Proposal to Reform Local Government Pension and OPEB
8-1-17 DRAFT

Underlying the proposal are two principles:

(1) For local units with fiscally sound pension and OPEB plans, reforms will not impact active employees or current retirees.

(2) Reforms will identify pension and OPEB plans that are fiscally distressed or are at risk of fiscal distress and find solutions to bring them back to long-term fiscal health.

1. Reforms that affect all local units

Under the proposed reforms, requirements that apply to all local units would be implemented to increase transparency and to assure pension and healthcare costs are affordable.

OPEB-related Reforms:

- *Require adoption of defined contribution plans for all new employees**

  For new employees, where OPEB is offered, the local unit can only offer a defined contribution plan. The details of the plan, such as contribution levels, are determined at the local level.

- *Require Medicare as primary insurer for all post-65 retirees**

  The cost of providing Medicare gap insurance for existing retirees is less than paying the full premium for private healthcare and would therefore lower liabilities. While the utilization of Medicare is already in large part the current practice of local governments, not all do so.

- *Phase in a requirement to annually pay OPEB normal costs for employees*

  By implementing this reform, the OPEB commitments to employees are paid for in the year in which they are accrued. Under Michigan's Constitution, payment of the normal costs for pension is required; this reform would apply that same requirement to OPEB.

- *For any significant proposed OPEB benefit increase, require actuarial impact analysis and full payment of the incremental increase in the annual required contribution (ARC)*

  This reform would simply require that the local unit be able to afford any significant increases in benefits.

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- *Require transparency reporting as described in the Responsible Retirement Reform for Local Government Task Force report*

  With respect to OPEB data, clarification of the December legislation is needed to clearly require annual valuations, reporting of actuarial assumptions (such as expected investment returns on plan assets, discount rates for ARC calculation, medical inflation and cost trends used, and amortization period for OPEB liability), and posting of annual reports on the local unit's website. These requirements for OPEB reporting are similar to what is required by locals for pension.

Pension-related Reforms:

- *Require actuarial impact analysis for any significant proposed increase in pension plan benefits*

  This reform would require that the local unit be fully aware of the cost of any proposed increases. Payment of the normal costs for pension is already required.

- *Require transparency reporting as described in the Responsible Retirement Reform for Local Government Task Force report*

  Under Act 134 of 1965, current reporting requirements for pension, which include an annual summary report, appear sufficient. Some minimal changes to the Act may be needed to clarify the requirements and timing of submissions.

2. Reforms that affect local units with pension and OPEB plans that are fiscally distressed or are at risk of fiscal distress (through the creation of a Fiscal Stress Monitoring System and Municipal Stability Board)

Under these reforms, a Fiscal Stress Monitoring system would be created to identify local units with pension and OPEB plans that are fiscally distressed or at risk of fiscal distress. The Fiscal Monitoring Stress System is comprised of the following five phases:

<u>Phase One</u>: Transparency and Reporting
Under this phase, local units provide the required pension and OPEB data to Treasury and post it on their websites. It is anticipated the data will be submitted to Treasury via the already utilized F-65 report.

<u>Phase Two</u>: Identify Potential Problems
Treasury analyzes the data to determine the general fiscal health of the local unit's pension and OPEB systems as well as the stress, if any, that is being put on the local unit's ability to provide services to its citizens. By applying standardized criteria that considers funding levels and employer contributions (ARC) as a percent of government wide revenues, Treasury identifies communities that could be near financial distress and warrant a more in-depth review by Treasury. As was proposed in the Task Force report, the following criteria would be used:

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Pension Criteria: If the plan's funding level (assets/liabilities) is less than 60 percent funded and the employer contribution (ARC) as a percent of government wide revenue is greater than 10 percent of revenue, then the local unit continues to Phase Three. Based on currently available pension data, it is estimated approximately 9% (46 of 511) of local units would not meet the criteria and therefore move to Phase Three.

OPEB Criteria: If the plan's funding level (assets/liabilities) is less than 40 percent funded and the employer contribution (ARC) as a percent of government wide revenue is greater than 12 percent of revenues, then the local unit continues to Phase Three. Based on currently available OPEB data, it is estimated approximately 5% (18 of 333) of local units would not meet the criteria and therefore move to Phase Three.

Phase Three: In-Depth Review for Pension and OPEB Fiscal Stress

Under this phase, local units that do not meet the criteria and have been "filtered" through the system receive a more in-depth review by Treasury. From this group of local units, those that can demonstrate they already have a plan in place to address the problem will be given a waiver by Treasury.

Phase Four: Development of a Corrective Action Plan through Mediation

Under this phase, the Municipal Stability Board (MSB) mediates the process between labor and management to develop a Corrective Action Plan (CAP). The CAP must detail the actions that will be taken to address the problem and bring it to the point of meeting the criteria within a reasonable amount of time. If the CAP is agreed upon, it must be approved by the MSB. As part of its approval, the MSB must confirm that the CAP is actuarially sound. However if, within a set period of time (e.g., 180 days), the mediation process does not result in an agreed upon CAP approved by the MSB, then the local unit moves to Phase Five. The goal here to is to create a system where both sides (management and labor) would be impacted and would have a rationale to bargain in good faith in mediation before arbitration sets in.

Phase Five: Arbitration and Placing the Question on the Ballot

Under this phase, the arbitration process begins and the arbitrator determines the components of the final CAP. In developing the CAP, the arbitrator can reduce employee or retiree benefits (vested benefits cannot be impacted) and/or mandate an increase in employer contributions. In this phase the MSB's role is to confirm that the CAP is actuarially sound. If execution of the CAP requires raising additional revenues by the local unit, then the question must be placed on the ballot for the voters to decide to either raise taxes or reduce the employee and retiree benefits. How to achieve this legislatively (e.g., if Act 345 can be expended to include general employees) is still being reviewed.

*Implementation of this reform would likely require amending PERA and Act 312. It is also important to note that none of the reforms will impact vested benefits.

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