SENATE FISCAL AGENCY
MEMORANDUM

DATE: March 15, 2010

TO: Members of the Senate

FROM: Kathryn Summers, Chief Analyst

RE: SFA Analysis of Retirement Proposals – SERS (State Employees)

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 SERS 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 substantially 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 SERS proposal; a separate memo that discussed the MPSERS proposal was published on March 9, 2010.

SERS Proposals for Existing Employees

- **Increase Employee Contribution to Pension.** The SBO analysis indicates that increasing employee contributions would provide savings to the State of $23.6 million Gross ($9.1 million GF/GP) in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $289.6 million Gross ($112.4 million GF/GP). The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

- **Cap Years of Service in Pension System at 30.** The SBO analysis indicates this would provide State savings of $2.2 million Gross ($0.8 million GF/GP) in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $14.8 million Gross ($5.7 million GF/GP). The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

- **Eliminate Retiree Dental/Vision Savings.** The SBO analysis indicates this would provide savings to the State of $0.5 million Gross in FY 2010-11. After 10 years, this proposal is estimated by the SBO to save $49.6 million ($19.2 million GF/GP). The SFA analysis uses the figures estimated by the SBO for this portion of the proposal.

201 N. Washington Square • Suite 800 - The Victor Center • Lansing, Michigan
Telephone: (517) 373-2768 • TDD: (517) 373-0543 • Fax: (517) 373-1986

TOTAL LONG-TERM SAVINGS FROM REFORMS

The SBO estimates that the long-term reforms would produce 10-year savings (as outlined in Table 1 at the end of this memo) that total $354.0 million Gross ($137.4 million GF/GP). The SFA analysis would concur with these estimates produced by the Budget Office in conjunction with the State's actuary.

SERS 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 85%, meaning that 6,300 out of the 7,400 total pool would retire this coming summer. The SFA analysis assumes a much lower percentage, given that the increased multiplier is less than half as generous as the incentives offered to State employees in the past, when participation was approximately 64%. Therefore, the SFA analysis uses a 40% participation rate.

    - **Wage and Health Care Savings.** The SBO analysis assumes continuous wage and health care plan savings for new employees over the 10-year analysis. However, wage and new health care plan 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 and health care plan 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 68% replacement ratio. However, the State already is replacing fewer people upon their retirement, due to constrained budgets. Also, hiring or laying off can be done by the State at any time. The SFA analysis recognizes that this proposal has the potential to accelerate the State's ability to keep vacancies open or not replace retirees, or to lay off employees and incur unemployment costs. However, given that these people are already eligible to retire and likely to do so within the next three years absent the incentives, the SFA analysis phases out the replacement ratio savings over three years, with all savings presumed gone by the fourth year, when it is likely that the State already would have not filled the retiree positions due to constrained budgets.

    - **Terminal Leave Deferral.** The SBO analysis spreads terminal leave payouts over five years, and includes those costs in the analysis. However, these costs have to be paid regardless of when a person retires, and the costs are not dependent on this proposal. Therefore, the SFA analysis zeroes out the terminal leave costs from the estimates.

TOTAL SHORT-TERM EFFECTS FROM INCENTIVES

Combining these effects, the SBO analysis estimates the net wage differential and replacement savings after payment of the additional retiree health care costs total $226.7 million Gross in FY 2010-11 ($88.0 million GF/GP). After 10 years, the incentives portion of the proposal is estimated by the SBO to save $1.6 billion. The SFA analysis assumes a lower participation rate, discontinues wage savings after three years, and phases out replacement ratio savings. The SFA analysis estimates savings from the incentives portion of the proposal in FY 2010-11 of $78.1 million Gross ($30.3 million GF/GP), with a cumulative cost (not savings) of $130.8 million Gross ($50.8 million GF/GP) 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 $2.0 billion Gross ($758.2 million GF/GP) savings to the State over 10 years. This is a combination of the $354.0 million estimate of long-term reform savings and $1.6 billion in savings associated with the short-term incentives.

The Senate Fiscal Agency calculates a $223.2 million Gross ($86.6 million GF/GP) savings to the State over 10 years. This is a combination of the $354.0 million of long-term reform savings estimated by the SBO and a $130.8 million cost estimated by the SFA to pay for the enhanced multiplier offered to induce additional retirements.

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 savings, and 3) wage savings.

Please feel free to call with any questions.

/wm

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

Table 1

State 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 (costs) TOTAL
Eliminate retiree dental/vision	$0.5	$1.5	$2.5	$3.4	$4.4	$5.4	$6.4	$7.4	$8.3	$9.8	$49.6
Increase employee contribution rate	23.6	39.7	36.9	35.1	32.3	29.6	26.8	24.9	22.2	18.5	289.6
Cap DB enrollment at 30 yrs	2.2	2.0	1.8	1.6	1.5	1.3	1.1	1.1	1.1	1.1	14.8
Terminal leave deferral	(28.4)	(28.4)	(28.4)	(28.4)	(28.4)	0.0	0.0	0.0	0.0	0.0	(142.0)
Retirement incentive – pension cost	0.0	0.0	(114.8)	(114.8)	(114.8)	(114.8)	(114.8)	0.0	0.0	0.0	(574.0)
Increased health care costs on pension system	(85.0)	(85.0)	(85.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(255.0)
Wage & replacement ratio savings	340.1	247.9	247.9	247.9	247.9	247.9	247.9	247.9	247.9	247.9	2,571.2
Gross Savings	**$253.0**	**$177.7**	**$60.9**	**$144.8**	**$142.9**	**$169.4**	**$167.4**	**$281.3**	**$279.5**	**$277.3**	**$1,954.2**
GF/GP Savings	**$98.2**	**$68.9**	**$23.6**	**$56.2**	**$55.4**	**$65.7**	**$65.0**	**$109.1**	**$108.4**	**$107.6**	**$758.2**

Source: State Budget Office

Table 2

State 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 (costs) TOTAL
Eliminate retiree dental/vision	$0.5	$1.5	$2.5	$3.4	$4.4	$5.4	$6.4	$7.4	$8.3	$9.8	$49.6
Increase employee contribution rate	23.6	39.7	36.9	35.1	32.3	29.6	26.8	24.9	22.2	18.5	289.6
Cap DB enrollment at 30 yrs	2.2	2.0	1.8	1.6	1.5	1.3	1.1	1.1	1.1	1.1	14.8
Terminal leave deferral	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Retirement incentive – pension cost	0.0	0.0	(54.0)	(54.0)	(54.0)	(54.0)	(54.0)	0.0	0.0	0.0	(270.0)
Increased health care costs on pension system	(40.0)	(40.0)	(40.0)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(120.0)
Wage & replacement ratio savings	118.1	86.1	55.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	259.2
Gross Savings	$104.4	$89.3	$2.3	($13.9)	($15.8)	($17.7)	($19.7)	$33.4	$31.6	$29.4	**$223.2**
GF/GP Savings	$40.5	$34.6	$0.9	($5.4)	($6.1)	($6.9)	($7.6)	$13.0	$12.3	$11.4	**$86.6**

Source: Senate Fiscal Agency