MAPERS

Michigan Association of Public Employee Retirement Systems

TO: COMMITTEE ON FINANCIAL LIABILITY REFORM

FROM: MAPERS

RE: HOUSE BILL NO. 5421

DATE: MARCH 16, 2016

MAPERS OPPOSES HB 5421 AND RESPECTFULLY REQUESTS THAT THE COMMITTEE TAKE NO ACTION TO REPORT OUT THIS LEGISLATION. WE LOOK FORWARD TO WORKING WITH THE BILL SPONSOR TO HELP ADDRESS RETIREE HEALTH CARE PLAN CONCERNS.

MAPERS

The Michigan Association of Public Employee Retirement Systems ("MAPERS"), was established to provide educational training and legislative updates to trustees of Public Employee Retirement Systems and Retiree within the State of Michigan. MAPERS is recognized as the principal educational, legislative forum for trustees, plan administrators, and other retirement, health care and financial professionals in the State of Michigan.

MAPERS membership represents 115 public pension and retiree health care plans in Michigan. These systems invest over $60 billion in public pension plan assets and administer pension and retiree health care benefits to over 250,000 retirees and nearly 500,000 active public employees. MAPERS is considered the leading non-state voice on public pension investments at the State Capitol.

Overview of HB 5421

House Bill No. 5421 ("HB 5421") was introduced by Representative Laura Cox on March 2, 2016. HB 5421 proposes amendments to the Public Employee Health Care Fund Investment Act, Public Act 149 of 1999, as amended ("PA 149"). PA 149 was enacted in 1999 to provide for the creation of public employee health care funds by the political subdivisions of the State and their agencies and instrumentalities, for the purpose of funding healthcare for retired employees of the political subdivision, agency or instrumentality.

As it currently reads, HB 5421 would amend PA 149 in part as follows:

- Add the following defined terms to Section 2 of PA 149:
  - "Bankruptcy Trust"
  - "Bankruptcy Trust Beneficiary"
  - "Board of Trustees"
  - "Independent Professional Trustee"
  - "Nonindependent Trustee"
  - "Plan for Adjustment"
- Amend the following defined terms under Section 2 of PA 149:
  - "Fund"
  - "Investment Fiduciary"
  - "Public Corporation"
  - "Qualified Person"

- Add Section 4a. to PA 149 addressing Trustee removal and administrative requirements in relevant part as follows:
  - allowing removal of an individual Trustee with or without cause by the "Appointing Authority" identified by the Bankruptcy Court or the Plan for Adjustment;
  - allowing removal of an individual Trustee by a 2/3 vote of the voting Trustees;
  - requiring application of the Open Meetings Act to all meetings of the Board of Trustees of a Bankruptcy Trust;
  - requiring application of the Freedom of Information Act to all records of the Bankruptcy Trust; and
  - requiring first-class mailing of the Bankruptcy Trust's Summary Annual Report to all beneficiaries of the Trust.

- Add Section 4b. to PA 149 addressing Trustee compensation as follows:
  - permitting compensation to a Trustee only for attending Board meetings in person or, if attending telephonically, upon a 2/3 vote of voting members;
  - limiting the per meeting stipend payable to voting members to $25.00 per hour for the first two years following the establishment of the Bankruptcy Trust and capping the compensation payable to 45 hours for the first 2 years and 24 hours thereafter;
  - requiring that compensation payable to individual Trustees who are members of the Retirement Systems of the City of Detroit be no less than the compensation paid to the elected retirant member(s) of the applicable Retirement Board;
  - limiting the hourly rate payable to a non-voting ex officio member of the Board to 50% of the hourly rate payable to voting members;
  - allowing the payment of an annual retainer fee to an Independent Professional Trustee upon a 2/3 vote of voting Board members;
  - permitting decreases and/or total elimination of the compensation payable to Trustees by a majority vote of voting Board members;
  - allowing an individual Trustee to decline compensation from a Bankruptcy Trust;
  - prohibiting compensation to Trustees who are employed on a full-time basis by the City of Detroit or by an employee organization whose members are Trust beneficiaries; and

  - requiring a 2/3 vote to approve the reimbursement of expenses related to Trustee attendance at an educational conference.

- Add Section 4c. to PA 149 providing for the initiation of Trustee removal procedures and changes to Trustee compensation as follows:
  - by petition signed by no less than 20% of Bankruptcy Trust Beneficiaries; or
  - by proposal of an organization representing no less than 50% of Bankruptcy Trust Beneficiaries.

