<u>ANALYSIS – PA 92 of 2012 (SB 401 – June 2017 MPSERS Changes)</u>

Last Updated: July 27, 2017

<u>Summary:</u> With Governor Snyder's signature, the pension bill passed in June (SB 401) is now Public Act 92 of 2017. In summary:

1) Unlike the initial versions of this legislation, new hires still have a choice between strictly a defined contribution (DC)/401(k)-style plan and a hybrid retirement system that combines a 401(k) with a traditional defined benefit system. **The preservation of that choice is thanks to the massive outcry from MEA members across the state – well done and thank you!**

2) The hybrid option now contains more risk for both employees and employers, because of requirements that they split any shortfalls in funding. While there are protections in the bill to keep future Legislatures from deliberately underfunding the retirement system to cause hardship on educators and their districts, market crashes could cause additional out of pocket costs – and those costs do not have a cap, so they could be significant.

3) The defined contribution (DC) option for new hires is improved under this legislation, providing more money from the employer up front and a better match for employee contributions. Current employees who previously chose the defined contribution (DC) option when they were hired will receive these increases. While this option falls short of being adequate for many members' retirement needs, it does bring the school employee DC option up to equity with what state employees and legislators receive.

4) New school employees will have 75 days to choose whether they want to remain in the defined-contribution-only plan or opt into the hybrid plan. As we move forward, MEA will be doing more analysis on this legislation and providing documents to help new hires work through that decision – please stay tuned for more coming from MEA in the coming months on this issue, as well as any updates to this document as we learn more.

<u>For current retirees:</u>

- No explicit changes address current retirees; however, the long term implications of this legislation on the health of the retirement system will need to be carefully monitored – something MEA has always done and will continue to do.

<u>For current active employees:</u>

- Other than the same unknown, long-term implications for current retirees, one explicit change was made for active employees, as it relates to purchase of service credit. It eliminates the purchase of service credit (other than credit for active duty in the armed forces or for the repayment of previously refunded contributions) in the Basic and Member Investment Plans for employees hired prior to July 1, 2010 unless the purchase is initiated by September 29, 2017 (this includes purchase of credit for time spent on parental leave, as well as Universal Service Credit, Out-of-Service Credit, Nonpublic School Credit, State of Michigan Employment Credit, time spent on Sabbatical, and other, less common forms of service credit leaves). MEA is planning communications to current members ensuring they understand this change and its impact on them.

READ MORE: MEA explains the changes to service credit purchasing under PA 92

- Current employees who chose the Defined Contribution/401(k) option will receive the same increases in that plan as new hires (see chart below).

For future new hires:

- The bills replace the current optional DC plan, which offers a 50% employer match capped at 3% of an employee's compensation, with a DC plan that moves all current participants and future school employees who do not choose the new hybrid option (see below) to a straight 4% employer contribution. In addition, the state will match employee contributions up to 3%. This change goes into effect on October 1, 2017.

- Current DC plan members will be transitioned in two phases to this new plan, which costs them less and provides greater benefit than their current plan

- A before/after comparison of the Defined Contribution plan (which includes both 457 and 401(k) components) is as follows:

	Current DC Plan	**Transition Date to New Plan**	**New DC Plan**
Initial Employer Contribution (this is not an official ORS term)	None.	First pay period following October 1, 2017.	4% into 401(k). No employee contribution is required for this to occur.
Employer Match on Employee Contributions	50% employer match on the next 6% of employee contributions.	February 1, 2018	100% employer match on the next 3% of employee contributions. [Employee funds into 457; employer funds into 401(k).]
Plan Summary (assuming maximum employer match contribution by the employee)	Employee contributes 6%, for which Employer contributes 3% for a total of 9%	Completed on February 1, 2018	Employee contributes 3%, for which Employer contributes 7% for a total of 10%
Personal Healthcare Fund (included for reference – no change from prior law)	100% employer match on first 2% of employee contributions.	Not Applicable. No difference between the plans.	100% employer match on first 2% of employee contributions. [Employee funds into 457; employer funds into 401(k).]

- The new hybrid is the same as the old hybrid in terms of multiplier and vesting.

- While the rate employees need to pay for the hybrid plan is subject to a formula that will likely cause the contribution rates to change, the current ORS estimated normal cost rate for the hybrid plan is 12.04% -- which would be 6.02% for both employee and employer. This represents an increase in cost over the current hybrid from an average cost of 4.89% (cost percentages differ from member to member, with higher income-earning members paying a higher percentage than lower income-earners) to 6.02% (regardless of income level) for the employee and an increase in cost from 3.05% (current rate) to 6.2% for the employer in the new Hybrid plan. The new Hybrid (no name as yet) Plan will cost more than the current Hybrid (Pension Plus) Plan for both the employer and the employee.

