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BILL ANALYSIS



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House Bill 4263 (Substitute H-5 as passed by the House)
House Bill 4265 (Substitute H-2 as passed by the House)
House Bill 4266 (Substitute H-3 as passed by the House)
Sponsor: Representative Brad Paquette (H.B. 4263)
Representative Ann Bollin (H.B. 4265)
Representative Tommy Brann (H.B. 4266)

House Committee: Appropriations
Senate Committee: Appropriations

Date Completed: 11-1-21

CONTENT

House Bills 4263 (H-5), 4265 (H-2), and House Bill 4266 (H-3), would amend the Public School Employees' Retirement Act, the Judges Retirement Act, and the State Police Retirement Act, respectively, to do the following:

- **Require the retirement systems to use layered amortization for new actuarial losses and use level dollar amortization to pay the layered amortization.**
- **Reduce the time period over which payments resulting from reconciliation must be made.**
- **Require that mortality tables be the most appropriate for the characteristics of the retirement systems' populations.**
- **Codify the current assumed rates of return and discount rates into statute.**
- **Eliminate retiree health care premium coverage for judges newly hired on or after July 1, 2021, and offer existing members the ability to monetize existing health care premium coverage and change to a health care savings plan.**

House Bill 4263 (H-5): Public School Employees' Retirement Act

The bill would require the retirement system to use layered amortization, beginning in fiscal year (FY) 2024-25 for open plans and, for closed plans, beginning in FY 2029-30. "Layered amortization" would mean a fixed and closed period that separately layers the different components of unfunded actuarial accrued liabilities (UAAL) to be amortized over a fixed period, not to exceed 10 years for a closed plan and 15 years for an open plan, as additional unfunded accrued liabilities emerge. The bill would require that the amortization period for layered amortization use a level dollar amortization method (rather than a level percentage of payroll method).

In addition, beginning with FY 2021-22, the bill would require shortfalls or overages in actual contributions compared to actuarially determined contributions (i.e., the process of reconciliation) to be paid over three years instead of five years (the current requirement). The bill also would require the Retirement Board and Department of Technology, Management, and Budget to adopt the most current mortality tables that were most appropriate for characteristics of the population in the system.

Finally, the bill would codify assumed rates of return on investments for the pension plan of not more than 6.8% and for retiree health benefits of not more than 6.95%. Under current

law, statutory rates of return range between 6.0-8.0% for pension plans, although the retirement system adopted a dedicated gains policy that uses investment gains in excess of assumed gains to 'buy down' the assumed rates of return. The percentages listed in the bill as maximums are what the Michigan Public School Employees' Retirement System currently assumes for pension and retiree health care.

House Bills 4265 (H-2) & 4266 (H-3): Judges & State Police

The other bills in the package propose similar changes for the Judges Retirement System and the State Police Retirement System as are proposed for the School Employees under House Bill (HB) 4263 (H-5), with differences noted below. (The State Employees' Retirement System would see similar changes under Senate Bill 700.)

In HB 4265 (H-2) (Judges), the maximum assumed rate of return on pension investments would be 6.25%, and for retiree health care, the rate would be 7%. As with HB 4264, layered amortization would be required beginning with FY 2027-28, and would be amortized over a fixed period not to exceed 10 years since the plan is already closed. The bill would discontinue retiree health care insurance coverage for certain judges and State officials first hired on or after July 1, 2021. Judges included under the Judges Retirement System and affected by this change would be those in the Supreme Court, Court of Appeals, and State Court Administrators, and State officials include the Governor, Lieutenant Governor, Secretary of State, Attorney General, Auditor General, and State Court Administrator.

Also, under HB 4265, members ineligible for retiree health care coverage would be allowed to contribute up to 4% of their own compensation into a defined contribution account. In addition, the bill would allow existing members eligible for retiree health care coverage to opt out of health insurance premium coverage and monetize the value of their contributions made for hospital and medical-surgical and sick care benefits. The monetization of these benefits would be deposited in the member's defined contribution account. The bill would require the retirement system to deposit \$2,000 into a defined contribution plan for individuals who became qualified participants after September 30, 2021, who were at least 60 years old, and who had at least 10 years of service at termination of employment. The bill would require the system to deposit \$1,000 into a defined contribution plan for individuals who became qualified participants after September 30, 2021, who were younger than 60 years old, and who had at least 10 years of service at termination of employment.

Finally, under HB 4265, the Office of Retirement Services (ORS) would have to design an autoenrollment program for members. This program, by default, would enroll a member to contribute the maximum amounts allowed to generate the highest possible matching employer contributions. In practice, ORS already does this, so the bill simply would codify this practice.

In HB 4266 (H-3) (State Police), the maximum assumed rate of return on pension investments would be 6.8%, and for retiree health care, the rate would be 6.9%. Under this bill, layered

amortization would be required beginning with FY 2024-25 for open plans and with FY 2029-30 for closed plans and would be amortized over a fixed period not to exceed 15 years for open plans and 10 years for closed plans. The bill would require that the normal cost contribution for any fiscal year not be less than the normal cost component of the actuarially determined contribution.

MCL 38.1341 (H.B. 4263)
38.2301 et al. (H.B. 4265)
38.1611 & 38.1614 et al. (H.B. 4266)

FISCAL IMPACT

The bills generally would have an indeterminate fiscal impact on local units of government (schools in Michigan Public School Employees' Retirement System (MPERS)) and on the State (Judges Retirement System (JRS) and State Police Retirement System). The requirement that reconciliation be recognized over three years instead of the current five years would result in increased short-term costs (if reconciliation were used to address a shortfall in contributions) but longer-term savings (because more money would be remitted into the systems earlier, thereby capturing a longer time period for potential investment earnings). At this time, and until the UAAL rate falls below the 20.96% cap, any short-term costs and longer-term savings attributable to the changes proposed for reconciliation would be borne by the School Aid Fund. After a point in time when the UAAL rate falls below 20.96%, the fiscal impact would be borne by participating employers in MPERS.

The requirement to use layered amortization for UAAL that accrues each year could result in higher long-term costs if those liabilities otherwise could have been paid off on time using the original amortization schedule. However, the bills do state that the amortization periods to be used for layered amortization are fixed and *not to exceed* 10 years (for closed plans) or 15 years (for open plans). Conceivably, then, the 'new' layered UAAL could be paid off on a cost-efficient schedule and may not result in higher costs.

The elimination of retiree health care in JRS would result in State savings. The normal cost payment in the FY 2019-20 valuation was calculated at \$216,165. Normal costs continue for the length of time a member remains actively employed. When a member ceases to be employed, the normal costs associated with that member decline to \$0. Therefore, if the bill were enacted, at a point in the future when no current members were actively employed, the State would see the maximum amount of normal cost savings. The retiree health care portion of JRS is fully funded, so there are no UAAL payments at this time.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.