



Senate Fiscal Agency
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BILL ANALYSIS



Telephone: (517) 373-5383
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Senate Bills 686, 688, 691, and 692 (as enacted)
Senate Bills 694, 696, and 699 (as enacted)
House Bills 5301, 5304, and 5306 (as enacted)
House Bills 5308, 5310, and 5313 (as enacted)
Sponsor: Senator Jim Stamas (S.B. 686, 694 & 696)
Senator Mike Shirkey (S.B. 688 & 699)
Senator Dave Hildenbrand (S.B. 691)
Senator Phil Pavlov (S.B. 692)
Representative Gary Glenn (H.B. 5301)
Representative Kathy Crawford (H.B. 5304)
Representative Eric Leutheuser (H.B. 5306)
Representative Gary Howell (H.B. 5308)
Representative James Lower (H.B. 5310)
Representative Rob VanHeulen (H.B. 5313)

Senate Committee: Michigan Competitiveness
House Committee: Michigan Competitiveness

Date Completed: 12-27-17

PUBLIC ACTS 202 - 205 of 2017
PUBLIC ACTS 206 - 208 of 2017
PUBLIC ACTS 209 - 211 of 2017
PUBLIC ACTS 212 - 214 of 2017

CONTENT

Senate Bill 686 enacted the "Protecting Local Government Retirement and Benefits Act" to do the following:

- Require a local unit of government, beginning July 1, 2018, to pay normal costs (the cost of retirement health benefits as they are earned) for new employees and to pay retiree premiums due for retirants in its retirement system, if the local unit offers or provides an employee, or a former employee hired before the Act's effective date, with a retirement health benefit.
- Require the local unit to submit a summary retiree health care report annually to its governing body and the Department of Treasury.
- Require the local unit to have an actuarial experience study conducted by the plan actuary for each retirement system at least every five years.
- Require the local unit, at least every eight years, to have a peer actuarial audit conducted by an actuary who is not the plan actuary or to replace the plan actuary.
- Require the State Treasurer annually to establish uniform actuarial assumptions of retirement systems for reporting purposes.
- Require a local unit annually to calculate the funded ratios of each retirement system using those assumptions and report to the Department of Treasury.
- Require the State Treasurer to create an evaluation system to identify and resolve the underfunded status of a local unit.
- Require the State Treasurer to determine the underfunded status of every local unit of government each year, and to provide for oversight of an underfunded local unit.

- Provide that a local unit is underfunded if the actuarial accrued liability of a retirement health system is less than 40% funded and, in the case of a city, village, township, or county, the annual required contribution for all of its retirement health systems is more than 12% of its general fund operating revenue.
- Provide that a local unit is underfunded if the actuarial accrued liability of a retirement pension system is less than 60% funded and, in the case of a city, village, township, or county, the annual required contribution for all of its retirement pension systems is more than 10% of its general fund operating revenue.
- Provide that a local unit is underfunded if it does not make its normal cost or retiree premium payments, or if it has not submitted required reports.
- Require the State Treasurer to waive a determination of a local unit's underfunded status if the local unit is adequately addressing it, and require the Treasurer to take certain steps if a waiver is not granted.
- Create the Municipal Stability Board in the Department of Treasury, and require a local unit in underfunded status to submit a corrective action plan to the Board for its approval.
- Require the Board to notify a local unit if the Board disapproves a corrective action plan, and require the local unit to resubmit the plan within 60 days.
- List corrective options that a corrective action plan may include.
- Require the Board to monitor each underfunded local unit's compliance with the Act and its corrective action plan.
- Require the Board to notify a local unit that is not in substantial compliance, and require the local unit to address the determination of noncompliance within 60 days.
- Require the State Treasurer to post on the Department's website the uniform actuarial assumptions, a summary of local units' reports, the underfunded status of each local unit, the waiver status of local units, and approved corrective action plans.
- Require a local unit to post the same information that applies to it.

Senate Bill 688 amended the Public Employee Retirement System Investment Act to delete provisions requiring a system to post an informational report outlining the steps it may be taking to decrease its unfunded actuarial accrued liability, if the system's actuarial accrued liability for retiree health or pension is not at least 60% funded.

