

PROTECTING LOCAL GOVERNMENT RETIREMENT AND BENEFITS ACT AND COMPANION BILLS

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**Senate Bills 686, 694 & 696 as enacted
Public Acts 202, 206 & 207 of 2017
Sponsor: Sen. Jim Stamas**

**House Bill 5304 as enacted
Public Act 210 of 2017
Sponsor: Rep. Kathy Crawford**

**Senate Bills 688 & 699 as enacted
Public Acts 203 & 208 of 2017
Sponsor: Sen. Mike Shirkey**

**House Bill 5306 as enacted
Public Act 211 of 2017
Sponsor: Rep. Eric Leutheuser**

**Senate Bill 691 as enacted
Public Act 204 of 2017
Sponsor: Sen. Dave Hildenbrand**

**House Bill 5308 as enacted
Public Act 212 of 2017
Sponsor: Rep. Gary Howell**

**Senate Bill 692 as enacted
Public Act 205 of 2017
Sponsor: Sen. Phillip Pavlov**

**House Bill 5310 as enacted
Public Act 213 of 2017
Sponsor: Rep. James A. Lower**

**House Bill 5301 as enacted
Public Act 209 of 2017
Sponsor: Rep. Gary Glenn**

**House Bill 5313 as enacted
Public Act 214 of 2017
Sponsor: Rep. Rob VerHeulen**

**House Committee: Michigan Competitiveness (House bills)
Senate Committee: Michigan Competitiveness (Senate bills)**

Complete to 12-21-17

BRIEF SUMMARY:

Senate Bill 686 would create the Protecting Local Government Retirement and Benefits Act (the proposed Act) in Michigan law. The bill states that it is intended to reflect the findings and recommendations of the governor's Responsible Retirement Reform for Local Government Task Force, which met from February to May of 2017.

Approximately one-third of the 1,856 general purpose governments in Michigan provide employees with post-retirement benefits—whether in the form of pension benefits or other post-employment benefits (OPEB), which principally include health care benefits, or both. According to the task force's July 2017 report, the total unfunded pension liability for local

units in Michigan is estimated at \$7.5 billion, and the total unfunded liability for retiree health care at \$10.1 billion.¹

Senate Bill 686 would do all of the following:

- Require local units to pay the normal costs (prefund rather than pay-as-you-go) for employees first hired after June 30, 2018, as well as retiree premiums that are due for retirees in the retirement system.
- Require the state treasurer to determine the underfunded status of each local unit's retirement health system and retirement pension system, based on its funded ratio and the annual cost of making required payments as a percentage of local revenues.
- Allow local units to apply for and receive a waiver of underfunded status if the state treasurer finds that the underfunded status is being addressed adequately.
- Require that local units submit annual retiree health care reports summarizing the assumptions and methods used to calculate long-term actuarially assumed assets and liabilities as well as the status of its system to the local unit's governing body and the Department of Treasury (Treasury).
- Create the *Municipal Stability Board* (the Board) within Treasury (although functioning independently of Treasury), which would monitor compliance of an underfunded local unit and of any *corrective action plan* proposed by the local unit and approved by the Board.

The remaining House and Senate bills would mainly make other local government retirement statutes subject to the proposed Act.

THE APPARENT PROBLEM:

Large unfunded liabilities are primarily due to local governments not prefunding retiree health benefits (setting aside funding for benefits as they are accrued) and instead waiting to pay for benefits as the annual health care costs are incurred. Even those local governments that do prefund retiree health care benefits often have substantial unfunded liabilities mainly due to the following: 1) they do not make the full annual required payments, 2) system assets do not generate the investment returns assumed, and 3) the cost of health care increases at a rate significantly higher than general inflation. According to the July 2017 Responsible Retirement Reform for Local Government Task Force, in 2015, retiree health care actuarial accrued liabilities for Michigan cities, villages, and townships were on average 19% funded, and those of Michigan counties were on average 34% funded.²

¹ The report can be found at http://www.michigan.gov/documents/snyder/R3_Task_Force_Report_579101_7.pdf, and is discussed in greater detail in the *Background* of this summary. According to the report, these numbers do not account for the city of Detroit. The city had estimates ranging from \$5.7 billion to \$6.4 billion in unfunded OPEB liabilities with no prefunding at the time of its municipal bankruptcy; these were largely eliminated in the bankruptcy.

