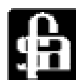

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BILL ANALYSIS

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Senate Bill 802 (Substitute S-1 as reported)
Sponsor: Senator Wayne Kuipers
Committee: Education

Date Completed: 8-23-10

RATIONALE

The Public School Employees Retirement Act establishes eligibility criteria and benefits, including pensions and health care coverage, for individuals who are members of the Michigan Public School Employees Retirement System (MPSERS). The Act provides for a defined benefit (DB) plan, in which a member's retirement allowance, or pension, is based on the individual's years of employment and final average compensation. Under recent amendments, individuals hired on or after July 1, 2010, will be placed in a new "hybrid" plan that has elements of the DB plan and a defined contribution (DC) plan—in which an individual's retirement benefits are based on the employer's and employee's contributions to an account and its investment performance, rather than a predetermined formula. The Act requires both employees and employers to make payments to MPSERS to cover retirees' pensions and health care benefits. Employers also must make contributions to pay off the system's unfunded actuarial accrued liability (UAAL, which represents the difference between the long-term cost of benefits offered and the amount of money in the system to pay those benefits). Employers, or "reporting units", include schools, intermediate school districts, community colleges, and other entities whose employees are members of MPSERS. Until 1996, seven of the State's public universities also belonged to MPSERS; although eligibility was eliminated for university employees hired after 1995, these institutions still contribute to MPSERS for employees who remain in the system and for the universities' portion of the UAAL.

It has been suggested that community colleges should be given an opportunity to opt out of MPSERS for new employees. Like other employers, community colleges must contribute to the system based on total payroll, but many community college employees never are eligible for retirement benefits due to the part-time and temporary nature of their jobs. Although full-time faculty and administrative staff may participate in a DC plan under the Optional Retirement Act, instead of belonging to MPSERS, this alternative is not available for part-time employees. Also, it has been estimated that the amount community colleges pay into the retirement system is, on average, equivalent to almost 40% of the amount they receive in State aid, which reduces the funding they can allocate to other purposes (although they also receive operational funding from tuition and property taxes). Some people believe that community colleges would save money if, instead of belonging to MPSERS, they had the option to create defined contribution plans similar to those established by universities and the State.

CONTENT

The bill would amend the Public School Employees Retirement Act to exclude from the Michigan Public School Employees' Retirement System a person who became employed by a tax-supported community or junior college that submitted a resolution to withdraw from MPSERS by December 1, 2010.

Under the Act, a public school employee is considered to be a member of MPSERS. The bill specifies that "public school employee" would not include a person who first became employed by a qualified tax-supported community or junior college on or after January 1, 2011. "Qualified tax supported community or junior college" would mean a tax-supported community or junior college that had submitted an appropriate resolution to withdraw from the retirement system to the retirement board by December 1, 2010.

Service performed by a person who first became employed by a qualified tax-supported community or junior college on or after January 1, 2011, would be considered out-of-system public education service.

Except as otherwise provided, the term "reporting unit" means a public school district, intermediate school district, public school academy, tax-supported community or junior college, or an agency having on its payroll employees who are members of MPSERS. Under the bill, on and after January 1, 2011, "reporting unit" would not include a qualified tax supported community or junior college except to the extent that it has on its payroll employees who are members of the retirement system.

MCL 38.1306 & 18.1307

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Defined benefit plans are fiscally unsustainable. State law requires actuaries to assume annual growth of 8% in the retirement system, in order to support projected benefit costs. When the system does not earn this amount or loses money due to the performance of the stock market, the system's unfunded liability will grow. In fact, between 2007 and 2009, MPSERS lost approximately $14.0 billion on its investment portfolio. As of September 2008, the retirement system's pension UAAL was $8.9 billion, and it presently will take 27 years to pay this off.