Senate Bill 691 amended Public Act 156 of 1851, which governs county boards of commissioners and allows counties to create pension plans for their employees, to specify that a pension or retirement benefit under the Act is subject to the Protecting Local Government Retirement and Benefits Act (referred to below as the new Act).

Senate Bill 692 amended Public Act 139 of 1973, which provides for an optional unified form of county government, to specify that, for a county that has adopted such a form of government and provides for a retirement system for the county's employees, the retirement system is subject to the new Act.

Senate Bill 694 amended Public Act 28 of 1966, which allows the board of trustees of various local retirement systems to increase benefits, to make a provision of the Act subject to the new Act. That provision allows a retirement system board of trustees, with approval of the local unit's governing body, to use up to half of the interest earned by any reserve fund in the system to contract for medical, hospital, or nursing care for any person receiving benefits from the system.

Senate Bill 696 amended Chapter 16 of the Revised Statutes of 1846, which provides for the powers and duties of townships, to make various powers of a township, including the authority to establish an employee retirement system, subject to the new Act.

Senate Bill 699 amended Public Act 566 of 1978, which prohibits a public officer from holding incompatible offices, to specify that the prohibition does not apply to a member of the Municipal Stability Board created under the new Act.

House Bill 5301 amended the Reciprocal Retirement Act to require a reciprocal unit and a reciprocal retirement system to comply with applicable requirements of the new Act.

House Bill 5304 amended Public Act 293 of 1966, which governs charter counties, to specify that if a county provides a system of retirement for its officers and employees under the Act, the system is subject to the new Act. The bill also deleted a provision under which the county board of commissioners, in a county with a population of 600,000 or more, could have up to 27, rather than 21, members.

House Bill 5306 amended the Fire Fighters and Police Officers Retirement Act to provide that a retirement board under the Act, a retirement system under the Act, and a city, village, or municipality that is the custodian of a retirement system's funds under the Act, must comply with the new Act.

House Bill 5308 amended Public Act 339 of 1927, which provides for a retirement system for public library employees, to specify that a retirement system established under the Act is subject to the new Act.

House Bill 5310 amended the Municipal Employees Retirement Act to make the powers and duties of the Municipal Employees Retirement System retirement board subject to the new Act.

House Bill 5313 amended the Home Rule City Act to specify that, if a city provides retirement benefits as part of a system of compensation, those benefits are subject to the new Act.

The bills took effect on December 20, 2017.

Senate Bills 686 and 688 are described in more detail below.

Senate Bill 686

Legislative Finding & Declaration

The Protecting Local Government Retirement and Benefits Act states, "The legislature finds and declares that this act is intended to reflect the July 2017 Report of Findings and Recommendations for Action of the Responsible Retirement Reform for Local Government Task Force." (That report is discussed in the **BACKGROUND** section below.)

Definitions

The Act defines "local unit of government" as any of the following:

-- A city.

- A village.
- A township.
- A county.
- A county road commission.
- A public airport authority created under the Aeronautics Code.
- A metropolitan government or authority established by the Legislature under the State Constitution.
- A metropolitan district created under the Metropolitan District Act (which allows two or more cities, townships, and/or villages to create metropolitan districts for various purposes).
- An authority created under Public Act 147 of 1939 (which established the Huron-Clinton Metropolitan Authority).
- A municipal electric utility system as defined in the Michigan Energy Employment Act.
- A district, authority, commission, public body, or public body corporate created by one or more of the entities listed above.

"Retirement system" means a retirement system, trust, plan, or reserve fund that a local unit of government establishes, maintains, or participates in and that, by its express terms or as a result of surrounding circumstances, provides retirement pension benefits or retirement health benefits, or both.

"Retirement health benefit" means an annuity, allowance, payment, or contribution to, for, or on behalf of a former employee or a dependent of a former employee to pay for any of the following components:

- Expenses related to medical, drugs, dental, hearing, or vision care.
- Premiums for insurance covering medical, drugs, dental, hearing, or vision care.
- Expenses or premiums for life, disability, long-term care, or similar welfare benefits for a former employee.

