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A Closer Look at Legacy Costs and Local Actions in Michigan in the Wake of PA 202

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White Paper

By: Shu Wang, Samantha Zinnes
MSU Extension Center for Local Government & Policy
Department of Agriculture, Food and Resource Economics
Michigan State University

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Introduction

Legacy costs have imposed challenges on local governments in Michigan. The lack of funding for retirement benefits, including pension and other post-employment benefits (OPEB) such as healthcare, affects the wellbeing of public employees, creates a financial burden on local governments, and constrains resources for other essential public services. As one of the first steps to address this problem, PA 202 of 2017 (PA 202), the *Protecting Local Government Retirement and Benefits Act*, came into effect in 2017 to ensure sustainable funding for local retirement benefits. PA 202 requires local governments that have defined-benefit (pension) retirement plans and/or OPEB plans to report their pension and OPEB funding information to the Michigan Department of Treasury.

The state Treasurer determines underfunded status for each local government retirement system based on funded ratio and annual required contribution[1] (ARC) as a share of local governmental revenue. The Treasurer deems a pension system underfunded if 1) funded ratio[2] is below 60 percent **and** 2) ARC is above 10 percent of local governmental revenue. In contrast, an OPEB system is underfunded for PA 202 purposes if 1) funded ratio is below 40 percent **and** 2) ARC is above 12 percent of local governmental revenue.

Once the Treasurer determines the local government has an underfunded pension or OPEB system (i.e. the local government has "triggered"), the local government must file a corrective action plan (CAP) that outlines the prior and prospective actions taken to address funding issues.

In this report, we first look at the scope of underfunded pension and OPEB liabilities in Michigan. Then, we document the actions that triggered local governments have taken in the past, as reported in the "prior actions" section of their CAPs, and the actions they plan to take in the future, as reported in the "prospective actions" section of their CAPs. We analyze the trends and patterns of these actions taken to address funding issues. We conclude this report with policy implications as well as reporting issues we noted based on our observations.

It is important to note that although we only focus on general-purpose governments (county, city, township, and village) in this study, PA 202 applies to special districts as well and they face the same challenges when it comes to funding retirement benefits.

1 ARC includes both the normal cost and a catch-up payment for past service costs to fund the Unfunded Actuarial Accrued Liability (UAAL), that is, the amount of promised retirement benefits that exceed a plan's assets.

2 Funded ratio is defined as the value of assets divided by liabilities of retirement plans.

3 Data is published by Michigan Department of Treasury and data is up to date as of August 27, 2019. https://www.michigan.gov/treasury/0,4679,7-121-1751_2194_84499---,00.html

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Part 1: The Scope of Underfunding Retirement Benefits

Pension

By Type of Government

Table 1 reports the number of pension systems and unfunded pension liabilities by the type of governments. In Michigan, there are 580 pension systems administered by general-purpose governments, and it is common for a government to administer more than one pension system, varying by employee category. 76 out of those 580 are determined by the Department of Treasury as underfunded (or "triggered" based on the two criteria outlined in the previous section.) More than half of the pension systems are administered by cities in Michigan, and together they account for 69 percent of the unfunded pension liabilities. Out of the 76 triggered systems, 62 systems are administered by cities.

Table 1: Pension Systems and Liabilities by Government Type				
	Triggered pension systems	All pension systems	Unfunded Pension Liabilities	
			Amount	%
City	62	305	$6,043,295,232	69%
County	2	93	$2,116,943,872	24%
Township	7	106	$532,005,952	6%
Village	5	76	$70,312,640	1%
Total	**76**	**580**	**$8,762,557,696**	**100%**

Table 2 present the funding level of different types of government. Currently, 152 pension systems are funded below 60 percent, one of the underfunded pension system triggers. Out of them, eight systems are funded below 30 percent. Again, it is cities that tend to have less funded pensions, with a third of the systems funded below 60 percent. Note that close to three quarters of the systems (428 out of 580) are funded above 60 percent, and 49 systems are over funded.