² The report can be found at http://www.michigan.gov/documents/snyder/R3_Task_Force_Report_579101_7.pdf.

THE CONTENT OF THE BILLS:

Senate Bill 686

Funding of other post-employment benefits (OPEB) required

The bill would provide that, beginning July 1, 2018, if the local unit offers or provides retirement health benefits to former or current employees, the local unit must pay for at least both of the following:

- Normal costs for employees first hired after June 30, 2018, where ***normal cost*** means the annual service cost of retirement health benefits as they are earned during active employment of employees of the local unit of government in the applicable fiscal year, using an individual entry-age normal and level percent of pay actuarial cost method.
- Retiree premiums that are due for retirees in the retirement system.

Summary retiree health care report

The bill would require that local units electronically submit a summary retiree health care report annually to the local unit's governing body and Treasury within 6 months after the end of its fiscal year. Treasury, in turn, would post an executive summary of each valuation report—which must include the applicable system's unfunded actuarial accrued liability for retiree health—on its website. Additionally, Treasury would submit each executive summary to the House and Senate Appropriations committees and House and Senate Fiscal Agencies at least 30 days after posting.

The report must contain all of the following for each retirement system that provides retirement health benefits:

- Name of the system and its fiduciaries and service providers.
- Assets and liabilities and changes in net plan assets on a plan-year basis.
- Funded ratio based on the ratio of valuation assets to actuarial accrued liabilities on a plan-year basis.
- Assumed rate of return and actual rate of return for the previous 1-, 5-, and 10-year periods.
- Discount rate used by the system.
- Amortization method for unfunded liability, indicating whether it is open or closed.
- Amortization method, indicating whether it is level percent or level dollar, and the assumed payroll growth rate.
- Remaining amortization time period.
- Annual required contribution for the retirement system, indicating the normal cost and the amortization payment toward the unfunded actuarial accrued liability.
- The retirement system's health care inflation assumption.
- Number of active employees and retirees in the retirement system.
- Amount of premiums paid on behalf of retirees in the retirement system.

Actuarial assessments

Under the bill, at least every 5 years each plan's actuary must conduct an ***actuarial experience study*** for each of that local unit's retirement systems. Additionally, at least every 8 years, the local unit must either have a peer actuarial audit conducted by an outside auditor, or replace the plan actuary, or both. These provisions would not apply to local units that are eligible to use a specified alternative measurement method under Governmental Accounting Standards Board standards.

Responsibilities of the state treasurer

The bill would require that the state treasurer annually establish ***uniform actuarial assumptions*** of retirement systems, including standard ranges for investment returns, salary increase rates, mortality tables, discount rates, and health care inflation.

The state treasurer must create an evaluation system and provide for review and oversight of an underfunded local unit beginning on the date the state treasurer determines that the local unit is underfunded. The state treasurer must determine whether local units are underfunded beginning December 31, 2017 and annually thereafter.

The state treasurer would determine that a local unit is underfunded if any of the following apply:

- The actuarial accrued liability of a local unit's retirement health system is less than 40% funded, according to the most recent annual report and, if the local unit is a city, village, township, or county, the annual required contribution for all of the local unit's retirement health systems is greater than 12% of the local unit's annual general fund operating revenues, based on the most recent fiscal year.
- The actuarial accrued liability of a local unit's retirement pension system is less than 60% funded, according to the most recent annual report and, if the local unit is a city, village, township, or county, the annual required contribution for all of the local unit's pension systems is greater than 10% of the local unit's annual general fund operating revenues, based on the most recent fiscal year.
- The local unit has not reported the annual cost of the liability of the retirement health system or retirement pension system using the uniform actuarial assumptions established by the state treasurer.
- The local unit fails to pay for at least the normal costs for employees hired after June 30, 2018 and retiree premiums that are due for retirees in the retirement system.

