

# Legislative Analysis



## PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM REVISIONS

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<http://www.house.mi.gov/hfa>

**House Bill 4263 as introduced**  
**Sponsor: Rep. Brad Paquette**  
**Committee: Appropriations**  
**Complete to 2-23-21**

Analysis available at  
<http://www.legislature.mi.gov>

### SUMMARY:

House Bill 4263 would amend the Public School Employees Retirement Act to do all of the following:

- Adopt layered amortization
- Reduce the time frame over which a deficiency in the actuarially determined contribution must be paid.
- Require that the most recent mortality tables provided by the Actuarial Standards Board be used.
- Implement a reduced cap for the assumed rate of return and discount rate.

#### Layered Amortization

Beginning in Fiscal Year (FY) 2021-22, and for each subsequent fiscal year, the bill would require the retirement system to use layered amortization with a fixed and closed period of not more than 10 years. Additionally, any layered amortization period must use level dollar amortization.<sup>1</sup> The practice of layered amortization requires any new actuarial losses in any given year to be amortized separately from the existing unfunded actuarial liability (UAL) in rolling 10-year periods. Currently, the existing UAL is amortized out over a schedule ending September 30, 2038. Any new actuarial losses are combined with the existing UAL and amortized over the same period.

#### Reconciliation

Beginning in FY 2022-23, and for each subsequent fiscal year, the bill would require the Office of Retirement Services (ORS) to certify the difference between the estimated and the actual aggregate compensation and the estimated and the actual contribution rate no less than 90 days after the end of the fiscal year. Further, the bill would require the legislature to appropriate the amount certified by ORS from the School Aid Fund in the following fiscal year. Current law amortizes this amount over five years, with interest, beginning with the second fiscal year following the certification.

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<sup>1</sup> The retirement system currently uses level percent of payroll amortization, but it has begun to reduce the payroll growth assumption to eventually reach level dollar amortization in FY 2027-28. The level dollar method contributes a fixed sum with more of the payment frontloaded because there is no assumed payroll growth. On its own, level dollar eliminates any risk associated with not meeting the assumed payroll growth and allows earlier higher contributions more time to accumulate investment earnings. See analysis of legislation [here](#).

### Mortality Tables

Beginning in FY 2021-22, and for each subsequent fiscal year, the bill would require the reporting unit to use the most recent mortality assumptions provided by the Actuarial Standards Board and adopted as risk assumptions by the actuary. Current law requires the retirement board to conduct and review an experience investigation study and adopt risk assumptions on which actuarial valuations are to be based. Currently, the experience study is completed every five years.

### Reduced Cap for Assumed Rate of Return and Discount Rate

Beginning in FY 2021-22, and for each subsequent state fiscal year, the bill would revise the cap on the investment rate of return and discount rate used by the retirement system to determine total system liability from 8% to a cap of 6.8%. According to the 2020 Comprehensive Annual Financial Report (CAFR), the Michigan Public School Employees' Retirement System (MPERS) currently uses a 6.8% rate of return and discount rate for the legacy pension system and 6.95% rate for other post-employment benefits (OPEB) due to the both the legislative adoption of a lower rate and the dedicated gains policy. The Pension Plus and Pension Plus 2 systems utilize a 6.8% and 6.0% rate, respectively. Under the current dedicated gains policy, the assumed rate of return and discount rate may go down but will not increase in future years.

MCL 38.1341

## **FISCAL IMPACT:**

Generally speaking, the bill likely would increase near-term budgetary cost pressures by creating higher upfront payments for the School Aid budget relative to current estimates but generate longer-term net savings for the state and MPERS employers overall. The combination of the shorter time frame over which any new actuarial loss would be amortized (10-year layered amortization using level dollar), reducing the time frame over which a deficiency in the actuarially determined contribution must be paid, reducing the assumed rate of return cap, and requiring that the most recent mortality tables provided by the Actuarial Standards Board be used could require increased allocations to the retirement system when compared to current projections in the near term. The magnitude of the near-term budgetary cost pressures and longer-term net savings would depend on system experience. Each component is explained in more detail below.

The bill would require any new annual actuarial loss to be amortized over rolling 10-year time periods using level dollar amortization, separate from the current UAL amortization schedule (ending September 30, 2038). Reducing the amortization schedule compared to current law and utilizing level dollar amortization (currently level percentage of payroll is used) for any new actuarial losses would increase annual payments upfront compared to current law but generate net savings overall because the funds would be deposited into the system earlier, thereby generating returns. Under the bill, layered amortization would lengthen the amortization period of any actuarial losses after FY 2027-28 relative to current law, potentially reducing costs in those years, but spreading actuarial losses beyond the current amortization horizon. It is unclear how negative UAL would be treated.

Reducing the time frame over which any deficiency in the actuarially determined contribution must be paid would also have the practical effect of creating higher upfront payments in years when there is a deficiency because currently any deficiencies are amortized over a five-year period with interest. In the longer term, the system would realize net savings.

Revising the assumed rate of return and discount rate to 6.8% would increase near-term costs related to OPEB because the current rate is 6.95%. Similar to other changes, the net effect would be long-term savings for the state and MPSERS employers. The other components of the MPSERS system use assumed rates of return of 6.8% or below.

Lastly, updating the mortality tables on a more regular basis would have an unknown fiscal impact. The retirement system updates mortality tables every five years through an experience study. Any fiscal impact would depend on the mortality tables required to be used under the bill and the mortality tables used in the most recent experience study.

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