Table 2: Pension Funded Ratio by Government Type						
	Funded Ratio Level					% of systems funded ratio < 60%
	0 - 30%	30% - 60%	60% - 100%	>100%	Total	
City	6	96	180	23	305	33%
County	0	11	73	9	93	12%
Town-ship	0	19	77	10	106	18%
Village	2	18	49	7	76	26%
Total	**8**	**144**	**379**	**49**	**580**	**26%**

Table 3 examines the second trigger, that is, ARC as a share of governmental revenue. A higher share indicates that a unit bears more of the burden to fund its pension. Based on this measure, it appears funding pensions is more burdensome for cities than for other types of government; 38 percent of the cities have ARC greater than 10 percent of governmental revenue.

Table 3: Pension ARC Ratio by Government Type						
	ARC/Governmental Revenue					% of systems with ARC/Govt Rev > 10%
	0-10%	10%-20%	20%-40%	>40%	Total	
City	188	102	14	1	305	38%
County	85	7	1	0	93	9%
Township	95	10	1	0	106	10%
Village	71	3	2	0	76	7%
Total	**439**	**122**	**18**	**1**	**580**	**24%**

By Population Bracket

Table 4 shows the distribution of triggered pension systems and unfunded liabilities by population. Per capita pension liability is calculated as the total unfunded pension liabilities within a population bracket, divided by the sum of population of units offering pensions within that bracket. There is a wide variation in unfunded pension liability per capita across population brackets. Compared to the statewide unfunded pension liability per capita ($1,361), the units with population over 200,000 stand out with the unfunded pension liabilities per capita of $4,338, despite having only 16 pension systems. Mid-sized units (population between 5,000 and 10,000) have the lowest unfunded pension liabilities per capita ($793).

Table 5 and table 6 show pension funded ratio and ARC as a share of governmental revenue by population group, respectively. Approximately 30 percent of the systems are underfunded for each population group except the ones above 30,000, which have fewer underfunded systems. In contrast, the distribution of systems by the ARC share across population groups is more uneven. Overall, the medium-large sized communities (population between 5,000 and 200,000) have more burdensome ARC payments compared to small communities (population below 5,000).

Table 4: Pension Systems and Liabilities by Population

Population	# of systems	Triggered systems	Unfunded pension liabilities	2017 Population	Unfunded pension liability per capita
<1,500	69	2	$31,203,620	30,175	$1,034
1,501-5,000	139	11	$266,379,248	323,273	$824
5,001-10,000	92	17	$423,397,632	534,201	$793
10,001-30,000	135	26	$1,456,904,192	1,481,933	$963
30,001-200,000	129	20	$3,694,868,736	3,402,262	$1,086
>200,000	16	0	$2,919,804,672	673,104	$4,338
Total	**580**	**76**	**$8,762,558,100**	**6,444,948**	**$1,360**

Table 5: Pension Funded Ratio by Population

	Funded Ratio Level					% of systems funded ratio < 60%
Population	0 - 30%	30% - 60%	60% - 100%	>100%	Total	
<1,500	0	18	43	8	69	26%
1,501-5,000	2	37	86	14	139	28%
5,001-10,000	1	28	58	5	92	32%
10,001-30,000	3	33	95	4	135	27%
30,001-200,000	2	25	88	14	129	21%
>200,000	0	3	9	4	16	19%
Total	**8**	**144**	**379**	**49**	**580**	**26%**

Table 6: Pension ARC Ratio by Population

	ARC/Governmental Revenue					% of systems with ARC/Govt Rev > 10%
Population	0-10%	10%-20%	20%-40%	>40%	Total	
<1,500	66	1	2	0	69	4%
1,501-5,000	119	17	3	0	139	14%
5,001-10,000	63	27	2	0	92	32%
10,001-30,000	87	41	7	0	135	36%
30,001-200,000	88	36	4	1	129	32%
>200,000	16	0	0	0	16	0%
Total	**439**	**122**	**18**	**1**	**580**	**24%**

By Region

Table 7 shows the distribution of pension systems and unfunded liabilities by region. When measuring on a per capita basis, the Upper Peninsula and the Northern Lower Peninsula have a much higher level of pension liabilities compared to other regions; per capita liabilities in the Northern Lower Peninsula are more than double of the statewide average.

