SENATE FISCAL AGENCY
MEMORANDUM

DATE: February 10, 2009

TO: Members of the Senate

FROM: Kathryn Summers-Coty, Chief Analyst
Lindsay Hollander, Fiscal Analyst

RE: Michigan Education Association Retirement Proposal

The Michigan Education Association (MEA) has proposed to incentivize members of the Michigan Public School Employees Retirement System (MPSERS) to retire. Under the MEA plan, any employee who is currently eligible to retire would receive a retirement allowance with a 2% multiplier if they apply for retirement by March 31, 2010 and retire between the end of the current school year and 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 their final average compensation (FAC). Offering a 2% multiplier instead would result in a person with a $40,000 FAC and 30 years of service to receive a $24,000 annual pension allowance instead of an $18,000 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). If a third of those members retired, the UAAL would total to $2.1 billion. If you divide the $6.3 billion by the 62,000 retirees, the average retiree would receive an additional $101,613 during their lives. According to the FY 2007-08 MPSERS Comprehensive Annual Financial Report (CAFR), the average FAC among current retirees is $39,069. If you assume an FAC of $39,069, the average number of years these retirees would receive pensions is about 16.5 years.

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, 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 to $9.8 billion. To generate contributions to fund the UAAL over a five-year period, the rate may rise by 12-14 percentage points if all of the members retired or by 4-5 percentage points if a third of these 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. 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 would also be costs associated with providing Other Postemployment Benefits (OPEBs) to the retirees, such as health and dental insurance. This is a cost increase only in years that a given retiree would otherwise be working. The cost of OPEBs is paid as the cost is incurred (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 62,000 employees retired and received health, dental, and vision benefits, in any years that the employees would otherwise have been working and not yet retired the additional cost would total to approximately $364.8 million, and would result in an increase in the health portion of the MPSERS rate.

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

Table 1

Impact of the MEA Proposal on MPSERS			
Percent retiring[1]	10%	33%	100%
Unfunded Actuarial Accrued Liability (UAAL)	$630 million	$2.1 billion	$6.3 billion
Percentage point increase in UAAL rate[2]	1 point	4-5 points	12-14 points
Additional Annual UAAL contribution	$126 million	$420 million	$1.3 billion
Other postemployment benefit costs[3]	$36.5 million	$121.6 million	$364.8 million
Total annual cost	**$162.5 million**	**$541.6 million**	**$1.6 billion**
Subtract salary savings[4]	$35.9 million	$119.6 million	$358.7 million
Net annual cost[5,2]	**$126.6 million**	**$422 million**	**$1.3 billion**

[1]During the 2002 early retirement offering for state employees, 65% of those eligible and 40% of those eligible after purchasing service credit participated.
[2]Rate increase during the smoothing period. Estimate based on five-year smoothing period.
[3]This is a cost increase only in years that a given retiree would otherwise be working.
[4]Salary savings assumes all retirees would be replaced.
[5]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

The additional cost to individual schools and community colleges of higher monetary contributions paid into the system due to the increased MPSERS rate may be offset by any salary savings that the employers may experience as a result of this proposal. For a teacher, the salary savings in the first year could be up to $30,000 per retiree. Salary savings would be greatly reduced once the new employees reach higher levels of the pay scale. Additionally, according to the FY 2007-08 MPSERS CAFR, the average FAC among current retirees is $39,069. Assuming this FAC would be the average for current employees who are eligible to retire, the savings for replacing the average retiree would be less than $30,000. According to the FY 2007-08 MPSERS CAFR, the average annual pay for MPSERS employees is $33,284. It is unknown how many retirees would be replaced. If the average salary savings was $5,785 per retiree in the first year, $119.6 million would be saved if a third of those eligible retired and were replaced. In the aggregate, this would cover all but $2.0 million of the additional OPEB cost in the first year. However, besides the OPEB cost as discussed above, the system would experience additional costs in order to fund the UAAL (about $2.1 billion if a third retired) since the decreased employer contributions to the pension system for new employees would only partially offset the increase in the UAAL rate.

For school districts that have more retirements than they otherwise would have, it is possible that they would see savings from this proposal. However, for school districts that do not experience more retirements as a result of this proposal, they 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 this proposal.

Please feel free to contact me if you have any questions.

/wm

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