Public School Employees Retirement Act provides that full actuarial cost is calculated by multiplying the highest compensation previously earned by the member before the school fiscal year in which they purchase service credit by the amount of service purchased and by a percentage that results in the average actuarial present value of the additional benefits resulting from crediting one additional year of service when multiplied by a member's compensation.

Investment Plan. (Member Investment Plan members can retire before reaching age 55 upon attaining 30 years of service.)

If a member who purchased service credit dies or withdraws from service and a retirement allowance is not payable, the payment for the credit would be refunded to the member or their refund beneficiary upon request.

Retirement age

Under the Public School Employees Retirement Act, the retirement board can increase the regular retirement age for Pension Plus 2 members, originally set at 60, under certain conditions.[5] However, the increase does not apply to a member who is within five years of the then-current regular retirement age as of the effective date of the increase, and the retirement board can also exclude members who are within eight years of the then-current regular retirement age.

HB 6060 would instead provide that an adjustment to the regular retirement age does not apply to an employee who first became a member before the effective date of the increase, and the regular retirement age for an employee who becomes a member on or after the date that an increase takes effect would be the regular retirement age as it existed on the date before the employee becomes a member.

MCL 38.1341 et seq. (amended); MCL 138.1369h (proposed)

BACKGROUND:

Michigan Public School Employees Retirement System

2012 PA 300 required all employees in the Michigan Public School Employees Retirement System (MPSERS) who were hired prior to July 1, 2010, (when new employees began entering a new hybrid retirement plan) to make an election between three options:

- Increase their own retirement 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.

MPSERS has several different benefit plans depending on the hire date of employees:

- The Basic and Member Investment plans are traditional pension plans for employees hired before July 1, 2010.

[5] The board can increase the regular retirement age by at least one year for each fiscal year in which the Office of Retirement Services completes an experience investigation study, if the most recent study of mortality of the system using a 65-year-old, 50-50 male-female blend shows an increase of at least one year from the previous study of mortality, unless the most recent actuarial funded ratio is greater than 100% after accounting for the increase in mortality. Any increase om the regular retirement age must account for the cumulate increase in mortality relative to the experience investigation study covering the years 2012 through 2017, less any actual increase accounted for in a previous increase to the regular retirement age.

- The hybrid Pension Plus Plan with both a pension and a DC benefit with employer match for employees hired between July 1, 2010, and February 1, 2018.[6]
- The hybrid Pension Plus 2 Plan with a pension and DC benefit, and a 50/50 contribution share between the employee and employer, for employees hired on or after February 1, 2018.[7] (The Pension Plus 2 Plan will close to new employees if the actuarial funded ratio falls below 85% for two consecutive years.)
- The Defined Contribution Plan, which has an automatic employer contribution of 4% of a participant's compensation and an additional 100% match of up to 3% of a participant's compensation for employees hired after September 4, 2012; employees who chose to transfer to the DC Plan in 2012; employees who were hired between February 1, 2018, and June 30, 2024, who did not choose the Pension Plus 2 Plan; or employees hired after July 1, 2024, who chose the DC plan.[8]
- Those hired since 2012 receive a matching contribution of up to 2% of compensation into a personal health care fund 401(k) plan.

FISCAL IMPACT:

House Bill 6060 would increase costs for employers (local school districts, intermediate school districts (ISDs), public school academies (PSAs), and community colleges because it is assumed that more employees would participate in the Pension Plus 2 pension/defined contribution hybrid (hybrid) retirement plan under the provisions of the bill. Specifically, the bill would increase normal costs for employers because the net normal cost percentage of payroll for employers under the hybrid plan would be higher than the defined contribution plan.

In addition, the bill includes a provision that would remove the normal cost and unfunded actuarial accrued liability (UAAL) 50/50 cost share requirement for employers and employees in the Pension Plus 2 (hybrid) plan. This would immediately shift approximately $84.3 million of employee paid share to the employer based on the most recent MPSERS valuation. This removal of the 50/50 cost share provision would also increase the overall cost to the employers for any current employees that elected to convert to the hybrid plan and likely would increase the number of employees who convert to or elect the hybrid retirement option. In addition, if a UAAL were to develop in the system, the contribution would be 100% the responsibility of the employer and not on a 50/50 cost share basis as is required under current law. The overall magnitude of the fiscal impact would depend on the extent to which future employees elect and existing employees elect to convert into the hybrid plan.

Additionally, to the extent that hybrid plan participation is increased, the bill would result in the employer taking on additional financial risk through the pension portion of the hybrid, which would lead to increased costs in the long term if the hybrid plan were to develop an UAAL at any point in the future (the current funded ratio of the Pension Plus 2 plan, as of the FY 2023 valuation, is 106.9%). That said, initially, any conversion to the hybrid plan should not result in unfunded liabilities of MPSERS hybrid plan. Unfunded liabilities could accrue in the future if actual experience failed to meet actuarial assumptions on factors like investment returns and mortality rates.

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[6] https://www.legislature.mi.gov/documents/2009-2010/billanalysis/House/pdf/2009-HLA-1227-7.pdf
[7] See https://www.legislature.mi.gov/documents/2017-2018/billanalysis/House/pdf/2017-HLA-0401-A84AD1A8.pdf
[8] https://www.legislature.mi.gov/documents/2023-2024/billanalysis/House/pdf/2023-HLA-5021-7C034DC4.pdf

Lastly, the bill would increase administrative costs for the Office of Retirement Services and Department of Technology, Management, and Budget by an unknown amount. To the extent that the costs exceed current appropriation levels, any new costs would be subject to legislative appropriation.

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