Table 8 and table 9 also show the challenge faced by the communities in the Upper Peninsula. Forty-three percent of the systems in this region are underfunded, which is the highest percentage among all regions. ARC payment is also more burdensome for this region. Communities in the Southeast region face a similar challenge, with 30 percent of their systems funded below 60 percent and having ARC payment greater than 10 percent of their revenues.

Table 7: Pension System and Liabilities by Region

Region	# of systems	Triggered systems	Unfunded pension liabilities	2017 Population	Unfunded pension liability per capita
East Central	78	5	$492,172,608	355,591	$1,384
West Central	78	3	$689,833,728	656,050	$1,051
Southeast	229	43	$6,091,422,208	4,442,976	$1,371
Upper Peninsula	61	13	$338,403,712	144,825	$2,337
Northern Lower Peninsula	50	3	$253,949,440	86,682	$2,930
Southwest	84	9	$896,776,064	2,748,162	$1,182
Total	**580**	**76**	**$8,762,557,760**	**26,326,917**	**$1,360**

Table 8: Pension Funded Ratio by Population

	Funded Ratio Level					
Region	**0 - 30%**	**30% - 60%**	**60% - 100%**	**>100%**	**Total**	**% of systems funded ratio < 60%**
East Central	1	17	53	7	78	23%
West Central	0	12	59	7	78	15%
Southeast	7	61	139	22	229	30%
Upper Peninsula	0	26	32	3	61	43%
Northern Lower Peninsula	0	8	40	2	50	16%
Southwest	0	20	56	8	84	24%
Total	**8**	**144**	**379**	**49**	**580**	**26%**

Table 9: Pension ARC Ratio by Region

	ARC/Governmental Revenue					
Region	**0-10%**	**10%-20%**	**20%-40%**	**>40%**	**Total**	**% of systems with ARC/Govt Rev > 10%**
East Central	65	10	2	1	78	17%
West Central	63	15	0	0	78	19%
Southeast	161	60	8	0	229	30%
Upper Peninsula	38	15	8	0	61	38%
Northern Lower Peninsula	44	6	0	0	50	12%
Southwest	68	16	0	0	84	19%
Total	**439**	**122**	**18**	**1**	**580**	**48%**

Table 10: OPEB Systems and Liabilities by Government Type					
	Triggered OPEB systems		All OPEB systems	Unfunded OPEB Liabilities	
	Count	%		Amount	%
City	62	31%	199	$5,808,640,000	68%
County	5	8%	62	$1,747,954,048	20%
Township	17	20%	85	$964,426,688	11%
Village	3	14%	21	$32,202,446	0%
Total	**87**	**24%**	**367**	**$8,555,223,182**	**100%**

Table 11: OPEB Funded Ratio by Government Type							
	Funded Ratio Level						% of systems funded ratio < 40%
	0 - 5%	5%-20%	20%-40%	40%-100%	>100%	Total	
City	93	37	27	31	11	199	79%
County	28	9	10	13	2	62	76
Township	38	10	9	22	6	85	67%
Village	14	1	1	4	1	21	76%
Total	**173**	**57**	**47**	**70**	**20**	**367**	**75%**

Table 12: OPEB ARC Ratio by Government Type						
	ARC/Governmental Revenue					% of systems with ARC/Govt Rev > 12%
	0-4%	4%-12%	12%-20%	>20%	Total	
City	74	58	42	25	199	34%
County	36	23	3	0	62	5%
Township	45	25	7	8	85	18%
Village	11	7	2	1	21	14%
Total	**166**	**113**	**54**	**34**	**367**	**24%**

Table 13: OPEB Systems and Liabilities by Population					
Population	# of systems	Triggered systems	Unfunded OPEB liabilities	2017 Population	Unfunded OPEB liability per capita
<1,500	7	2	$8,293,932	3,498	$2,371
1,501-5,000	75	11	$160,222,624	201,615	$795
5,001-10,000	61	13	$396,656,704	406,403	$976
10,001-30,000	108	28	$1,696,937,984	1,519,977	$1,116
30,001-200,000	103	33	$5,350,965,248	3,622,733	$1,477
>200,000	13	0	$940,146,880	673,104	$1,397
Total	**367**	**87**	**$8,553,223,372**	**6,427,330**	**$1,331**