The bill would require that a local unit annually calculate and report to the state treasurer the funded ratios of each of its retirement systems using the uniform actuarial assumptions. The report must be submitted within 6 months of the end of the local unit's fiscal year.

Finally, the state treasurer must post on the Treasury website the uniform actuarial assumptions, a summary report of the local unit reports, the underfunded status and current waiver status of local units, and any corrective action plan (described below).

(The local unit must also post on its website, or in a public place if it does not have a website, the information listed above, as applicable.)

Waiver of determination of underfunded status

A local unit would qualify for a waiver of the underfunded status determination if its administrative officer and governing body approve a plan demonstrating that the underfunded status is being addressed. The state treasurer must issue the waiver if the state treasurer determines that a local unit's underfunded status is being addressed adequately.

If an underfunded local unit is not granted a waiver, Treasury must do all of the following:

- Complete an individualized and comprehensive internal review of the local unit's retirement system.
- Discuss with the local unit's designated officials changes or reforms that have been made.
- Review actuarial trends and projections.

Establishment of Municipal Stability Board

The bill would create the Board within Treasury. Generally, the Board would function independently of the state treasurer, but the budget, procurement, and related management functions would be performed under the direction and supervision of the state treasurer. Additionally, Treasury would provide administrative support to the Board.

The governor would appoint the Board's three members, with one member representing state officials (and serving as the board chairperson), one representing local officials, and one representing employees and retirees. All three must be Michigan residents with knowledge, skill, or experience in accounting, actuarial science, retirement systems, retirement health benefits, or government finance. One would serve an initial term of 4 years, one of 3 years, and one of 2 years. Thereafter, terms would be 4 years.

The Board must meet at least quarterly. The Board could contract for professional services, including, but not limited to, accounting, actuarial, appraisal, auditing, investment advisor, and legal services. Members of the Board would serve without compensation but may receive reimbursement for travel and expenses incurred in the discharge of official duties. Members and agents or contractors would be subject to the Contracts of Public Servants with Public Entities Act and the Conflict of Interest Act.

The bill would require the Board to review and annually update a list of best practices and strategies to assist an underfunded local unit in developing a corrective action plan.

Corrective action plan

Under the bill, an underfunded local unit would develop and submit a corrective action plan for approval by the Board, after the plan is approved by its own governing body.

The Board would then review and vote on the corrective action plan. The plan must be submitted within 180 days after determination of underfunded status, but the Board may extend the deadline by an additional 45 days if the local unit submits a reasonable draft of the plan and requests an extension. Then, the Board must approve or reject the plan within 45 days after submission.

If the Board rejects a plan, it must notify the local unit within 15 days and detail the reasons for rejection. Each fiscal year, the local unit would have 60 days from the notification to address the reasons for rejection and resubmit the plan for approval.

If the Board approves the plan, the local unit has 180 days after approval to begin to implement the plan or otherwise negotiate with employees and retirees to achieve the necessary cost reductions and funding improvements to permanently correct its underfunded status in all future years.

The Board would monitor compliance with the Act and any corrective action plan, and adopt a schedule to recertify plans at least every 2 years. If the Board determines that a local unit is not in substantial compliance with the corrective action plan requirements, the Board must notify the local unit within 15 days and detail the reasons for the finding of noncompliance. The local unit would then have 60 days from notification to address the determination.

A corrective action plan would present options by which the local unit would address and permanently resolve its underfunded status. The options may include any of the following:

- For retirement systems, any of the following:
 - Closing the current defined benefit plan.
 - Implementing a pension calculation multiplier limit.
 - Reducing or eliminating new accrued benefits.
 - Implementing final average compensation standards.
- For retirement health benefits, any of the following:
 - Requiring cost sharing of premiums and sufficient copays.
 - Capping employer costs.

