Committee on Retirement Savings Plan and
Retiree Health Benefits

FINAL REPORT

December 17, 2013

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TABLE OF CONTENTS

Title ................................................................................................................. Page

Executive Summary ............................................................................................ 1
Committee Report ............................................................................................... 8
1. Background .................................................................................................... 8
   1.1 Structure of the Committee ...................................................................... 8
   1.2 Committee Charge .................................................................................. 8
2. Process for Developing Recommendations ..................................................... 9
   2.1 Communications and Community Input .................................................. 9
   2.2 Impact of Additional Data Analysis and Community Input on the Process .... 11
3. Principles ...................................................................................................... 12
   3.1 Benefit Plan Design Principles ................................................................ 12
   3.2 Committee Principles and Values .......................................................... 12
4. Retirement Savings Plan ................................................................................. 14
   4.1 Current Retirement Savings Plan Design ................................................. 14
   4.2 Tax Advantage Efficiencies .................................................................... 14
      4.2.1 Tax-Advantaged Savings in Public Universities .............................. 15
      4.2.2 Maximizing Voluntary Tax Deferral Savings ................................. 15
5. Market Competitiveness Considerations ......................................................... 16
   5.1 Aon Hewitt Benefit Index ...................................................................... 16
6. Cost Savings Options Considered: Retirement Plan Savings ......................... 20
   6.1 Analysis of Alternatives for Retirement Saving ...................................... 22
      6.1.1 Reducing the University Contribution Rate .................................... 22
      6.1.2 Changing Eligibility Criteria for Part-Time Employees .................. 24
      6.1.3 Changing the Definition of Income Used to Calculate Contributions ......................................................... 26
      6.1.4 Vesting and Waiting ...................................................................... 27
      6.1.5 Vary Contributions Based on Years of Service .............................. 29
      6.1.6 Age and Service Formulas ............................................................ 30
      6.1.7 Base and Optional Matching Plan .................................................. 31
   6.2 Relationship between Cost Savings and Benefit Index Calculations .......... 33
   6.3 Plans Discussed, but Not Modeled .......................................................... 34
      6.3.1 Age .............................................................................................. 34
      6.3.2 Income .......................................................................................... 34
7. Retirement Savings Plan Findings and Recommendations ............................. 35
   7.1 Campus Areas: Ann Arbor, Dearborn, Flint ........................................... 35
      7.1.1 Findings ........................................................................................ 35
      7.1.2 Recommendations ......................................................................... 36
   7.2 Hospital and Health Centers (HHC) Staff ................................................. 36
      7.2.1 Findings ........................................................................................ 36
      7.2.2 Recommendations ......................................................................... 37
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>8. Retiree Health Benefits and Recommendations</td>
<td>38</td>
</tr>
<tr>
<td>8.1 Current Retiree Health Benefit</td>
<td>39</td>
</tr>
<tr>
<td>8.2 Issues Considered: Retiree Health</td>
<td>39</td>
</tr>
<tr>
<td>8.3 Issues Considered: Long-Term Care</td>
<td>40</td>
</tr>
<tr>
<td>8.4 Recommendations</td>
<td>41</td>
</tr>
<tr>
<td>9. Further Considerations</td>
<td>41</td>
</tr>
<tr>
<td>9.1 Save More, Not Less</td>
<td>41</td>
</tr>
<tr>
<td>9.2 Proposals to Encourage Saving for Retirement</td>
<td>42</td>
</tr>
</tbody>
</table>

## Appendices

<table>
<thead>
<tr>
<th>Appendix</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Committee on Retirement Savings Plan and Retiree Health Benefits</td>
<td>A-1</td>
</tr>
<tr>
<td>Membership 2013</td>
<td></td>
</tr>
<tr>
<td>2. Committee Charge</td>
<td>A-2</td>
</tr>
<tr>
<td>3. Summary Report of Survey Results</td>
<td>A-6</td>
</tr>
<tr>
<td>4. Provost Peer List</td>
<td>A-19</td>
</tr>
<tr>
<td>5. Local and National Healthcare Peer List</td>
<td>A-20</td>
</tr>
<tr>
<td>6a. Retirement Savings Plan Contribution Comparison of</td>
<td>A-21</td>
</tr>
<tr>
<td>All 23 Provost Peers – Base Plan</td>
<td></td>
</tr>
<tr>
<td>6b. Retirement Savings Plan Contribution Comparison of</td>
<td>A-22</td>
</tr>
<tr>
<td>All 23 Provost Peers – High Benefit</td>
<td></td>
</tr>
<tr>
<td>7a. Compensation Eligible for Retirement Contributions:</td>
<td>A-23</td>
</tr>
<tr>
<td>U-M Provost Peers</td>
<td></td>
</tr>
<tr>
<td>7b. Compensation Eligible for Retirement Contributions:</td>
<td>A-24</td>
</tr>
<tr>
<td>Local and National Healthcare Peer List</td>
<td></td>
</tr>
<tr>
<td>8. U-M Retiree Health Benefit Contributions</td>
<td>A-25</td>
</tr>
</tbody>
</table>
## LIST OF TABLES/FIGURES

<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1. Plan Changes Considered and Implications for Cost Savings and the Benefit Index</td>
<td>7</td>
</tr>
<tr>
<td>Figure 5.1a Benefit Index: U-M Faculty vs. Provost Peers</td>
<td>19</td>
</tr>
<tr>
<td>Figure 5.1b Benefit Index: U-M HHC Staff vs. Local and National Peers</td>
<td>20</td>
</tr>
<tr>
<td>Table 6.1.0 Current Baseline Benefit Index: Local Health Peers And Provost Peers</td>
<td>22</td>
</tr>
<tr>
<td>Table 6.1.1 Cost Savings and Benefit Index: Across-the-Board Benefit Reduction</td>
<td>23</td>
</tr>
<tr>
<td>Table 6.1.2 Cost Savings and Benefit Index: Eliminate Retirement Saving Contribution for Some Part-Time Employees</td>
<td>25</td>
</tr>
<tr>
<td>Table 6.1.3 Cost Savings and Benefit Index: Elimination of Contributions on Certain Types of Income</td>
<td>26</td>
</tr>
<tr>
<td>Table 6.1.4a Cost Savings and Benefit Index: Three- and Five-Year Vesting</td>
<td>28</td>
</tr>
<tr>
<td>Table 6.1.4b Cost Savings and Benefit Index: Increase Waiting Period from One to Two Years</td>
<td>29</td>
</tr>
<tr>
<td>Table 6.1.5 Cost Savings and Benefit Index: Varying Contributions Based on Years of Service</td>
<td>30</td>
</tr>
<tr>
<td>Table 6.1.6 Cost Savings and Benefit Index: Varying Contributions Based on Age and Years of Service Formula</td>
<td>31</td>
</tr>
<tr>
<td>Table 6.1.7 Cost Savings and Benefit Index: Base and Optional Matching Plan</td>
<td>32</td>
</tr>
</tbody>
</table>
Executive Summary

The University of Michigan’s Executive Vice President for Medical Affairs Ora Hirsch Pescovitz, Provost and Executive Vice President for Academic Affairs Martha E. Pollack, Executive Vice President and Chief Financial Officer Timothy P. Slottow, and Associate Vice President for Human Resources Laurita Thomas, sponsored and established the Committee on Retirement Savings Plan and Retiree Health Benefits (CORSPRHB) in July 2013.

Committee Charge

The Committee was charged “to look at market data and make recommendations that would identify annual recurring savings beginning in calendar year 2015 in the General Fund of at least $5 million, all other non-General Fund units of at least $8.7 million, and annual recurring HHC [Hospitals and Health Centers] cost savings of at least $8.5 million, for a total savings target for CY 2015 of at least $22 million. The Committee is encouraged to consider creative approaches that will result in even larger savings. Initiatives that lead to these savings should result in an overall (All Benefits) market position on the Aon Hewitt Benefit Index between 95 and 105 for the University, excluding HHC staff, and movement closer to the market average for HHC staff.”

The Committee was asked to use peer and market data “to examine the structure and design of U-M’s retirement savings plan, review eligibility options, application of waiting periods, and the level of University contribution.”

Furthermore, the Committee was asked “to make recommendations that better align the U-M retirement savings plan with the market, and should also make recommendations regarding retiree health benefits incorporating emerging trends and opportunities to best prepare U-M for current and anticipated changes in the health benefit landscape.”

Committee Process

The Committee, supported by its staff, began work in early September 2013 and completed its report in December 2013. The Committee examined the current retirement plan and a wide range of alternatives to the plan that were designed to produce the cost savings indicated in the charge. The Committee evaluated these changes for adherence to the benefits principles articulated by the University and the Committee, for their cost savings, and for their effect on the competitiveness of the University’s benefits program for recruitment and retention of faculty and staff. The staff provided the Committee with estimates of the overall savings of
alternatives and estimates of their effects on faculty and staff by age, years of service, wages and salary, and gender. Aon Hewitt provided the Committee with estimates of the impact of these changes on the Benefit Index for U-M for retirement savings and overall benefits, distinguished by different groups of employees. The Committee’s charge specifies using the Aon Hewitt Benefit Index to compare the value of the University’s benefits to the values of benefits provided by other comparable institutions known as “Provost Peers.” The Committee conducted an evaluation of the Aon Hewitt methodology and considered other market data, including detailed information on the retirement savings plans of Provost Peers.

