HOUSE FISCAL AGENCY

**MEMORANDUM**

**DATE:** April 5, 2012

**TO:** House Appropriations Subcommittee on Higher Education

**FROM:** Kyle I. Jen, Deputy Director, and Bethany Wicksall, Senior Fiscal Analyst

**RE:** Public Universities in the Michigan Public School Employees Retirement System

## MPSERS History

The Michigan Public School Employees Retirement System (MPSERS) is a defined benefit retirement system. Employees who are members of the system receive a pension upon retirement. Public employers and employees in the system make financial contributions to prefund the costs of those benefits, adjusted each year based on actuarial calculations. Additionally, employees and their dependents are eligible for certain health care-related benefits as retirees. The costs of those benefits are funded by employers on a "pay-as-you-go" basis.

MPSERS was established by Public Act 136 of 1945 to provide a system of uniform retirement benefits for employees of local school districts in the state. Health care benefits were added by the Legislature in 1975. The provisions governing MPSERS were recodified as Public Act 300 of 1980. That act, as amended, currently governs the system.

When MPSERS was created, the employees of five public universities were included in the system by the Legislature: Central Michigan, Eastern Michigan, Michigan Tech, Northern Michigan, and Western Michigan. Four of those five universities (all but Michigan Tech) were originally established as teaching colleges. The employees of Michigan State, the University of Michigan (UM), and Wayne State were not included.

As new universities were established by the state after 1945, their employees were included in MPSERS: Lake Superior State in 1946 (previously a branch campus of Michigan Tech) and Ferris State in 1949 (previously a private institution).

The subsequent set of public universities to be established were *not* included in MPSERS: UM-Flint in 1956, Oakland in 1957, UM-Dearborn in 1959, Grand Valley State in 1960, and Saginaw Valley State in 1963.

In total, then, the employees of seven universities were included in MPSERS: Central, Eastern, Ferris, Lake Superior State, Michigan Tech, Northern, and Western. Additionally, employees of public community colleges in the state were included (and remain) in MPSERS. The enactment of the Optional Retirement Act of 1967 allowed full-time faculty and administrative staff of universities and colleges in MPSERS to opt out of MPSERS retirement benefits and into an Optional Retirement Plan (ORP)—a 401k-style retirement program operated by the individual institution. Support staff and part-time employees were not made eligible for the ORP.

Initially, the state funded the costs of providing retirement benefits to those employees. In 1974, the state began assessing school districts, colleges, and universities for a portion of MPSERS costs. And, in conjunction with the adoption of Proposal A in 1994, the full costs associated with MPSERS were billed to school districts, colleges, and universities. (School districts received additional funding for this purpose under the changes associated with Proposal A.)

**1995 Legislation**
Shortly thereafter, Public Act 272 of 1995 provided that employees of the seven MPSERS universities hired on or after January 1, 1996 would not become members of MPSERS. Employees of the seven universities hired since that date, then, have been placed into independent retirement systems maintained by the individual universities—generally 401(k)-style plans, comparable to those maintained by the eight non-MPSERS universities. (Based on a survey conducted in 2010, the employer contribution rates for these plans across the 15 universities generally fall in the range of 10 to 14 percent of employee salaries.)

Over the last 15 years, the number of active MPSERS members employed by the universities has gradually declined. As of September 30, 2010, the seven MSPERS universities had 2,224 active members (i.e., employees who have not yet retired or left university employment) in the system. This represented 0.9 percent of the total number of active MPSERS members.

At the same point in time, the MPSERS universities accounted for 4,970 retirees and beneficiaries in MPSERS. This represented 2.6 percent of the total number of MPSERS retirees/beneficiaries. The university retirees were receiving an average annual pension of $14,382.

At the time of the change to no longer place new university employees in MPSERS, the assets in the retirement system were substantially below the full actuarial accrued liability of the system. As of September 30, 1995, the system's funded ratio (assets/liability) was 74.6%.