Jurisdiction and presumed validity of the Board

The validity of the Board would be conclusively presumed unless questioned in an original action filed with the court of claims within 60 days after the bill takes effect. The court of claims would have exclusive jurisdiction to hear any action challenging the validity of the proposed Act or an action or inaction under the proposed Act. Treasury would be a necessary party in such an action.

Other House and Senate bills

Generally, the other bills in the package would incorporate the new Protecting Local Government Retirement and Benefits Act (the proposed Act) throughout Michigan law.

Senate Bill 688 would amend the *Public Employee Retirement System Investment Act*. Currently, a system must provide a supplemental actuarial analysis before adoption of any proposed pension benefit change. The bill would amend this requirement so that the analysis is only required when an increase is proposed, instead of any change. Additionally, the bill would remove a requirement that a system post an information report on its website if its retiree health or pension is not at least 60% funded, as well as steps the system is taking to address the shortfall. This requirement was added by Public Act 530 of 2016 (House Bill 6075)³ and would be replaced by a schedule for required funding in the proposed Act. (MCL 38.1133 and 38.1140h)

Senate Bill 691 would provide that a pension or retirement benefit provided under the *County Board of Commissioners Act* would be subject to the proposed Act. (MCL 46.12a et al.)

Senate Bill 692 would amend the *Optional Unified Form of County Government Act* to provide that a retirement system for the county's employees operating under the Act would be subject to the proposed Act. (MCL 45.554a et al.)

Senate Bill 694 would amend the *Firemen and Policemen Pensions Act* to provide that certain interest payments from reserve funds allowed under the Act would be subject to the proposed Act. (MCL 38.571)

Senate Bill 696 would amend the *Revised Statutes of 1846* to make the provision of retirement benefits by a township under the statute subject to the proposed Act. (MCL 41.110b)

Senate Bill 699 would amend the *Incompatible Public Offices Act* to state that the prohibition on public officers or employees holding two or more incompatible offices at the same time would not apply to members of the Municipal Stability Board. (MCL 15.183)

House Bill 5301 would amend the *Reciprocal Retirement Act* to provide that a reciprocal unit and a reciprocal retirement system must comply with any applicable requirements of the proposed Act. (proposed MCL 38.1102a)

House Bill 5304 would provide that, if a county provides a system of retirement under the *Charter Counties Act*, that system is subject to the proposed Act. (MCL 45.514 et al.)

³ House Fiscal Agency analysis: <http://www.legislature.mi.gov/documents/2015-2016/billanalysis/House/pdf/2015-HLA-6075-6163453F.pdf>

House Bill 5306 would stipulate that a retirement board, a retirement system, and a city, village, or municipality that is the custodian of funds of a retirement system under the *Fire Fighters and Police Officers Retirement Act* must comply with any applicable requirements under the proposed Act. (proposed MCL 38.552a)

House Bill 5308 would provide that a retirement system established under the *City Library Employees' Retirement System Act* is subject to the proposed Act. (MCL 38.702)

House Bill 5310 would provide that the powers and duties delegated to the Municipal Employees Retirement System (MERS) board in the *Municipal Employees Retirement Act of 1984* would be subject to the provisions of the proposed Act. (MCL 38.1536)

House Bill 5313 would stipulate that the provision of retirement benefits as part of a system of compensation by a city under the *Home Rule City Act* would be subject to the proposed Act. (MCL 117.4i and 117.4p, proposed MCL 117.4u)

Tie-bars

All of the other House and Senate bills are tie-barred to Senate Bill 686, meaning that they could not take effect unless SB 686 were also enacted.