Also beginning in September 2013, the Executive Vice Presidents, the Committee, and the Benefits Office staff took a number of steps to communicate with, and get feedback from, the University community. The leadership convening the Committee sent an email to all faculty and staff sharing the charge to the Committee and the composition of the Committee membership. A website and articles in the University Record and in Health System Headlines provided background. Meetings were held with stakeholder groups including the Academic Programs Group, University Senate Assembly, Senate Advisory Committee for University Affairs (SACUA), and Voices of the Staff. Finally, all University faculty and staff were invited to complete an online survey that was conducted during the second week of October.

Shortly after the close of the survey, the Committee assessed its own analysis and the community input.

- The Committee found that the Aon Hewitt index likely overstates the generosity of the University’s retirement savings plan for faculty and campus staff relative to Provost Peers.\(^1\)

- The Committee modeled various changes to the retirement savings plan. These plan changes could produce the mandated cost savings, but only by moving the value of the overall benefit package for faculty and campus staff below average. This finding was essentially an arithmetical necessity since according to Aon Hewitt the current overall benefits are exactly at the average of Provost Peers.

- The input from the University community was overwhelmingly negative. Many of the concerns raised by the University community resonated with the technical discussion of the Committee.

In mid-October, the Committee therefore consulted with the executive sponsors of the Committee, the Executive Vice Presidents and the Associate Vice President of

\(^1\) For purposes of this report, campus staff is defined as all staff outside of Hospital and Health Centers (HHC) staff.
Human Resources for their direction relating to the charge of the Committee. In particular, the Committee asked for guidance on how to balance two components of its charge: cutting costs and maintaining benefits that are competitive with peers. The executive sponsors gave direction that retaining the overall market competitiveness for all benefits was of importance. Specifically, they provided guidance that the Committee not recommend changes in the benefits plan that reduce the overall Benefit Index below the average of Provost Peers defined as an All Benefits Index of 100. The sponsors recognized that this direction would result in lower-than-targeted savings to the General Fund and other funds outside of HHC staff.

The Committee had been prepared to recommend substantial changes to the structure of the retirement savings plan in order to achieve the cost savings mandated in its charge. Because of the clarification of the charge received in late October, the Committee did not make recommendations that would reduce the overall value of benefits below the Aon Hewitt Benefit Index value of 100.

**Analysis of Retirement Savings Plan**

The Committee’s analysis of the retirement savings plan addressed three broad issues: the rationale for the retirement plan (Section 4); how the plan compares to plans offered by Provost Peers (Section 5); and potential changes in the plan that would reduce the University’s costs (Section 6).

**Rationale for Retirement Plan.** The University has long provided a defined-contribution retirement plan for faculty and staff. The rationale for this benefit is both that it provides for a secure income in retirement and that it provides a tax-efficient method of compensating employees. The plan differs substantially from plans typically used in the private sector. U.S. tax law allows public universities to have plans that are substantially more generous than typical 401(k) plans while retaining their tax advantages. This feature of the tax law encourages universities and certain other non-profit institutions to structure their compensation in ways that emphasize tax-deferred income, possibly at the expense of taxable wages and salaries.

**Comparison with Market Peers.** The Committee examined both the Aon Hewitt indexes and publically-available information to assess the competitiveness of the University’s benefits for retirement saving, retiree health insurance, and overall benefits. For faculty and campus staff, the Committee has the following findings.

- According to Aon Hewitt, the overall value of all U-M benefits exactly equals the average of Provost Peers, so any reduction in benefits would by definition make the University’s index below average.
• The value of the U-M retirement savings plan is close to the average of the Provost Peers, and not 7 percent above the average, as the Aon Hewitt index suggests.

• Provost Peers typically provide retiree health benefits, though U-M’s contribution to the cost of those benefits is above average.

Hence, for faculty and campus staff, there is limited opportunity for reducing benefit costs if the aim is to maintain benefits that are average relative to peer institutions.

For HHC staff, the situation is very different. The Aon Hewitt Benefit Index is above average relative to local and national peers for retirement savings, retiree health insurance, and overall benefits. There is substantial opportunity for cost savings in benefits for HHC staff while remaining competitive.

*Alternative Retirement Savings Plans.* The Committee analyzed a wide range of possible changes in the retirement plan that would deliver substantial cost savings (Section 6). The analysis begins with consideration of reductions in the University contribution rate. A reduction of the University contribution from 10% to 9% would achieve the cost savings for faculty and campus staff targeted in the charge. A reduction from 10% to 8% would achieve the targeted cost savings for HHC staff.

The Committee also analyzed a variety of other approaches to achieving substantial cost saving: changes in eligibility for retirement contribution based on part-time employment or type of income; formulas based on years of service or a combination of age and years of service; changes in vesting schedules or waiting periods; and a plan with a mandatory base contribution and optional matching contribution. The report discusses advantages and disadvantages of these approaches. The changes the Committee analyzed together with their implications for cost savings and the benefit index are summarized in Table 1 and discussed in Section 6.

*Analysis of Retiree Health Benefits*

The Committee was charged with examining changes in retiree health benefits for new hires only. The University expects to reexamine the retiree health benefit for all employees within the next few years. The Committee analyzed the market for retiree health (Section 8). The Committee recommends deferring any consideration of changes to retiree health for new hires until the benefit is reexamined for all employees. Elimination of retiree health benefits for faculty and campus staff would reduce the value of overall benefits below 100. There is opportunity for reducing or eliminating retiree health benefits for HHC staff while remaining competitive, but the Committee does not recommend it.
Given the uncertainties around the implementation of the Affordable Care Act (ACA) and the associated exchanges, considering changes in retiree health at this time is not advisable.

**RECOMMENDATIONS**

The Executive Vice Presidents provided guidance that the Committee not recommend changes in the benefits plan that reduce the overall Benefit Index below the average of Provost Peers defined as an All Benefits Index of 100. This guidance implies that the recommended changes cannot meet the cost savings targets in the charge to the Committee. These cost savings targets are part of an overall cost-reduction program at the University. If the benefits programs contribute less to overall cost saving, there will be pressure for greater cost savings from other areas of the budget.

The Committee was requested to recommend retirement cost savings consistent with maintaining U-M benefits at a value no lower than the average of Provost Peers.

- The Committee recommends that all University and employee retirement saving contributions be calculated on base pay (Section 6.1.3).

For HHC staff, there is significant opportunity for reducing retirement saving benefits while remaining competitive with peers. The charge to the Committee spells out different percentage cost savings for different groups of employees, so the charge envisions that benefit programs may differ by groups of employees. Because the Committee is not recommending University-wide changes in the structure of the retirement savings plan, it defers to the appropriate leadership what specific form changes in the retirement plan for HHC staff might take.

- The Committee finds that the retirement savings plan and overall benefits for Hospital and Health Center (HHC) staff exceed those for local and national peers. Accordingly, the Committee finds that there is opportunity for changes in the retirement savings plan for HHC staff that would save the costs targeted for HHC staff in the charge while retaining a competitive benefit package for HHC staff (Section 7.2.2).

The Committee was also charged with examining the retiree health benefit in the context of the current market for health insurance and making recommendations about this benefit for new hires.

- The Committee does not recommend any changes in retiree health benefits for new hires at the present time. For faculty and campus staff, reducing the retiree health benefit would reduce the value of the
overall benefits index below the average of Provost Peers. More generally, given the uncertainty about the marketplace for retiree health benefits currently, the Committee recommends that any changes for new employees be deferred until the future planned review of the retiree health benefit (Section 8).
## Plan Changes Considered and Implications for Cost Savings and the Benefit Index

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<th>Plan Changes Considered</th>
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<th>General Fund Ann Arbor</th>
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<td><strong>Reduce from 10% to 9%</strong></td>
<td>$4,280,000</td>
<td>$5,270,000</td>
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<td><strong>Reduce from 10% to 8%</strong></td>
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<td><strong>Working less than 20 hours per week (&lt;50% appt.)</strong></td>
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<td><strong>Working between 20 -31.99 hours per week (&lt;80% appt.)</strong></td>
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<td><strong>Adopt base pay income approach (exclude certain earning types)</strong></td>
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<td><strong>Vesting and waiting period</strong></td>
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<td><strong>Vesting 5 Yr Cliff</strong></td>
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<td><strong>Vesting 3 Yr Cliff</strong></td>
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<td><strong>Increase waiting period</strong></td>
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<td><strong>Reduce to 5% Years 2 - 5</strong></td>
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<td><strong>Base/Optional/non HHC: 2:1 match</strong></td>
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Sources: U-M (Cost Savings); Aon Hewitt Benefit Index. See Section 6 for details of the plan changes considered.
Committee on Retirement Savings Plan and Retiree Health Benefits
FINAL REPORT

Committee Report

1. Background

1.1 Structure of the Committee

The University of Michigan’s Executive Vice President for Medical Affairs Ora Hirsch Pescovitz, Provost and Executive Vice President for Academic Affairs Martha E. Pollack, Executive Vice President and Chief Financial Officer Timothy P. Slottow, and Associate Vice President for Human Resources Laurita Thomas, sponsored and established the Committee on Retirement Savings Plan and Retiree Health Benefits (CORSPRHB) in July 2013. The ten members were appointed for their expertise and experience. The Committee membership and full Committee charge are listed in Appendices 1 and 2.