OPEB

By Type of Government

Tables 10 through 18 follow the same structure as tables 1 through 9, and report OPEB funding issues of local governments in Michigan. Overall, challenges for OPEB funding are more pressing compared to pensions. Table 10 presents the distribution of OPEB systems and unfunded liabilities across types of government. Similar to pensions, cities are the main drivers for legacy costs, responsible for more than two thirds of OPEB systems. Based on the 40-percent cutoff for OPEB, three quarters of OPEB systems are underfunded (table 11). In particular, 47 percent (173 out of 367 OPEB systems) have a funding level below five percent.

Compared to pensions, fewer local units have an ARC level above Treasury's trigger. Only 88 (24%) local governments have ARC greater than 12 percent of their total governmental revenues, and 67 out of the 88 systems are administered by cities (table 12).

By Population Bracket

Tables 13 through 15 present OPEB funding and liabilities by population group. Per capita OPEB liability is calculated as the total unfunded OPEB liabilities within a population bracket, divided by the sum of population of units that offer OPEB within this bracket. Units with population less than 1,500, although having the fewest OPEB systems, have the highest unfunded OPEB liabilities per capita of $2,371. This is much higher than the statewide unfunded OPEB liabilities per capita of $1,331. Small-medium sized units (population between 1,500 and 30,000) have less unfunded OPEB liabilities on a per capita basis.

Table 14 shows three quarters of the communities have funded ratios below 40 percent, and that close to half are below five percent. Communities with population greater than 200,000 are the exception; only 38 percent of these communities (four systems out of 13 in total) are below 40 percent. In contrast, all seven systems of communities with population less than 1,500 are less than 40 percent funded.

Table 15 shows the distribution of systems in population group based on the second trigger, ARC as a share of governmental revenues. There is not much variation across population groups in terms of the share of communities with

Table 14: OPEB Funded Ratio by Population							
	Funded Ratio Level						% of systems funded ratio < 40%
Population	0 - 5%	5%-20%	20%-40%	40%-100%	>100%	Total	
<1,500	5	2	0	0	0	7	100%
1,501-5,000	47	10	5	11	2	75	83%
5,001-10,000	34	9	7	7	4	61	82%
10,001-30,000	50	16	14	25	3	108	74%
30,001-200,000	56	17	20	21	9	103	71%
>200,000	1	3	1	6	2	13	38%
Total	**173**	**57**	**47**	**70**	**20**	**367**	**75%**

Table 15: OPEB ARC Ratio by Population						
	ARC/Governmental Revenue					% of systems with ARC/Govt Rev > 12%
Population	0-4%	4%-12%	12%-20%	>20%	Total	
<1,500	3	2	2	0	7	29%
1,501-5,000	40	23	9	3	75	16%
5,001-10,000	30	18	8	5	61	21%
10,001-30,000	53	26	16	13	108	27%
30,001-200,000	35	36	19	13	103	31%
>200,000	5	8	0	0	13	0%
Total	**166**	**113**	**54**	**34**	**367**	**24%**

ARC greater than 12 percent of governmental revenues. Communities with population greater than 200,000 are, again, the exception, with no system having an ARC greater than 12 percent of the governmental revenue.

By Region

Table 16 reports the distribution of OPEB systems and unfunded OPEB liabilities per capita by region. When measuring on a per capita basis, we see an uneven distribution of unfunded OPEB liabilities across regions. The East Central region has the highest unfunded OPEB liabilities ($2,788 per capita), followed closely by the Upper Peninsula ($2,196). The West Central region has the lowest unfunded liabilities ($488 per capita).

However, across regions, OPEB systems are funded at a lower ratio compared to pensions. As shown in table 17, approximately half of the OPEB systems are offered in the Southeast region, and here 70 percent of the systems are less than 40 percent funded. This percentage unfortunately is the lowest across all regions; in the Upper Peninsula, 19 out of 21 OPEB systems are funded below 40 percent, and 13 out of the 19 systems are less than five percent funded. In fact, out of the total 367 OPEB systems, 173 (47%) systems have a funded ratio below five percent.

