Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bills 686 and 687 (as reported without amendment)
Senate Bill 688 (Substitute S-1 as reported)
Senate Bills 689 through 701 (as reported without amendment)
Sponsor: Senator Jim Stamas (S.B. 686, 687, 690, 694, 696, & 698)
Senator Mike Shirkey (S.B. 688, 689, 695, 697, & 699)
Senator Dave Hildenbrand (S.B. 691)
Senator Phil Pavlov (S.B. 692)
Senator Dave Robertson (S.B. 693)
Senator Arlan Meekhof (S.B. 700 & 701)
Committee: Michigan Competitiveness

CONTENT

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

-- Prohibit a local unit of government that offered retirement health benefits, beginning July 1, 2018, from reopening a defined benefit (DB) retirement system or reoffering any other DB plan to provide any new retirement health benefits after the DB retirement system or other plan had been closed.
-- Require the normal cost of retirement health benefits to be funded in a percentage increasing from 20% to 100% between fiscal years beginning after June 30, 2019, and fiscal years beginning after June 30, 2023.
-- Allow a local unit to seek a temporary waiver of the normal cost requirement if it would impose undue hardship.
-- Require a local unit of government to submit a summary retiree health care report annually to its governing body and the Department of Treasury.
-- Create an irrevocable trust for each retirement system, and require the normal cost funding and other prefunding of retirement health benefits to be deposited into the trust.
-- Prohibit a local unit that offered a retirement pension benefit under a defined benefit plan, beginning July 1, 2018, from reopening a DB plan or reoffering any other DB plan to provide new pension benefits after the system or plan had been closed to new hires.
-- Prohibit a local unit from providing pension benefits through a DB system or other DB plan to an individual elected or appointed to office after June 30, 2018, if he or she were new to the system or plan.
-- Require a local unit to pay at least the incremental cost increase in the annual required contribution if it adopted a benefit change to increase current or future pension benefits.
-- Prohibit a local unit, for fiscal years beginning after 2020, from using a rolling amortization method or an open amortization method for an unfunded actuarial accrued liability of pension benefits.
-- Require the State Treasurer to promulgate rules establishing standards for local units for actuarial assumptions and other methods of valuation of retirement systems.
-- Require the State Treasurer each year to determine the underfunded status of each local unit of government, based on whether the actuarial accrued liability of a retirement health system or retirement pension system was less than adequately funded, or other factors.

- -- Allow the State Treasurer to waive a determination of underfunded status under certain circumstances.
- -- Create the Local Government Retirement 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 monitor each underfunded local unit's compliance with the proposed Act and its corrective action plan.
- -- List corrective options that a corrective action plan could include, such as requiring additional employer contributions for future pension or health benefits; altering eligibility and benefit calculation provisions of a retirement system; submitting to the local electors a ballot question to impose or increase millage; and not subsidizing retirement health insurance benefits for future employees.
- -- Require the State Treasurer to declare that a financial emergency existed within a local unit if it could not agree on a corrective action plan, the Board disapproved its proposed plan, or the Board determined that the local unit's plan was not being implemented in a manner that would accomplish its objectives.
- -- Appropriate $1.5 million for fiscal year 2017-18 from the General Fund to the Department of Treasury for purposes of implementing the Act.

<u>Senate Bill 687</u> would add Sections 9a and 9b to the Local Financial Stability and Choice Act to:

- -- Require a financial management team to be created as the emergency manager for a municipal government, if the State Treasurer declared that a financial emergency existed within the municipal government under the proposed Act.
- -- Authorize the financial management team to take various actions to rectify the municipal government's underfunded status.
- -- Allow the financial management team to enter into a consent agreement with the municipal government.
- -- Require the Governor to appoint an emergency manager under the Local Financial Stability and Choice Act, and dissolve the financial management team, if municipal government failed to comply with proposed mandates or requirements.
- -- Require the Department of Treasury to create a website allowing residents of the municipal government to submit input.
- -- Appropriate $250,000 for fiscal year 2017-18 from the General Fund to the Department of Treasury for purposes of implementing Sections 9a and 9b.