- New hybrid members will split the cost of any future unfunded liabilities for their hybrid plan with school districts 50/50 amortized over 10 years. There is no cap on employee or employer required contributions if the Hybrid becomes underfunded. To determine the level of funding, the state will do their calculations as if the Legislature had appropriated the Actuarially Recommended Contributions – therefore, intentionally underfunding the plan by the Legislature will not allow them to artificially trigger these additional contributions. The new Hybrid Plan assumes a 6% rate of return on investment (MIP and Basic assume 8%, Pension Plus assumes 7.5%), making the fund more likely to avoid possible future unfunded liabilities and maintain 100% funding status.

- The new Hybrid Plan's Retirement Eligibility (also called the Regular Retirement Age) will be increased if the most recent experience investigation study (done at least once every 5 years) shows a life expectancy increase of more than 1 year from the previous rate. This increase may only be avoided if actuaries determine that the fund will remain at greater than 100% funding after taking into account this increase in member lifespans. Should an increase in the Regular Retirement Age occur:
    - Change would not apply to members within 5 years of retirement age
    - Change is discretionary for members between 5 and 8 years of retirement age (determined by the MPSERS Board)

- Beginning February 1, 2018, new hires will have 75 days to choose whether they want to be in the new Hybrid plan or the new DC-only plan. If no choice is made, they will default to the DC plan.

- If the Actuarial Funding Ratio of the new hybrid falls below 85% for 2 consecutive years using a 5-year smoothing of returns, the new hybrid system will be closed 12 months later. The Legislature could appropriate the money to eliminate the unfunded liability and keep the plan open. If not and the plan is closed, this creates huge transition costs for the state. Again, these figures are calculated as if the Legislature had appropriated the Actuarially Recommended Contributions, so they can't intentionally underfund and trigger the plan's closure.

- All members currently participating in the Personal Healthcare Fund will continue to do so, along with new hires. The Personal Healthcare Fund is a component of both the new DC plan and the new hybrid plan, with participants receiving a matching contribution of up to 2% of compensation to help pay for healthcare in retirement (employee funds go into the 457; employer funds go into the 401(k). See final row of chart above.)

Frequently Asked Questions:

Q. If a current employee who is on the Basic/MIP or Hybrid plans severs their employment and is hired by a new district, does that new employee make a new election based upon this law?
A. No. All traditional school districts participate in the same retirement system, so changing jobs doesn't change the plan you are in.

Q. We have an early retirement incentive clause in our district that allows teachers close to retirement to commit to retiring earlier than anticipated with the understanding that the district will purchase up to 3 years of service credit. Now PA 92 looks like it will eliminate this option for our district teachers. What is the effective date of the service credit restriction (and will it impact people who have already chosen to retire under this incentive)? How does that impact provisions like this in a contract?
A. The effective date is September 29, 2017. All Service Credit paperwork must be completed, submitted to ORS, and paid for (a completed tax-deferred purchase agreement counts as "paid for") prior to 5 p.m. Eastern Daylight Savings Time on that date. Because it will not be lawful for ORS to process a service credit purchase after this deadline, individual contracts with a provision like this will see that provision become effectively moot/unenforceable once the deadline has passed.

Q. What happens if I have purchased service credits, but I'm still paying?
A. Nothing. You may continue paying for any years that had a purchase initiation date prior to the September 29, 2017 deadline.

Q. What will these changes do to the overall solvency of the pension fund?
A. While the funding shortfall for the MIP and Basic plans was given by many as the reason for this legislation, the truth is that this legislation does absolutely nothing to impact this portion of MPSERS funding other than to eliminate the possibility of future service credit purchases by MIP and Basic members after 09/29/17. Fortunately, the plan that was in place to fix this issue is already doing so – and ahead of schedule.

Since we were able to stop the first version of the bill, and a hybrid plan is still open with a defined benefit component, the projections that this legislation could cost millions of extra dollars may not come to pass. The key factor is how many new hires choose the hybrid plan instead of the DC-only plan. Right now about 20% of new hires choose the DC option – we expect that number to go up now that the option has been improved. If, for example, an additional 10% or so choose the DC over the hybrid, the state should be able to absorb those costs. If every new hire chose the DC plan, that could cause problems because no new investments would be flowing into the pension component of MPSERS.

Q. So as a current employee, should I be worried that I might not get a pension?
A. You should not. The Michigan State Constitution clearly states (as does this new legislation), that all MPSERS members will get the pensions they have earned.

MEA will continue to conduct analysis and develop materials to help members understand these changes. If there are any changes or new information to share, we will update this document.