- Section 4c. of HB 5421 would also allow for such a petition or proposal to be filed with the applicable Retirement Board requiring the submission of a ballot question proposing the removal of a Board member or changing the compensation payable to Board members. The costs of conducting such a ballot proposal may be payable by the Bankruptcy Trust if the proposal is approved by a majority of the voting Bankruptcy Trust Beneficiaries.

Background on "Bankruptcy Trusts"

The City of Detroit, Michigan filed a voluntary petition for relief under Chapter 9 of the United States Bankruptcy Code on July 18, 2013, in the United States Bankruptcy Court for the Eastern District of Michigan (the "Bankruptcy Court"). The Bankruptcy Court approved the Plan for the Adjustment of Debts of the City of Detroit (the "Plan of Adjustment") with an effective date of December 10, 2014. The Plan of Adjustment provides for the establishment of two (2) separate and distinct voluntary employees beneficiary associations ("VEBAs") to provide health care benefits to certain eligible City of Detroit retirees and their eligible dependents as of January 1, 2015 (i.e., one plan for Police and Fire retirees and one plan for general employee retirees).

The VEBAs were funded in accordance with the terms of the OPEB Settlement between the City and the Official Committee of Retirees which recognized OPEB Claims in the aggregate amount of 4,303,000,000.00. The settlement of the OPEB Claims and subsequent establishment of the VEBAs to provide future retiree health care benefits to the retirees holding such OPEB Claims was essential to the approval of the City's Bankruptcy Plan. As explained by the Bankruptcy Court in its Order Confirming the Plan of Adjustment:

> U. The OPEB Settlement. The OPEB Settlement is the result of extensive arm's length negotiations between the City and the Retiree Committee, which was represented by sophisticated counsel, and is an integral component of the City's global settlement of pension-related and other labor-related issues negotiated with, among others, the Retiree Committee. The compromises and settlements embodied in the OPEB Settlement (1) resolve all disputes with respect to the aggregate valuation of Claims classified in Class 12 under the Plan and the issues raised by the Retiree Committee in the Retiree Health Care Litigation; and (2) are, collectively, a key compromise upon which several provisions of the Plan rest. In the absence of such compromises and settlements, the City's emergence from chapter 9 likely would have been delayed by litigation and burdened with additional expenses, with no assurance of a better result for the City.

> 1. The OPEB Settlement is in the best interests of the City and its creditors and residents as it fully resolves (a) the dispute between the City and the Retiree Committee regarding the aggregate valuation of OPEB Claims and the treatment of OPEB Claims under the Plan and (b) the Retiree Health Care Litigation. The OPEB Settlement is within the range of reasonable results if the disputes resolved by the OPEB Settlement, including the Retiree Health Care Litigation, were instead litigated to a conclusion.

The Plan of Adjustment established the specific terms of the City of Detroit Police and Fire Retiree Health Care Trust and the City of Detroit General Retiree Health Care Trust (collectively the "VEBA Trust documents"), as the vehicles for funding the benefits to be provided under the VEBAs. The Plan of Adjustment and the VEBA Trust documents established the Board of Trustees of the VEBA Trusts and named the initial Trustees. In accordance with the Plan of Adjustment and the Trust document, the VEBA Trusts can only be amended by an Order of the Bankruptcy Court or a vote of 6 of the 7 VEBA Trustees.

<u>General HB 5421 Concerns</u>

The amendments to PA 149 proposed under HB 5421 are clearly intended to apply only to the retiree health care VEBA Trusts created under the City of Detroit's Bankruptcy Plan and directly conflict with the existing provisions in the VEBA Trust documents which are a part of, and attached exhibits to the Plan of Adjustment. The adoption of HB 5421 would undermine the federal bankruptcy process and contravene the Order of the Federal Bankruptcy Court. Such action accordingly raises potential unconstitutionality issues under Article VI of the United States Constitution (the "Supremacy Clause"). Federal Bankruptcy law trumps state law as was evidenced by the ability of the Bankruptcy Court to impair and diminish the Michigan Constitutional protections afforded to public pension benefits. Federal bankruptcy laws are "the supreme law of the land . . . anything in the Constitution or Laws of any State to the contrary notwithstanding." U.S. Constitution at Article VI ¶ 2. Additionally, the rights of the retirees under the VEBA Trust upon emergence from bankruptcy are protected contractual and property rights under Article I, Section 10 and the Fourteenth Amendment of the U.S. Constitution to which they are entitled to due process of law. Settlement of the OPEB claims had, and continues to have, direct implications upon the Grand Bargain.

