Legislative Analysis

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STATE POLICE RETIREMENT SYSTEM REVISIONS

House Bill 4266 as introduced
Sponsor: Rep. Tommy Brann
Committee: Appropriations
Complete to 2-23-21

SUMMARY:

House Bill 4266 would amend the State Police Retirement Act to do all of the following:

- Adopt layered amortization.
- Reduce the time frame over which a deficiency in the actuarially determined contribution must be paid.
- Require that the most recent mortality tables provided by the Actuarial Standards Board be used,
- Implement a reduced cap for the assumed rate of return and discount rate.

Layered Amortization
Beginning in Fiscal Year (FY) 2021-22, and for each subsequent fiscal year, the bill would require the retirement system to use layered amortization with a fixed and closed period of not more than 10 years. Any layered amortization period must use level dollar amortization. The practice of layered amortization requires any new actuarial losses to be separately amortized from the existing unfunded actuarial liability (UAL). Currently, the existing UAL is amortized over a schedule ending September 30, 2038. Any actuarial losses are combined with the existing UAL and amortized over the same period.

Reconciliation
Beginning in FY 2022-23, and for each subsequent fiscal year, the bill would require the Office of Retirement Services (ORS) to certify the difference between the estimated and the actual aggregate compensation and the estimated and the actual contribution rate no less than 60 days after the end of the fiscal year. Further, the bill would require the legislature to appropriate the amount certified by ORS in the following fiscal year. Current law amortizes this amount over five years, with interest, beginning with the second fiscal year following the certification.

Mortality Tables
Beginning in FY 2021-22, and for each subsequent fiscal year, the bill would require the actuary to use the most recent mortality assumptions provided by the Actuarial Standards Board and adopted as risk assumptions by the actuary. Current law requires the retirement board to conduct and review an experience investigation study and adopt risk assumptions on which actuarial valuations are to be based. Currently an experience study is conducted every five years.

Reduced Cap for Assumed Rate of Return and Discount Rate

Beginning in FY 2021-22, and for each subsequent fiscal year, the bill would require the retirement system's assumed rate of return on investments and discount rate to be capped at 6.8%. Under the bill, the rate could only be changed with the approval of the retirement board and the director of the Department of Technology, Management, and Budget (DTMB). Currently, the State Police Retirement System utilizes a 6.8% rate for the legacy pension system, 6.85% rate for Pension Plus, and 6.9% for other post-employment benefits (OPEB). Under the current dedicated gains policy, the assumed rate of return and discount rate may go down, but will not increase in future years.

MCL 38.1611 & 38.1614

FISCAL IMPACT:

Generally speaking, the bill likely would increase near-term budgetary cost pressures by creating higher upfront payments for the state but generate longer-term net savings for the state and system overall. The combination of the shorter time frame over which any new actuarial loss would be amortized (10-year layered amortization using level dollar), reducing the time frame over which a deficiency in the actuarially determined contribution must be paid, and requiring that the most recent mortality tables provided by the Actuarial Standards Board be used could require increased near-term allocations to the pension system when compared to current projections. The magnitude of the near-term budgetary cost pressures and longer-term net savings would depend on system experience. Each component is explained in more detail below.

The bill would require any new annual actuarial loss to be amortized over rolling 10-year time periods using level dollar amortization, separate from the current UAL amortization schedule (ending September 30, 2038). Reducing the amortization schedule and utilizing level dollar amortization for any new actuarial losses would increase annual payments upfront compared to current law but generate net savings overall because the funds would be deposited into the system earlier, thereby generating returns. Under the bill, layered amortization would lengthen the amortization period of any actuarial losses after FY 2027-28 relative to current law, potentially reducing costs in those years, but spreading actuarial losses beyond the current amortization horizon. It is unclear how negative UAL would be treated.

Reducing the time frame over which any deficiency in the actuarially determined contribution must be paid would also have the practical effect of creating higher upfront payments in years when there is a deficiency because currently any deficiencies are amortized over a five-year period with interest. In the longer term, the system would realize net savings.

Revising the assumed rate of return and discount rate to 6.8% would increase near-term costs related to the Pension Plus component and OPEB because the current rates are 6.85% and 6.9%, respectively. Similar to other changes, the net effect would be long-term savings for the state.

Lastly, updating the mortality tables on a more regular basis would have an unknown fiscal impact. The retirement system updates mortality tables every five years through an experience study. Any fiscal impact would depend on the mortality tables required to be used under the bill and the mortality tables used in the most recent experience study.

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