"Retirement pension benefit" means an allowance, right, accrued right, or other pension benefit payable under a defined benefit pension plan to a participant in the plan or a beneficiary of the participant.

Retiree Health Benefits

Beginning July 1, 2018, if a local unit of government offers or provides an employee of the local unit, or a former employee first employed by the local unit before the new Act's effective date, with a retirement health benefit, the local unit is subject to all of the provisions described below.

Normal Cost & Premium Payments. The local unit is required to pay at least both of the following:

- Normal costs for employees first hired after June 30, 2018.
- Retiree premiums that are due for retirants in the retirement system.

("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 Health Care Report. The local unit annually must electronically submit a summary retiree health care report in a form prescribed by the Department of Treasury to its governing body and the Department within six months after the local unit's fiscal year ends. The Department must post on its website an executive summary of each report submitted to the

Department, and include in the executive summary the applicable system's unfunded actuarial accrued liability (UAAL). The Department also must submit each executive summary to the Senate and House of Representatives Appropriations Committees and Fiscal Agencies within 30 days after the posting.

"Summary retiree health care report" means a report that includes all of the following for each retirement system of the local unit that provides retirement health benefits:

- The name of the system and the names of its investment system and service providers.
- The system's assets and liabilities and changes in net plan assets on a plan-year basis.
- The system's funded ratio based on the ratio of valuation assets to actuarial accrued liabilities on a plan-year basis.
- The assumed rate of return of the system.
- The actual rate of return of the system for the previous one-year, five-year, and 10-year periods.
- The discount rate used by the system.
- The system's amortization method for unfunded liability, indicating whether it is open or closed.
- The system's amortization method, indicating whether it is level percent or level dollar, and the assumed payroll growth rate.
- The system's remaining amortization time period.
- The annual required contribution for the system, indicating the normal cost and the amortization payment toward the UAAL.
- The retirement system's health care inflation assumption.
- The number of active employees and retirants in the system.
- The amount of premiums paid on behalf of retirants in the system.

Actuarial Experience Study & Actuarial Audit. At least every five years, the local unit must have an actuarial experience study conducted by the plan actuary for each retirement system of the local unit.

At least every eight years, the local unit must do one or both of the following:

- Have a peer actuarial audit conducted by an actuary that is not the plan actuary.
- Replace the plan actuary.

A local unit is exempt from these requirements if it is eligible to use a specified alternative measurement method under Government Accounting Standards Board (GASB) standards.

Retirement System Actuarial Assumptions; Annual Report

For purposes of the reporting requirements described below, the State Treasurer annually must establish uniform actuarial assumptions of retirement systems, including investment returns, salary increase rates, mortality tables, discount rates, and health care inflation.

On an annual basis, a local unit of government must electronically submit a report in a form prescribed by the Department to the governing body of the local unit and to the Department, within six months after the end of the local unit's fiscal year. The report must include at least all of the following:

- The funded ratios of each retirement system of the local unit.
- Annual required contributions for each retirement system of the local unit.
- The local unit's annual general fund operating revenue, if any.

For purposes of the report, a local unit annually must calculate the funded ratios of each retirement system of the local unit using the uniform actuarial assumptions established by the State Treasurer.

Underfunded Status Determination

The State Treasurer must create an evaluation system and provide for review and oversight of an underfunded local unit beginning on the effective date of a determination by the Treasurer that the local unit is in underfunded status. ("Evaluation system" means the local government retirement and benefits fiscal impact evaluation system created under these provisions to provide for the identification of, and a corrective action plan to resolve, the underfunded status of a local unit of government).

Each year beginning after December 31, 2017, the State Treasurer must determine the underfunded status of each local unit of government.

The State Treasurer must determine that a local unit is in underfunded status if the actuarial accrued liability of a retirement health system of the local unit 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 retirement health systems of the local unit is greater than 12% of its annual general fund operating revenue, based on the most recent fiscal year.

The State Treasurer also must determine that a local unit is in underfunded status if the actuarial accrued liability of a retirement pension system of the local unit 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 retirement pension systems of the local unit is greater than 10% of its annual general fund operating revenue, based on the most recent fiscal year.