1.2 Committee Charge

The Committee was charged “to look at market data and make recommendations that would identify annual recurring savings beginning in calendar year 2015 in the General Fund of at least $5 million, all other non-General Fund units of at least $8.7 million, and annual recurring HHC\(^2\) cost savings of at least $8.5 million, for a total savings target for CY 2015 of at least $22 million. The Committee is encouraged to consider creative approaches that will result in even larger savings. Initiatives that lead to these savings should result in an overall (All Benefits) market position on the Aon Hewitt Benefits Index between 95 and 105 for the University, excluding HHC staff, and movement closer to the market average for HHC staff.”

The Committee was asked to use peer and market data “to examine the structure and design of U-M’s retirement savings plan, review

\(^2\) “Hospital and Health Centers” (HHC) are defined as all departments reporting to the Executive Vice President of Medical Affairs (all of U-M Health System) except for those departments in the Medical School.

“General Fund/Ann Arbor” is defined as all operations of the University’s Ann Arbor Campus funded by the General Fund.

“All Other Units” are defined as the entire University of Michigan not part of the groups above.
eligibility options, application of waiting periods, and the level of University contribution.”

Furthermore, the Committee was asked “to make recommendations that better align the U-M retirement savings plan with the market, and should also make recommendations regarding retiree health benefits incorporating emerging trends and opportunities to best prepare U-M for current and anticipated changes in the health benefit landscape.”

Committee recommendations about changes to the retirement savings plan would be applied to both current and future faculty and staff. Retiree health benefit recommendations would apply to new hires, and not to current faculty and staff.

2. **Process For Developing Recommendations**

The Committee, supported by its staff, began work in early September 2013 and completed its report in December 2013. The Committee examined the current retirement plan and a wide range of alternatives to the plan that were designed to produce the cost savings indicated in the charge. The Committee evaluated these changes for adherence to the benefits principles articulated by the University and the Committee, for their cost savings, and for their effect on the competitiveness of the University’s benefits program for recruitment and retention of faculty and staff. The staff provided the Committee with estimates of the overall savings of alternatives and estimates of their effects on faculty and staff by age, years of service, wages and salary, and gender. Aon Hewitt provided the Committee with estimates of the impact of these changes on the Benefit Index for U-M for retirement savings and overall benefits, distinguished by different groups of employees. The Committee’s charge specifies using the Aon Hewitt Benefit Index to compare the value of the University’s benefits to the values of benefits provided by other comparable institutions known as “Provost Peers.” The Committee conducted an evaluation of the Aon Hewitt methodology and considered other market data, including detailed information on the retirement savings plans of Provost Peers.

2.1 **Communications and Community Input**

Several mechanisms were used to help develop community awareness of the formation and charge of the Committee and the rationale for change.

i. The leadership shared the charge and committee membership in an email communication to faculty and staff
from each U-M campus and the U-M Health System. Additional targeted emails were sent to key constituents.

ii. A website provided background, FAQs and other details. The site also included a video presentation about the scope and work of the Committee.

iii. Articles were printed in the University Record and in the Health System Headlines.

iv. Meetings were held with stakeholder groups including the Academic Programs Group, University Senate Assembly, SACUA, and Voices of the Staff.

v. All University faculty and staff were invited to complete an online survey, which was conducted from October 7 through October 13. See Appendix 3 for a summary of the survey.

In the survey, faculty and staff were asked to respond to questions regarding proposed changes to the retirement savings plan. The survey aimed to discover the function of the benefits program, and how possible changes to the program would impact University faculty and staff. Over 8,500 faculty and staff completed the survey with almost 1,900 respondents providing written comments.

Three major themes were reported in the survey's open comments:

i. The role of total compensation in choosing and continuing to work at U-M: that U-M salaries are lower than peer institutions, and the benefits package was the main reason for choosing and continuing to work for the University. Without these benefits, many respondents say they would consider leaving the University.

ii. The impact of changes should be limited: that changes to the retirement savings plan should only affect incoming employees with existing employees grandfathered.

iii. The impact on recruitment: that cuts to the retirement savings plan would impair efforts to recruit and retain faculty and staff with the experience, skill, and commitment necessary for effective functioning of the University.

Responses in the survey also came in the form of suggestions to the Committee about cost savings while retaining benefits.
2.2 Impact of Additional Data Analysis and Community Input on the Process

Several considerations led to an adjustment of the Committee’s understanding of its charge.

First, the Committee studied the Aon Hewitt Benefit Index in some detail. While it finds much of the information from Aon Hewitt valuable for evaluating the University’s benefit program, it found that the index calculations overstate the generosity of the University’s retirement savings plan relative to Provost Peers. (See Section 5).

Second, the Committee modeled various changes to the retirement savings plan. These plan changes could produce the mandated cost savings, but only by moving the value of the overall benefit package for faculty and campus staff below average. This finding was essentially an arithmetical necessity since according to Aon Hewitt, the current overall benefits are exactly at the average of Provost Peers.

Third, the Committee received substantial input from the University community. It is not an exaggeration to say that this input was overwhelmingly negative (see Appendix 3). While negative reactions to proposed benefit cuts are not unexpected, many of the concerns raised by the University community resonated with the technical discussion of the Committee.

In mid-October, the Committee therefore consulted with the executive sponsors of the Committee, the Executive Vice Presidents and the Associate Vice President for Human Resources for their direction relating to the charge of the Committee. In particular, the Committee asked for guidance on how to balance two components of its charge: cutting costs and maintaining benefits that are average relative to peers. The executive sponsors gave direction that retaining the overall market competitiveness for all benefits was of importance. Specifically, they provided guidance that the Committee not recommend changes in the benefits plan that reduce the overall Benefit Index below the average of Provost Peers defined as an All Benefits Index of 100. The sponsors recognized that this direction would results in lower-than-targeted savings to the General Fund and other funds outside of HHC staff.
The Committee had been prepared to recommend substantial changes to the structure of the retirement savings plan in order to achieve the cost savings mandated in its charge. Because of the clarification of the charge received by the Committee in late October, it did not make recommendations that would reduce the overall value of benefits below the Aon Hewitt Benefit Index value of 100.

The Committee notes that the process of convening the Committee and disseminating its charge was very open, precise and transparent. The EVPs made the charge and membership of the Committee public in a prominent way. The charge clearly laid out in quantitative terms the aims of the Committee. The EVPs also supported broad outreach to the University community. Finally, the EVPs clarified the charge halfway through the Committee’s efforts in response to the Committee’s analysis and the public reactions. The Committee found the EVPs’ transparency, precision, and their willingness to clarify the charge very valuable as it carried out its work.

3. Principles

3.1 Benefit Plan Design Principles

The charge to the Committee noted that the University’s benefit plan designs and cost-sharing policies should adhere to U-M’s guiding principles for benefits to ensure that benefits for U-M will:

- Provide quality programs at affordable cost
- Provide market competitive programs to recruit and retain faculty and staff
- Serve as a responsible fiscal agent
- Enable informed decision making
- Leverage internal and external expertise in the development of innovative benefit designs and programs that promote a culture of health

3.2 Committee Principles and Values

The Committee identified specific retirement savings principles and values. These provided background and context for understanding the evaluation of the retirement plan design and cost savings options. They focused and guided the Committee’s attention on a variety of issues related to market competitiveness, design changes, and types of cost savings options discussed.
In addition to the University’s benefit design principles, the following shaped the discussion regarding the purpose of a retirement plan and the consideration of potential options:

- Market competitiveness of the retirement plan should be maintained since it is a decisive element in the recruitment and retention of faculty and staff.
- The University should continue to be responsible to its faculty and staff by providing a meaningful retirement savings program that facilitates the timely and orderly transition from the workforce into retirement, while providing economic security once retirement has occurred.
- Fairness and equity with regard to the benefit programs provided is an important institutional hallmark.
- Tax and employment law provisions encourage universities, especially public universities, to make more extensive use of tax-deferred retirement savings plans than is common in the private sector; these laws and regulations allow the University to deliver a benefit package that maximizes value to U-M employees while minimizing costs to the University.
- The retirement plan design should facilitate high levels of participation and appropriate savings rates among individuals.
- Changes to the plan should be understandable and effectively communicated.

The Committee recognized that some of these values need balancing when they have competing tradeoffs. For example, rewarding length of service versus the value of an early start on savings or the current plan design that is uniform across all campus areas and employees versus a plan that would recognize the differences in markets for campus areas or groups of employees.
4. **Retirement Savings Plan**

4.1 **Current Retirement Savings Plan Design**

Upon completion of a one-year waiting period, regular faculty and staff with a 1% appointment or greater lasting for at least four months are eligible to participate in the University retirement savings plan. Faculty and staff who have completed the waiting period contribute 5% of salary while the University contributes 10%.

New hires in the waiting period may contribute 5% of salary in the basic retirement plan while the University does not contribute until 12 months of service is completed.

The University contribution applies to earnings up to $255,000 (2013 earnings limit.)

