SENATE FISCAL AGENCY

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MEMORANDUM

DATE: March 9, 2010

TO: Members of the Senate

FROM: Kathryn Summers, Chief Analyst

RE: SFA Analysis of Retirement Proposals

As part of the fiscal year (FY) 2010-11 budget recommendation, Governor Granholm proposed numerous long-term reforms and short-term incentives for the State's two largest pension systems: the State Employees' Retirement System (SERS) and the Michigan Public School Employees' Retirement System (MPSERS). Two memos published in February by the Senate Fiscal Agency (SFA) detail the proposals along with estimates of savings published by the State Budget Office, and can be found at http://www.senate.michigan.gov/sfa/main/featured.html. This memo will discuss the SFA estimates of costs and savings for the MPSERS plan, and compare those to the assumptions and figures published by the State Budget Office (SBO).

In short, the SFA assumes that the SBO estimates of savings that would result from implementation of long-term "reforms" or changes are accurate. However, the SFA analysis differs from the SBO estimates when discussing the impact of the short-term incentives used to induce people to retire earlier than planned. This memo addresses the MPSERS proposal, and a separate memo will discuss the SERS proposal.

MPSERS Proposals for Existing Employees

- **Increased Employee Contribution to Pension.** The SBO analysis indicates that increasing employee contributions would provide local savings to employers of $207.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $2.4 billion. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal. For this proposal and the two described below, the only way the savings estimated by the SBO could be achieved for employers (K-12 districts, intermediate school districts, community colleges, and participating universities, charter schools, and libraries) in FY 2010-11 would be to lower the already-published employer contribution rate from 19.41% to a rate that would reflect the increased employee contributions. In future years, the reforms would reduce the MPSERS employer contribution rate that otherwise will occur, though in the near term the rate likely would continue to increase due to relatively recent investment losses in the stock market.

- **Cap Years of Service in Pension System at 30/Transfer to DC Plan Thereafter.** The SBO analysis indicates this would provide local savings to employers of $41.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $479.0 million. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

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- **Eliminate Retiree Dental/Vision Savings.** The SBO analysis indicates this would provide local savings to employers of $1.0 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $206.4 million. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

MPSERS Proposals for New Hires

The Governor also is proposing substantial changes for new hires, in addition to the elimination of dental and vision care and the capping of service credit at 30 years, detailed above. The proposal includes:

- **Hybrid Defined Benefit/Defined Contribution for New Hires.** The SBO analysis indicates this would provide local savings to schools of $3.9 million in FY 2010-11. The only way this could be achieved for FY 2010-11 would be to lower the already-published employer contribution rate from 19.41% to a rate that would reflect the increased employee contributions. In future years, this reform would reduce the MPSERS employer contribution rate that otherwise will occur, though in the near term the rate would continue to increase due to relatively recent investment losses in the stock market. After 10 years, this proposal is estimated by the SBO to save $410.6 million. The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

TOTAL LONG-TERM SAVINGS FROM REFORMS

The SBO estimates that the long-term reforms would produce 10-year savings (as outlined in <u>Table 1</u> at the end of this memo) that total $3.5 billion. The SFA analysis would concur with these estimates produced by the Budget Office in conjunction with the State's actuary.

MPSERS Retirement Incentives for Employees Currently Eligible to Retire

- **Increased Pension Multiplier.** The administration assumes that an increased multiplier (1.6% instead of 1.5%), in combination with the other proposed changes, would induce people to retire earlier than otherwise planned.

    - **Participation Rate.** The SBO assumes a participation rate of 75%, meaning that 29,000 out of the 39,000 total pool would retire this coming summer. The SFA analysis assumes a somewhat lower percentage, given that the increased multiplier is not as large as those offered to State employees in the past, when participation was approximately 64%. Therefore, the SFA analysis uses a 60% participation rate.

    - **Wage Savings.** The SBO analysis assumes continuous wage savings over the 10-year analysis. However, wage savings cannot be counted past the time an employee would have otherwise retired and been replaced with a (presumably) lower-wage new hire. The SFA analysis assumes wage savings would cease after three years, since on average, people work three years past their earliest retirement date.

- **Replacement Ratio.** The SBO analysis assumes savings from a 90% replacement ratio. However, schools already do not replace retirees at 100% due to declining pupil populations and shrinking revenue. Also, hiring or laying off is a local decision. Therefore, the SFA analysis eliminates all replacement ratio savings, noting that schools likely adjust their hiring/employment levels based upon need and available funding, and would do so in the absence of this proposal.