In addition, the State Treasurer must determine that a local unit is in underfunded status if either of the following applies:

- The local unit has not submitted reports as required under these provisions.
- The local unit fails to make the required payments for normal costs for new employees, and for retiree premiums due for retirants in the retirement system.

("Annual report" means the most recent audited financial statement reporting a local unit of government's liability for retirement pension benefits and retirement health benefits as determined under applicable GASB government accounting standards.)

Waiver of Underfunded Status Determination; Treasury Requirements

To qualify for a waiver of an underfunded status determination, a local unit of government's administrative officer and governing body must approve a plan demonstrating that the underfunded status is being addressed, and approve a waiver application. The State Treasurer must issue a waiver of the determination of underfunded status for a local unit if he or she determines that the local unit is adequately addressing the underfunded status.

For any underfunded local unit that is not granted a waiver, the Department must do all of the following:

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

-- Review actuarial projections, including trends and projections.

Municipal Stability Board

The Act creates the Municipal Stability Board within the Department of Treasury. Except as otherwise provided in the Act, the Board must exercise its powers, duties, and functions independently of the State Treasurer. The Board is to consist of three members appointed by the Governor. Each member must be a resident of the State with knowledge, skill, or experience in accounting, actuarial science, retirement systems, retirement health benefits, or government finance. One member must represent State officials, one must represent local officials, and one must represent employees and retirees.

The Board must meet at least quarterly. Board members will serve without compensation but may receive reimbursement for travel and expenses incurred in the discharge of official duties. The Board may contract for professional services.

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

The validity of the Board must be conclusively presumed unless questioned in an original action filed in the Court of Claims within 60 days after the Act's effective date.

Corrective Action Plan

An underfunded local unit of government must develop and submit for approval a corrective action plan for the local unit, and must determine the components of the plan.

The Municipal Stability Board must review and vote on the approval of a corrective action plan submitted by a local unit. A local unit that is in underfunded status must submit a corrective action plan to the Board within 180 days after the determination of that status. The Board may extend that deadline by up to 45 days if the local unit submits a reasonable draft of a corrective action plan and requests an extension.

The governing body of the local unit must approve the plan before submitting it to the Board. The Board will have to review or reject the plan within 45 days after it is submitted.

A corrective action plan may include the corrective options for correcting underfunded status (as set forth below) and any additional solutions to address underfunded status. A local unit also may include in its plan a review of the local unit's budget and finances to determine any alternative methods available to address its underfunded status.

The Board may review the inclusion of the corrective options and additional solutions as part of its approval criteria to determine whether a corrective action plan is designed to remove the local unit from underfunded status.

If the Board votes to disapprove a corrective action plan that has been submitted, within 15 days the Board must notify the local unit and provide a report detailing the reasons for the disapproval. The local unit will have 60 days to address those reasons and resubmit a plan for approval.

A local unit will have up to 180 days after approval of a corrective action plan to begin to implement the plan to address its underfunded status.

The Board must monitor each underfunded local unit's compliance with the Act and any corrective action plan. The Board must adopt a schedule, not less than every two years, to

certify that the local unit is in substantial compliance with the Act. If the Board determines that a local unit is not in substantial compliance, within 15 days the Board must provide a notification and report to the local unit detailing the reasons for that determination. The local unit will have 60 days to address the determination.

Corrective Options

A corrective action plan may include the development and implementation of corrective options for the local unit to address and permanently resolve its underfunded status.

For retirement pension benefits, corrective options may include, but are not limited to, any of the following:

- Closing the current defined benefit plan.
- Implementing a multiplier limit.
- Reducing or eliminating new accrued benefits.
- Implementing final average compensation standards.

For retirement health benefits, corrective options may include, but are not limited to, the following:

- Requiring cost sharing of premiums and sufficient copays.
- Capping employer costs.

Posting Requirements

The State Treasurer must post all of the following on the Department's website:

- The uniform actuarial assumptions established by the Treasurer.
- A summary report of the reports submitted by local units, calculating the funded ratios of each retirement system using the actuarial assumptions.
- The underfunded status of local units.
- The current waiver status of local units.
- Any approved corrective action plan.