For employees with union contracts, retirement saving is a bargained-for benefit. Current union contracts that have a retirement saving benefit have the same plan as the non-bargained-for employees.

For eligible faculty and staff, enrollment in the retirement savings plan becomes compulsory when an individual meets the following three criteria:

- age 35 or older
- has a 100% appointment effort, and
- has completed two years of service

Individuals who meet these three criteria may choose between the full contribution rate and a Reduced Benefit Option (RBO). These individuals who choose not to contribute 5% receive a reduced University contribution of 5% instead of 10% on earnings below the FICA wage base ($113,700 in 2013.)

4.2 **Tax Advantage Efficiencies**

In general, the U.S. tax system includes several provisions that encourage retirement saving by U.S. taxpayers. In many circumstances, amounts that employees and employers contribute to retirement accounts can be excluded from that year’s taxable income, thereby affording immediate tax savings compared to a situation in which all compensation were taxable. And in almost all circumstances the investment returns generated by retirement accounts are untaxed at the time they are earned.
In a typical retirement account an employee therefore is untaxed on annual contributions to the account and on annual earnings by the account, and will pay tax on these funds only when they are withdrawn in retirement. The exclusion of retirement contributions and retirement account returns from annual taxable income permits individuals to defer paying taxes on income and to earn returns on their retirement saving that compounds tax-free. Even though there is tax due when funds are ultimately withdrawn, many taxpayers face lower income tax rates when retired than when they were working; and even if tax rates in retirement are the same as those during the working life, a taxpayer will generally benefit from deferral of tax liability up to the point of retirement.

4.2.1 Tax-Advantaged Savings in Public Universities

As a result of these favorable tax provisions, employees generally stand to benefit from receiving significant amounts of their compensation in the form of retirement savings. There are, however, restrictions on an employer’s ability to offer tax-favored retirement accounts, and the tax law treats different types of employers differently. Public higher education institutions, such as the University of Michigan, offer 403(b) and 401(a) plans, which are very distinct from the 401(k) plans offered by private sector employers. For example, nondiscrimination rules significantly affect plan design and employer contributions of private sector employers, yet these rules do not apply to public universities. Private universities and for-profit employers are subject to these provisions, which extensively restrict employer contributions. The absence of these constraints facilitates the ability of public universities, such as the University of Michigan, to provide contributions that are typically larger than what for-profit employers provide.

4.2.2 Maximizing Voluntary Tax Deferral Savings

In addition to a base retirement plan, public higher education institutions may also offer savings vehicles like a 457(b) plan and a 403(b) plan. These vehicles have higher employee contribution limits than 401(k) plans. In the case of U-M, employees are entitled to make additional contributions to their 403(b) and 457(b) retirement plans to augment their retirement savings. The University does not match these contributions, but amounts voluntarily contributed nonetheless generate tax savings in the same
way as do mandatory contributions. The University retirement provisions are structured to permit employees to contribute as much as possible voluntarily before hitting federal contribution limits. The reason why U.S. law permits public educational institutions the flexibility to structure retirement benefits in this way is that public educational employees typically do not receive tax-favored forms of compensation common in the for-profit sector, such as company stock option plans and profit sharing. U-M designs its plans to provide a comprehensive portfolio of products that enable faculty and staff to maximize the potential to save for retirement in a manner that is highly tax-efficient.

5. Market Competitiveness Considerations

5.1 Aon Hewitt Benefit Index

One of the University’s tools for assessing whether its benefit plans are competitive is the Aon Hewitt Benefit Index. Aon Hewitt regularly updates its benefits database. Its Benefit Index compares the relative value of an employer’s benefits with the benefits provided by the employer’s peers. A base score of 100 equals the average of a peer group’s benefit plan values.

The University commissioned Aon Hewitt to conduct the 2013 Benefit Index Study, comparing U-M to a list of 23 peer institutions that we compete with for faculty talent. This list is referred to as the “Provost Peer List.” In some cases, U-M benefits for faculty and campus staff are compared to institutions on the Provost Peer List, while benefits for HHC are compared to those for local and national peer institutions of the U-M health system. See Appendices 4 and 5 for both the Provost Peer List and the local and national healthcare peer list that are used in these comparisons. The Aon Hewitt Benefit Index provides aggregated information beyond what is readily available publicly. Aon Hewitt has access to confidential data on peers that allows it to calculate costs and values of plans on a comparable basis. The Committee both relied on these calculations and critically evaluated them.

The 2013 Aon Hewitt study, which uses data collected in 2012, reports a Benefit Index score of 107 for the contributions the University makes to the retirement plan on behalf of faculty. The meaning of a score of 107 is that Aon Hewitt’s estimate of the value of the University’s contribution to the retirement plan is 7% above the average of the University’s peers.
A benefit index that compares the value of U-M benefits relative to peers is an important input into evaluating how to reduce costs while maintaining competitiveness. The following should be considered in the analysis of whether to increase or decrease benefits based on the Aon Hewitt Benefit Index:

First, the Benefit Index attempts to be comparable across institutions. To do so, it uses procedures that attempt to calculate value and cost for the typical (average) employee. In particular, the Index uses proprietary assumptions and standard actuarial techniques to calculate and compare estimated average component and total benefit values.

Second, the Benefit Index should be understood as providing an estimate based on a single set of data and on one type of calculation; it is not intended to provide a precise data point, but instead provides a directional perspective on market conditions for organizational review and decision making.

Third, the Benefit Index uses average in two ways: the benefit of the average employee, and compares U-M to the average of peer institutions. Averages tend to be misleading in a number of ways. Most importantly, other statistics such as the median might better represent how U-M compares to its peers. Additionally, by valuing benefits using calculations based on averages, the index in no way takes into account the distributional impact.

Fourth, the proprietary nature of the Aon Hewitt calculations results in considerable opaqueness. The index has built-in assumptions that are difficult to evaluate, thus it is hard to use it as a decision making tool. This opaqueness becomes particularly problematic when the index is used to make fine distinctions rather than indicate broad comparisons that can be checked against external data.

For these reasons, the Committee believes it is important for decision makers to evaluate carefully the robustness of the Aon Hewitt Index data, particularly when Index scores are within or close to an acceptable range. For example, the reliability of an Index score can be assessed by making comparisons with the publicly available benefits information about University peers, using other benefits surveys, and considering other appropriate information, especially over a period of time. The Committee finds that the Aon Hewitt indexes are not a precise tool.
Nonetheless, they do contain some useful information about the value of benefits and how the University’s benefits compare with peers.

As reflected in the charge document and in the benefit index data, competitiveness differences exist by groups of employees, namely faculty, campus staff, and HHC staff. The Committee focused on two components of the Benefit Index: the overall value of benefits (All Benefits) and the value of retirement savings. The U-M Faculty and Provost Peers Index in Figure 5.1a shows the “All Benefits” value index and its components, such as retirement income. Here and throughout the report, the “Provost Peers” index refers to the relative value of benefits for the U-M faculty and campus staff relative to 23 institutions selected by the Provost for comparison. The overall All Benefits Index is at 100, that is, at the average of the peer institutions.

According to the Aon Hewitt Index, the value of the retirement contribution made by U-M is seven percent above average, while the value provided by retiree health is substantially above average. These above-average components that are targeted in the charge to the Committee are offset by below-average benefits in areas such as long-term disability and dependent tuition. Hence, reducing the index values for the above-average components would make the All Benefits Index below average. More specifically, taking the Aon Hewitt Benefit Index at face value, reducing the retirement component to average would reduce the All Benefits Index to 98 (100 – 7 x 0.23 where 0.23 is the weight of retirement saving in the overall index). Taking retiree health to average would reduce the All Benefits Index to 99 (100 – 23 x 0.03 where 0.03 is the weight of retiree health in the overall index).
Figure 5.1a
Benefit Index: U-M Faculty vs. Provost Peers

Source: Aon Hewitt Benefit Index.
Note: Chart shows the University’s employer paid value versus the Provost Peers for faculty and campus staff.

The Committee did not, however, take the Aon Hewitt Index at face value. Rather, the Committee carefully examined calculations and feels that the 10% retirement contribution is much closer to the central tendency of peers than the Index value 107 suggests. Specifically, examination of actual contribution rates indicates the following:

i. The median basic contribution rate of peers is 9.5.
ii. A number of peers increase contribution rates above the basic rate for threshold levels of income or years of service.
iii. This comparison group, with defined contribution plans comparable to the University’s, excludes several peers with defined benefit plans that tend to be more generous.

Hence, while the 10% University contribution rate is somewhat more generous than the median basic contribution rate for peers, it is much closer to par than the Aon Hewitt Index implies. See Appendices 6a and 6b for a listing of university contributions of Provost Peer institutions.
The competitive comparison for HHC staff differs considerably whether compared to the local or national peers for health care. The All Benefits Index for HHC staff is above average at 112 and 117 respectively for the local and national markets. Retirement saving and retiree health insurance are substantial drivers of the overall index. The retirement saving benefit is over 60 percent more generous than either local and national peers. Further, many HHC peers do not provide any retiree health benefit, a circumstance that pushes the U-M benefit so far above average.

These differences are large enough and consistent with other data to support that the benefits are above average for HHC employees. The charge to the Committee explicitly contemplates having different benefits for HHC staff. The Committee believes that the markets for HHC staff are sufficiently different from those for the rest of the University to warrant consideration of having the HHC staff benefits be different from those elsewhere in the University.