To address the portion of the unfunded actuarial accrued liability (UAAL) corresponding to university employees, the Legislature included the following provision in the 1995 legislation (section 41a, shown as subsequently amended; emphasis added):

> For fiscal years that begin on or after March 28, 1996, the retirement system shall determine a separate contribution rate for a reporting unit that is a university listed in section 6(5). The retirement system shall determine the separate contribution rate in the manner prescribed in section 41, except that *the unfunded actuarial accrued liability shall be amortized over 40 years beginning October 1, 1996 and ending on September 30, 2036, with the payment schedule for universities being based on and applied to the combined payrolls of the universities' employees who are members and who were hired before January 1, 1996 and the universities' employees who would have been members on or after January 1, 1996, but for the enactment of 1995 PA 272*. . . .

This provision effectively segregated the transition costs of the universities moving out of MPSERS from the rest of the retirement system (K-12 school districts and community colleges) while creating a long-term time horizon, ending in 2036, for paying off the full costs of the unfunded actuarial accrued liability (UAAL) associated with university employees and retirees in the system.

Spreading the costs of paying off the UAAL across all university employee payroll, rather than just MPSERS payroll, addresses the inevitable decline that has taken place in MPSERS payroll as new employees enter university-run retirement systems. The costs were applied on a percentage-of-payroll basis, rather than a fixed-dollar basis, to avoid larger dollar contributions in the years immediately following the legislative change that removed new employees from MPSERS.

Since FY 1996-97, then, the MPSERS universities have paid two separate rates associated with MPSERS pension benefits:

- A rate for normal pension costs, applied only to the payroll for MPSERS employees and corresponding to overall normal costs for all employers in MPSERS (including K-12 districts and community colleges). Normal costs represent the additional actuarially-determined costs of prefunding the pension benefits employees earn by accruing additional service time.

- A rate for UAAL costs amortized over the period ending in 2036, applied to the payroll of both MPSERS employees and non-MPSERS employees—those hired after January 1, 1996, who would have previously been included in the system. These costs correspond with any shortfall that exists between retirement systems assets and already-accrued liabilities—often created as a result of investment returns failing to meet actuarial assumptions (8% per year in the case of MPSERS).

For the non-member payroll against which the UAAL rate is also applied, the universities have been reporting payroll for support staff and part-time employees, excluding employees who would have been eligible to opt into the ORP prior to 1996 (full-time faculty and administrative staff). On a percentage basis, then, the UAAL rate is higher than it would be if the all non-member payroll were included.

Additionally, the universities fund the costs of health care benefits for their MPSERS retirees on a pay-as-you-go basis, with each university paying the health insurance premium costs for its own retirees.

**University Costs and Senate Bill 1040 Implications**

In FY 2010-11, the seven MPSERS universities reported $44.8 million in total MPSERS costs. These costs were equal to 2.0% of total current fund revenue for those universities.[1] The costs are split into two major components: pension costs and health care costs.

Pension Costs

An attached chart shows recent pension contribution rates charged to the universities, from FY 2005-06 to FY 2012-13. The rate for normal costs, applied only to the payroll for employees in MPSERS, has actually declined from 6.01% to 3.21%. This decline is largely the result of legislative changes to MPSERS affecting the retirement benefits of K-12 and community college employees hired in recent years. While universities no longer have new employees entering the system, they have benefited from the associated cost reductions. (Employer normal costs are lowered by employee contributions. That is, absent such contributions, the rate would be higher than 3.21%. University employees in the Member Investment Plan (MIP) contribute either 3.9% or 4.3% of salary, depending on date of hire. Employees in the Basic Plan, which provides a less generous pension benefit, do not make a contribution.)

[1] Current fund revenue captures all ongoing university revenue, including self-supporting non-instruction-related activities funded by sources other than state appropriations and student tuition. Employees engaged in those activities (residence hall operations, externally-funded research, etc.) are also subject to MPSERS requirements.

