

JUDGES RETIREMENT SYSTEM REVISIONS

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House Bill 4265 as introduced
Sponsor: Rep. Ann Bollin
Committee: Appropriations
Complete to 2-23-21

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

House Bill 4265 would amend the Judges Retirement Act to implement a lower rate of return and discount rate cap, adopt layered amortization, and require that the most recent mortality tables be used. Additionally, the bill would eliminate the current retiree health insurance coverage premium for individuals who became a member or qualified participant on or after July 1, 2021, and offer existing qualified participants and members the ability to opt out of receiving a retiree health insurance coverage premium.

Layered Amortization

Beginning in Fiscal Year (FY) 2022-23, 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. Additionally, any layered amortization period must use level dollar amortization. The practice of layered amortization requires any new actuarial losses to be separately amortized from the existing unfunded actuarial liability (UAL). Currently, the existing UAL is currently amortized over a schedule ending September 30, 2036. Any actuarial losses are combined with the existing UAL and amortized over the same period.

Mortality Tables

Beginning in FY 2022-23, and for each subsequent fiscal year, the bill would require actuarial equivalent retirement allowance to be determined by using an assumed rate of return and discount rate not to exceed 6.25% and the most recent mortality assumptions provided by the Actuarial Standards Board and adopted as risk assumptions by the actuary during the most recent experience study. Current law requires the use of interest rate determined by the retirement board and mortality tables adopted by the Department of Technology, Management, and Budget (DTMB) and the retirement board. Currently, mortality tables are updated through the adoption of an experience study completed every five years.

Reduced Cap for Assumed Rate of Return and Discount Rate

Beginning in FY 2022-23, 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 6.25%. Due to the current dedicated gains policy, the current assumed rate of return and discount rate is 6.25% for the judges pension system and 7.0% for other post-employment benefits (OPEB). Under the current dedicated gains policy, the assumed rate of return and discount rate may go down, but will not increase in future years.

Retiree Health Care

For an individual who became a member (participant in the defined benefit plan) or qualified participant (participant in the defined contribution plan) on or after July 1, 2021, the bill would eliminate eligibility for a retiree health insurance coverage premium. Also, a member or qualified participant would be eligible to opt out of health insurance coverage between July 1, 2021, and September 15, 2021. As an alternative, the new member or qualified participant or member or qualified participant who opted out would be authorized to contribute up to 4% of their salary to a Tier 2 account, tax-deferred savings account (401(k) or 457).

As a replacement for any health insurance coverage premium that might have been paid, the retirement system would be required to credit the following amounts to a health reimbursement account for qualified participants who are plan 1 or plan 2 members:

- \$2,000 to an individual who first became a qualified participant after September 30, 2021, who is at least 60 years of age, and who has at least 10 years of service at their first termination of employment.
- \$1,000 to an individual who first became a member or qualified participant after September 30, 2021, who is less than 60 years of age, and who has at least 10 years of service at their first termination of employment.

For each qualified member who opts out of receiving a retiree health insurance coverage premium benefit, the retirement system would calculate an amount to be credited to a Tier 2 account. This amount would equal the contributions made by the qualified member for hospital and medical-surgical and sick care benefits. The qualified member who opts out would cease making payments no later than the first payroll date after October 1, 2021, and the amount calculated to be credited to a Tier 2 account would have to be deposited no later than the first payroll date after January 1, 2022. The qualified member would be immediately 100% vested in amounts deposited in the Tier 2 account.

The qualified member who elected to opt out of retiree health insurance coverage premiums would cease accruing years of service credit for purposes of calculating the health insurance coverage premium. A qualified member who does not opt out would not be eligible for the Tier 2 account provisions. An individual who is not a qualified member, who is a former member on June 30, 2021, and who is reemployed by an employer after June 30, 2021, would retain eligibility for the retiree health insurance premium coverage premium benefit. A qualified member with a break in service who is reemployed would retain the same election made before the break in service.

The Office of Retirement Services (ORS) would be required to determine a method for implementing the retiree health care changes under the bill. The bill would require the Tier 2 plan provisions to be implemented as soon as feasible but not later than January 1, 2022.