Figure 5.1b
Benefit Index: U-M HHC Staff vs. Local and National Peers

![Benefit Index Chart](source: Aon Hewitt)

6. **Cost Savings Options Considered: Retirement Plan Savings**

In keeping with the charge, the Committee considered a number of approaches to achieve the cost savings target of providing recurring annual savings in the General Fund of at least $5 million, other non-General Fund
units of at least $8.7 million, and in HHC of at least $8.5 million beginning in calendar year 2015. It examined the structure and design of the retirement savings plan; eligibility options; waiting periods; and the level of University contribution. In framing the options to be modeled, the Committee relied on:

- The principles for benefits discussed in Section 3 of the report.
- Data on the parameters of benefit plans that were in use at peer institutions.
- Its own expert judgment as to what plans might be effective and practical in serving the needs of faculty and staff while delivering the substantial savings in the charge.

The Committee discussed a range of changes in the retirement plan that would address the objectives of meeting the benefits principles as articulated in Section 3; that would be an effective part of the benefit package; and that would deliver substantial cost savings. It modeled various plan changes:

- Benefit staff experts provided estimates of the cost savings by applying the new plan parameters to the population of employees working during fiscal year 2013.
- Aon Hewitt provided estimates of the retirement and overall benefits indexes under the alternative plan parameters. The indexes presented are for U-M faculty and campus staff versus Provost Peers and HHC Staff versus Local and National Peers.

The Committee considered additional plan changes that are not detailed here because they were viewed as not being as effective at meeting the objectives. They are described at the end of this section.

Finally, the Committee continued to consider plan changes that would reduce the overall index to below 100. It viewed its charge as to model various changes in benefit structure and to evaluate them for cost savings, competitiveness and general pros and cons. This work was well underway before the clarification of the charge by the Committee’s sponsors in late October. It remains useful information even if the plan changes are not under consideration for immediate adoption. The Committee was prepared to recommend substantial changes to the structure of the retirement savings plan in order to achieve the cost savings mandated in its charge. Because of the clarification of the charge received by the Committee, it did not make recommendations concerning the alternatives that were judged to be out of scope of the committee’s charge because they would reduce the overall value of benefits below an index value of 100.
To summarize where the Committee left the discussion, there was little support for an across-the-board cut in the University contribution across the whole University, though that step might be the appropriate change if one part of the campus were adopting this plan design. The Committee saw the pros and cons of the plan designs based on years of service or an age/years of service formula versus the plan design combining mandatory and voluntary contributions. Had the Committee been asked to deliberate further about these options, it might have compromised on a hybrid design with base and voluntary matches where the match rate was a function of a formula relating to age and years of service. Nonetheless, because of the guidance the Committee received from its sponsors in late October, the Committee did not attempt to reach a consensus about the relative merits of the major plan design changes.

6.1 Analysis of Alternatives for Retirement Saving

The Committee considered multiple approaches in developing cost savings options such as across-the-board reductions in the contribution rate, approaches that adjusted the contributions based on individual eligibility, income, age, years of service, and hire date, and combinations of these individual attributes. This section discusses the likely impact of several alternatives representing different approaches. In Table 6.1.0, the current baseline Benefit Index is reported.

<table>
<thead>
<tr>
<th>Table 6.1.0</th>
<th>Current Baseline Benefit Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Health Peers and Provost Peers</td>
<td></td>
</tr>
<tr>
<td>Hospital and Health Centers (Staff)</td>
<td>General Fund Ann Arbor</td>
</tr>
<tr>
<td>Baseline Benefit Index</td>
<td>Local Health BI</td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>161</td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>112</td>
</tr>
</tbody>
</table>

Source: Aon Hewitt (Benefit Index)

6.1.1 Reducing the University Contribution Rate

Reducing the retirement contribution from 10% to 9% for U-M faculty and campus staff and from 10% to 8% for HHC staff is the first option the Committee considered. These changes in plan parameters generate almost exactly the cost savings in the charge to the Committee. The Committee understands that the charge was based on calculating this benefit reduction.
Table 6.1.1 shows the cost savings and benefits indexes. Subsequent tables will have similar formats. This table reflects the across the board cut in the University contribution from 10% to 8% for HHC staff and from 10% to 9% for the balance of faculty and staff. The dollar figures give the savings to the University had these changes been in place. The savings are recurring and will increase with the size of the wage and salary base.

The benefits indexes are shown for two comparisons: HHC staff versus local peers and faculty and campus staff versus Provost Peers. The rows show the Retirement Savings and All Benefits Indexes with these changes taken into account. Recall that the current retirement and All Benefits Indexes for faculty are 107 and 100, respectively and for HHC staff, they are 161 and 112 respectively. See Table 6.1.0. Hence, the across-the-board reductions in this change would place overall faculty benefits 3% below the peer group. It would, in contrast, leave HHC staff, still above average.

<table>
<thead>
<tr>
<th>Source</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce from 10% to 9%</td>
<td>$4,280,000</td>
<td>$5,270,000</td>
<td>$9,190,000</td>
<td>$18,740,000</td>
</tr>
<tr>
<td>Benefits Index</td>
<td>Local Health BI</td>
<td>Provost Peers BI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>145</td>
<td>96</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>109</td>
<td>97</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Source</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce from 10% to 8%</td>
<td>$8,560,000</td>
<td>$10,540,000</td>
<td>$18,390,000</td>
<td>$37,490,000</td>
</tr>
<tr>
<td>Benefits Index</td>
<td>Local Health BI</td>
<td>Provost Peers BI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>129</td>
<td>86</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>107</td>
<td>95</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index)

The above calculations leave open the level of the employee contributions. The EVPs, when calibrating the cost saving for the charge, perhaps had in mind that the two-for-one match, would continue, so the employee contribution would decrease to 4.5% (4.0% for HHC staff). The Committee notes that this would lead to an overall retirement saving rate of 1.5 percentage points lower (3.0 percentage points for HHC staff). Given that many employees are likely saving too little for retirement (see Section 9) and that the University’s basic plan
is most or all of retirement saving for most employees (see survey in Appendix 3), the Committee is concerned that this cut in saving will impair retirement security. On the other hand, it is reluctant to frame a proposal that decreases the University contribution and increases the employee contribution because many employees, especially those who are young or lower income, will find it hard to absorb what amounts to a cut in take-home pay. Accordingly, the across-the-board option, if it were adopted, should be accompanied with policies to encourage supplemental saving for retirement as described below in Section 9.

**Discussion:** The approach of cutting across-the-board the University contribution and maintaining the two-for-one match achieves the cost savings desired. It is minimally complex because it does not change plan rules, only contribution rates. It will be clear to employees that compensation is being cut across the board by 1 or 2 percentage points.

The Committee does not recommend this approach for the University overall. It puts the benefit index significantly below average and thereby will compromise the ability to recruit and retain the best faculty and staff; it is tax-inefficient, delivers a given amount of compensation at higher cost; and it would lead to a significant reduction in retiree saving.

As discussed below, the situation for the HHC staff is very different with respect to its market, so HHC administration may want to consider this option. While it would be a significant cut in HHC staff benefits, given that HHC retirement benefits are far above market, there is room for making adjustments to achieve cost savings without impairing competitiveness.

### 6.1.2 Changing Eligibility Criteria for Part-Time Employees

The Committee considered cost savings change based on tightening the eligibility criteria for employees to participate in the retirement savings plan and to receive a University contribution. Currently, employees with at least a 1% appointment are eligible for the University contribution. These changes included eliminating the University contribution for appointments less than half time.
(less than 20 hours per week) or appointments considered part-time (20 – 31.99 hours per week).

**Table 6.1.2**

Cost Savings and Benefits Index

Eliminate Retirement Saving Contribution for Some Part-Time Employees

<table>
<thead>
<tr>
<th>Working Less than 20 hours per week (&lt;50% appt.)</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Health BI</td>
<td>190,000</td>
<td>100,000</td>
<td>210,000</td>
<td>500,000</td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>161</td>
<td>107</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>112</td>
<td>100</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Working between 20 - 31.99 hours per week (&lt;80% appt.)</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Health BI</td>
<td>1,910,000</td>
<td>990,000</td>
<td>3,090,000</td>
<td>5,990,000</td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>161</td>
<td>107</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>112</td>
<td>100</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index).

The change in eligibility to participate in the retirement savings plan from the current 1% appointment to working more than half time (50% or more) or the change to full-time benefits as the basis for participation with eligibility for a University contribution has greater alignment with the University’s current approach to health benefits eligibility. Currently for health benefits the U-M contribution requires at least a 50% appointment for eligibility for medical benefits.

**Discussion:** The Committee recommends against this change in eligibility. The version that limits benefits to those with at least half-time appointments saves little money. To save significant amounts, eligibility would have to be increased to those with at least 75 or 80 percent appointments. Many employees working between 51 and 80 percent time have very similar jobs and make very similar contributions to the University as do full-time employees.

