Legislative Analysis

MUNICIPAL RETIREMENT SECURITIES

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Senate Bill 838 (H-3) as reported from House committee
Sponsor: Sen. Jack Brandenburg
House Committee: Michigan Competitiveness
Senate Committee: Michigan Competitiveness
Complete to 12-18-18

(Enacted as Public Act 575 of 2018)

SUMMARY:

Senate Bill 838 would amend Section 518 of the Revised Municipal Finance Act to extend the sunset (expiration date) for a county, city, village, or township to issue a municipal security to pay costs of an unfunded accrued liability (UAL) when closing a defined benefit pension plan and implementing a defined contribution plan or to pay costs of a retiree health care UAL. The bill would also add and revise provisions governing those securities.

Under current law, through December 31, 2018, a county, city, village, or township ("local government") may issue a municipal security, subject to certain requirements, to pay all or a part of the costs of the UAL when closing a defined benefit pension plan and implementing a defined contribution plan. The bill would extend the sunset to December 31, 2023, and would specify that, instead of "all or part of the costs of the unfunded pension liability for that retirement program," the municipal security could be issued to pay "an amount not to exceed the difference between 95% of the actuarial value of liabilities and 100% of the actuarial or market value of assets for that retirement program."

Current law also allows, through December 31, 2018, a local government to issue a municipal security, subject to certain requirements, to pay all or a part of the costs of a retiree health care UAL. The bill would also extend this sunset to December 31, 2023, and would add two new conditions to the issuance of such a security:

- The issuance of the municipal security would have to be in connection with the closure of a retiree health care plan to new employees or to fund the costs of a local government that had already closed its retiree health care plan to new employees.
- The municipal security would have to be issued to pay an amount that does not exceed the difference between 60% of the actuarial value of liabilities and 100% of the actuarial or market value of assets of the costs of the health care UAL. [Note: It is unclear what the phrase "assets of the costs of the unfunded accrued health care liability" means.]

The bill would also provide that, within one year before a local government issued a municipal security described above, it would have to conduct a review to verify eligible participants in the plan and that the participants are receiving appropriate pension or other retiree benefits consistent with the plan.

Current law requires a local government to prepare and make available to the public a comprehensive financial plan before issuing a municipal security described above and prescribes information the plan must include. The bill would add that the plan must be posted in a prominent and conspicuous place on the local government's website, if any, and at the office of the clerk no later than the date notice of intent to issue the security is published. The plan would also have to be approved by ordinance or resolution of local government's governing body on or before the notice of intent is published.

Current law requires the comprehensive financial plan to include an analysis of the current and future obligations of the local government with respect to each retirement program and retiree health care program it has. The bill would add that this analysis must include the retirement program or retiree health care program expected to be funded with the municipal security and all other retirement programs or retiree health care programs not funded with a municipal security described above.

Under current law, the plan must include "A debt service amortization schedule and a description of actions required to satisfy the debt service amortization schedule." The bill would change this to "A debt limit calculation that shall be in accordance with statutory, charter, and constitutional debt limits."

The bill would add that the debt service schedule for a municipal security described above must not materially deviate from level or descending annual debt service or, unless otherwise approved by the Department of Treasury for a period of up to five years from the date of issuance, must not materially deviate from a level or descending annual debt service when taking into account other municipal securities of the local government.

Under the bill, the proceeds from the municipal security could not fund capitalized interest on the security or any required UAL payments not made prior to the issuance of the security. The bill would also require the projected net present value savings between the actuarially determined amortization payments at the plan's investment rate of return and the municipal security's debt service requirements at the time of issuance, calculated using a method determined by the Department of Treasury, to be at least 15% of the par amount of a proposed security to pay costs of a pension plan UAL or at least 20% of the par amount of a proposed security to pay a retiree health care UAL, unless the Department of Treasury determines that otherwise the plan in its entirety is in the financial best interest of the local government.

The bill would also require the comprehensive financial plan to include all of the following:

- A comparison of the current investment rate of return assumption of the defined benefit plan or retiree health care plan and the actual annualized investment rates of returns for the past year, five years, and 10 years of those plans.
- An acknowledgment by the local government that UAL of a pension or retiree health plan may increase after a municipal security is issued, thus requiring the local government to make additional actuarially determined amortization payments to the respective plan beyond the payments due on the municipal security.
- A certification that the local government's most recent audit report shows that the sum of all of its defined benefit plans' actual contributions for the most recent three

fiscal years is equal to or greater than the sum of those plans' actuarially determined contributions for the same period.
- A certification that the local government is compliant with any reporting requirements under the Protecting Local Government Retirement and Benefits Act.

To the types of trusts in which a local government is required to deposit proceeds from a municipal security described above, the bill would add a pension trust fund, defined as a trust or fund established to fund the liabilities of a defined benefit plan that is intended to qualify under section 401(a) of the Internal Revenue Code, or in a trust that has as its beneficiary a pension trust fund. Pension trust funds, along with other trusts created under Section 518, would be subject to limitations regarding investments and investment instruments imposed on public employee retirement systems under the Public Retirement System Investment Act.

Finally, the bill would require that, unless otherwise approved by the Department of Treasury, a municipal security described above would have to mature by no later than the date the final amortized payment for the respective UAL would have been made had the local government not elected to issue a municipal security.

MCL 141.2518

HOUSE COMMITTEE ACTION:

The House Committee on Michigan Competitiveness reported an H-3 substitute for the bill, which included most of the provisions described above. The Senate-passed version of the bill had extended the sunset to December 31, 2020 and added pension trust funds to the types of trusts in which a local government is required to deposit proceeds from a municipal security.

FISCAL IMPACT:

To the extent that eligible counties, cities, villages, or townships opted to issue securities to pay off the UAL, those local units would incur fixed debt obligations as opposed to retirement system contributions for UAL costs, which increase or decrease as investment returns and other factors built into actuarial assumptions fluctuate over time. (New UAL costs could arise over time, beyond those for which the local unit initially borrows.) Generally, securities issued for this purpose are not exempt from federal taxation since the purpose of the borrowing is to take advantage of borrowing rates that are lower than assumed rates of returns for defined benefit system investments. The amount of any savings (or costs) to local units borrowing under the bill's provisions would depend on the interest rate at which they could borrow funds relative to future retirement system investment returns.

The bill would create an indeterminate amount of administrative costs for the Department of Treasury to review and approve the issuance of securities allowed under its provisions for an additional two years.

POSITIONS:

A representative of the Department of Treasury testified in support of the bill. (12-18-18)

The following entities indicated support for the bill (12-18-18):

- Michigan Association of Counties
- Michigan Bankers Association
- Michigan Townships Association
- City of Warren
- Grand Traverse County
- Washtenaw County

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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.