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BILL ANALYSIS

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House Bill 5568 (Substitute H-2 as passed by the House) *(enacted version)*
Sponsor: Representative Gail Haines
House Committee: Detroit's Recovery and Michigan's Future
Senate Committee: Government Operations

Date Completed: 6-2-14

CONTENT

The bill would amend the Home Rule City Act to do the following with respect to a city that has a population over 600,000 or has discharged $1.0 billion of pension liabilities in bankruptcy, or both (i.e., Detroit):

-- Provide that the calculation of a pension benefit under a defined benefit plan could include only base pay, except as provided in a plan for adjustment.
-- Prohibit an annual pension benefit from including an additional payment based on the rate of the retirement system's investment return, except as provided in a plan for adjustment.
-- Allow the city to offer a retirement plan for employees hired after July 1, 2023, if it did not contribute more than 7.0% of base pay to a retirement account or if it offered the same retirement plan as provided in a plan for adjustment.
-- Limit the amount the city could contribute to a tax-deferred account for retirement health care insurance benefits for employees hired after July 1, 2023.

("Plan for adjustment" would mean a plan for adjustment of debts entered and approved by a Federal bankruptcy court.)

Section 4i of the Act authorizes a city to provide in its charter for a system of compensation for city employees and the dependents of city employees in the event of the employees' disability, injury, or death. Under the bill, this authority would be subject to Section 4p, which the bill would add, as described below.

Pension Benefits

Except as provided in a plan for adjustment, the following would apply if the city provides a defined benefit plan as part of the system of compensation under Section 4i.

The calculation of a pension benefit under the defined benefit pension plan could include only base pay. This limitation would not apply to years of service accrued before January 1, 2015.

The annual pension benefit could not include an additional payment based solely on the rate of investment return earned on the assets of the retirement system (a public employment retirement system established by the city). This would not prohibit the fulfillment of rights and benefits earned under a retirement system agreed to in a plan for adjustment.

The bill would define "base pay" as the remuneration paid an employee on account of his or her services rendered to the city. Base pay would not include payment for overtime services; remuneration paid in lieu of accumulated sick leave; remuneration received as a bonus; payment for accrued vacation pay; one-time lump-sum payments; or the cost of fringe benefits, including a medical benefit plan (as defined in the Publicly Funded Health Insurance Contribution Act).

Retirement Plans: Employees Hired after 7-1-23

If the city provides retirement benefits for employees first hired after July 1, 2023, as part of the system of compensation under Section 4i, either of the following would apply for the employees first hired after that date:

-- The city could offer retirement plans as long as it did not contribute more than 7.0% of the employee's base pay to an appropriate retirement plan.
-- The city could offer the same retirement plan as provided in a plan for adjustment.

Retirement Health Benefits: Employees Hired after 7-1-23

If the city provides retirement health care insurance benefits for new employees after July 1, 2023, as part of a system of compensation under Section 4i, the city could not contribute more than one of the following, whichever was greater, to an appropriate tax-deferred account:

-- 2.0% of the employee's base pay.
-- The percentage a qualified participant's employer contributes on behalf of a qualified participant under Section 68b(1) of the State Employees' Retirement Act.

(Under the conditions specified in Section 68b(1), a qualified participant's employer must make a matching contribution of up to 2.0% of the employee's compensation to an appropriate tax-deferred account, in lieu of any health insurance coverage premium that the State might have paid.)

The bill would define "retirement health care insurance benefit" as hospitalization and medical insurance, dental coverage, vision coverage, and any other health care insurance provided for a retirant or dependent of a retirant under a system of compensation that includes retirement benefits established under Section 4i.

Certification of Compliance

By January 1, 2024, and each subsequent January 1, if the city provides retirement benefits as part of a system of compensation under Section 4i, the city or a retirement system established by the city, as applicable, would have to submit a certification of its compliance with Section 4p to the Financial Review Commission created under the Michigan Financial Review Commission Act (which House Bill 5566 would enact).

MCL 117.4i et al. Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would have no fiscal impact on the State. The following local fiscal impacts were provided by the Governor's Office upon request by the Senate Fiscal Agency.

The bill would result in savings to the City of Detroit ("the City") and its pension systems. Specifically, the proposal to eliminate anything other than base pay from the calculation of a pension benefit would result in annual savings to the City estimated at $2.0 million, based on general feedback from the actuary for the retirement systems. The savings would be realized by lower annual contributions to the Police and Fire pension plan; savings for the General Retirement System would likely be relatively insignificant because overtime is much lower for general employees.

The proposal to eliminate any additional payments based solely on the rate of investment returns also would result in reduced costs to the pension systems, although by an indeterminate amount. Since 1985, the retirement systems have paid out nearly $175.0 million in "13th" checks; future payments for these additional payments would be prohibited by this legislation. Had that money remained in the funds instead of being paid out, the unfunded accrued liability today would be lower, and that would have resulted in lower contributions from the City. Prohibiting this in the future, then, could result in indeterminate savings to the City, as long as an unfunded accrued liability exists in the pension plans.

The proposal to cap, for employees newly hired after July 1, 2023, the amount the City may pay for a retirement plan at 7.0% would result in savings to the City compared to the plans offered to employees prior to the plan for adjustment. The previous General Retirement System had a normal cost contribution projected to equal 12.11% of payroll, or $8.7 million in fiscal year 2014-15; the proposed plan described in the plan for adjustment would have the City contribute 5.0%, for a cost of $3.6 million. Therefore, the first-year savings in normal costs are estimated at $5.1 million for the retirement pension plan identified in the plan for adjustment. The requirement that something similar be continued after July 1, 2023, likely would continue similar savings.

The proposed plan for Police and Fire as found in the plan for adjustment would require the City to deposit 12.25% of payroll into the retirement accounts, but since Police and Fire retirees do not receive social security, the City saves the 6.2% that otherwise would be paid for social security, bringing the "net" cost for Police and Fire to an equivalent cost of 6.05% for pension (12.25% contribution for retirement less 6.2% not required for social security). The 12.25% for the new proposed Police and Fire plan translates into roughly $25.0 million in annual contributions by the City, compared to the existing plan where the normal cost was estimated at 24.75% of payroll, at a cost of $54.5 million. Therefore, the City is estimated to save about $29.5 million in annual normal cost pension contributions for police and firefighters. Again, continuing something similar for police and firefighters first hired after July 1, 2023, as required under the legislation, likely would continue similar savings compared to the plan in place prior to the plan for adjustment.

Turning to retiree health care, the cost of retiree health insurance in fiscal year 2012-13 was approximately $135.0 million, excluding transportation retirees. In March 2014, the City put into place a new plan that was intended to reduce total retiree health costs to approximately $38.0 million annually. The total projected costs in 2023 for employees first hired on or after July 1, 2023, is estimated at $4.8 million, which reflects the 2.0% cap specified in the bill (for general employees) and 1.0% for police and fire retirees.

Fiscal Analyst: Kathryn Summers