Additionally it should be noted that a part-time workforce is essential in maintaining appropriate staffing levels for the 7 day/24 hour schedules in U-M Hospitals. This approach
may pose operational issues for other units as well, that rely on recruitment and retention of part-time workers. It also unsettles expectations of long-service part-time employees. Accordingly, the Committee feels that such a change would be highly disruptive and impair the University’s ability to employ such part-time employees. Note that the plan changes modeled in this section do not affect the Aon Hewitt indexes because the indexes are calculated for full-time employees. The Committee views this as an artifact of assumptions used to calculate the index. It is an example where making a decision based on the index without reference to the actual circumstances would be highly problematic.

6.1.3 Changing the Definition of Income Used to Calculate Contributions

Currently, the University uses a very broad definition of income when computing retirement contributions. Table 6.1.3 projects cost savings based on the elimination of the U-M contribution on certain types of income. Excluded income (i.e. those projected to not be eligible for retirement contributions under this model) include administrative and added duties differentials, faculty honors, overtime, and shift differentials, and payments for cash out of vacation accruals.

<table>
<thead>
<tr>
<th>Adopt Base Pay Income Approach (exclude certain earning types)</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adopt Base Pay Income Approach (exclude certain earning types)</td>
<td>$1,790,000</td>
<td>$950,000</td>
<td>$1,690,000</td>
<td>$4,430,000</td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>Local Health BI</td>
<td>Provost Peers BI</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>148</td>
<td>107</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>110</td>
<td>100</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index)

**Discussion:** This plan change has no effect on the Provost Peers index because the Aon Hewitt Benefit Index does not reflect these sources of income for faculty. Sixteen of the twenty-three Provost Peer institutions report paying retirement on base pay. This plan change could be made
without substantially altering the competitive position for recruitment and retention. See Appendix 7a. For HHC peer comparisons in the local and national markets, the majority of employers do provide retirement plan contributions on base pay and other forms of compensation, such as overtime and bonus pay. See Appendix 7b. This approach does have a modest effect on lowering the HHC Staff index but still leaves it well above average for both all benefits and retirement savings.

**Recommendation:** The Committee recommends that University and employee contributions be limited to base pay. Because they serve as an important component of overall compensation, physician incentive pay and faculty summer compensation for teaching or research would continue to be eligible for retirement contributions.

6.1.4 **Vesting and Waiting**

In 2009, the Committee to Study Vesting Options for the Retirement Savings Plan considered changes to the retirement plan that included vesting and waiting. That committee recommended the one-year waiting period that is part of the current plan design. This Committee also considered additional changes to vesting and waiting. The Committee feels that further changes in vesting or waiting are not attractive options when combined with other major changes in the retirement benefits such as changes in the contribution schedules across-the-board, as a function of years of services, or with a voluntary match. (See Sections 6.1.1 and 6.1.4 - 6.1.7.) They become more worthy of consideration as part of an incremental approach to cost savings such as in combination with adjustments to eligible income (6.1.3).

**Vesting.** Table 6.1.4a shows the cost and benefit implications of vesting the University’s contribution only after 3 or 5 years. Vesting recognizes the value of long-service faculty and staff while also providing a retention incentive to earn eligibility. The larger savings come from the five-year vesting. The savings from vesting in general and the three-year vesting in particular, are reduced by the existing one-year waiting period.
Table 6.1.4a  
Cost Savings and Benefit Index  
Three- and Five-Year Vesting

<table>
<thead>
<tr>
<th>Vesting 5 Yr Cliff</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,180,000</td>
<td>$1,450,000</td>
<td>$2,520,000</td>
<td>$5,150,000</td>
<td></td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>Local Health BI</td>
<td>151</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>Provost Peers BI</td>
<td>110</td>
<td>98</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Vesting 3 Yr Cliff</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>$340,000</td>
<td>$420,000</td>
<td>$740,000</td>
<td>$1,500,000</td>
<td></td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>Local Health BI</td>
<td>157</td>
<td>104</td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>Provost Peers BI</td>
<td>111</td>
<td>99</td>
<td></td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index)

**Discussion:** Adopting vesting would reduce the value of the retirement plan because, even in ideal circumstances, there is attrition. New hires are aware of this, and vesting reduces the value to them. On the other hand, in an environment where there is an imperative for cost savings, vesting is a relatively attractive option because it does, by definition, not harm individuals who have a long-term commitment to the institution.

Several considerations apply to implementing a vesting feature to the plan. First, the Committee feels that five-year vesting would severely hurt the competitive position. Second, the Committee notes that third-year reviews are common for new hires in the instructional track, so three-year vesting would remove any financial issue for such reviews. Third, vesting should only apply to new employees, so any cost saving would be deferred.

*Increasing the Waiting Period.* Table 6.1.4b shows the analysis for delaying eligibility for the University retirement savings contribution to two years of service from the current one year waiting period.
Table 6.1.4b
Cost Savings and Benefit Index
Increase Waiting Period from One to Two Years

<table>
<thead>
<tr>
<th>Increase Waiting period</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$1,840,000</td>
<td>$2,270,000</td>
<td>$3,960,000</td>
<td>$8,070,000</td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td>150</td>
<td></td>
<td>101</td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>110</td>
<td></td>
<td>99</td>
<td></td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index)

Discussion: Increasing the waiting period from the current one year to a two year option would place the U-M plan behind almost three quarters of our peer institutions. There is concern that any apparent savings would not offset the increased cost of recruiting highly desirable faculty and staff who are at a later point in their career, are receiving higher contributions from their current institution and have a higher salary, and who are beginning to think more seriously about the need to save for retirement.

The Committee therefore recommends against extending the waiting period because it would make our retirement package increasingly uncompetitive.

6.1.5 Vary Contributions Based on Years of Service

The Committee considered several options for having a years-of-service phase-in for retirement contributions. Table 6.1.5 shows an alternative where the University contribution is limited to 5% in the second through fifth years of service and then 10% for years of service thereafter. The one-year waiting period is retained. The General Fund Ann Arbor cost savings and benefit index implications are nearly identical to the across-the-board reduction of the University contribution by 1 percentage point in Table 6.1.1. This option would therefore meet the cost savings target of the charge for the main campus. It would meet less than half of it for the HHC staff. The employee contribution would remain 5 percent.
Table 6.1.5  
Cost Savings and Benefit index  
Varying Contributions Based on Years of Service

<table>
<thead>
<tr>
<th></th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce to 5% Years 2 - 5</td>
<td>$4,020,000</td>
<td>$4,945,000</td>
<td>$8,630,000</td>
<td>$17,595,000</td>
</tr>
<tr>
<td>Bi Ret. Savings</td>
<td>Local Health Bi</td>
<td>Provost Peers Bi</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bi All Benefits</td>
<td>139</td>
<td>96</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index).

Discussion: The years-of-service change rewards employees who have a long-term commitment to the institution. It could allow employees eventually to receive the current level of University contribution after substantial service to the University. The Committee generally supported this aim, but notes that a years-of-service approach also has problems. It decreases saving early in career and therefore reduces tax-deferred compounding. It may also add to salary pressure at time of hire, or place the University in an adverse position for recruitment. Additionally, the cost savings would be deferred because the years-of-service requirement could only be imposed for new hires. Given that not all employees work their entire careers at the University, the years-of-service formulation could adversely affect the recruitment of more senior employees disproportionately.

6.1.6 Age and Service Formulas

The Committee considered various formulas based on age and years-of-service. Such a formula has precedent in other areas of benefits, for example, the calculation of eligibility for retirement. It also balances some of the characteristics of the pure years-of-service formula while offsetting some of its problems with the recruitment of mid-career employees. In the plan change presented in Table 6.1.5, the University contribution is 5 percent after the one-year waiting period. It then increases to 10 percent according to the following formula:

- Age (Maximum Points = 10): An employee would receive 1 point at age 31, 2 points at age 32, and up to 10 points at age 40.
- Years of Service (Maximum Points = 10): An employee would receive 1 point for every year of
service. An employee with 5 years of service would receive 5 points and an employee with 10 years of service would receive 10 points.

- The Age and Years of Service points are then added together and divided by 4 to get the additional contribution rate in percentage points.

For example, a 35 year old employee with 5 years of service would have 10 points yielding a total University contribution of 7.5 percent. An employee with 20 points would have University contribution of 10 percent. The employee contribution would remain 5 percent. The cost savings and index implications are similar to those for the years-of-service plan.

### Table 6.1.6
Cost Savings and Benefit Index
Varying Contribution Based on Age and Years of Service Formula

<table>
<thead>
<tr>
<th>Points: YOS and Age</th>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>BI Ret. Savings</td>
<td>$4,120,000</td>
<td>$4,530,000</td>
<td>$10,190,000</td>
<td>$18,840,000</td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>134</td>
<td>105</td>
<td>99</td>
<td>105</td>
</tr>
</tbody>
</table>

Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index)

**Discussion:** Similar to the plan change based on years of service alone, this formula allows employees with a combination of years of service and age to receive a 10% University contribution. It will make the benefits package less competitive in ways similar to the pure years-of-service formula, though less dramatically so for mid-career recruitments. It also shares the problem of deferring tax-deferred compounding of retirement savings. Again, the cost savings would be phased in because the formula could be applied only to new hires.

### 6.1.7 Base and Optional Matching Plan

The Committee considered a hybrid plan that would combine a mandatory contribution and an optional contribution, both with matches. In order to achieve the savings for the HHC staff targeted by the charge to the Committee, the match rate would be different for HHC staff and for faculty and campus staff.
There would be a mandatory 5% employee contribution matched by a 5% University contribution.

