Legislative Analysis

STATE POLICE RETIREMENT SYSTEM REVISIONS

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House Bill 4266 (H-3) as reported from committee
Sponsor: Rep. Tommy Brann
Committee: Appropriations
Complete to 3-24-21

SUMMARY:

House Bill 4266 would amend the State Police 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) 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.

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 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 2 that is open for new hires.

Reconciliation
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, 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 fiscal year, the bill would require the retirement system's assumed rate of return on investments and discount rate to be capped at 6.8% for the pension and 6.9% for retiree health care, as of September 30, 2020. Under the bill, the rate could only be changed with the approval of the retirement board and the director of DTMB. Currently, the State Police Retirement System utilizes a 6.8% rate for the legacy pension, 6.85% rate for Pension Plus, and 6.9% for retiree health care. 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 38.1611 and 38.1614

FISCAL IMPACT:

Generally speaking, the bill would have an indeterminate fiscal impact. The magnitude and scope of any 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 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 time frame 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 cap to 6.8% for pension and 6.9% 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 the Office of Retirement Services, it is expected that the assumed rate of return would only move lower.

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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