TOTAL SHORT-TERM EFFECTS FROM INCENTIVES

Combining these effects, the SBO analysis estimates the net wage differential and replacement savings after paying the additional health care costs to total $448.2 million in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $2.8 billion. The SFA analysis assumes a lower participation rate, discontinues wage savings after three years, and eliminates any replacement ratio savings. The SFA analysis estimates wage differential savings in FY 2010-11 of $227.0 million, with a cumulative cost (not savings) of $585.0 million over 10 years to pay for the enhanced multiplier and overlapping health care costs (more fully discussed in the original February 22 memo).

COMBINED TOTAL OF LONG-TERM REFORMS AND SHORT-TERM INCENTIVES

The State Budget Office calculates a $6.4 billion net savings to MPSERS employers over 10 years. This is a combination of the $3.5 billion estimate of long-term reform savings and $2.8 billion in savings associated with the short-term incentives.

The Senate Fiscal Agency calculates a $2.9 billion net savings to MPSERS employers over 10 years. This is a combination of the $3.5 billion estimate of long-term reform savings estimated by the SBO and a $585.0 million cost estimated by the SFA.

Table 1 follows on the next page, and details the year-by-year fiscal impacts of the various components of the package, as estimated by the State Budget Office. Table 2 details the year-by-year fiscal impacts as estimated by the SFA.

Clearly, the major differences in the analyses rely on the following: 1) participation rate, 2) replacement ratio, and 3) wage savings. A separate memo will detail a companion SERS analysis.

Please feel free to call with any questions.

/wm

c: Gary S. Olson, Director
Ellen Jeffries, Deputy Director

Table 1

School Employee Pension Reforms: 10-Year Savings Analysis (in millions)	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20	Cumulative Savings TOTAL
Eliminate retiree dental/vision savings	$1.0	$5.0	$8.9	$13.1	$17.3	$22.1	$26.9	$32.0	$37.3	$42.8	$206.4
Increase employee contribution rate savings	$207.0	$214.3	$221.8	$229.5	$237.5	$245.9	$254.4	$263.3	$272.6	$282.2	$2,428.5
Hybrid plan for new employees savings	$3.9	$12.8	$20.5	$28.1	$35.8	$43.8	$52.2	$61.7	$71.2	$80.6	$410.6
Cap DB enrollment at 30 yrs - savings	$41.0	$42.0	$44.0	$45.0	$47.0	$48.0	$50.0	$52.0	$54.0	$56.0	$479.0
Retirement incentive – pension cost	$0.0	($285.0)	($285.0)	($285.0)	($285.0)	($285.0)	$0.0	$0.0	$0.0	$0.0	($1,425.0)
Increased health care costs on pension system	($292.5)	($292.5)	($292.5)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	($877.5)
Replacement savings (ratio of 1:1.1 – 90%)	$740.7	$699.5	$651.6	$646.2	$548.4	$492.8	$434.6	$373.4	$309.1	$241.6	$5,137.9
Gross Savings	**$701.0**	**$396.0**	**$369.3**	**$676.9**	**$601.0**	**$567.7**	**$818.1**	**$782.4**	**$744.2**	**$703.2**	**$6,359.8**

Source: State Budget Office

Table 2

School Employee Pension Reforms: 10-Year Savings Analysis (in millions)	FY 11	FY 12	FY 13	FY 14	FY 15	FY 16	FY 17	FY 18	FY 19	FY 20	Cumulative Savings TOTAL
Eliminate retiree dental/vision savings	$1.0	$5.0	$8.9	$13.1	$17.3	$22.1	$26.9	$32.0	$37.3	$42.8	$206.4
Increase employee contribution rate savings	$207.0	$214.3	$221.8	$229.5	$237.5	$245.9	$254.4	$263.3	$272.6	$282.2	$2,428.5
Hybrid plan for new employees savings	$3.9	$12.8	$20.5	$28.1	$35.8	$43.8	$52.2	$61.7	$71.2	$80.6	$410.6
Cap DB enrollment at 30 yrs - savings	$41.0	$42.0	$44.0	$45.0	$47.0	$48.0	$50.0	$52.0	$54.0	$56.0	$479.0
Retirement incentive – pension cost	$0.0	($230.0)	($230.0)	($230.0)	($230.0)	($230.0)	$0.0	$0.0	$0.0	$0.0	($1,154.5)
Increased health care costs on pension system	($236.5)	($236.5)	($236.5)	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	($709.5)
Wage savings	$468.0	$427.1	$384.1	$0	$0	$0	$0	$0	$0	$0	$1,279.1
Gross Savings	**$479.8**	**$234.6**	**$212.7**	**$85.7**	**$107.6**	**$129.8**	**$383.5**	**$409.0**	**$435.1**	**$461.6**	**$2,939.6**

Source: Senate Fiscal Agency