The rate for UAAL costs, meanwhile, dropped dramatically from FY 2005-06 to FY 2006-07 when investment gains were captured on an accelerated basis by "marking to market" but has increased substantially over the ensuing six years, from 5.56% to 13.41%. The increase in this contribution rate has been driven mainly by investment losses realized in 2008 and 2009; those losses are phased into the actuarial calculations for the retirement system over a period of five years (but paid off over the full length of the amortization period). An early retirement incentive enacted by the Legislature in 2010 has also contributed to the increased UAAL.

Pursuant to the statutory provision cited earlier in this memo, the UAAL rate is applied to the payroll for both MPSERS and non-MPSERS employees (support staff and part-time employees only). As shown in a second attached chart, the total payroll against which the UAAL rate is charged has been roughly flat in recent years, while the portion of that total composed of MPSERS payroll has dropped as MPSERS employees retire over time. MPSERS payroll accounted for 51.0% of the total payroll in FY 2009-10, vs. 65.4% in FY 2005-06. (The overall payroll figures shown in the graph do not reflect overall growth in university payrolls as employees replacing full-time faculty and administrative staff retiring under MPSERS do not become part of the non-MPSERS payroll figure.)

University MPSERS payroll will continue to decline in coming years, reaching zero in roughly 2035, when nearly all MPSERS employees will have retired. This roughly corresponds to the point at which the full UAAL corresponding to university MPSERS employees will be paid off under statutory provisions.[2]

Because of the trends in contribution rates and payroll amounts, the large majority of pension-related costs paid by the universities into MPSERS are related to the UAAL. According to estimates from the universities, the seven universities will pay a total of $25.4 million for pension-related costs in FY 2011-12. Only $3.3 million of that total is for normal costs; the remaining $22.1 million is for UAAL costs.

The introduced version of Senate Bill 1040 includes a number of proposed changes to MPSERS employee contributions or benefit levels—in particular, increasing university employee contribution rates by about 4 to 5 percentage points of salary (or reducing the pension multiplier from 1.5 to 1.25 for those employees opting not pay the higher rates; employees could also opt into a 401k-style plan). This will further reduce the normal rate paid by employers for pension costs, potentially eliminating that rate.

In order to significantly lower pension-related costs beyond the normal rate costs for the MPSERS universities, the state would have to directly offset UAAL-related costs through a state-financed mechanism. As of September 30, 2010, the long-term UAAL for the university portion of the MPSERS pension plan totaled $333.3 million.

Health Care Costs

While they are a significant cost to the MPSERS universities, health insurance costs within MPSERS have been maintained at relatively flat levels in recent years. According to data supplied by the MPSERS universities, total MPSERS retiree health care costs for the universities increased rapidly in the late 1990's—from $6.9 million in FY 1996-97 to $22.3

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[2] Presumably, any new UAAL corresponding to retired university employees that emerged after that point would no longer be the responsibility of the universities to pay off and would instead be paid by K-12 districts, community colleges, and/or the state.

million in FY 2002-03. As shown in a third attached chart, those costs have been fairly stable, however, in recent years; FY 2010-11 costs of $23.5 million were only $1.2 million higher than the FY 2002-03 figure.

According to the Office of Retirement Services (ORS), total MPSERS health care expenditures per retiree (across all employer groups) have declined from $6,794 in 2005 to $5,380 in 2010, as the result of various cost-saving measures implemented by ORS and the establishment of Medicare Part D at the federal level.[3]