<u>Senate Bill 688 (S-1)</u> would amend 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.

<u>Senate Bill 689</u> would amend Public Act 293 of 1966, which governs charter counties, to:

- -- Specify that if a county provided a system of retirement for its officers and employees under the Act, the system would be subject to the proposed Protecting Local Government Retirement and Benefits Act.
- -- Delete a provision under which the county board of commissioners, in a county with a population of 600,000 or more, may have up to 27, rather than 21, members.

<u>Senate Bill 690</u> would amend the Municipal Employees Retirement Act to:

- -- Make the powers and duties of the Municipal Employees Retirement System (MERS) retirement board subject to the proposed Act.

-- Allow a municipality to revoke its election to participate in MERS.
-- Require a municipality revoking its participation to select an actuary to analyze the municipality's contribution requirements associated with a revocation.
-- Provide that the municipality would be responsible for funding those contribution requirements.

Senate Bill 691 would amend 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 would be subject to the proposed Act.

Senate Bill 692 would amend Public Act 139 of 1973, which provides for an optional unified form of county government, to specify that, for a county that had adopted such a form of government and provided for a retirement system for the county's employees, the retirement system would be subject to the proposed Act.

Senate Bill 693 would amend 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 would be subject to the proposed Act.

Senate Bill 694 would amend 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 proposed 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 695 would amend the Fire Fighters and Police Officers Retirement Act to:

-- Provide that a retirement board, retirement system, and city, village, or municipality that was the custodian of a retirement system's funds under the Act would be subject to the proposed Act.
-- Require appropriations made by a municipality under the Retirement Act to be sufficient to pay the normal costs of any retirement health benefits provided by a retirement system in the amount required by the proposed Act.
-- Provide that a tax levied by a municipality under the Retirement Act could not be transmitted to or captured or retained by any other governmental entity.

Senate Bill 696 would amend 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 proposed Act.

Senate Bill 697 would amend the Home Rule City Act to specify that, if a city provided retirement benefits as part of a system of compensation, those benefits would be subject to the proposed Act.

Senate Bill 698 would amend the Reciprocal Retirement Act to require a reciprocal unit and a reciprocal retirement system to comply with applicable requirements of the proposed Act.

Senate Bill 699 would amend Public Act 566 of 1978, which prohibits a public officer from holding incompatible offices, to specify that the prohibition would not apply to a member of a financial management team or a member of the Local Government Retirement Stability Board created under the proposed Act.

Senate Bill 700 would amend the Revised Municipal Finance Act to establish a sunset of December 31, 2017, rather than December 31, 2018, on provisions that allow counties, cities, villages, and townships to issue municipal securities to pay the costs of unfunded pension liability for a retirement program or the costs of unfunded accrued health care liability.

Senate Bill 701 would amend the Open Meetings Act to provide that the Act would not apply to a financial management team or the Local Government Retirement Stability Board created under the proposed Act.

Legislative Analyst: Suzanne Lowe

MCL 141.1542 (S.B. 686)
MCL 38.1133 & 38.1140h (S.B. 688)
MCL 45.514 et al. (S.B. 689)
MCL 38.1536 et al. (S.B. 690)
MCL 46.12a et al. (S.B. 691)
MCL 45.554a et al. (S.B. 692)
MCL 38.702 (S.B. 693)
MCL 38.571 (S.B. 694)
MCL 38.559 et al. (S.B. 695)
MCL 41.110b (S.B. 696)
MCL 117.4i et al. (S.B. 697)
Proposed MCL 38.1102a (S.B. 698)
MCL 15.183 (S.B. 699)
MCL 141.2518 (S.B. 700)
MCL 15.263 (S.B. 701)

FISCAL IMPACT

Senate Bills 686 and 687

State

The bills would increase costs to the State by at least $1.75 million for fiscal year (FY) 2017-18. Senate Bill 686 would appropriate $1.5 million General Fund/General Purpose (GF/GP) revenue to the Department of Treasury to implement the requirements of the Protecting Local Government Retirement and Benefits Act, and Senate Bill 687 would appropriate $250,000 GF/GP to the Department for the purpose of implementing Sections 9a and 9b of the Local Financial Stability and Choice Act.