A local unit of government must post on its website, or in a public place if it does not have a website, the information described above that applies to the local unit.

Senate Bill 688

The Public Employee Retirement System Investment Act codifies the investment authority of State and local public employee retirement systems, and defines and limits the amount and type of investments that may be made by those acting as an investment fiduciary (typically, the applicable retirement board) on behalf of a retirement system.

Previously, for a system other than a State unit, if the system's actuarial accrued liability for retiree health care or pension was not at least 60% funded according to the most recent summary annual report, the system had to post an informational report on its website outlining the steps, if any, the system may have been taking to decrease its unfunded actuarial accrued liability. If a system did not have a website, the political subdivision sponsoring the system had to make these steps available to plan participants and beneficiaries, as well as the residents of the political subdivision. The system also had to submit to the Department of Treasury the steps the system may have been taking to decrease its UAAL.

The bill deleted those requirements.

The Act requires an investment fiduciary to publish a summary annual report and lists the information that the report must contain. For a system other than a State unit, the investment fiduciary must submit the summary annual report to the Department of Treasury not less than 30 days after publication.

The Department must post on its website an executive summary of each summary annual report submitted to it. The executive summary must include the applicable system's unfunded actuarial accrued liability for retiree health care and pension. Previously, the executive summary also had to include the system's UAAL for retiree health care.

(A State unit is a system established under the State Employees' Retirement Act, the Public School Employees Retirement Act, the Judges Retirement Act, or the State Police Retirement Act.)

MCL 38.2801-38.2812 (S.B. 686)
MCL 38.1133 & 38.1140h (S.B. 688)
MCL 46.12a et al. (S.B. 691)
MCL 45.554a et al. (S.B. 692)
MCL 38.571 (S.B. 694)
MCL 41.110b (S.B. 696)
MCL 15.183 (S.B. 699)
MCL 38.1102a (H.B. 5301)
MCL 45.514 et al. (H.B. 5304)
MCL 38.552a (H.B. 5306)
MCL 38.702 (H.B. 5308)
MCL 38.1536 (H.B. 5310)
MCL 117.4i et al. (H.B. 5313)

BACKGROUND

Task Force

In his 2017 State of the State address, Governor Snyder spoke about the "legacy liability" that many Michigan communities face with respect to pension and health benefits for retirees. While the primary concern involves municipalities' unfunded liabilities, there also is concern that measures taken to fund pensions and other post-employment benefits might not be adequate. ("Other post-employment benefits", or OPEB, are benefits, other than pensions, that governmental entities provide to their retired employees. These benefits principally involve health care, but also may include life insurance, disability coverage, and legal and other services.) To address these issues, the Governor announced his intention to form a collaborative work group "to ensure the financial stability that will lead to the effective delivery of local services and look to protect their benefits".

A task force consisting of 20 voting members and four ex officio members was formed. Named the Responsible Retirement Reform for Local Government Task Force, the task force issued its Report of Findings and Recommendations for Action in July 2017. According to the report, "Of the approximately 1,800 local general purpose governments [cities, villages, townships, and counties] in Michigan, roughly one third provide post-retirement benefits. Due to a multitude of factors, many communities are now facing challenges funding the benefits to retirees. The total unfunded pension liability is estimated to be around \$7.46 billion. The total unfunded liability for retiree health care is estimated at \$10.13 billion. It is estimated that, for many Michigan cities, roughly 20 cents on the dollar goes to pay pension and OPEB costs.

In some communities, this number is growing faster and continues to be a bigger share of local budgets over time."

The task force pointed out that the severity of the problem varies widely and some communities have already taken proactive steps to address their situations. In addition, many of Michigan's local governments do not offer retirement plans to their employees.

The following is a synopsis of information contained in the task force report.

Payment of Pension & OPEB; Unfunded Liability

As part of the total compensation for local government employees, many local units include retirement income (defined benefit or defined contribution) and access to retiree health care. (In a defined benefit plan, or pension, the employer promises a specified payment, or a lump-sum amount, that is predetermined based on the employee's earnings history, length of service, and age, rather than individual investment returns. In a defined contribution plan, the employer's and employee's contributions are defined in advance, but the benefit to be paid is not known in advance.)