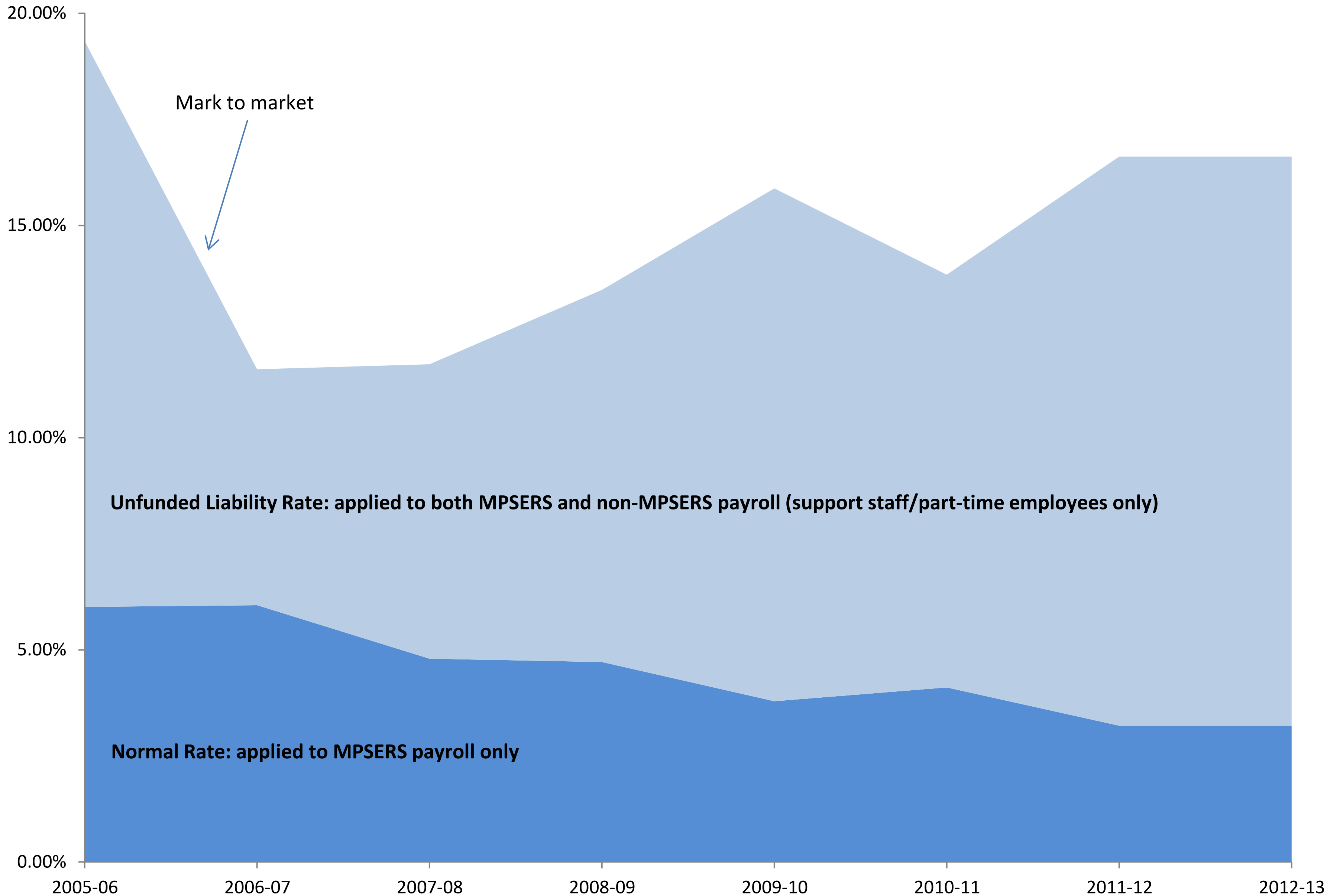
Senate Bill 1040 includes a number of proposed changes to retiree health care benefits, which would result in financial savings to the universities: reducing the maximum premium coverage provided by the state from 90% to 80%, increasing the age of eligibility for retiree health care to age 60, and retroactively applying graded premium coverage for retiree health care benefits to all current employees.

Finally, the FY 2012-13 Executive Budget proposes to appropriate $446,200 in School Aid Fund revenue to offset a portion of university MPSERS retiree health care costs. The versions of the FY 2012-13 Higher Education budget reported by the House and Senate appropriations subcommittees last week concur with that funding item.