From a public policy perspective, for the legislature to now reopen the City of Detroit's bankruptcy mediation process and resulting Plan of Adjustment through legislation would open the proverbial "Pandora' Box" and every special interest group that was subject to the City of Detroit's bankruptcy could seek legislative redress to their individual impairment. The legislature would essentially be creating a means to a second bite at the apple. This would also create great uncertainty amongst all retirees that the legislature could seek further cuts to benefits when they were told that the Plan of Adjustment was set in stone and no further revisions could be made.

Further, as is noted above, PA 149 is applicable to all public employee health care funds and trusts created under the Act by the political subdivisions of the State, their agencies and instrumentalities.

Accordingly, to the extent that HB 5421 is unclear and ambiguous, its impact could be far more wide-ranging.

Specific HB 5421 Concerns

- Section 2

- The reference to a court order within the proposed definition of "Bankruptcy Trust" is much too broad. The phrase "court order" contemplates any order by any court regardless of jurisdiction.
- The proposed definition of "Board of Trustees" or "Board" is too broad and could cause confusion to the extent that non-bankruptcy created funds and trusts are also governed by a Board of Trustees. Almost all retiree health care plans refer to their governing body as the "Board of Trustees".
- The reference to "expert knowledge" and/or "extensive experience" within the proposed definition of "Independent Professional Trustee" is entirely subjective with respect to what would constitute the requisite knowledge and/or experience to satisfy the definition.

- Section 4A

- Subparagraph (1) decrees that the individual Trustees of a Bankruptcy Trust would serve at the pleasure of the "Appointing Authority". This section would contradict the Plan of Adjustment to the extent that it provides specific terms of office for the Trustees (i.e. 4 years). Additionally, this provision would undermine the individual Trustees' fiduciary duties to the members and beneficiaries of the trust independent of any outside influence from the Appointing Authority. In other words the question becomes who do the Trustees serve, the members and beneficiaries or the Appointing Authority. Furthermore, it is noted that the Board of Trustees of the Police and Fire VEBA Trust unanimously approved an amendment to the VEBA Trust document providing for the removal of an individual Trustee as follows:

> A Board member may be removed or replaced at any time by an affirmative vote of six (6) of the voting Board members in the event that such members lose confidence in the capacity or willingness of the Board member being replaced to fulfill his or her duties and responsibilities as a Board member as set forth in this Trust Agreement. In the event of a vacancy of a Board member position, whether by expiration of term, resignation, removal, incapacity, or death, a successor shall be appointed in accordance with this Trust Agreement.

- Requiring mailing of the Summary Annual Report under subparagraph (7) is inconsistent with the provisions the Public Employee Retirement System Investment Act, Public Act 314 of 1965, as amended (MCL 38.1132 *et seq.*) which only requires website publication. Furthermore, this would create an unfunded mandate on the Bankruptcy Trusts by requiring them to pay for printing, first class postage, copying, labor, etc. in publishing and mailing

a copy of the Summary Annual Report to 20,000 or more retirees and beneficiaries on an annual basis.

- Section 4B

- Section 4B of HB 5421 is inconsistent with the Plan of Adjustment which currently provides for an annual stipend payable to Trustees on a monthly basis. The current stipend structure is specifically provided in the VEBA Trust documents, recognizes the fiduciary role of Trustees both in and outside of official meetings, and is scheduled to decrease by 50% after the second year of VEBAs effective date. The per meeting stipend proposed under HB 5421 fails to recognize the amount of time required by a plan fiduciary to be spent outside of meetings reviewing materials in preparation for the meeting. Furthermore, the requirement that compensation payable to a "Nonindependent Trustee" be "reasonable" is too subjective.
- Subparagraphs (1)(l) of Section 4B has potential tax implications under the doctrine of constructive receipt.

- Section 4C

- This Section which proposes to allow removal of a Trustee and changes to the compensation payable to Trustees via petition or proposal, further opens the terms of the Bankruptcy Plan of Adjustment, beyond legislation, and to the individual members and beneficiaries of the VEBAs.
- This Section may require the VEBAs, which are approximately 40% funded as of 1/1/2015, to reimburse the costs of conducting an election for each and every ballot proposal which is approved. In such event, this would be an unfunded mandate on the applicable VEBA.