OFFICE OF THE STATE BUDGET
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State Employee Pension Reforms and Retirement Incentive

Background

The State Employee Retirement System (SERS) has over 27,000 plan members, comprised of active employees hired prior to March 31, 1997 who have elected to remain in the defined benefit plan. Based on a preliminary valuation, SERS has an unfunded liability of $3.1 billion at the end of fiscal year 2009. The impact of this unfunded liability, combined with the closed nature of the system, is continuing to exert budgetary pressure in the form of increased contributions required to be paid into the pension plan.

In addition, nearly 7,900 SERS plan members are currently eligible to retire. These employees are the longest serving, and typically the highest earning in the state workforce. The retirement of these employees allows for the hiring of less costly replacements, both in terms of salary and the recently negotiated health benefit package for new employees set to take effect April 1, 2010.

Proposal

In order to constrain long-term pension obligations and reduce state employee costs, the following SERS reforms are recommended:

- Eliminate the state subsidy for **retiree dental/vision coverage** for employees retiring after October 1, 2010. Future retirees will still be able to buy coverage in the state plan, but at their own cost.

- Require a **3% employee salary contribution** for active SERS plan members effective October 1, 2010. This reform re-instates a 3% member contribution in effect prior to 1974, and requires contributions similar to those in the other state-administered pension plans for legislative members, judges and public school employees.

- **Cap SERS plan service credit after 30 years;** employees would be transferred to the defined contribution plan for any additional years of service accrued subsequent to September 30, 2010. This cap does not apply to service credit purchased by the employee. Employees currently exceeding 30 years of service would retain all service time accrued prior to this date, and would be vested immediately upon transfer in the defined contribution plan. The final average compensation calculation for the defined benefit plan for transferred employees' would continue to be factored on the highest consecutive three years of compensation at the date of separation from state employment.

- Establish a **phased retirement option** whereby an employee can draw their SERS pension, but must reduce hours worked by at least 50% (1,040 hours maximum). The option would be offered at the discretion of the employer, and available to employees age 60 and older. The option is for one year, but can be renewed annually for up to a total of three years.

- Provide a **limited retirement incentive** with the multiplier increased from 1.5% to 1.6% for employees eligible for a full retirement (age 60 with at least 10 years of service, or age 55 with 30 years of service) who retire between July 1, 2010 and October 1, 2010. Eligible employees in "covered" positions may choose between the 1.6% multiplier and the supplemental benefit to which they would otherwise be entitled. Terminal leave obligations (excluding banked leave time) for employees retiring under this incentive program would be paid over 60 months beginning in fiscal year 2011. The deferral of annual leave payouts will not impact the final average compensation calculation. This retirement incentive is also only available to employees occupying positions subject to the new State Health Plan PPO/HMO. This new employee health benefit plan takes effect for new hires on or after April 1, 2010.

Due to the above reforms, it is assumed that approximately 6,300 eligible employees will elect to retire, resulting in career opportunities for over 4,300 new employees to enter the state workforce. Overall, the state workforce will be permanently reduced by nearly 2,000 employees due to a limitation on the number of replacement hires.

Assuming expedited legislative action, the retirement application window would be April 15, 2010 through May 15, 2010. Applicants would have the ability to rescind applications from May 16, 2010 through May 31, 2010. The new retirees would enter the pension system on the first of each month following separation, beginning with July 1, 2010 and continuing through October 1, 2010. Replacement hiring would begin immediately in fiscal year 2010, with the phased-in hiring of replacements continuing to occur throughout fiscal year 2011. A limited number of extensions would be allowed until April 1, 2011, for critical positions in which a transition period is necessary.

Additional information on the SERS pension reforms and retirement incentive is available on the Office of Retirement Services website at www.michigan.gov/ors.

Fiscal Impact

The net savings of these anticipated 6,300 retirees in fiscal year 2011 is estimated to be $264.8 million gross / $102.7 million general fund. The savings estimate assumes 85% of eligible employees will elect to retire. The assumed retiree replacement rate is 1:2 (direct care/client staff replaced at a rate of 1:1), lending to an equated replacement rate of 2:3. The estimate provides for the amortization of pension costs over five years, and assumes salary and benefit savings from less costly replacement employees. The cumulative net savings of the proposed reforms over ten years is $1.97 billion gross / $764 million general fund.