Table 18 shows the distribution of systems in each region based on their ARC as a share of governmental revenues. The share of communities that have ARC greater than 12 percent of their governmental revenues ranges from zero percent (Northern Lower Peninsula) to 37 percent (Southeast).

Table 16: OPEB System and Liabilities by Region					
Region	# of systems	Triggered systems	Unfunded OPEB liabilities	2017 Population	Unfunded OPEB liability per capita
East Central	35	7	$731,518,848	262,345	$2,788
West Central	53	7	$360,688,960	739,199	$488
Southeast	185	64	$6,137,001,984	4,601,878	$1,334
Upper Peninsula	21	2	$159,045,904	72,423	$2,196
Northern Lower Peninsula	24	0	$35,286,676	63,445	$556
Southwest	49	7	$1,129,680,768	688,040	$1,642
Total	**367**	**87**	**$8,553,223,140**	**6,427,330**	**$1,33,1**

Table 17: OPEB Funded Ratio by Region							
	Funded Ratio Level						% of systems funded ratio < 40%
Region	0 - 5%	5%-20%	20%-40%	40%-100%	>100%	Total	
East Central	21	7	1	4	2	35	83%
West Central	25	9	9	8	2	53	81%
Southeast	74	31	25	41	14	185	70%
Upper Peninsula	13	3	3	2	0	21	90%
Northern Lower Peninsula	14	2	3	5	0	24	79%
Southwest	26	5	6	10	2	49	76%
Total	**173**	**57**	**47**	**70**	**20**	**367**	**75%**

Table 18: OPEB ARC Ratio by Region						
	ARC/Governmental Revenue					% of systems with ARC/Govt Rev > 12%
Population	0-4%	4%-12%	12%-20%	>20%	Total	
East Central	18	10	3	4	35	20%
West Central	37	12	3	1	53	8%
Southeast	57	60	42	26	185	37%
Upper Peninsula	9	10	1	1	21	10%
Northern Lower Peninsula	21	3	0	0	24	0%
Southwest	24	18	5	2	49	14%
Total	**166**	**113**	**54**	**34**	**367**	**24%**

Part 2: Summary Tables of Corrective Action Plans

Summary of Corrective Actions for Pension Systems

	Prior	Future
System design changes		
Close system	39	10
Coverage		
Reduce multiplier	18	5
Increase member contribution	17	4
Change FAC	6	0
Increase normal retirement age	3	0
Adjust COLA	2	2
Other	8	4
Consolidate systems	1	0
Negotiation	0	12
Funding		
Additional contributions	15	16
Lump sum payment	11	5
Transfer from other funds	3	6
Millage rates	2	2
Bonding	1	3
Establish trust fund	1	0
Others		
Change in projection	18	22
Use of enterprise funds	13	0
Data updates	9	0
Change of actuarial assumptions	6	0
Fill delinquency	0	1
Total	**173**	**92**

Definitions of Popular Actions

System Design Changes

Close System. The defined benefit (pension) system is closed to new hires and the local government either replaced the pension system with a defined contribution (401(k) or similar) plan or did not replace the pension system at all. This category is discussed further in the observations section.

Coverage. Umbrella category. Local governments reported making numerous coverage design changes, however some changes were more common than others and those are listed in the summary table. An "Other" sub-category is also included. The Coverage category is discussed further in the observations section.

Additional Funding

Additional Contributions. Payments made to the pension system that are in addition to a local government's annual required contribution (ARC) payment. These additional payments must occur on a regular basis, such as annually or monthly. This category is discussed further in the observations section.

Lump Sums. One-time infusion of money into the pension system in addition to paying the ARC.

Transfers from other funds. Local government makes multiple, but not regular or repetitive, payments into the pension system in addition to paying the ARC. This category is discussed further in the observations section.

Other Considerations

Change in projection. Some local governments will change projection methodology that leads to changes in projected pension assets and liabilities. As a result, the new projected data of assets and liabilities will show the local government to have funded pensions.