There would be an additional, optional employee contribution of contribution of between 0 and 2.5%

- For faculty and campus staff, the optional contribution would be matched 2 for 1 by the University for a maximal additional University contribution of 5%
- For HHC staff, the optional contribution would be matched 1 for 1 for the University for a maximal additional University contribution of 2.5%

For income above the FICA wage base, the additional 2.5% employee contribution and the corresponding University match would be mandatory rather than optional.

### Table 6.1.7

<table>
<thead>
<tr>
<th>Cost Savings and Benefit Index</th>
<th>Base and Optional Matching Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sources: U-M (Cost Savings); Aon Hewitt (Benefit Index)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hospital and Health Centers (Staff)</th>
<th>General Fund Ann Arbor</th>
<th>All Other Units</th>
<th>Total Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base/Optional HHC: 1:1 match</td>
<td>$13,325,000</td>
<td></td>
<td>$13,325,000</td>
</tr>
<tr>
<td>Base/Optional/non HHC: 2:1 match</td>
<td>$7,230,000</td>
<td>$10,885,000</td>
<td>$18,115,000</td>
</tr>
<tr>
<td>Local Health BI</td>
<td>114</td>
<td>103</td>
<td></td>
</tr>
<tr>
<td>Provost Peers BI</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI Ret. Savings</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI All Benefits</td>
<td>104</td>
<td>99</td>
<td></td>
</tr>
</tbody>
</table>

Cost estimation: For this plan change, it is necessary to make a behavioral assumption about the take up of the optional matching plan in order to estimate its cost. The cost estimates are based on assuming that employees take up half the optional match opportunities.

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3 Making the base and additional contributions mandatory above the FICA ceiling precisely parallels the current retirement plan that makes the 5 percent employee contribution mandatory above the FICA ceiling. Making the contributions above the FICA ceiling mandatory is necessary for preserving the 401(a) tax treatment. Note that it does not increase the opportunities for matches for high-income employees, but simply requires a level of participation that is optional at lower incomes.

4 The Committee requested Aon Hewitt to do an independent analysis of the likely take-up of the optional match. Its estimates were very similar to those shown in the table.
Discussion: As with the plans based on years of service and a formula based on years of service and age discussed in the previous two proposed plan changes, this plan change permits faculty and campus staff the potential to achieve a 10% University contribution in some circumstances. In the plan changes discussed in Sections 6.1.5 and 6.1.6, the 10% contribution is achieved through the passage of time. That involves sacrificing lower benefits earlier in return to higher benefits later. In this plan, there is a sacrifice to get the highest match rate, but instead of waiting, what is required is a higher employee contribution.

This plan increases retirement saving for faculty and campus staff that choose to participate fully. Given that there are many reasons for employees to save more rather than less, this feature of the plan is an advantage.

The cost savings from this plan change comes from incomplete participation in the optional match. This has different distributional features than the reduced participation by years of service or the age/years-of-service formula in the previous plan change. On the positive side, since this plan has an optional component, it targets the benefit to those who value it most and are willing to make an incremental contribution to obtain it. On the negative side, there is a serious concern that the take-up rates of the optional match will be lower for younger or lower income employees. The low take-up of Supplemental Retirement Accounts (SRAs) among lower income employees suggests that this will be the case.

6.2 Relationship between Cost Savings and Benefit Index Calculations

The tables in this section and the summary Table 1 in the Executive Summary compare the plan changes considered, the cost saving, and Aon Hewitt’s calculation of the change in the retirement and overall Benefits Index. The Committee notes that the benefit index implications for plan changes with similar cost saving can be quite different. Some of the reasons for the differences are definitional, for example, plan changes affecting part-time workers do not affect the Aon Hewitt indexes. Other reasons for the differences reflect how Aon Hewitt calculates the index to present the average employee. In several plan changes modeled in Section 6, the faculty and campus staff All Benefits
Index changes from 100 to 99 despite different changes in the retirement savings index. The common 1 percentage point change in the index is due to rounding. In any case, the index obscures substantial changes in the value of retirement benefits. This issue provides a cautionary note for relying solely on the Aon Hewitt Benefit Index to evaluate the competitiveness of the range of plan changes considered.

6.3 Plans Discussed, but Not Modeled

The Committee also discussed several types of plan modifications that it does not model because it believes they are not advisable. These include (1) plans based on age alone and (2) plans with contributions based on income.

6.3.1. Age

In the initial discussions, the Committee discussed options where contributions were reduced until certain ages, e.g., 35 or 40 years old, were reached. In the survey, there was overwhelming preference for a years-of-service rather than age criterion. Similarly, the Committee felt employment at the University could be defended as meriting additional compensation in a way that age alone could not. Therefore, the Committee abandoned consideration of formulas based on age alone.

The Committee did not consider formulas where the retirement saving benefit declined with age. Laws and regulations against age discrimination generally forbid discrimination against individuals over the age of 40. Similarly, the Committee did not consider formulas that discontinued retirement contributions after a certain number of years of service because they have the effect of discriminating against older employees who have devoted most of their careers to the University.

6.3.2. Income

A number of peers have contribution rates that increase at a given income threshold. There is a rationale for such plans because the contribution for Social Security and accrual of Social Security benefits is capped. The Committee did not consider such plans because it felt that having retirement contributions proportional with income once eligibility requirements had been met is the best way to keep
retirement savings a meaningful part of compensation while maintaining equity. The same considerations argue for not capping retirement contributions according to income beyond the caps that currently apply.

7. Retirement Savings Plan Findings and Recommendations

7.1 Campus Areas: Ann Arbor, Dearborn, Flint

7.1.1 Findings

After reviewing the Aon Hewitt Benefit Index, having detailed conversations with Aon Hewitt about its report, carefully scrutinizing and comparing the benefits of the U-M Provost Peers, and considering other publicly available survey results, the Committee’s conclusion is that only modest changes in the retirement plan for University staff and faculty are appropriate at this time. More significant cuts would jeopardize the University’s ability to recruit and retain faculty and staff.

The Committee examined a number of approaches to achieving the cost saving target stated in the charge. The plan changes studied included an across-the-board reduction of retirement contributions, changing the employment and income eligibility for retirement contributions, increasing the waiting period for contributions or eliminating immediate vesting of contributions, phasing-in contributions as a function of age or years-of-service, and creating a plan with a mandatory base contribution and optional matching contribution. Except as noted in the recommendation below, changes in the plan that would produce substantial cost savings would also substantially reduce the value of the retirement benefit and the overall benefit. The cost saving in the charge to the Committee for these campus areas corresponds to reduction in the value of benefits of approximately one percent of wage and salary income. All of the plan changes that meet the cost savings goal would reduce the overall value of benefits in these campus areas to below average, and specifically, to below a value of 100 for the Aon Hewitt All Benefits Index relative to Provost Peers. Therefore, in keeping with the guidance from the Executive Vice Presidents that the Committee not recommend plan changes that would reduce the overall Benefits Index to lower than 100; the Committee does not recommend changes in the
general structure or in the contribution rate of the retirement savings plan for faculty and campus staff.

**7.1.2 Recommendations**

The Committee examined several changes in the retirement savings plan that would yield cost saving in these campus areas, maintain the competitiveness and effectiveness of the benefit, and adhere to the principles articulated by the University and Committee while being consistent with not reducing the Aon Hewitt overall benefit index to lower than 100 relative to Provost Peers.

**RECOMMENDATION:** The Committee recommends that all University and employee retirement saving contributions be calculated on base pay (Section 6.1.3). Certain categories of income including administrative and added duties differentials, faculty honors, overtime and shift differentials, and payments for cash out of vacation accruals would not be eligible for retirement contributions.

**7.2 Hospital and Health Centers (HHC) Staff**

**7.2.1 Findings**

The Hospitals & Health Centers (HHC) staff, however, appears to be in a very different competitive situation than that of the University campus areas. The Aon Hewitt index shows that the University’s retirement plan contributions on behalf of HHC staff are substantially ahead of both the local and national health care market peer groups. Specifically, the 2013 Aon Hewitt Benefit Index estimates that the value of the University’s portion to the retirement plan for HHC staff have a base score of 161 or 61% higher than local peers and 162 or 62% higher than national peers.

As a result of the changing health care landscape, this industry will continue to experience significant pressures in the short and long term to remain overall cost competitive. The trends driving the pressure for cost reduction include payors in search of value-based contracts that reward health care providers for cost reductions/containment, the consolidation of facility and physician organizations, and the components of the health care reform aimed to deliver...
quality care while reducing the rate of increase of health costs.

While there is a pressing need to reduce operating expenses to sustain and grow, it is carefully balanced with the essential need to recruit the best and brightest people to UMHS. Optimization of the Health System’s compensation and benefits programs is supported by recognizing that health care is benchmarked to a different industry than higher education. Therefore, U-M Health System should have the opportunity to structure the current U-M retirement savings plan, as well as all other rewards programs, to be competitive within its industry.

