



**Senate Fiscal Agency**  
P. O. Box 30036  
Lansing, Michigan 48909-7536

**BILL ANALYSIS**

**Telephone: (517) 373-5383**  
**Fax: (517) 373-1986**

House Bill 4338 (Substitute H-2 as passed by the House)  
Sponsor: Representative Anthony Forlini  
House Committee: Financial Liability Reform  
Senate Committee: Appropriations

Date Completed: 9-6-16

**CONTENT**

The bill would amend the Public School Employees Retirement Act to require the Department of Technology, Management, and Budget (i.e., its Office of Retirement Services) to administer Tier 2 (defined contribution) through a third party administrator, and to designate between three and eight investment vendors that would be eligible to provide investment options for qualified participants who are employed by reporting units (schools, intermediate districts, participating libraries and charter schools, and community colleges).

Employees hired since the introduction of the hybrid pension plan in 2010 and the alternative defined contribution-only plan in 2012 have had at least some portion of their retirement savings deposited into a Tier 2 (defined contribution) plan. At present, the Office of Retirement Services (ORS) administers the Tier 2 plans, and has the exclusive authority and responsibility to employ or contract with personnel and for services necessary for the proper administration of and investment of assets of Tier 2. The bill would require the ORS, beginning July 1, 2016, to administer Tier 2 through a third party administrator.

The bill specifies that the third party administrator could not be affiliated with an entity that provides investment services to the retirement system, a reporting unit, or a qualified participant, and that the selection of the administrator would have to be based on a competitive proposal process. The bill further specifies the composition of the request for proposal (RFP), including a requirement for bidders to disclose conflicts of interest, criminal convictions, investigations, and pertinent litigation, and to certify experience and demonstrated ability to administer Tier 2. The selected administrator would be required to provide administration, enrollment, and record-keeping, and coordinate customer education with all Tier 2 investment vendors, as well as conform to the payroll and information sharing processes established by the ORS.

The bill would require the ORS to designate at least three, but not more than eight, investment vendors that would be eligible to provide investment options for qualified participants. Again, an RFP would be issued for these vendors, with requirements similar to those for the administrator of the plan. The bill would require this RFP to be conducted at least once every five years. The bill specifies that an investment vendor could include, but would not be limited to, an insurance company, investment adviser, or broker-dealer.

An entity chosen as an investment vendor would have to offer a variety of investment options and provide to its customers authorized investment advisers that would provide investment advice. The entity also would have to meet disclosure requirements of covered service providers and not be subject to disqualification, as specified in the bill. The ORS would be required to consider the experience of the entity, the quality of investment options, the

suitability of investment options, the capability and commitment to perform in a manner that was in the best interests of qualified participants, and the fees and expenses associated with proposed investment options.

The bill further would allow in-plan transfers of Tier 2 account balances across Tier 2 contracts or account plans, whether the contract or plan was with the default investment vendor or an alternate investment vendor. A default investment vendor would be one selected by the ORS to provide investment options for qualified participants of reporting units that did not select one of the (up to eight) alternate investment vendors identified by ORS.

The bill would allow a reporting unit to select one or more alternate investment vendors from those chosen by the ORS to provide investment options for that reporting unit's employees who are qualified participants. An alternate investment vendor chosen by a reporting unit would be required to designate at least one authorized investment adviser to provide at least one hour of financial literacy education and customer service at the reporting unit per school year. If a reporting unit did not choose an alternate investment vendor, the default investment vendor would be required to designate the adviser and provide the financial literacy education.

The bill would prohibit the ORS from collecting employer or employee contributions related to Tier 2 from a reporting unit that selected an alternate investment vendor, unless authorized to do so by the reporting unit. The bill specifies that the State and the reporting unit would not have a duty to monitor the alternate investment vendor's performance.

MCL 38.1425 et al.

### **FISCAL IMPACT**

According to the Office of Retirement Services, the current cost of administering Tier 2 is \$2.1 million. However, the ORS has estimated that the costs of administering the plan could increase substantially if the bill were enacted because all of the existing administrative tasks relating to fiduciary oversight that are done with the current single plan vendor would have to be done with each potential vendor (at least three, and up to eight). The ORS has provided estimates of an additional \$850,000 to \$1.7 million for each vendor, plus another \$800,000 per year for audits of vendors. At the low end of the estimates, the additional yearly administrative costs could total \$2.9 million (three vendors at \$850,000 each plus \$300,000 for three audits); at the high end, the additional yearly administrative costs could total \$14.4 million (eight vendors at \$1.7 million each, plus \$800,000 for eight audits).

Local units (schools) likely would not see increased administrative costs if choosing an alternate investment vendor, because typically investment vendors build their administrative costs into fees assessed on investors' accounts. Often, fees in smaller plans are higher than those in bigger plans. According to a 2013 study by Deloitte Consulting, the average fee for plans with assets between \$1.0 million and \$10.0 million was 1.17%; the average fee for plans with assets between \$10.0 million and \$100.0 million was 0.89%; the average fee for plans with assets between \$100.0 million and \$500.0 million was 0.63%; and, the average fee for plans with \$500.0 million or more in assets was 0.41%. (According to the ORS, currently the 130,000 participants in the State's plan have nearly \$6.5 billion in assets and pay an average of between roughly 0.3% and 0.4% in fees.)

Fiscal Analyst: Kathryn Summers

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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.