Use of enterprise funds. Related to the second trigger—ARC as a share of governmental revenues. Using enterprise funds to increase funded ratio in certain circumstances. This category is discussed further in the observations section.

Observations of Popular Actions

Prior Actions vs. Prospective Actions

Overall, local governments reported "prior actions" at a much higher rate than they reported "prospective actions." There are double the amount of prior actions recorded on the CAPs than there are prospective actions. Additionally, under prior actions, local governments report using System Design Changes more often than they do Additional Funding changes or other actions that do not fit into those two categories (the Other Considerations category).

System Design Change Actions

Close the system. Closing the pension system is the most popular System Design Change for "prior actions." This category includes local governments that closed their pension systems to new hires and subsequently opened defined contribution plans for those new hires; also included are local governments that closed systems, but did not open defined contribution plans (DC) for new hires and decided not to replace the pension system with a comparable retirement benefit. When a local government closes a pension system to new hires, it is very common for them to also open up a hybrid or defined contribution plan to replace the closed pension system. Local governments rarely reported closing a pension system only to not replace it with some type of comparable retirement system.

Coverage. Decreasing multipliers and increasing employee contributions are the second and third most popular "prior action" System Design Change, respectively. These sub-categories are the two most common ways local governments report trying to lower unfunded liabilities with coverage changes. These are also the second and third most popular prior action changes recorded overall on CAPs for pension systems. The "Other" sub-category includes local governments that lowered costs or changed employee coverage. Because there are so many different ways to do this, it was not practical to list all the ways reported, therefore, the "lower cost" category and "change coverage" were combined into one, "Other," sub-category.

Additional Funding Actions

Additional Contributions. The most popular Additional Funding action local governments recorded was making additional contributions. Additional contributions are payments the local government makes on a regular basis (such as annually or monthly) to fund the pension system in addition to paying ARC. If a local government reported transferring money into the pension system from another fund or reported making multiple, but not repetitive, payments to a pension system, those actions were classified as transfers from other funds, not "additional contributions" for this report.

Lump Sums. Another popular Additional Funding action is making one-time, lump sum payments to pension systems (in addition to paying ARC). This one-time infusion of money is used by local governments to help bring down unfunded liabilities and increase funded ratio.

Other Considerations Actions

Change in Projection. The most popular action in the Other Considerations category is change in projection. It is also the most popular prospective action reported overall.

Use of Enterprise Funds. Some local governments argue that, when pensions are provided to employees who are supported by enterprise funds, local governments should be able to transfer enterprise funds to governmental revenues, which, in turn, will prevent the local government from triggering.

Summary of Corrective Actions for OPEB Systems

	Prior	Future
System design changes		
Close system	40	8
Coverage		
Other	45	14
Increase member contribution	20	2
Increase normal retirement age	5	0
Reduce multiplier	2	1
Change FAC	1	0
Change Vesting years	1	0
Use Medicare	15	3
Change funding method	4	3
Consolidate systems	2	0
Negotiation	0	22
Funding		
Establish trust fund	27	13
Additional contribution	13	26
Transfer from other funds	12	12
Millage rates	1	0
Lump sum payment	0	2
Bonding	0	2
Others		
Data updates	12	2
Change in projection	10	31
Change of actuarial assumptions	10	0
Use of enterprise funds	4	0
Total	**224**	**141**

Definitions of Popular Actions[3]

System Design Changes

Close System. Similar to pension definition, with one important difference. This category is discussed further in the observations section.

Coverage. Umbrella category. Sub-categories are defined similarly to pension sub-categories, including the "Other" sub-category.

Additional Funding

Establish trust fund. Creation of a qualified trust to prefund OPEB obligations. This is in contrast to the PAYGO method of providing employees with healthcare benefits as they become needed and due.

Additional Contributions. Similar to pension definition. Also, if a local government made additional and regular infusions of money into the OPEB system, in additional to whatever expenses or payments were necessary for a PAYGO system, those local governments were counted as making "additional contributions."

Lump Sums. One-time infusion of money into the OPEB system in addition to paying the ARC.

