Legislative Analysis

HOUSE FI$CAL AGENCY

STATE EMPLOYEE RETIREMENT SYSTEM REVISIONS

Phone: (517) 373-8080
http://www.house.mi.gov/hfa

House Bill 4264 as enrolled
Sponsor: Rep. Steven Johnson
House Committee: Appropriations
Senate Committee: Appropriations
Complete to 2-2-23

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

(Vetoed by the Governor 12-22-22)

SUMMARY:

House Bill 4264 would amend the State 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 actuary that are most appropriate for the characteristics of the population be used.
- Implement a reduced cap for the assumed rate of return and discount rate.

Layered Amortization

Beginning in fiscal year (FY) 2027-28, 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. Beginning in FY 2027-28, the normal cost contribution for any fiscal year must not be less than the normal cost component of the actuarially determined contribution.

The practice of layered amortization requires any new actuarial losses to be amortized separately from the existing unfunded actuarial liability (UAL). Currently, the existing UAL is amortized over a schedule ending September 30, 2038. Any actuarial losses are combined with the existing UAL and amortized over the same period.

Reconciliation

Current law requires 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 60 days after the end of the fiscal year. Beginning in FY 2022-23, and for each subsequent fiscal year, the bill would require a minimum of 34% of any difference between the estimated and the actual aggregate compensation, if any, to be paid by the employer in the next fiscal year. The employer would be required to pay a minimum of 50% of the remaining difference in each of the following two fiscal years or until 100% of the remaining difference is submitted, whichever occurs first. Current law amortizes this amount over five years, with interest, beginning with the second fiscal year following the certification.

Mortality Tables

Beginning in FY 2021-22, and for each subsequent fiscal year, the bill would require the retirement board and the Department of Technology, Management, and Budget (DTMB) to adopt, on the recommendation of the actuary and in accordance with all applicable actuarial standards of practice, the most current mortality tables that are most appropriate for the characteristics of the population. Current law requires mortality tables be adopted by DTMB and the retirement board. Mortality tables are updated through an experience study conducted every five years.

Reduced Cap for Assumed Rate of Return and Discount Rate

The bill would revise the investment rate of return and discount rate cap used by the retirement system to determine total system liability from 8.0% to 6.0% for the pension and from 8.0% to 6.2% for retiree health care. The State Employee Retirement System currently uses a 6.0% rate of return and discount rate for the pension and 6.2% for retiree health care.

Lastly, the bill would include a provision that would require the actuarial equivalent retirement allowance to be determined by using an assumed rate of return and discount rate not to exceed 6.75%. Current law requires the use of an interest rate determined by the retirement board and this rate is currently set at 6.75%.

MCL 38.20g et seq.

FISCAL IMPACT:

Under the provisions of the bill, the magnitude and scope of any annual fiscal impact would depend on system experience. Each component is explained in more detail below.

Beginning in FY 2027-28, 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). Implementing 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. This would effectively reduce the risk of contribution volatility in a short existing amortization period.

Reducing the time frame over which any deficiency in the actuarially determined contribution must be paid would generate higher upfront payments in years when there is a deficiency because currently any deficiencies are amortized over a five-year period with interest. The bill would lower this reconciliation period to no more than three years. In the longer term, the system would realize net savings. Due to more conservative actuarial assumptions, annual deficiencies in future years, if any, are expected to be relatively small.

Revising the assumed rate of return and discount rate to 6.0% for the pension plan and 6.2% for retiree health care would have no fiscal impact because the revised rates reflect the current rates used by the pension plan and retiree health care plans.

The provision concerning mortality table revisions would have no fiscal impact compared to current law. The language is assumed to ensure the retirement system follows actuarial recommendations with regard to mortality tables when they are provided. The retirement system updates mortality tables every five years through an experience study.

***Vetoed 12-22-22*:**

The bill was among several that Governor Whitmer said she vetoed because they "were rushed through a lame duck session and need closer examination."

Fiscal Analyst: Ben Gielczyk