The benefits provided to HHC staff are currently the same as provided to faculty and staff on the main campus and faculty in the Medical School. The labor markets of southeast Michigan and of the healthcare sector have now evolved to a status where the benefit package for the Health System is misaligned with the market. The value and cost of these benefits far exceeds those in peer hospital systems, both nationally and in southeast Michigan, that constitute the market from which HHC staff are recruited and retained. Relative to the southeast Michigan market, the index for the value of benefits to HHC staff is 61% above average for retirement saving and 12% above average overall benefits.

7.2.2 Recommendations

By targeting greater cost-savings for HHC staff than for other employees of the University, the Committee sponsors made clear that the Committee should contemplate different parameters for benefits for HHC staff than provided elsewhere in the University. That the HHC staff benefits indexes, unlike the indexes on the main campus, are above average suggests that there is more room to seek necessary cost-savings by benefits reductions for HHC staff without compromising the competitive position for that group of employees.

To achieve the 20% cost savings for the retirement plan for HHC staff it would be necessary to depart substantially from the University’s current retirement plan parameters. Since the Committee does not recommend such a change of the University’s overall retirement savings plan because of
concern that it would make benefits non-competitive for faculty and campus staff, it is clear that plan parameters for HHC staff will have to be different from those for the rest of the University if the cost-reduction for HHC staff benefits is to be realized. In section 6, the Committee discusses various options for reducing the retirement benefit together with their pros and cons. Since the cost and competitiveness of HHC staff benefits is a relatively narrow and specialized issue, the Committee defers to the HHC to make the management decision about which, if any, of these specific changes in HHC staff benefits should be implemented.

RECOMMENDATIONS: The Committee finds that the retirement savings plan and overall benefits for Hospital and Health Center (HHC) staff exceed those for local and national peers. Accordingly, the Committee finds that there is opportunity for changes in the retirement savings plan for HHC staff that would save the costs targeted for HHC staff in the charge while retaining a competitive benefit package for HHC staff.

Because the Committee is not recommending University-wide changes in the structure of the retirement savings plan, it defers to the appropriate leadership what specific form changes in the retirement plan for HHC staff might take. Any changes to the retirement savings plan should be attentive to the needs of employees to save adequately for retirement and should therefore consider both the University and employee contributions.

Additionally, the Committee recommends that University and employee retirement saving contributions be calculated on base pay as discussed in Section 6.1.3.

8. **Retiree Health Benefits and Recommendations**

The Committee was charged with examining changes in retiree health benefits for new hires only. The University expects to reexamine the retiree health benefit for all employees within the next few years. In the charge, the Committee was also asked to consider the possibility of offering long-term care insurance, which is not currently provided as an employee benefit. See Appendix 2 for the Committee charge document.
8.1 Current Retiree Health Benefit
Currently, a faculty or staff member is eligible for retiree health benefits from the University provided they meet the stated eligibility for age and years of service. For new hires effective as of January 1, 2013, the maximum University contribution is 68% for the single contribution towards the retiree premium and 26% of the premium for his or her dependent. The amount of University and retiree contributions towards retiree benefits plans will vary based on hire date, age, retirement, eligibility for Medicare, coverage level and health plan selected. See Appendix 8 for details.

8.2 Issues Considered: Retiree Health
Retiree health benefits are an important part of compensation. This benefit is critical to U-M’s ability to recruit and retain faculty. Like health insurance for active workers and their dependents, retiree health insurance is a tax-favored benefit since beneficiaries pay no income taxes on the value of the university’s contribution. Any change to retiree health benefits requires consideration of a number of complex, uncertain, and interrelated issues:

- **Elimination of coverage**
  If U-M were to simply eliminate the Retiree Health Coverage for new hires it would have an impact on the overall competitiveness of our All Benefits Index (BI) by approximately 3 basis points. Therefore, the Faculty BI would drop from 100 to 97 and HHC staff BI would drop from 112 to 109.

- **Uncertainty in the health insurance market**
  Non-group health insurance markets for individuals under the age of 65 are in a state of flux. The insurance exchanges created by the Affordable Care Act (ACA), which could potentially provide an alternative to employer-sponsored coverage, are scheduled to begin providing coverage in January 2014.

- **Uncertainty about the future of Medicare**
  The Medicare program faces structural deficits that make changes to Medicare, such as increases in premiums for higher-income beneficiaries, likely in the near term. Fundamental changes, such as a transition to a premium support model, cannot be ruled out.
• **Tax considerations affecting low-income and high-income workers differently**
  Under ACA, early retirees with incomes below 400% of the Federal Poverty Level (currently $62,040 for a couple) will be eligible in 2014 and later for tax credits that substantially reduce the cost of health insurance purchased through an exchange. Early retirees with higher incomes, however, will not be eligible for these subsidies and would have to pay the full premium, which may be very high depending on the composition of the exchange risk pool. These higher-income retirees would be better off, and, by extension, the U-M would maintain more of its competitive advantage, by continuing to offer them retiree health insurance as a tax-favored fringe benefit. It is unclear how to balance these competing pressures, particularly without information on the unsubsidized, steady-state premium for older individuals with exchange coverage.

• **Differences in the competitive landscape for faculty versus HHC employees**
  Currently, retiree health insurance offerings are the same for faculty and staff. It should be noted that the Hospital/Health System market varies considerably from the higher education market in regards to the prevalence of retiree health benefits. Compared with retiree health insurance benefits offered by peer institutions for faculty, the generosity of the U-M benefit is somewhat above average (U-M rank is 9/10 out of 23; Aon Hewitt Benefit Index = 123.) The U-M retiree health benefit is much more generous, however, than what is typically offered by local peer institutions for health system employees (Aon Hewitt Benefit Index = 524; 4 of 6 local peers offer no retiree health benefit for staff.)

### 8.3 Issues Considered: Long-Term Care

Long-term care insurance provides financial protection against the risk of certain home health and nursing home expenses. The Committee notes at the outset that although its charge includes consideration of long-term care insurance in the context of potential changes to retiree health insurance, these two types of insurance are not substitutes for one another, since they cover different services. Federal and state governments currently pay for most long-term care expenses, primarily through the Medicaid program. As a result, the market for private long term care insurance is less robust than it might be. Moreover, there is considerable uncertainty currently about whether the government’s
role in this market is likely to expand or contract, compounding the challenge of entering the market as a private sponsor.

8.4 Recommendations

Potential changes to retiree health benefits or long-term care insurance are complex and deserve more careful study than the current Committee was able to give them, given the short time frame in which it was to reach a recommendation on the retirement savings plan. Elimination of this benefit would drop the faculty and campus staff all benefit index relative to Provost Peers below 100 to 97. Moreover, the current uncertainty around health insurance exchanges makes this a particularly problematic time to propose changes to health benefits for retirees under the age of 65.

The retiree health care benefit could be reduced for HHC staff and maintain competitiveness with most peers. The same uncertainties about the health care marketplace apply to HHC staff. Therefore, the Committee feels that the retirement savings plan is a better source of cost savings for HHC benefits at present.

RECOMMENDATIONS: The Committee does not recommend any changes in retiree health benefits for new hires at the present time. The market for retiree health is subject to substantial uncertainty and potential change over the near term. The University has determined that it will revisit retiree health for all employees in several years.

The Committee recommends that the University continue not to offer a long-term care insurance benefit. The University’s benefits staff should continue to monitor the market for long-term care, and should attractive policies become available, they should be considered. The Committee is not optimistic, however, that such policies will be available in the near future.

9. Further Considerations

9.1 Save More, Not Less

The Committee’s charge pointed toward reducing the retirement savings benefits. The assessment of the Committee is, however, that most employees should be saving more than the combined 15% rate embodied in the current retirement plan. Many employees do save more, either through supplemental retirement accounts or other mechanism. Many, however, do not.
There are many factors that point toward the need for greater retirement saving. (1) Retirees will be required to pay more of the costs of their health care in the future. The University has already reduced the portion of retiree health that it pays, and the Committee anticipates that it will make further cuts in the future. Additionally, the combination of fiscal imbalances, an aging population, and escalating health care costs make it likely that Medicare will be less generous in the future. (2) Retirees should expect to live longer and therefore require greater retirement savings to fund a secure retirement. (3) Social Security, though in better shape than Medicare, is likely to become incrementally less generous for future retirees because of the same budget and demographic pressures. (4) Many retirees will need long-term care, something that is difficult or costly to insure against. (5) Returns on retirement savings might be lower in the future than they have been historically.

There are many reasons to be saving more. These reasons underscore the Committee’s caution about recommending changes to the retirement plan. They also point to the need for individual employees and their families taking increased responsibility for financing a secure retirement.

9.2 Proposals to Encourage Saving for Retirement

While the University and employee contributions to the basic retirement plan will and should remain the substantial majority of how U-M employees assure retirement security, the University should encourage additional and effective saving. (1) It should consider approaches that make it easier to elect a Supplemental Retirement Account (SRA), for example, check off options to contribute a fixed percentage to an SRA or to devote annual merit raises to an SRA. (2) Consistent with the recommendations of the Committee to Study Adding Certain New Funds to the Retirement Savings Program, the University should continue to be attentive that its retirement plans offer very low cost, well-diversified investment opportunities and should continue to monitor its plan providers to assure that they only market plans to employees that are in the best interest of employees. (3) The University should maintain its practice of designing retirement plans to maximize elective deferral of tax liabilities.