Testimony on Michigan House Bill 6475

Submitted to:
Michigan House Financial Liability Reform Committee
November 8, 2018

Submitted by:
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Chairman Albert and members of the Committee, thank you for the opportunity to submit testimony on House Bill 6475.

My name is Leonard Gilroy, and I am the Senior Managing Director of the Pension Integrity Project at Reason Foundation, a 501(c)3 nonprofit, think tank. The 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.

We have been very encouraged by the progress the state of Michigan has made in recent years in advancing policies designed to support and enhance the solvency of state pension systems. Most recently, the funding policy reforms unanimously enacted for the state public school employee pension plan (MPSERS) earlier this summer demonstrate that pension solvency and good stewardship of retiree benefit systems are universal aims and need not be partisan issues.

Michigan's reform work has been acknowledged by Standard & Poor's, which earlier this year cited the state's recently enacted pension reforms as a key factor influencing its decision increase the state's credit rating from -AA to AA with a stable outlook.

HB 6475 would continue this work in several ways, most notably by bringing a major funding policy improvement to the Michigan State Police Retirement System (MSPRS).

MSPRS was 68% funded at the end of FY2017 with $656 million in unfunded pension liabilities, and recent—and prudent—adjustments to the assumed rate of return and other key pension assumptions will require recognizing additional unfunded liabilities in the system not previously captured in financial reporting.

As a result, the current situation is one where approximately two-thirds of every pension contribution into MSPRS today is allocated to paying down unfunded pension liabilities, or pension debt, not prefunding benefits as they are earned and accrued.

Further, the way current MSPRS pension debt is amortized over time is problematic, as it ties "level percent of payroll" contributions to an assumption of a growing payroll, creating a backloading effect with the expectation of perpetually rising contributions in dollar terms.

This backloading creates a financial risk that future contributions will be insufficient to fully fund all benefit promises in the event that experience deviates significantly from assumed payroll growth patterns. This has been the case in Michigan's recent past, where public sector payroll has generally grown slower than assumed by most pension plans, including MSPRS.

Consistent with recently—and unanimously—enacted changes to the MPSERS teacher pension system, the proposed policy would phase in an elimination of this backloaded approach to amortizing pension debt. Instead, it would adopt a much more even and predictable contribution approach that significantly reduces the financial risk of having insufficient future assets if payroll experience deviates from assumptions.

We independently reviewed the cost projections developed by the Office of Retirement Services, and we concur with their assessment that with a small, two-year extension of the current MSPRS amortization period from 2036 to 2038, the proposed policy represents a credible and reasonable approach to phasing into a more prudent "level dollar" amortization method on a generally cost-neutral basis that will virtually eliminate backloading in the coming years, thereby significantly reducing financial risk exposure for the state and taxpayers.

Put simply, the proposed legislation will, over time, eliminate the large and underappreciated risks associated with missed assumptions about future payroll growth to ensure that the plan is restored to full funding as soon as possible and stays that way.

Further, HB 6475 would importantly clarify some inconsistencies between current law and collective bargaining agreements as it pertains to the retirement benefits received by law enforcement officers hired after 2012 to ensure a strong and unambiguous pathway to retirement security for all officers hired into the Michigan State Police.

Last, the proposed legislation would extend transparency reporting enacted as part of the MPSERS reform of 2017 to the MPSRS plan, with the intention of providing policymakers, beneficiaries and stakeholders with more robust risk assessment information to help them understand the solvency of the state's pension plans and how prone they are to market underperformance, missed assumptions and other risks.

Overall, HB 6475 is consistent with Michigan's pattern of being a trend setter on tackling pension underfunding through substantive reform designed to strengthen the ability of public sector retirement systems to sustainably deliver promised retirement benefits over the long term.

Thank you again for the opportunity to comment on this important work. Please do not hesitate to reach out if we can provide additional information or insights on this subject.

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