Testimony on Michigan House Bill 6060 (2024)

Prepared for: Michigan House Committee on Labor

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Chairman Haadsma and members of the Committee,

We are managing directors of the Pension Integrity Project at Reason Foundation, a national nonpartisan think tank. Our project has played a key technical assistance role in dozens of bipartisan pension reforms across the states over the last several years, and we have over a decade of experience in public pension research, actuarial modeling, and pro bono plan design consulting. Thank you for the opportunity to submit technical comments regarding House Bill 6060.

The bill you are considering today would have profound consequences for your teacher pension system, for the entire public K-12 education system in Michigan, for the ability of Michigan to manage its state budget for the long term, and for every public service offered by the state. While the costs associated with the bill are breathtaking—between $17 billion to $20 billion in guaranteed new state and school district spending over the next 30 years—the risks to K-12 service delivery, long-term school district financial solvency, and the entire state budget are even more extreme.

Due to its far-reaching implications, a bill of this magnitude demands rigorous analysis. However, this bill has not even been accompanied by a fiscal note, let alone a proper actuarial analysis–both of which are critical to fully understand how decisions impacting every K-12 hire today can ripple out decades into the future and move in unforeseen directions. Fortunately, we have built a robust actuarial model for the Michigan Public School Employees' Retirement System (MPSERS) to help you understand the potential impacts of HB 6060.

The Great Recession was devastating for teacher pension systems across the country, generating hundreds of billions of dollars in underfunded liabilities, driving up retirement-related spending for public K-12 systems, and forcing money intended for the classrooms to be spent on higher payments to cover the retirement of past educators. MPSERS was no different and arguably was hit harder than most, as the legislature had failed to fully fund the annual required actuarial contributions to the plan for several years prior. Accordingly, MPSERS entered the Great Recession with approximately $9 billion in unfunded liabilities in 2007, which skyrocketed to nearly $25 billion by 2011.

This prompted one wave of reform in 2012 that made some fairly small improvements around the edges, but that reform failed to meaningfully move the needle on cost and risk due to a flawed design. In 2017 the legislature enacted the current plan design of MPSERS to avoid a doubling of unfunded liabilities and annual pension contributions, which already projected to exceed $5 billion per year in the coming decades. The logic was to offer all new teachers a choice of two risk managed plan designs, a defined contribution plan or a risk managed hybrid pension design that splits costs and risks equally with teachers, a fair and even balance when considering that the teacher then receives a 100% taxpayer guaranteed retirement for life. This was an improvement upon the previous benefit tier, where teachers were covering two thirds of their pension costs.

Since the 2017 reform took effect, the legislature has enacted a range of additional improvements to funding policy, assumptions setting and other key pension mechanisms on a bipartisan basis. Some of these improvements involved recognizing previously hidden underfunding and aggressively moving to pay down MPSERS unfunded liabilities much faster. Today MPSERS stands at $29 billion underfunded, but it also now has a number of key financial guardrails in place, such that there is a realistic plan to pay off that debt within the next 15 years.

HB 6060 would eliminate a critical protection against financial risk by eliminating employee contributions to their pensions (forcing the state and public school districts to bear the entire cost), allowing five years of credited service purchase and guaranteeing a 6% conversion rate on those liabilities, and allowing all new hires to enter a re-risked pension system instead of a de-risked one.

Our analysis and actuarial modeling find that:

- **House Bill 6060 will add between $17 billion to $20 billion in new employer costs over the next few decades**, depending on market performance. Given that the legislature just lowered the cap on local school district MPSERS contributions, this means that the state is likely to bear the majority of responsibility for these costs, which will impact every other area of state government and crowd out spending on other important services.
- HB6060 would require immediate **increased additional annual employer contributions of between 7 to 10 percent of payroll** that would persist for at least the next 30 years.
- If MPSERS were to hit all of its assumptions and pay off all of its current unfunded liabilities by 2037 as planned, the **annual employer "normal cost" contributions under HB 6060 contributions would be 13.7% in perpetuity, nearly double the 7% employer normal cost today**.

Further, transferring current defined contribution account balances to MPSERS pension at the current discount rate would create a major immediate financial risk of immediate underfunding of those transferred liabilities. The bill would allow defined contribution plan participants to

transfer up to five years of credited service toward an actuarially equivalent pension benefit, but their previously earned service would be transferred using a relatively high discount rate of 6.0%. Such transfers would create the risk of a pension-obligation-bond-like situation where any downturn in market performance (meaning, any year where investment returns underperform 6%) or any future lowering of the MPSERS assumed rate of investment return would generate immediate unfunded liabilities.

In conclusion, HB 6060 would reverse decades of responsible pension reform, skyrocket pension costs, make it almost impossible to increase teacher salaries in perpetuity, and force appropriators to make difficult spending tradeoffs with the rest of the state budget in order to put more resources toward MPSERS. The move would also likely be viewed as a credit negative from the ratings agencies, who looked favorably upon the 2017 reform as being a credit-positive factor for the state's long term financial stability. Instead of moving backward, we believe the legislature should focus on restoring the funding that it diverted from MPSERS this year in order to remove pension debt from the state's books as fast as it can.

Thank you very much for the opportunity to submit testimony. We stand ready to respond to any questions the committee may have related to this subject.

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