Good morning Mr. Chairman and members of the committee, and thank you for the opportunity to testify today.

My name is Daniel Takash, a policy analyst at the Pension Integrity Project at Reason Foundation. Reason Foundation is a 501(c)3 national think tank, and Pension Integrity Project works with policymakers, labor associations, and other interested stakeholders around the country by offering data-driven analysis and policy concepts designed to improve the overall solvency of public-sector retirement systems.

The proposed legislation would reform MPSERS's current unfunded liability amortization policy so it accelerates debt payments by setting a contribution floor and bring one of the most important assumptions used to determine unfunded liability amortization payments more closely in line with reality. These changes will make it easier for the state to accurately determine how much is needed to pay down current pension debt and will ensure that taxpayers pay less in long-term interest costs than under the status quo.

When a pension system becomes underfunded, the plan develops an unfunded liability, which is simply the present value of promised benefits minus the assets in the plan.

Even if 100% of the plan's assumptions are met 100% of the time starting today, the unfunded liability will still exist and must be paid down. Contributions made to pay for underfunded benefits are called amortization payments, and they are made according to an amortization schedule, at the end of which the unfunded liability should be completely paid off. MPSERS is currently projected to pay down its unfunded liability by 2038.

The level percent of payroll method, a method used by most plans across the country, sets the required payments as a constant share of payroll over the amortization schedule. Because payroll is expected to grow, so too will the amortization payments when using this method. As long as payroll growth is positive, these payments are back-loaded so larger and larger payments are required over the long run.

The level percent of payroll amortization method can be problematic though. Because payments made are a function of payroll, any underperformance of the payroll growth assumption means amortization payments will be less than they should be, making the state's plan for how to pay off the debt unworkable.

That has been the case with MPSERS, and we believe that the current assumption for payroll growth is too high, leading to a historic pattern of systematic underfunding. MPSERS assumed payroll growth of 4% between 2000 and 2006, when the rate was reduced to 3.5%. During this period, actual payroll growth never met the plan's assumption. Indeed, over this period the long-run payroll growth was *negative* 0.5%.

This is reflective of declining school enrollment in the State of Michigan. According to MLive, school enrollment in Michigan is at the lowest level since 1950. In 2002, there were 1.7 million students. In 2017, there were about 1.5 million—a 12% decline over this period.

To put this into more concrete terms, overestimating the growth in payroll has contributed about $1.4 billion to MPSERS's total unfunded liability since 2000. If the assumption remains unchanged, the House Fiscal Analysis states that by the end of the amortization schedule, if payroll growth is 1.5% (well above historic trends) then this bill alone will reduce required contributions by almost $3 billion.

This legislation addresses the problem in two ways. First, by requiring amortization payments be no less than they were the year before beginning in 2022, it prevents any temporary market upswing or other positive shock to the pension system from slowing down the state's debt repayment. Making a greater commitment to paying down pension debt in good years shields against market downturn during bad years.

Second, by phasing in a 0% payroll growth assumption, the plan brings the assumptions used more in line with actual plan experience. A 0% payroll growth assumption with a level percent method produces a similar effect to a "level dollar amortization method," which is a bit more conceptually straightforward compared to a level percent method. Plan actuaries determine much a series of payments of a constant dollar amount should be to fully fund the plan at the end of the amortization schedule.

Level dollar amortization methods also accelerate debt repayment, avoiding the back-loading problem and lowering long-term interest costs, saving future taxpayers and the state more money in the long-run.

Failure to accurately estimate payroll growth has contributed to systematic underfunding of MPSERS when paying down pension debt and has created a persistent back-loading of debt payments. This legislation addresses many of the problems presented by current amortization policy and accelerates much-needed contributions to the underfunded pension system.

I am happy to answer any questions the committee may have.