AFT MICHIGAN POLICY BRIEF

A SECURE MPSERS RETIREMENT WITH LOWER EMPLOYER COSTS

FEBURARY 2012

School Employees and Retirement

The Michigan Public School Employees Retirement System (MPSERS) was established in 1954 to provide consistent pension benefits for most Michigan educational employees. To ensure that MPSERS continues to meet its purpose, AFT Michigan supports several concrete policy changes that would lower employer costs while maintaining a secure retirement for educators.

The benefit reductions already enacted by the Legislature and MPSERS Board will take time to produce their full savings potential. Therefore, policymakers should not rush into dismantling this fundamentally sound system. While the early retirement incentive increases employer costs in the *short term*, it will begin to lower rates in the near future. Moreover, the MPSERS Board and Office of Retirement Services (ORS) continue to do an excellent job of restraining retiree health care costs.

Current discussions center on unfunded actuarial accrued liability (UAAL) and employer cost. AFT Michigan believes the issues are real but misunderstood. Most importantly, **retiree health benefits are not currently prefunded** like pension benefits, which reduces the potential for investment earnings. In addition, changes in federal accounting standards have altered the UAAL calculation for MPSERS and most other US public systems (without changing the underlying financial reality). And contrary to some misconceptions, **school employees already make substantial contributions to their own pensions** (up to 10% of salary for many new employees).

Policymakers can further strengthen MPSERS by:

- **Prefunding retiree health care,**
- **Reversing the continued seepage of members from MPSERS,** and
- **Updating the underlying investment act** through SB 797 and HB 5416**.**

Recently Enacted Changes are Creating Significant Savings

1. **PA 110 and 111 of 2007** reduced benefits and costs by:
   - **Implementing a "graded scale premium"** that pays employees hired starting mid-2008 only 30% of premium after 10 years of service and an additional 4% for each added year (*Estimated savings: 45% of costs employers would otherwise pay*[1]).
   - **Eliminating the use of purchased service credits for retiree health care** *(Estimated savings: $45.4 million/year).*
   - Requiring 2 years of service prior to purchasing credits (*Estimated savings: $5.7 million/year).*
   - **Increasing employee contributions from 4.3% of salary over $15,000 to 6.4%** *(Estimated savings: $5 million in the first year, growing to $29 million by the sixth year).*
2. **PA 75 of 2010** increased employee contributions and reduced pension benefits (*Estimated savings: $679.6 million in 2010-11 and $3.15 billion over 10 years*[2]). Under this law:
   - All employees who began working for a public school since July 1, 2010 are placed into a **hybrid defined contribution/defined benefit pension plan** rather than the existing pension plan**.** The defined benefit component uses a 5-year rather than a 3-year "final average compensation" and requires employees to contribute $510 annually plus 6.4% of all salary earned above $15,000 (in addition to whatever they contribute to the defined contribution plan and the 3% described below).
   - Also for hybrid plan members, **the minimum retirement age was raised to 60, cost of living adjustments were eliminated, and the chance to purchase service credits was essentially eliminated**.
   - The state also placed **further restrictions and limitations on post-retirement earnings** for those retiring since July 1, 2010**.**
   - All employees **pay 3% of salary** to provide funding for retiree health benefits.

[1] Office of Retirement Services
[2] State Fiscal Agencies

3. The MPSERS Board approved initiatives for 2012 to contain retiree medical care costs (*Estimated savings: $64 million*[3]) by:
    - **Establishing a prescription drug plan + wrap** to maximize Medicare negotiated discounts on "doughnut hole" claims (the gap in Medicare coverage where enrollees must pay the full cost of prescription drugs) and cap Medicare subsidies in the "catastrophic" range**;**
    - **Eliminating coverage for two drug classes and "lifestyle" drugs**; and
    - **Increasing annual retiree cost-sharing** for the medical coinsurance maximum from $700 to $800 and for the deductible from $400 to $500.

Defined Contribution is not the Answer

When the legislature significantly changed MPSERS benefits in 2010, it chose to move to **a hybrid plan, with a slimmed down defined benefit plus a defined contribution component**. This decision reflected the recognition of the costs of moving to a defined contribution plan for both employees and employers. These **costs include the fact that the UAAL would need to be paid off under accounting rules as a level dollar amount over 30 years, rather than a level percentage of payroll**, as it is now, increasing short and intermediate term costs. Moving to the hybrid plan was estimated by the fiscal agencies to **save $1.2 million in the first year and $129.4 million over 10 years.** In addition, individuals are unable to earn comparable returns as institutional investors in the market. Finally, as outlined above, school employees already make substantial contributions to their pension.

What Needs to be Done

- ***Prefund retiree healthcare so investment earnings help finance future healthcare costs.*** Even partial prefunding can substantially reduce future costs. If the employer pays just the cash benefits, both liabilities and the Annual Required Contribution (ARC) are based on short term assumptions (approximately 4%), making both liabilities and ARC much higher. However, if the ARC is fully funded in a qualified trust with a long range investment policy, liabilities and ARC are calculated assuming returns of approximately 8%--reducing the size of both.
- ***Stop the seepage of the workforce not participating in MPSERS.*** Change state law and local decisions to increase the ratio of active members to retirees in the system.
- ***Update the investment act (PA 314) to allow Treasury greater ability to invest in non-correlating assets—SB 797 and HB 5416.*** Investment earnings have a major impact on employer costs. In 2010, investment earnings were over 2.2 times as much as employer contributions and in 2011, investment earnings totaled more than three-quarters of total employer contributions. SB 797 and HB 5416 would enable Treasury to increase these returns.

[3] Office of Retirement Services

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