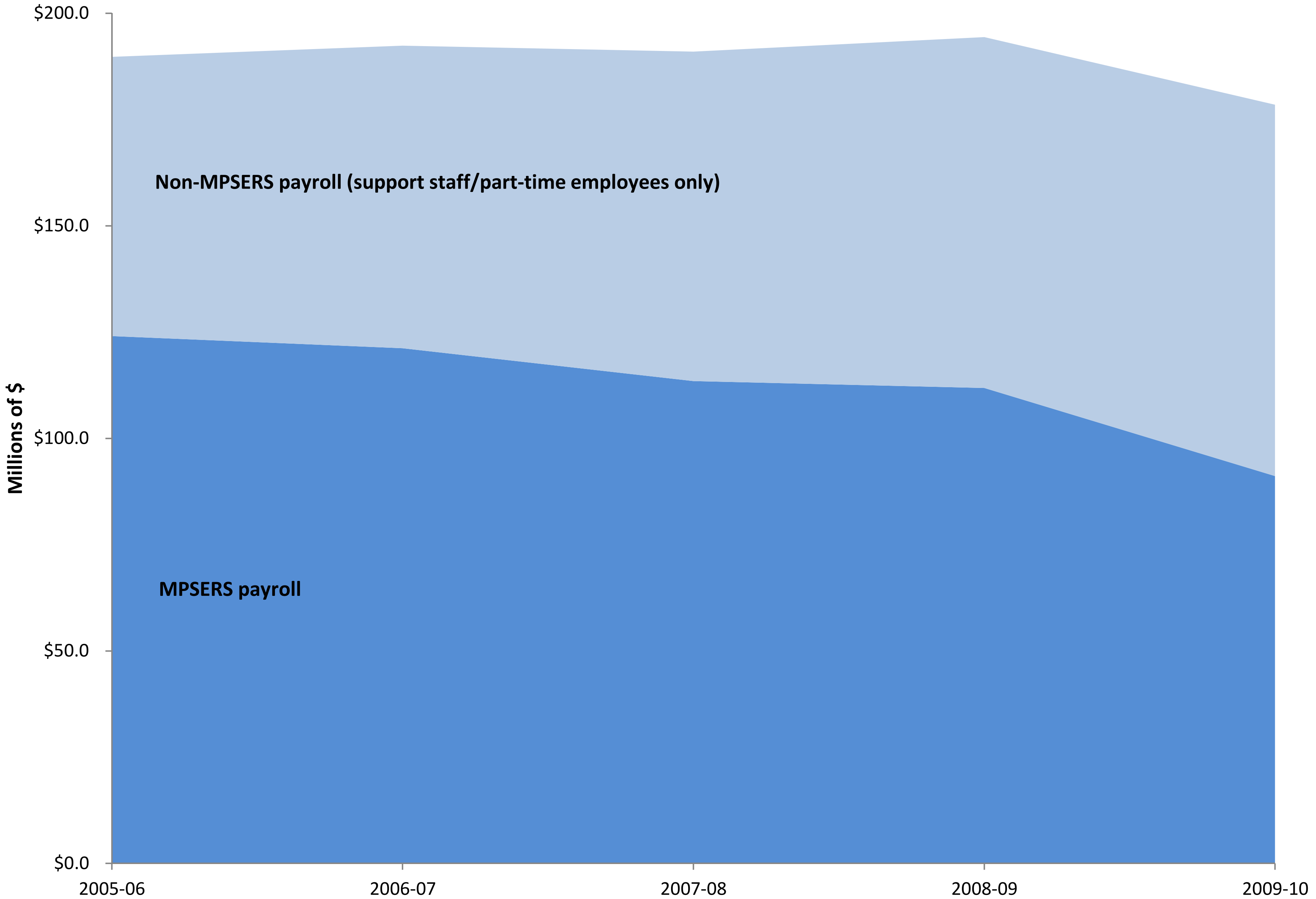
Attachments (3)

[3] MPSERS employees began contribution 3.0% of salary toward retiree health care costs under 2010 MPSERS legislation, but those contributions are being held in escrow pursuant to court order until the legality of the contribution is determined. Those contributions are not, therefore, currently lowering employer retiree health care costs.