Although Public Act 75 of 2010 created a hybrid plan for new school employees, the plan still contains a DB component and community colleges will continue to contribute disproportionately to the system. Like other reporting units, the colleges must pay a percentage of their total payroll to MPSERS, regardless of whether their employees will ever be eligible for retirement benefits. Because a large share of community college employees are part-time or temporary, they will never vest in the system and collect benefits, although they must contribute to MPSERS. Under the Optional Retirement Act, full-time employees of community colleges and seven universities may choose to participate in a defined contribution plan, which does not require vesting and allows participants to cash out at any time. The salaries of these employees then are not included in the college's total payroll subject to MPSERS contributions (except for the employer's share of Social Security). This alternative, however, is not available to part-time employees.

Community colleges are unable to fund other priorities due to the continually increasing costs of the retirement system. In the case of Washtenaw Community College, for example, the college is projected to contribute $9.8 million to MPSERS for 2010-11, more than three times the amount it paid a decade ago. At the same time, the college is expected to receive $11.9 million in State appropriations, making its MPSERS contribution equivalent to approximately 80% of its State aid.

The bill would give community colleges a one-time option to withdraw from the retirement system. If a community college adopted a resolution to withdraw by December 1, 2010, its current employees would remain members of MPSERS, but someone hired after December 31, 2010, would not be a member. The community college would continue to pay into MPSERS for those employees who remained members, but the wages of newly hired workers would not be included in the college's total payroll for purposes of its contribution to MPSERS. After withdrawing from MPSERS, the college then could offer a defined contribution plan much like the plans universities offer.

Opposing Argument

Permitting community colleges to withdraw from MPSERS would weaken the retirement system and shift additional costs onto remaining members. Every reporting unit is required to contribute a percentage of total payroll each year toward the retirement

system's unfunded liability. Although Public Act 272 of 1995 removed public universities from MPSERS, they are required to contribute to the UAAL based on the payroll of employees who are members of MPSERS *and* the employees who would have been members but for the enactment of Public Act 272. The bill contains no such requirement; instead, if a community college withdrew, its UAAL contribution would be based only on the payroll of employees remaining in MPSERS.

Also, switching to a defined contribution plan could actually cost community colleges more over the short run, according to an analysis by the Department of Management and Budget. The DMB estimates that under current law, for new employees in MPSERS, the "normal" cost rate is 4.21% of payroll, while the average normal cost for new employees in a DC plan would be 6.55%, based on the experience of the State Employees Defined Contribution Plan (which took effect in March 1997 for new employees). (The normal cost rate applies to the portion of an employer's contribution that covers pensions. It does not include the UAAL rate or the health benefit rate.) Those figures suggest that withdrawing from MPSERS would not produce the savings that some have projected.

Response: If a community college withdrew from MPSERS and chose to offer a DC plan, the college could structure the plan in a way that would be affordable and that would enable it to budget for future retirement costs. Although contributions under the State's DC plan might be higher than the DB cost at this time, the defined contribution plans offered by universities vary and not each university contributes the same amount to its plan.

Opposing Argument

Retirement systems provide a safety net to employees when they retire. If a community college withdrew from MPSERS, there is no guarantee that it would offer an alternative plan that would provide adequate retirement benefits. Many retirees are having a difficult time making ends meet and may have to turn to public assistance for their basic needs. Changing or eliminating retirement plans in order to save employers money can have a detrimental impact on people's lives and ultimately increase costs to all taxpayers.

Response: Since many community college employees never vest in MPSERS, they would lose nothing under the bill. On the other hand, they would no longer have to contribute 6% of their wages to MPSERS. If colleges opted out of the system, they could offer an alternative plan that might be more advantageous to employees. Without the opportunity to do so, however, colleges may resort to firing part-time employees and retaining them as contract workers, in order to reduce the total payroll subject to MPSERS contributions. At least one college, Washtenaw Community College, is considering this approach, which reportedly would save the college about $1.0 million annually.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

