Coalition for Secure Retirement
SB 1040 Talking Points

Powerful interest groups are pushing hard for the Michigan Legislature to place new public school employees into a Defined Contribution (i.e. 401(k) style) pension system.

Such a move would not only create a less secure retirement plan for the new employees placed into it, it would cost schools more money. Though this seems counterintuitive, it is easily provable.

Two ways that moving school employers to Defined Contribution will cost schools more:

1. The current Hybrid pension system that was adopted in 2010 is less expensive on its face than a defined contribution plan.

This fact has been almost completely overlooked by backers of the Defined Contribution plan. Schools currently pay approximately 27% of their employees' wages into the retirement plan. However, the vast majority of this amount goes to pay for past obligations, not ongoing pension costs.

For example, part of that money is paying off the current Pension Unfunded Accrued Liability, part of it goes toward the Early Retirement Incentive enacted in 2010, and part of it is for Retiree Health Care. Only 3.47% of that number is the so-called "Pension Normal Rate," which is used to fund ongoing pension costs.

Should the Legislature place newly hired school employees into a Defined Contribution plan similar the one state employees have, the contribution rate for schools will almost certainly go up. The state employee plan has the State contributing 4% of payroll into an employee's defined contribution account, but matching up to an additional 3%. The average employer contribution for state employees is approximately 6.2% of salary. This is almost double the 3.47% match for employees in the current Hybrid system.

The state Office of Retirement Services has estimated that shifting to defined contribution would cost schools an increasing amount of money each year as a higher and higher percentage of their staff were placed in the more expensive system. According to the Senate Fiscal Agency, the change would increase costs ***by "between $9 million and $12 million in Year 1, $20 and $27 million in Year 2, $32 million to $42 million in Year 3, and growing over time as more new employees become part of the DC plan."***

2. Governmental Accounting Standards require huge upfront costs when switching from a defined benefit or hybrid to a defined contribution plan in order to avoid disastrous consequences.

The Governmental Accounting Standards Board requires that public entities that close a traditional pension plan invest large amounts of money into that plan if it is closed (due to the switch to a defined contribution plan). This requirement is there to protect the members of the old plan from having their pensions reduced or eliminated should the old plan run out of funds decades in the future. Since new funds would no longer be coming into the plan from new members, GASB requires a large infusion of funding in the first several years after the plan is closed. The Office of Retirement Services has estimated that in order to follow GASB standards, the MPSERS system would need ***an additional $1.6 billion in the first six years alone.***

However, organizations like the Mackinac Center and the Arnold Foundation have argued that this up front funding is not required. They maintain that GASB only requires the gap in funding to be accounted for, and it can be made up over time. This is a very dangerous suggestion. In fact, it can be argued that it was deferring investments into MPSERS over the past decade that has created the large unfunded accrued liabilities that SB 1040 is supposedly seeking to reduce.

Moreover, failure to follow GASB standards in terms of funding could lead to disastrous consequences should bonding agencies decide to lower the state's credit rating due to that failure. This would not only have a hugely negative impact on the state's finances, but also on local units of government who would be adversely affected by the reduction in bond rating.

Aside from the fiscal consequences of failure to follow GASB standards, however, is the very real possibility that the MPSERS system will continue to be chronically underfunded if the up-front funding is not invested. SB 1040 was introduced to fix this very problem, but the Senate-passed version is a very risky and costly way of doing it.