It is likely that at least some of this $1.75 million would be necessary on an annual basis to fund the ongoing requirements of the Department (e.g., reviewing and overseeing funded status, reporting to the Legislature, providing administrative support, and establishing a financial management team and associated staff for local units for which a financial emergency was declared) and the Local Government Retirement Stability Board (e.g., review, oversight, travel, and contracting with professional services to assist local units of government).

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 is made, along with the normal cost payment.

Prefunding is not currently required for retiree health care plans. Local units offering retiree health care may 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 may choose to pay the costs as they arise (e.g., pay-as-you-go). The latter costs more on a long-term basis due to the foregoing of investment earnings.

The bills propose to establish funding requirements for retiree health care, and to manage existing requirements for pension funding.

<u>Local - Retiree Health Care</u>

The bills would have an indeterminate fiscal impact on local units of government. Senate Bill 686 would not allow local units of government to reopen a closed defined benefit health plan; the fiscal impact of this would be determined by a cost comparison of the closed plan versus what would be offered in its place. The bill would include mandatory minimum normal cost contributions for retiree health plans, and a requirement to pay at least the incremental cost increase in the annual required contribution for any material benefit change adopted.

For local units of government not already following at least the prescribed contribution levels, there would 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 invested today, the more time those dollars have to grow and be used to pay the cost of benefits down the line.

<u>Local - Pension</u>

Senate Bill 686 would eliminate a defined benefit plan for individuals first elected or appointed to an office of a local unit of government after June 30, 2018 (for individuals who would be new to the defined benefit retirement system or defined benefit plan). The fiscal impact of this would be determined by a cost comparison of the existing defined benefit plan to whatever would be offered in its place.

The bill also would require the local unit to pay at least the incremental cost increase in the annual required contribution for any material benefit change adopted. Similar to retiree health care described above, any increase in dollars contributed to a retirement plan today should result in lower costs in the future due to the capture of (presumed) investment earnings.

The bill also would prohibit local units of government from using a rolling amortization period to finance the unfunded actuarial accrued liability.

For local units of government that either were using a rolling amortization period or planning to use one, the prohibition would require the UAAL to instead be financed over a fixed period of time (like a mortgage), with an end date instead of open-ended. The fiscal impact would be indeterminate; however, if the UAAL grew over the amortization period, and the end date were fixed under the bill, additional contributions likely would be necessary to "pay the mortgage off" in the prescribed time, compared to a rolling amortization period where a final payoff would not be required, and payments could be stretched out indefinitely.

Under a system in which rolling amortization periods were eliminated, once the UAAL "mortgage" was paid off, the only contributions required of the local unit of government would be any applicable normal costs. Therefore, after the amortization period ended and the UAAL was paid off, the local unit would experience lower costs compared to a local unit that used a rolling amortization period and had to continue to make annual UAAL payments.

Local - Corrective Action Plans

The fiscal impact for local units of government required to submit and comply with corrective action plans (i.e., those determined to be in underfunded status and not granted a waiver) is indeterminate. Corrective action plans could require any of the following (with the fiscal impact noted parenthetically):

- -- Additional employer contributions (increased short-term cost, likely long-term reduction in costs due to capture of likely investment earnings).
- -- Additional employee contributions (stable or reduced costs for employers).
- -- Adjustment of debt structure, altering of eligibility, calculation of benefits, copays, drug prescription coverage, or other provision modifications (indeterminate).
- -- Submitting a ballot question to impose a new millage or increase an existing millage (increased revenue to the local unit, if passed).
- -- Limiting the amount the local unit may pay toward the cost of providing retiree health benefits (stable or lower costs for local units).
- -- Levying a property tax to meet an appropriation made under the Fire Fighters and Police Officers Retirement Act (increased revenue for the local unit to meet a mandated cost).
- -- Requiring each individual to enroll in Medicare Parts A and B when eligible (likely reduction in costs to local unit if not already requiring this enrollment).
- -- Requiring the local unit not to subsidize retiree health insurance benefits for any employee first employed after a specified date in the future (indeterminate, depending on whether some form of compensation was provided to the employee in lieu of the retiree health benefits and to what extent).