To the extent that the State's 28 community colleges submitted resolutions to withdraw from the Michigan Public School Employees' Retirement System, the bill would have a fiscal impact on the State and local units of government. The retirement rate charged to MPSERS' reporting units consists of a pension rate (broken into a "normal cost" rate and a rate to recover unfunded liabilities) and a health benefits rate. According to the Office of Retirement Services (ORS), in the case of qualified community colleges, the normal cost rate as well as the unfunded actuarial accrued liability (UAAL) rate would be applied only to the portion of payroll of the employees who are members of MPSERS. Additionally, according to ORS, for the universities that have withdrawn from MPSERS, the State does not charge the health benefits rate charged to other member entities, and instead charges them the insurance premiums for their current retirees. The bill does not address modifications to the community colleges' contribution rates that could arise from the implementation of this legislation.

The normal cost rate is determined by the actuaries, and to the extent that the funds contributed to the system through this rate, employee contributions, and the return on investments do not meet pension liabilities, the system experiences UAAL. This liability is financed over a declining amortization period and, currently, 27 years remain to pay off this unfunded liability. Under the bill, other reporting units whose employees are members of MPSERS, such as community colleges that did not opt out, public school districts, intermediate school districts,

participating public school academies, and participating local libraries, would experience UAAL contribution increases because the bill would not require the qualified community colleges to apply the UAAL rate to their total payroll; instead, they could apply the rate to the portion of payroll of their employees who are members of MPSERS. Thus, qualified community colleges would pay less than what they otherwise will pay for the system's unfunded actuarial accrued liability. As a result, the UAAL contribution rate would increase for remaining reporting units with MPSERS members.

For example, the UAAL rate for FY 2009-10 is 6.15% of payroll. That rate is based on an expected total payroll for fiscal year (FY) 2009-10. If payroll is $10 billion, then the retirement system can expect to receive $615 million in contributions toward UAAL. Under the bill, the total payroll on which the UAAL rate would be applied could decrease to the extent that community colleges withdrew from MPSERS. For example, if payroll of MPSERS members were to decrease by $100 million, the UAAL rate would not provide for the full $615 million. In order to get the full $615 million, the rate charged to all reporting units would have to be raised to 6.21%. Reporting units would have the rate of 6.21%, instead of the original 6.15%, charged on their total payroll, resulting in a negative fiscal impact on community colleges that did not withdraw from MPSERS, school districts, intermediate school districts, participating public school academies, and participating local libraries.

The fiscal impact on qualified community colleges with regard to the normal cost of pensions and retiree health benefit cost is indeterminate. Qualified community colleges would decrease their retirement-related expenditures if they enrolled employees in retirement plans or retiree health care plans with a normal cost rate less than their contributions to MPSERS. If qualified community colleges offered a plan with a normal cost rate that was higher than their MPSERS contribution, they would incur increased costs. Table 1 outlines MPSERS's rate history.

The Office of Retirement Services would incur increased administrative costs associated with providing separate rate calculations to qualified tax-supported community and junior colleges.

Table 1

MPSERS Employer Contribution Rates

Fiscal Year	Pension Normal Cost Rate	Pension UAAL Rate	Health Benefits Rate	Total Rate Applied to Payroll
1996-97	7.62%	3.60%	3.95%	15.17%
1997-98	7.14	0.00	3.98	11.12
1998-99	6.73	0.00	4.04	10.77
1999-2000	6.47	0.59	4.60	11.66
2000-01	6.42	0.19	5.55	12.16
2001-02	6.06	0.06	6.05	12.17
2002-03	6.26	0.68	6.05	12.99
2003-04	6.26	0.68	6.05	12.99
2004-05	6.31	2.01	6.55	14.87
2005-06	5.47	4.32	6.55	16.34
2006-07	5.49	5.70	6.55	17.74
2007-08	5.28	4.89	6.55	16.72
2008-09	5.17	4.56	6.81	16.54
2009-10	3.98	6.15	6.81	16.94

Source: Office of Retirement Services

Fiscal Analyst: Matthew Grabowski

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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.