COALITION FOR SECURE RETIREMENT - MICHIGAN

OVERVIEW OF SEGAL STUDY: MPSERS PA 300 of 2012

November 19, 2012

PA 300 of 2012, amending the school employees' retirement act, required an independent study to be commissioned regarding a number of issues on which the legislature was seeking input and had not yet resolved. Given the very short time frame to complete the study, the Segal Group's report was both thorough and balanced. The ten components of the report included:

1. An executive summary that outlines background and key findings.
2. Plan design comparison, reviewing seven kinds of risk for the current "hybrid" plan for new hires, the proposed defined contribution plan, and the "legacy" (pre-hybrid) plan. This section demonstrates that while the legacy plan had employers as the primary bearers of risk, the defined contribution plan **shifts nearly all risks to employees**. By contrast, **the hybrid plan splits risks fairly evenly between employers and employees.**
3. Peer group plan survey comparing Michigan's school employee retirement plan to those of ten other states. **No other "peer" state has closed its defined benefit plan and transitioned new hires to a defined contribution plan**.
4. A section on plan design and economic impact of variability in plan experience, which suggests that a periodic review of service purchase may be useful to control costs. It also comments that both Michigan's assumed rates of return and its mortality table are reasonable. Regarding the issue of funding the annual required contributions or other annual funding requirements, the report comments that **if contributions were "no longer actuarially determined, the unfunded liabilities would increase**." The report also notes that the bond ratings for governmental entities whose plans are poorly funded are lower than those for governments with better-funded pension plans.
5. The analysis of benefit adequacy suggests that retirees need 94 to 78% replacement ratios to maintain similar lifestyles after retirement, with the lower figure in the range applying to higher income employees. The retirement benefits provided by **the Hybrid plan for a long-service retiree would meet or exceed the adequacy retirement. The PA 300 defined contribution plan, however, falls short of the adequacy test.**
6. Regarding workforce management, the report indicates that defined benefit plans in the private sector have mainly been solely financed by employers. However, private companies have mostly eliminated these plans because of "onerous IRS and accounting rules and the high volatility associated with these measurements." **Because hybrid plans have both defined benefit and defined contribution elements, they can be attractive to both older and younger new hires. At the other end of work experience,**

if defined contribution participants experience poor returns, they may be required to work well intro old age. Defined benefit plans also offer an opportunity to target a group of employees to retiree early through incentives. **"If new employees are moved to a DC plan, it will be more difficult to address workforce management issues through the plan."**

7. The section regarding plan transition notes that projected annual normal costs under the current Hybrid plan are expected to increase by $500 million over 30 years. By contrast, **under the state defined contribution plan, projected contributions would go up by nearly $1.5 billion during that same period of time**—with an additional cost of around $13.6 billion over thirty years, if one does not discount for interest. Under PA 300, the employer contribution drops over the short term, **but over the long term, the required employer contribution is lowest if all members select the Hybrid plan option.**
8. Several different amortization methods are compared in this section, as well as their impact on the school aid fund. The report recommends that no matter which method is chosen, no contribution caps be implemented and that the amortization method be applied consistently to all employers.
9. The retiree health care analysis discussed the new GASB OPEB rules and their impact on governmental employers. In brief, while noting that GASB standards do not require prefunding retiree health care, the report comments "**there are significant advantages to prefunding these costs, such as utilizing higher discount rates and reporting lower liability and expense…."** At the same time, the report acknowledges the budgetary difficulty of moving into prefunding. However, **even partial prefunding is beneficial.** The report also credits the many steps taken by MPSERS to control costs through a strategic planning initiated, initiated in the early 1990's, which has resulted in cumulative savings of more than $1 billion. Consequently, the employer contribution rate for retiree health benefits has increased only three times in the past ten years, keeping **MPSERS' health care expenditure well below the national per capita.** In 2009, the national per capita cost was $8086, compared to MPSERS health care per capita cost of $3180. Finally, the report notes that shifting the financial responsibility for retiree health coverage to employees "has an overall negative impact on the adequacy of retirement income."
10. The final section of the report outlines **comments from three of the four organizations that provided input, including the Coalition for Secure Retirement**. MARSP suggested that the regular retirement eligibility age should be indexed to life expectancy and that an analysis should determine a fair way to incorporate the UAL cost into the pupil foundation grant. The Michigan School Business Officials recommended a study to identify a method that fairly allocates the UAL to the school districts responsible for the costs. Appendices to the report included an analysis of the impact on benefits and costs of the options under PA 300, background on the actuarial assumptions used, and the input from organizations.