Local - Financial Emergency

Senate Bill 686 would allow the State Treasurer to declare that a financial emergency existed within a local unit of government under three situations: the local unit could not reach agreement on the formation of a corrective action plan; the Local Government Retirement Stability Board did not approve the corrective action plan; or, the Board determined that the approved corrective action plan was not being implemented in a manner that would accomplish its objectives.

Under any one of these scenarios, the State Treasurer would have to notify the Governor of the declaration of a financial emergency for the purposes of Section 9a of the Local Financial Stability and Choice Act. Senate Bill 687 would establish Section 9a, which would require that a financial management team be created in the Department of Treasury as the emergency manager for a local unit of government to address the underfunded status.

The financial management team would be granted "broad powers" to address the underfunded status of a local unit while preserving the local unit's fiscal stability and capacity to provide essential services. The following are the actions that the team would be allowed to take under the bill (with the fiscal impact noted parenthetically):

-- Require the local unit to take corrective options described above under corrective action plans (varying fiscal impact depending on option(s) chosen).
-- Require the local unit to amend, revise, approve, or disapprove its proposed budget to address required payments for retiree health and pension benefits (indeterminate).
-- Require the local unit to employ or contract auditors, actuaries, and other technical personnel necessary to address the underfunded status (a cost increase to the local unit to the extent applicable personnel were employed).
-- Require the local unit to sell, lease, assign, or otherwise use or transfer the assets or liabilities of the municipal government (indeterminate).
-- Require any other action to address the underfunded status (indeterminate).
-- Enter into a consent agreement with the local unit, which could grant to an officer of the local government one or more powers vested in the financial management team (indeterminate).

If a financial management team determined that a local unit failed to comply with the mandates or requirements of Section 9a, and if the local unit failed to rectify its noncompliance within 30 days, then the team would have to declare that a financial emergency existed and the Governor would be required to appoint an emergency manager. Under the Local Financial Stability and Choice Act, an emergency manager is required to act for and in the place of the governing body, and is given broad powers to rectify a financial emergency.

Senate Bills 688 (S-1), 689, and 691 through 698 would amend various acts to require compliance with the requirements of Senate Bill 686, and as such would not have independent fiscal impacts.

Senate Bill 690 would allow a local unit to revoke its participation in the Municipal Employees Retirement System (MERS). There are at least two potential fiscal impacts related to this bill. If local units were allowed to revoke participation, MERS would have to liquidate assets in the portfolio in order to have cash on hand to return to a local unit that revoked its participation. Liquidating assets into cash would in all likelihood mean a lower rate of return on that cash compared to what the assets could have earned as nonliquid assets. The lower rate of return on cash would affect all municipalities, even if none left MERS, by leaving less funds in the portfolio, which would mean a higher contribution into the system to pay benefits.

Also, MERS pools the retirement contributions of participating municipalities and invests those contributions to maximize investment opportunities. If a large number of municipalities revoked participation (or a small number of municipalities with large contributions left MERS), this could adversely affect the ability of MERS to invest using economies of scale, which would reduce purchasing power and could lead to lower investment earnings for municipalities that remained in MERS. Again, lower investment earnings would mean a higher contribution from local units remaining in MERS to make up for those lower earnings and to pay for benefits.

Senate Bill 699 would amend Public Act 566 of 1978 to bring it into compliance with Senate Bills 686 and 687, and as such would not have an independent fiscal impact.

Senate Bill 700 would remove an option that currently exists for municipalities, in certain situations, to issue securities to finance their retirement obligations. This option is available until December 31, 2018; the bill would change that date to December 31, 2017. Eliminating this option could affect those local units that may have sought to issue securities, but the extent of that impact is unknown, and the number of local units seeking this option between December 31, 2017, and December 31, 2018, likely would be small.

Senate Bill 701 would have no fiscal impact on State or local government.

Date Completed: 12-6-17 Fiscal Analyst: Kathryn Summers