BACKGROUND INFORMATION:

This bill package is understood to be based on recommendations from the Responsible Retirement Reform for Local Government Task Force, initiated by Governor Snyder and made up of 20 municipal, business, and union leaders from around the state. In July of 2017, the task force released its report, based around the following four main recommendations:

- Greater reporting and transparency must be required of all local units to ensure a full understanding of the size and scope of the problem, and where the biggest challenges exist. This includes reporting using uniform assumptions to allow for better comparisons.
- A pension and OPEB fiscal stress test system for local governments should be created to alert and assist local units in crafting solutions to best position them to continue to serve their residents, while funding their obligations and protecting benefits for employees and retirees. This system should identify and focus action on the local units experiencing the greatest fiscal stress.
- This system, along with the creation of a new Municipal Stability Board (MSB), should assist in the review of a local unit's finances and the development of a corrective action plan. The MSB should also provide research, training, and technical assistance.
- In addition to meeting existing constitutional and statutory requirements to pay pension costs, going forward all local governments should meet a minimum requirement to pay

OPEB normal costs for new hires (i.e., to prefund new active employee's current year obligation), if offered.

The report noted that some task force members objected to the establishment of new funding requirements, as they felt the requirements would have too severe an impact on local units' ability to provide current services. Additionally, the report stated that members disagreed on the powers to be delegated to an MSB, with a majority believing that the role should be limited to making recommendations and providing technical support and a minority that "the MSB should be able to unilaterally impose changes if the local unit was unable to successfully implement a corrective action plan."

FISCAL IMPACT:

Senate Bill 686

The bill could increase costs for local units of government depending on the extent to which their current practices align with the following proposed requirements:

- Prefunding retiree health care costs for new employees.
- Conducting an actuarial experience study every 5 years which could create both the cost of the study itself as well as potential increases in annual required contributions due to revised assumptions driven by experience changes.
- Conducting a peer actuarial audit every 8 years absent a change in actuaries.
- Reporting funded ratios calculated based on the uniform actuarial assumptions Treasury would have to establish under the bill. This would either require an additional actuarial valuation if the local unit's retirement systems' assumptions were not aligned or would require the local unit to adopt Treasury's assumptions, which may increase a local unit's annual required contributions.

Increased contributions, either to prefund retiree health or to increase contributions toward a system's unfunded liability, while raising costs initially, would likely create long-term savings because prefunding those costs allows a system to gain interest with which to pay the benefits in the future.

Creating an underfunded status for local units that must then create corrective action plans could create an incentive for local units to take measures that would improve their retirement benefit systems' funded status. The fiscal impact would vary from one unit to the next depending on each unit's corrective action plan.

The bill would create costs for the state Department of Treasury related to the additional administrative requirements, including summarizing local OPEB reports and making them available online, annually establishing standards for actuarial assumptions, creating an evaluation system to provide for review and oversight of underfunded local units, providing staff support, including contracted professional services, and reimbursing the Municipal Stability Board for expenses.

Other bills

The remaining bills in the package simply align other statutes to SB 686 and as such would have no direct fiscal impact on the state or local units of government.

ARGUMENTS:

For:

Proponents of the bill package include organizations that represent more than 30,000 police and firefighters across the state of Michigan. Those professions are inherently dangerous, with health risks following retirees beyond their working years. They argue that, in many cases, police and firefighters made concessions during their working years based on the assurance that their pension and health benefits were guaranteed after retirement. While they sought to ensure that local units were meeting certain benchmarks for funding plans, they rejected what they called draconian measures in the bill package as introduced. Instead, they argue, the bills as passed provide oversight, but allow local units the flexibility to fund plans as appropriate for that community.

Those who opposed the bill package as introduced repeatedly stated that the Responsible Retirement Reform for Local Government Task Force's recommendations were issued unanimously, and that they would support a plan based on those recommendations. They feel that the bills, as amended and passed by the House, would codify those recommendations into statute.

Against:

As introduced, the bills included the possibility of a financial management team and an emergency manager. Proponents of that plan argued that those possibilities were only available as a last resort, and were necessary in order to give the plan the "teeth" it needed to ensure compliance. Without phase 5's possibility of a financial management team (and, if determined necessary by the team, an emergency manager), local units might continue as they have—increasingly falling further behind in funding their pension and OPEB obligations. Critics of the bills as passed ask: wouldn't a financial team, however unwelcome, be preferable to allowing a bankruptcy judge to cut benefits unilaterally?

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.