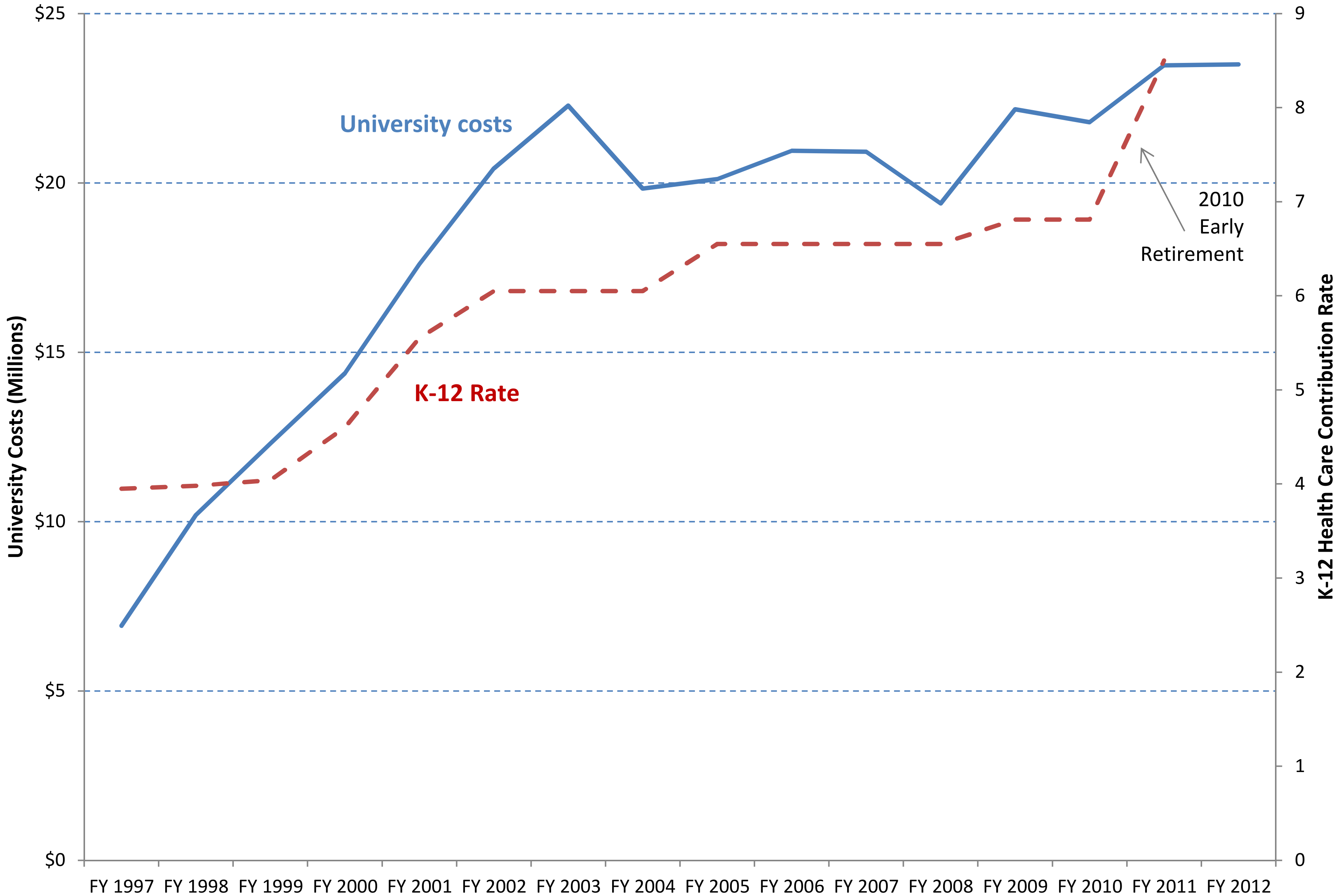
# MPSERS University Contribution Rates



# MPSERS University Payroll



# MPSERS University Retiree Health Care Costs




Source: MPSERS universities and Office of Retirement Services