Senate Fiscal Agency
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BILL ANALYSIS

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House Bill 6475 (Substitute H-3 as passed by the House)
House Bill 6476 through 6481 (as passed by the House)
Sponsor: Representative Thomas Albert (H.B. 6475, H.B. 6476, & H.B. 6477)
Representative Steven Johnson (H.B. 6478 & H.B. 6479)
Representative Rob VerHeulen (H.B. 6480 & H.B. 6481)
House Committee: Financial Liability Reform
Senate Committee: Appropriations

Date Completed: 12-11-18

CONTENT

The main bill in the package, House Bill 6475 (H-3), would codify the provisions of the current State Police contract pertaining to retirement, namely a 'hybrid' pension plan that has been applicable for employees hired since June 10, 2012, and the elimination of retiree health care premium coverage. The bill also would lower the assumed growth in payroll (used to determine annual employer contributions) and lengthen the date by which unfunded actuarial accrued liabilities (UAAL) in the system would be paid off, from 2036 to 2038. The remaining bills in the package update references throughout other statutes to reflect the amendments in House Bill 6475 (H-3).

The bill would codify the hybrid pension plan, which combines components of a traditional defined benefit pension and a defined contribution (i.e., a 401k-style) plan. The main components of the hybrid plan compared to the traditional pension plan include the following:

-- Using the previous five years, instead of two, to calculate the final average compensation (FAC).
-- Eliminating overtime from the FAC calculation.
-- Requiring a member to contribute 4% of compensation for deposit into the reserve for employee contributions.
-- Calculating the FAC with 2% multiplied by up to 25 years of service, plus a 40 basis point reduction in the 2% multiplier for each of the next five years, until the multiplier reaches 0% for the years of service that exceed 30.
-- Eliminating the purchase of service credit for volunteering in the VISTA program or for time separated from service due to maternity, paternity, or child rearing.
-- Eliminating retiree health insurance premium coverage, and replacing it with a 401k-style savings account that may be used for retiree health care (or for other purposes). The employer is required to match the first 2% deposited by the member.
-- Enrolling the member in a defined contribution plan where the employer is required to contribute 50% of the first 2% deposited by the member into the account (i.e., the maximum employer contribution to the defined contribution component of the hybrid plan is 1% of compensation).

The bill would codify retirement allowance payment options that have been part of bargained contracts affecting members hired on or after July 1, 2006, that allow members to choose a

straight retirement allowance, or a reduced retirement allowance that would make payments to the member's beneficiaries. The bill also would codify the requirement for members hired before June 10, 2012, who are in the previous traditional defined benefit plan, to pay 2% of compensation for deposit into the reserve for employee contributions. The bill specifies that any unclaimed contributions from this reserve would be transferred to the reserve for retired benefit payments.

Beginning with fiscal year (FY) 2021-22, the payroll growth assumption used to calculate required contributions would have to be reduced by 50 basis points each year, until the assumed payroll growth were 0%. (It is currently assumed to grow 2.75% annually.) This effectively phases in a change whereby contributions made currently as a flat percentage of an assumed growing payroll instead would convert to 'level dollar' payments where each annual dollar payment is roughly the same (adjusting for changes in UAAL). The bill also would allow ORS and the retirement board to agree to reduce the payroll growth assumption by more than 50 basis points in any year. Reducing the payroll growth assumption would increase payments into the system on the front end, but would reduce payments down the road. Because of the cost for the higher annual payments, the bill would extend the amortization period by two years, requiring the UAAL to be paid off not later than September 30, 2038.

Beginning with FY 2018-19, and for each subsequent year, the bill would require contribution 'floors' for both the required contribution for normal costs and for the required contributions for the UAAL. The bill further would require that the *employer* portion of the UAAL payment in a given year not be less than the payment in the previous year. Instituting the floors would eliminate any reductions that may have occurred in the State's payments to the retirement system, which would help to stabilize funding in the system and would likely lead to lower costs over time, since the additional payments would have a longer time to generate investment earnings over the lifetime of the amortization period.

Other provisions in House Bill 6475 (H-3) include requiring an annual (instead of biennial) valuation of assets and liabilities and requiring the retirement board and Office of Retirement Services (ORS) to conduct and review an experience investigation study, with the review occurring at least once every five years. In addition, every April 1 following a periodic review of risk factors, the bill would require ORS and the State Treasurer to submit a report with forecasted rates of return on investments at various probability levels, actual rates of return, mortality assumptions, retirement age assumptions, payroll growth assumptions, and any other assumptions with material impacts on the financial health of the retirement system.

MCL 38.1603, et. al.

FISCAL IMPACT

The provisions related to codifying in statute the pension plan that has been in the contract for Michigan State Police since 2012 would have no fiscal impact to the State at this time.

Reducing the assumed rate of payroll growth would increase costs in the short run, but would reduce costs in the long run since higher payments in the near term would have more time to generate investment earnings. However, the extension of the amortization period (the period by which the UAAL must be paid off) would result in a cost of approximately $100.1 million, according to the Office of Retirement Services. This cost would be spread out over the remaining 20 years of the amortization period. The table below illustrates the estimated fiscal impact over the next 20 years that would be faced by the State.

It is important to understand that the $100.1 million cost differential would decline if payroll does not grow 2.75% per year for each of the next 18 years, which is what is assumed in the

annual contribution costs shown in the first column. If payroll grows at a smaller percentage than 2.75% annually, the $100.1 million cost would decline.

If the bill did not include an extension of the amortization period, then the reduction of payroll growth assumptions, compared to the assumed 2.75% growth assumed now, would cost more in the initial years but in the long run would result in savings of roughly $50.0 million. The $50.0 million savings would increase if the 2.75% assumed payroll growth did not materialize over the next several years. (These figures are not shown below.)

Implementing contribution floors would ensure that no future payment would be less than the previous year's payment, until the UAAL is paid off. This should lead to paying off the UAAL more quickly, all else being equal, because in years when experience is more favorable than assumed (e.g., better investment returns), and contributions could have been lowered, those contributions instead would remain flat and would be added to the assets of the system.

Estimated Fiscal Impact of House Bill 6475

Fiscal Year	Current Law: Level Percent of Payroll	House Bill 6475: Phase In Level % and Extended Amortization	Estimated Dollar Difference
2018-19	$109,844,294	$109,844,294	$0
2019-20	101,188,365	109,844,294	8,655,929
2020-21	113,095,585	109,844,294	(3,251,291)
2021-22	115,935,055	112,357,723	(3,577,332)
2022-23	119,504,959	117,041,140	(2,463,819)
2023-24	123,060,061	122,948,173	(111,888)
2024-25	126,444,212	127,964,202	1,519,990
2025-26	129,921,428	132,255,818	2,334,390
2026-27	133,494,267	134,156,214	661,947
2027-28	137,165,359	134,156,215	(3,009,144)
2028-29	140,937,406	134,156,215	(6,781,191)
2029-30	144,813,185	134,156,215	(10,656,970)
2030-31	148,795,547	134,156,214	(14,639,333)
2031-32	152,887,425	134,156,215	(18,731,210)
2032-33	157,091,829	134,156,214	(22,935,615)
2033-34	161,411,855	134,156,216	(27,255,639)
2034-35	165,850,681	134,156,215	(31,694,466)
2035-36	170,411,575	134,156,214	(36,255,361)
2036-37	0	134,156,215	134,156,215
2037-38	0	134,156,215	134,156,215
Total	**$2,451,853,088**	**$2,551,974,515**	**$100,121,427**

Source: Office of Retirement Services

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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.