Local units can pay for pensions and OPEB in two ways. The first is called pay-as-you-go, which means that governments do not presently save, or separately fund, to pay for the benefits that will have to be paid out in the future. Rather, they pay the liabilities as they come due, which means that the liabilities are unfunded. The second way is called prefunding, which is based on setting money aside at present, as services are performed, and earning interest or investment income, to build savings that will cover future payments. Governments that do not entirely and accurately prefund a pension or post-employment benefit are required to account for it as a liability.

Nearly 600 general purpose local units of government in Michigan offer defined benefit pension plans. Approximately 340 general purpose local units offer other post-employment benefits.

It is estimated that local government public pensions in Michigan have a total unfunded liability of approximately \$7.5 billion. It also is estimated that pension assets of \$28.0 billion are held against \$35.4 billion in total pension liabilities. This means that the current average funding ratio is 78%. Whether that is adequate depends, in part, on the rate at which it is assumed that pension assets will grow over time from investments. In addition, there is a wide dispersion of funding levels across public sector pension plans in Michigan. Approximately 180 local units have a funded ratio below 60.0%, while 130 have a funded ratio over 80.0%. Ten have funded ratios that range from 22.0% to 42.7%.

With respect to other post-employment benefits, on a long-term basis, it is estimated that Michigan local governments have more than \$10.0 billion in unfunded OPEB liabilities. This equates to an estimated actuarially required annual contribution of \$800.0 million. Local governments are contributing only an estimated \$500.0 million annually, however, leaving a gap of \$300.0 million.

Between 2011 and 2015, municipal OPEB liabilities remained virtually unchanged, while OPEB assets grew to some extent, and the average funded ratio remained flat at just over 19.0%. At the county level, OPEB unfunded liabilities are \$3.0 billion and the average funded ratio was 34.0% in 2015.

Constitutional & Statutory Requirements

The Michigan Constitution guarantees the payment of public pensions and contains prefunding

requirements. Specifically, the "accrued financial benefits" of public pension plans are a contractual obligation that may not be diminished (although future unaccrued benefits may be reduced if labor contracts will not be violated). The Constitution also requires financial benefits arising from service performed in a fiscal year to be funded during that year. In addition, the Public Employee Retirement System Investment Act requires annual funding of an amortized portion of any unfunded pension liability.

Similar requirements do not exist for other post-employment benefits. Most local governments that offer OPEB have chosen to pay for the benefits on a pay-as-you-go basis, and the Michigan Supreme Court has held that other post-employment benefits are not a constitutionally protected "accrued financial benefit". Thus, OPEB are owed only if a public employer binds itself contractually to provide them, and only vested retirees are entitled to receive OPEB beyond the term of the contract that guaranteed the benefits.

Factors Contributing to Underfunding

The task force report cited a number of factors that contributed to the underfunding of liabilities, and continue to do so. With regard to past governmental practices, the factors include the lack of prefunding and the assumptions relied on by actuaries to estimate long-term liabilities and costs.

Another set of factors involves revenue challenges. Significant limitations have placed on property taxes and the tax base since the "Headlee amendment" to the Constitution was approved in 1978, the Proposal A school funding reform was approved in 1994, and various statutory changes were made. In addition, revenue sharing payments from the State to local units were about \$300.0 million lower in 2017 than they were in 2001.

The economic recession of 2008-2009 also has had a negative impact on local units that invested retirement plan assets. Pension and OPEB assets that were invested experienced losses similar to those experienced by the stock market. For several reasons, however, pension and OPEB investments have not recovered along with the market.

Another negative factor for OPEB is the cost of health insurance, which has increased at a rate that outpaces general inflation.

In addition, workforce demographics play a role in underfunding. Approximately 120,000 full-time equivalent employees work in general purpose local governments and nonschool special districts in Michigan. At the same time, approximately 170,000 beneficiaries receive some form of pension or OPEB from local retirement systems. This is a ratio of roughly one active employee for every one and a half retirees, although the ratio is higher in some local units. Flint, for example, has one employee for every five retirees.

