Legislative Analysis

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PUBLIC EMPLOYEE RETIREMENT HEALTH CARE FUNDING ACT

House Bill 4073
Sponsor: Rep. Richard Hammel
Committee: Judiciary

Complete to 2-10-09

A SUMMARY OF HOUSE BILL 4073 AS INTRODUCED 1-22-09

The bill would create the "Public Employee Retirement Health Care Funding Act" to do the following:

Create a Section 115 trust for each retirement system. Authorize and create one irrevocable trust under Section 115 of the Internal Revenue Code, 26 USC 115, for each retirement system under the following retirement acts:

- State Employees' Retirement Act
- Public School Employees Retirement Act of 1979
- Judges Retirement Act of 1992
- State Police Retirement Act of 1986
- Michigan Legislative Retirement System Act

Trust grantor/administrator. Designate the governing board of each retirement system as the trust grantor and require the governing board to administer the trust to pay retirement health care benefits to its past members and specified dependents.

Trustees. Designate board members as trustees; require trustees to adopt a written trust agreement meeting specified requirements; allow trustees to adopt administrative policies and procedures and to contract for bookkeeping, benefit payment, and other plan functions; allow trustees to establish an administrative and investment fee structure.

Each trust managed separately. Require each irrevocable trust to be managed and operated separately.

Services provided by state departments. Require the Departments of Management and Budget, Treasury, and the Attorney General to provide services as requested by trustees.

Investments. Require trust assets to be invested according to the Public Employee Retirement System Investment Act; designate the state treasurer as investment fiduciary of the trusts (unless a retirement system's governing board elects to serve as investment fiduciary); and assign the investment fiduciary exclusive authority to employ or contract for personnel or services necessary for proper investments.

Trust deposits. Specify that each trust "would receive state appropriations, employer contributions, employee contributions, investment earnings, refunds and reimbursements, and other permitted deposits."

Limit on amount of deposits absent certification regarding impact on federal funds received by state. Prohibit a deposit in an amount exceeding twice the annual obligations of the irrevocable trust unless the state treasurer certifies that the deposit would not materially reduce the amount of federal funds received by the state to support payments under the Social Welfare Act (Medicaid).

Separation of health care trust and pension assets. Require irrevocable health care trusts to be kept separate from pension assets.

Establish funding and administrative accounts. Require trustees to establish a funding account for the funding and prefunding of retirement health care benefit obligations and allow them to create other accounts deemed necessary to administer the trust.

Right of past members in aggregate to funding account assets. Specify that past members in the aggregate would have contractual rights to the assets in the funding account for the payment of retirement health care benefits required under the applicable retirement act.

Deposits into and distributions from funding accounts. Allow a retirement system's governing board to authorize deposits into a funding account from time to time of any eligible funds on deposit within the retirement system for the purpose of paying eligible benefits; and allow distributions from a funding account to satisfy the retirement system's requirements for all retirement health care benefits provided by the system.

Annual financial statements. Require annual financial statements to be prepared in accordance with generally accepted accounting principles and an audit to be conducted each fiscal year by a qualified independent certified accounting firm in accordance with generally accepted accounting principles.

Irrevocability of asset contributions. Specify that, except as otherwise provided in Sections 4, 8, and 18, the contribution of assets to the trust would be irrevocable and could not be refused, refunded, or returned to the employer or employee.

Separate reserves/no diversion of reserve accounts or assets received from specific members. Allow trustees to establish separate reserves within the funding account to ensure that the assets are used for the exclusive benefit of specified groups of members and past members; prohibit the diversion of a separate reserve account for a purpose other than the payment of retirement health benefits and administrative costs for the specified group until the liabilities for each group have been satisfied; and prohibit assets received from specific members from being used to pay the benefits of any other member who is not that member's beneficiary.

Allowable use of irrevocable trust's assets. Require the irrevocable trust's assets to be used solely to provide retirement health care benefits as provided under this act (described as an essential function of government) and related administrative costs.

Prohibit assignment or alienation of trust assets or member benefits. Protect the assets of the irrevocable trust and a member or past member's right to benefits from execution, garnishment, attachment, the operation of bankruptcy laws, and other legal processes; and prohibit the assignment of assets or rights to benefits.

Prohibit diversion of assets of irrevocable trust. Require the assets of the irrevocable trust to be used exclusively for the benefit of past members and specified dependents and prohibit the diversion of the assets for a purpose other than the payment of retirement health care benefits and related administrative costs.

