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

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 255 (as introduced 2-18-09)
Sponsor: Senator Wayne Kuipers
Committee: Education

Date Completed: 3-10-09

CONTENT

The bill would amend the Public School Employees Retirement Act to provide for an increased retirement allowance for a limited number of members of the Michigan Public School Employees Retirement System (MPSERS) who applied for retirement between April 1, 2009, and March 31, 2010.

Specifically, a member who retired under the bill would receive a retirement allowance equal to the member's number of years and fraction of a year of credited service multiplied by 2% of his or her final average compensation, rather than 1.5% as currently provided.

A member could retire with a retirement allowance as described above if all of the following applied:

-- The member filed a written application with the retirement board and the reporting unit on or after April 1, 2009, and on or before March 31, 2010.
-- The member was working as a public school employee immediately preceding the retirement allowance effective date.
-- The member otherwise was eligible to retire under Section 81 of the Act (described in **BACKGROUND**, below).

The application would have to request a retirement allowance effective date that was at least 30 days after the date of the application and on or before June 30, 2010. If a member were employed in a critical shortage discipline, as compiled by the Superintendent of Public Instruction, as of October 8, 2008, the member could extend his or her retirement date one year beyond June 30, 2010.

The number of members who could retire under the bill could not exceed a number that limited the aggregate liability to MPSERS to not more than $1.5 billion of the present value of future benefits attributable to the increased multiplier and incurred in the applicable plan year.

The aggregate liability cap would apply on a school-year basis so that a member who was not permitted to retire as of June 30, 2009, could reapply for consideration to retire by June 30, 2010. If a member were not permitted to retire due to these provisions, his or her application would be considered to be withdrawn in a timely manner.

Members who otherwise qualified under the bill would have to be selected according to the following:

-- Age and years of actual service as a member, with the greatest number of actual years of service receiving first preference.
-- The date the application was received, with the earliest dated application receiving first preference.

The retirement system would have to make all determinations concerning aggregate liability and members who would be permitted to retire under the bill.

A member could withdraw a written application by March 15, 2010. An application submitted by a member and not withdrawn by that date would be irrevocable.

If a member who retired under the bill were rehired by the public school system as an independent contractor, either as an individual or through an employment agency, the member would agree to have his or her pension suspended for the period of employment.

Except for the increased multiplier, the retirement allowance of a member retiring under the bill would be subject reduction under Section 84 (which provides for the reduction of the retirement allowance of a member who retires before his or her 60th birthday with less than 30 years of credited service).

MCL 38.1384 et al.

BACKGROUND

Under Section 81 of the Public School Employees Retirement Act, a member of MPSERS who no longer is working as a public school employee or in any other capacity for which service credit is allowed under the Act is entitled to a retirement allowance if he or she is 60 years of age or older and has 10 or more years of credited service as a public school employee.

For a member who contributes to the Member Investment Plan (MIP), the 10 years of credited service requirement is reduced to five years if the member is a public school employee and has received credit in each of the previous five school years.

Alternatively, a member is entitled to a retirement allowance if he or she is 55 years of age or older and has 30 or more years of credited service, including at least 15 years served as a public school employee. (For a member who contributes to MIP, the age requirement does not apply.)

A member also is eligible for a retirement allowance if he or she is 55 years of age or older and has 15 or more but less than 30 years of credited service, of which the last five years are immediately preceding the member's retirement allowance effective date.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

Under the bill, any employee who is currently eligible to retire would receive a retirement allowance with a 2% multiplier if he or she applied for retirement between April 1, 2009, and March 31, 2010, and retired by the end of the 2009-10 school year. Under current law, the pension allowance is calculated by multiplying the employee's years of service by 1.5% of his or her final average compensation (FAC). The FAC is calculated by taking the average of a member's compensation earned within the period in which his or her average compensation was highest. The averaging period is three years for Member Investment Plan participants and five years for Basic Plan participants. If a 2% instead of a 1.5% multiplier were used, a person with a $55,000 FAC and 28 years of service would receive a $30,800 annual pension allowance instead of a $23,100 pension allowance.

Table 1 outlines the potential impact on MPSERS. According to the Office of Retirement Services, 55,000 employees are eligible to retire immediately, and an additional 7,000 would be eligible if they purchased service credit. If all 62,000 of those members retired, the increased allowance would result in MPSERS having a $6.3 billion increase in its unfunded actuarial accrued liability (UAAL). This assumes that those eligible to retire have an average of 28 years of service, have a $55,539 salary, and would receive a pension for 21 years. Under the bill, the maximum UAAL would be capped at $1.5 billion, and this cap would apply on a school-year basis. It is unclear whether this provision means that if a member could not retire under the bill during the 2008-09 school year due to the $1.5 billion cap, he or she could do so under a second $1.5 billion cap during the 2009-10 school year. This analysis assumes that there would be one $1.5 billion cap in the first year. Under that assumption, on average, in the first year, a maximum of 14,629 would be permitted to retire, for a total UAAL of $1.5 billion.