Task Force Recommendations

The members of the task force agreed upon four main recommendations, quoted below:

- 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...
- 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 task force report contains details about these recommendations, and describes a five-stage fiscal stress system for a local government.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

Senate Bill 686

State

The bill likely will increase costs to the State in the Department of Treasury. Under the bill, the Department may experience increased costs related to annually establishing uniform actuarial assumptions, creating an evaluation system, and providing for comprehensive review and oversight of local governments' funded status. In addition, the creation and operations of the Municipal Stability Board may increase costs to the Department, particularly if the Board contracts for professional services, and for reimbursement of travel and expenses.

For context, the existing Financial Independence Team in the Department, which reviews school district finances, has 9.0 full-time equated positions and a fiscal year 2017-18 General Fund/General Purpose appropriation of \$4.2 million. There are roughly 900 school districts, charter schools, and intermediate districts that submit financial data to the Department under the early warning system. There are roughly 1,800 local units of government that will be required, under the bill, to submit annual summary pension and retiree health care reports to the Department for review.

Overview of Funding Pensions and Retiree Health Care

Under the State Constitution (Article IX, Section 24), pension plans are required to be prefunded, and the annual prefunding payment for a pension is called the normal cost. The normal cost represents the amount of money necessary to be contributed in a given year to pay for that year's benefits that are earned. If that money is invested, and all of the actuarial assumptions are met, that year's worth of normal cost contributions will grow over time with investment earnings and then pay for that year's worth of pension payments in the future.

However, if actual experience differs from the assumptions in a negative manner (e.g., the stock market does not earn the assumed rate of return, or benefits are paid for a longer period of time due to people living longer than assumed), a shortfall can occur in the assets funding the plan. That shortfall is called the unfunded actuarial accrued liability (UAAL). The UAAL represents the shortfall in assets necessary to pay for benefits earned in the past. Another way to think of the UAAL is like a home mortgage; however, the mortgage is not necessarily a fixed amount and can change based on actual experience in a given year compared to assumptions. For systems with funding shortfalls, an annual UAAL payment should be made, along with the normal cost payment.

Until now, prefunding was not required for retiree health care plans. Local units offering retiree health care could choose to prefund (which means putting money aside now so that it can

generate investment earnings to help defray retiree costs in the future), or choose to pay the costs as they arose (e.g., pay-as-you-go). The latter costs more on a long-term basis due to the foregoing of investment earnings.

Local

The bill will have an indeterminate fiscal impact on local units of government. The bill mandates minimum normal cost contributions for retiree health plans for employees newly hired after June 30, 2018, as well as the payment of retiree premiums due for retirees. In addition, the bill's requirement to submit annually a summary retiree health care report may impose some additional slight cost on local units of government; however, it is likely that most already prepare such a report, so there should be little to no cost in those situations. The requirements to have an actuarial experience study at least every five years, and a peer actuarial audit at least every eight years, also may impose some additional costs on a local unit not already doing these activities.

For local units of government not already following at least the prescribed contribution levels for retiree health care, there will be an increase in costs in the short run, with likely reductions in costs in the long run. Contributions made today are assumed to grow over time as those contributions are invested and earn a rate of return. The more dollars that are invested today through the required normal cost contributions (if a local unit is not already making these contributions), the more time those dollars will have to grow and be used to pay the cost of benefits down the line.

Local units determined to be underfunded may experience an indeterminate fiscal impact related to the requirements to develop, submit, and implement a corrective action plan. There may be some slight costs associated with the actual development of the plan, and, depending on the extent to which a local unit follows and implements an approved plan, as well as what the plan contains in terms of cost reductions and funding improvements of pension or retiree health care plans, there may be either costs or savings to the local unit. The bill specifies that a local unit will have up to 180 days after approval of a corrective action plan to begin implementation. If a local unit is determined to be in noncompliance with its corrective action plan, it will have 60 days from the notification of noncompliance to address that determination.

Senate Bills 688, 691, 692, 694, 696, & 699 and House Bills 5301, 5304, 5306, 5308, 5310, & 5313

The bills amended various acts to require compliance with Senate Bill 686, and as such will not have an independent fiscal impact.

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