Use of assets remaining in funding account after satisfaction of all liabilities. Require that any assets remaining in the funding account after all eligible benefits have been paid and all other liabilities satisfied be distributed to the state or other qualified employer (i.e., one whose income would be excluded under Section 115(1) of the Internal Revenue Code) within the applicable retirement system.

Dissolution. Require, upon dissolution of the irrevocable trust, any assets remaining after the payment of debts and satisfaction of liabilities to be distributed to one or more states, political subdivisions, or other qualified organization (i.e., one with income excluded under Section 115(1) of the Code).

Requirements for written trust agreements. Specify provisions that must be contained in the written trust agreement for each trust regarding the creation and purpose of the trust, other requirements, management and operation, and various accounts to carry out the function of the trust.

Contributions to funding account. Allow the state, an employer within a retirement system, a member, or any other person to contribute amounts to a funding account within an applicable trust for the prefunding of retirement health care benefits; require contributions and investment earnings on them to be credited properly.

Separate plan document regarding reimbursements. Require trustees to establish a separate written plan document to govern reimbursement of expenses for medical, dental, and vision care with terms consistent with the applicable retirement act.

Use of funds when other retirement system funds contributed to funding account. If a retirement system's governing board has made a deposit of other eligible retirement system funds into a funding account, require the trust to use the funds in the funding account to satisfy the requirements for "all retirement health care benefits provided by the retirement system" that are consistent with the bill and the plan document.

Annual required contributions. Allow any funds in the funding account to be used for purposes of determining the annual required contribution for annual financial statements.

Ineligible medical expenses. Provide that any claims incurred before a past member became entitled to receive reimbursements under the applicable retirement act or the bill are not eligible medical expenses.

Severability; qualified plan status; Section 115 status. Specify that if the bill, or any portion of it, would cause a retirement system to lose its tax qualified status or prevent an irrevocable trust from meeting the requirements of Section 115, then that portion of the bill would not apply. Specify that if any part of the bill is declared invalid or unconstitutional, that declaration would not affect other parts.

Validity and duration of trusts. Provide that trusts created by the bill would not be invalid because of (1) any indefiniteness or uncertainty of the persons designated as beneficiaries, (2) any rules against perpetuities, against suspension of the power of alienation of title to property, or against trusts for the accumulation of income. Allow each trust to continue for the amount of time needed to accomplish its purpose.

State and local taxation of income of, and distributions from, trusts. Specify that (1) all assets and income of the trusts and (2) distributions from the trusts to past members or their dependents would be exempt from state and local taxation.

Trustee liability; indemnification. Protect trustees from personal liability and allow them to be indemnified for losses and expenses (including attorney fees) except in cases of willful misconduct or intentional wrongdoing. Specify that they are not responsible for the adequacy of the trust to meet its obligations and are not required to take action to enforce the payment of any contribution or appropriation.

Contractual nature of certain benefit obligations. Require retirement benefit obligations under the applicable acts to be construed as defining or otherwise granting a contractual right or privilege to health care benefits or other post-employment benefits to members and beneficiaries if a benefit, right, or privilege is established in the applicable retirement act. Members and past members would have a contractual right to a health care benefit if it is provided under the applicable retirement act at the time they separate from employment.

Correction of errors. Require the correction of errors in trust records that result in members, past members, or dependents paying to or receiving from a trust the wrong amount of money. Require trustees to incrementally adjust future payments to correct the error, to the extent practicable.

FISCAL IMPACT:

The bill would have an indeterminate fiscal impact on the State as well as local school districts. Currently retiree health benefits for the State's five retirement systems are funded on a pay-as-you-go basis rather than pre-funding long-term liabilities. While creating the legal framework for an irrevocable trust for the deposit of funds for retiree health care benefits, the bill neither changes current benefit levels nor identifies a specific source of revenue to fund benefit costs.

However, it may be interpreted that the bill increases State and school district costs by guaranteeing retiree health benefits that are not currently guaranteed. Section 17 would provide that members and past members of each of the retirement systems shall have contractual rights to a health care benefit provided in statute at the time of their separation from employment. The most recent estimation available of the unfunded actuarial accrued liability (UAAL) for all five systems totaled approximately $39 billion at the end of FY 2006-07.

Additionally, the governing board of each retirement system would be responsible for managing each trust and would be authorized to charge the trust for the cost of its administration.

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