This liability would be paid down over a period of years. Typically, a period of five years is used to smooth out the impact of additional UAAL. During the period used, the UAAL portion of the retirement rate would rise to cover the pension allowance increase. The MPSERS retirement rate, which includes the pension normal cost, UAAL, and health benefits rates, is paid by participating MPSERS employers (including school districts and community colleges). The rate is charged on each employer's total payroll. For FY 2006-07, payroll for all MPSERS employers totaled $9.8 billion. To generate contributions to fund the UAAL over a five-year period, the rate could rise by three percentage points if 14,629 members retired. This additional cost could be partially offset by any reduction in the normal pension cost for new employees, who, due to recent statutory changes, would contribute more to their retirement than the employees they would be replacing contribute. This year, the MPSERS retirement rate is 16.54%, which includes a 5.17% pension normal cost rate, a 6.81% health benefits rate, and the UAAL rate, which is 4.56%.

There also would be costs associated with providing Other Postemployment Benefits (OPEBs), such as health and dental insurance, to the retirees. This would be a cost increase only in years in which a given retiree otherwise would be working. According to the FY 2007-08 MPSERS Comprehensive Annual Financial Report (CAFR), 9,704 members retired during FY 2006-07, and an average of 8,941 members retired annually between FY 1997-98 and FY 2006-07. This analysis assumes that 9,000 of those eligible under the bill would retire under current law annually. Thus, 9,000 of the 14,629 would have retired in the first year, and the remaining 5,629 would have retired in the second year under current law along with 3,371 other employees. The cost of OPEBs is paid as the cost is incurred (a pay-as-you-go basis). According to the FY 2007-08 MPSERS CAFR, $650.4 million was spent providing health benefits to 123,897 retirees and $84.1 million was spent providing dental and vision benefits to 132,728 retirees during FY 2007-08. If all 14,629 employees retired and received health, dental, and vision benefits, in any year in which the employees otherwise would have been working and not yet retired, the additional cost (excluding the cost for the 9,000 members who would have retired anyway) would total approximately $33.1 million in the first year, and would result in an increase in the health portion of the MPSERS rate. In subsequent years, there would be no additional OPEB cost because the employees would have retired under current law.

The additional cost to individual schools and community colleges of higher monetary contributions paid into the system due to the increased MPSERS rate could be offset by any salary savings that the employers experienced as a result of this proposal. The salary savings in the first year would be $32,914 per retiree on average. However, this analysis assumes that 9,000 of those eligible under the bill would retire under current law annually. Table 2 outlines the salary savings timeline for a retiring employee. If this employee would have retired in Year 2 under current law and was replaced with an employee earning a lower salary, the cost of the position would total $197,000 over the five-year period. However, if the employee were to retire in Year 1 under the bill, the cost of the position would total $145,000 over the five-year period. The bill would result in a $52,000 saving for this particular retirement. Salary savings would increase if retirees were not replaced, but it is unknown how many retirees would be replaced. If 14,629 employees retired under the bill, $185.3 million would be saved in the first year. However, besides the OPEB cost discussed above, the system would experience additional costs in order to fund the UAAL since the decreased employer contributions to the pension system for new employees would only partially offset the increase in the UAAL rate. Over five years, the total cost is equal to $1.3 billion, as shown in the table below.

Table 1

Impact of SB 255 on MPSERS

Year	1	2	3	4	5	Total
Current Law Retirees	9,000	9,000	9,000	9,000	9,000	45,000
SB 255 Retirees	14,629	3,371	9,000	9,000	9,000	45,000
Additional Retirees	5,629	0	0	0	0	
Additional Annual UAAL[1]	$300,000,000	$300,000,000	$300,000,000	$300,000,000	$300,000,000	$1,500,000,000
Rate increase in UAAL[1]	3.1%	3.1%	3.1%	3.1%	3.1%	
OPEB[2]	$33,117,282	$0	$0	$0	$0	$33,117,282
Total annual cost	$333,117,282	$300,000,000	$300,000,000	$300,000,000	$300,000,000	$1,533,117,282
Minus salary savings[3]	$185,278,218	$0	$0	$0	$0	$185,278,218
Net cost[4]	$147,839,064	$300,000,000	$300,000,000	$300,000,000	$300,000,000	$1,347,839,064

[1]Rate increase during the smoothing period. Estimate based on five-year smoothing period.
[2]This is a cost increase only in years in which a given retiree would otherwise be working. Assumes 9,000 members would retire annually under current law.
[3]Salary savings assumes all retirees would be replaced. Assumes 9,000 members would retire annually under current law.
[4]Does not include any savings from the reduction in normal pension cost for new employees.

Sources: MPSERS Comprehensive Annual Financial Report Fiscal Year Ended September 30, 2008; Dept. of Management and Budget Office of Retirement Services; and Senate Fiscal Agency Estimates

Table 2

Salary Savings Timeline For A Retiring Employee

	Year	1	2	3	4	5
Retiring Under Current Law	Employee's Salary	$55,000	$55,000	$0	$0	$0
	Replacement's Salary	0		29,000	29,000	29,000
	Annual Cost of Position	55,000	55,000	29,000	29,000	29,000
Retiring Under SB 255	Employee's Salary	0	0	0	0	0
	Replacement's Salary	29,000	29,000	29,000	29,000	29,000
	Annual Cost of Position	29,000	29,000	29,000	29,000	29,000
	Savings Due to SB 255	**26,000**	**26,000**	**0**	**0**	**0**

For school districts that experienced more retirements than they otherwise will under current law, it is possible that they would see savings from the bill. However, school districts that did not experience more retirements as a result of the bill would have to pay the increased retirement rate without any savings through additional retirements. It is unknown how each employer would fare until actual retirements were to take place under the bill.

Fiscal Analyst: Lindsay Hollander

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