Michigan Public School Employees Retirement System: Major Changes in Recent Years and More Changes to Come (Addendum)

In May 2012, the Coalition for Secure Retirement-Michigan released a report entitled "Michigan Public School Employees Retirement System: Major Changes in Recent Years and More Changes to Come." This report was written by Public Sector Consultants, and discussed the current status of the Michigan Public School Employees Retirement System (MPSERS) and proposed changes to the system being considered by the Michigan Legislature in Senate Bill 1040. Subsequent to the release of the report, the Michigan Senate added a provision to Senate Bill 1040, which effectively closed out the defined benefit retirement system for all public school employees hired after July 1, 2013. This provision was not contained in the original version of Senate Bill 1040, as introduced.

Under current law, all public school employees hired after July 1, 2010, are members of a hybrid retirement plan. The Hybrid Plan consists of a defined benefit plan combined with a defined contribution plan. The defined benefit portion of the Hybrid Plan allows these public school employees to draw a pension at age 60 with a minimum of 10 years of credited service. The calculation for the defined benefit plan is years of service multiplied by 1.5% multiplied by the average compensation over 5 years. There is no cost of living adjustment to pensions in the Hybrid Plan. Members of the Hybrid Plan contribute $510 annually plus 6.4% of their salary above $15,000. The defined contribution portion of the Hybrid Plan allows employees to contribute 2% of their salary to the defined contribution plan; the employer will match this with a 1% contribution.

The Senate-passed version of Senate Bill 1040 would eliminate the hybrid retirement plan and replace it with a defined contribution plan. The defined contribution plan provides a 4% employer contribution, plus an additional 3% employer contribution if the employee decides to contribute 3% of their salary to the plan. If employees contribute the 3% of their salary to the defined contribution plan, the total employer cost would equal 7% of salary. This defined contribution plan is the same plan being utilized by state employees hired since 1997.

The Senate's decision to close out the Hybrid Plan and replace it with a defined contribution plan may result in cost increases for the employers or the state. The cost increase occurs because the current employer contribution to the Hybrid Plan is 3.7% of payroll of plan members. Switching these new employees to a defined contribution plan with an employer match of 7% of payroll may result in an increased employer cost of 3.3% (or a near doubling—89% increase—of the current employer costs for these members).

Closing out the Hybrid Plan would also result in smaller flows of funding from active employees to cover the pension obligations of employees now enrolled in the Hybrid Plan. This may also drive up future costs. Therefore, the Senate's closing out of the Hybrid Plan and replacing it with a defined contribution plan for newly hired employees may have significant short-term cost implications for employers.

The Senate Fiscal Agency, based on projections from the Office of Retirement Services, places these increased employer costs at $402 million in FY 2013–14, $338 million in FY 2014–15, $273 million in FY 2015–16, $206 million in FY 2016–17, $138 million in FY 2017–18, and $69 million in FY 2018–19. These increased costs total over $1.4 billion across the next 6 fiscal years, and may result in lower funding in other areas of public school funding if the school funding is held constant.

The increased costs estimates of the switch to a defined contribution system for all newly hired public school employees are based on accounting for the MPSERS based on Governmental Accounting Standard Board (GASB) guidelines. The MPSERS is currently following GASB accounting guidelines in the operation of MPSERS. There was discussion in the Michigan Senate as to possibly making the switch for newly hired public school employees to a defined contribution system, but not following the accounting guidelines set by the GASB. The proponents of this deviation from GASB accounting guidelines suggest that such a change would drive down the cost to the employer and not threaten the future of MPSERS.

In spite of many challenges to the State Budget over the recent years, Michigan has accounted for its budget, including retirement plans, based on accounting guidelines set forth in the GASB. This practice allows state financial health to be compared to other states using a uniform method of accounting. Any decision by MPSERS to deviate from GASB accounting guidelines could result in short-term savings, but will likely have a negative impact on the credit rating of the state. Deviating from GASB accounting guidelines could result in a drop in Michigan's credit rating, which may increase borrowing costs for the State of Michigan and local units of government. Any deviation from GASB accounting standards will likely cost the State of Michigan more in the long run than might be gained in short-term cost savings.