The bill would subject Tier 2 and tax-deferred accounts to the following terms and conditions:

- Before April 2, 2022, ORS would be required to design an automatic enrollment feature whereby the qualified participant would contribute an amount required to qualify for all eligible matching contributions unless they elected to contribute a lesser amount.
- Authorize the state to use elective employee contributions to the state 457 deferred compensation plan as a basis for making employer matching contributions to Tier 2 or a tax-deferred account.
- Allow employer matching contributions to be made to a different plan or account than the elective employee contributions.
- Prohibit elective employee contributions from being used as the basis for more than an equivalent amount of employer matching contributions.
- Require ORS to design and implement a method to determine the proper allocation of employer matching contributions based on elective employee contributions.

Qualified member is defined as a member or qualified participant who became a member or qualified participant prior to July 1, 2021, earned service credit in the 12 months ending June 30, 2021 (or was on approved professional services or military leave of absence on June 30, 2021), and is a plan 1 or plan 2 member who is eligible to qualify for future health insurance coverage premium from the retirement system.

MCL 38.2301 et seq.

FISCAL IMPACT:

Retirement System Financial Calculation Revisions

Generally speaking, the bill likely would increase near-term budgetary cost pressures by creating higher upfront payments for the state, but generate longer-term net savings for the state and system overall. The combination of the shorter time frame over which any new actuarial loss would be amortized (10-year layered amortization using level dollar), reducing the assumed rate of return cap, and requiring that the most recent mortality tables provided by the Actuarial Standards Board be used could require increased allocations to the retirement system when compared to current projections in the near term. The magnitude of the near-term budgetary cost pressures and longer-term net savings would depend on system experience. Each component is explained in more detail below.

The bill would require any new annual actuarial loss to be amortized over rolling 10-year time periods using level dollar amortization, separate from the current UAL amortization schedule (ending September 30, 2036). Reducing the amortization schedule and utilizing level dollar amortization for any new actuarial losses would increase annual payments upfront compared to current law, but generate net savings overall because the funds would be deposited into the system earlier, thereby generating returns. Under the bill, layered amortization would lengthen the amortization period of any actuarial losses after FY 2025-26 relative to current law, potentially reducing costs in those years, but spreading actuarial

losses beyond the current amortization horizon. It is unclear how negative UAL would be treated.

Revising the assumed rate of return and discount rate to 6.25% would increase near-term costs related to OPEB because the current rate is 7.0%. Similar to other changes, the net effect would be long-term savings for the state.

Lastly, updating the mortality tables on a more regular basis would have an unknown fiscal impact. The retirement system updates mortality tables every five years through an experience study. Any fiscal impact would depend on the mortality tables required to be used under the bill and the mortality tables used in the most recent experience study.

Retiree Health Care

The bill would create an indeterminate amount of future savings for the state related to future retiree health care obligations by doing the following:

- Eliminating the retiree health insurance premium coverage currently provided to members and qualified participants of the system for individuals who are hired on or after July 1, 2021, and replacing the benefit with a calculated lump sum to a health reimbursement account to those that are eligible (see analysis above). In addition, the member or qualified participant would be authorized to contribute up to an additional 4% of their salary to Tier 2. The bill has no employer contribution matching provisions.
- Allowing current members or qualified participants to opt out of retiree health insurance. The health insurance coverage premium already earned would be converted into a lump sum payment deposited into a Tier 2, tax-deferred account. The member or qualified participant would be authorized to contribute up to an additional 4% of their salary to their Tier 2 account. As noted above, the bill has no employer contribution matching provisions.

For the most part, the state would not begin to realize these savings until a substantial number of employees in the graded premium health insurance begin to reach retirement age, and savings would depend on the number of existing employees who chose to forgo retiree health insurance in exchange for the monetized lump sum. The plan would save the state more in the long term by avoiding increasing unfunded liabilities by eliminating retiree health insurance for all new employees hired after July 1, 2021.

The changes may also slightly reduce the amount required for the pre-funding payment related to retiree health insurance benefits.

The changes to retiree health care under the provisions of the bill would increase administrative costs and likely would create one-time information technology changes necessary to effectuate the change. No estimate of costs is currently available.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.