

Legislative Analysis



PUBLIC SCHOOL EMPLOYEE RETIREMENT SYSTEM REVISIONS

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

House Bill 4263 (proposed substitute H-5)

Sponsor: Rep. Brad Paquette

Committee: Appropriations

Complete to 3-24-21

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 timeframe over which a deficiency in the actuarially determined contribution must be paid (a process known as reconciliation).
- 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) 2024-25 for an open plan and FY 2029-30 for a closed plan, 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 for a closed plan and not more than 15 years for an open plan, as it emerges. Additionally, any layered amortization period must use level dollar amortization.¹ 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 in any given year to be amortized separately from the existing unfunded actuarial liability (UAL) in rolling 10-year (closed plan) or 15-year periods (open plan). 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.

The bill defines a "closed plan" as a plan under Tier 1 that is closed to new hires. An "open plan" is defined as a plan under Tier 1 that is open to new hires.

¹ 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](#).

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 90 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 and the estimated and the actual actuarial employer contribution rate, 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

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 the retirement board to conduct and review an experience investigation study and adopt risk assumptions on which actuarial valuations are to be based at least once every five years. Currently, the experience study is completed every five years and mortality tables are updated at that time. The provisions of the bill ensure that will continue.

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 caps on the investment rate of return and discount rate used to determine total system liability from 8% to a cap of 6.8% for the pension benefit and from 8% to 6.95% for retiree health benefits. 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 plan and 6.95% rate for retiree health benefits due to the both the legislative adoption of a lower rate and the dedicated gains policy. The Pension Plus and Pension Plus 2 plans 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 would have an indeterminate fiscal impact on the state and School Aid Fund. 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 2024-25 for an open plan and FY 2029-30 for a closed plan, the bill would require any new annual actuarial loss to be amortized over rolling 15-year time periods (open plan) or 10-year time periods (closed plan) using level dollar amortization, separate

from the current UAL amortization schedule (ending September 30, 2038). Under the bill, implementing layered amortization would lengthen the amortization period of any actuarial losses after FY 2024-25 for an open plan and FY 2029-30 for a closed plan 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 remaining 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 timeframe to no more than three years. In the longer term, the system would realize net savings. Due to both more conservative actuarial assumptions and a dollar contribution floor, annual deficiencies in future years, if any, are expected to be relatively small.

Revising the assumed rate of return and discount rate cap to 6.8% for the pension and 6.95% for retiree health care would have no fiscal impact because the new rates reflect the current rates used by the pension and retiree health care plans. Further, under the current dedicated gains policy utilized by ORS, it is expected that the AROR would only move lower. The other components (Pension Plus I and Pension Plus II) of the MPSERS system use assumed rates of return of 6.8% and 6.0%, respectively, and would not be affected by this change.

Lastly, 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.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.