Transfers from other funds. Similar to pension definition.

Other Considerations

Change in projection. Some local governments will change projection methodology, leading to changes in projected pension assets and liabilities. As a result, the new projected data of assets and liabilities will show the local government to have sufficient funds for OPEB.

Data Updates. Local government reports that the reason the local government triggered was based on out of date information and the local government provided additional information in an attempt to demonstrate it met the funded ratio necessary not to be triggered.

Observations: Highlighting Differences Between Pension CAPs and OPEB CAPs

There are not many differences between the actions reported on OPEB CAPs and the actions reported on pension CAPs. Many of the observations made regarding the OPEB CAP actions were made earlier, in the section discussing pension CAP action observations. Consequently, this section merely highlights some of the differences between the two data sets.

Similar to the pension CAPS, prior actions were reported more often than prospective actions and the most popular prior action was to close the system.[4] That said, local governments reported opening reduced or different OPEB funds for new hires less frequently than they reported doing so in the wake of closing pension systems; when local governments reported closing a pension system, they tended to also report opening a defined contribution or similar retirement system for new hires.

Also, some actions are unique to OPEB, such as the use of Medicare. Requiring, or "encouraging," employees to use Medicare is one way local governments leverage support provided by other levels of government (in this case, a federal program) to enhance their retirement benefits. This is not readily found for pension system design changes.

Negotiation is also a popular prospective action for OPEB but not for pension. While pension benefits are protected by the Michigan Constitution, OPEB does not enjoy such privilege and thus offers more room for negotiation. However, it remains an open question what agreements would be reached through negotiation and, if an agreement can be reached, would the agreement sufficiently address the funding issue.

Establishing an OPEB trust fund was the most popular Additional Funding action overall. Increasing employee contributions is a popular prior action and, for OPEB CAPs, the most reported way of increasing employee contributions is to increase the amount employees have to pay out-of-pocket for healthcare or to increase copays. For prospective actions, many local governments committed to making additional contribution.

3 Overall, other post-employment benefit (OPEB) action definitions are similar to pension action definitions.

4 The sub-category "Other" under the Coverage section was recorded more often, however this sub-category contains a few different types of coverage change and cost lowering actions. Closing the system is the most popular category that does not have a multitude of actions within it.

Part 3: Policy Implications and Reporting Issues

Policy Implications

Overall, the policy implications derived from the actions reported on the OPEB CAPs are similar to those on the pension CAPs. Therefore, this section covers both OPEB and pension CAPs. Policy considerations or implications specific to pension or to OPEB are highlighted at the end of this section.

Closing the Plan

Closing a retirement plan does not halt the accrual of legacy costs, but rather, introduces a series of policy changes that all have implications. For instance, there are financing options available to closed systems that are not available for open systems, specifically the ability to bond. In Michigan, a local government can only issue a pension obligation bond (POB) for a closed pension (or OPEB) system. The local government issues a POB and uses the proceeds to increase the funded ratio of the pension or OPEB fund. While taking on additional debt is a somewhat counterintuitive policy consideration for an already indebted local government, the goal is to generate returns on investment by financing its retirement system and using the returns on investment to pay ARC and maintain adequate services.[5]

Once a current plan is closed, a local government also needs to consider what to do with new hires – to replace a closed pension system with a new retirement plan, or to not provide any pension-like benefit at all. Usually, when a local government reported closing a pension plan, the local government also reported opening a DC or hybrid type plan for new hires. Some local governments did not report opening a DC plan after closing pension systems, which raises some questions. Did the local government simply not report the opening of a DC system or did the local government not replace the pension system with a DC plan? If it is the former, these local governments may need more direction on how to fill out PA 202 forms; if it is the latter—there are numerous policy implications and questions that come with that decision. For starters, would employees in that local government have any sort of local or state government retirement benefit? Would the lack of benefits impact recruitment and the ability to retain public employees?[6] Delving into the consequences of closing a pension plan is beyond the scope of this paper, but it is important to remind policy makers of the long-term impact that changing retirement benefits can make.

Similar to pensions, closing an OPEB fund (or the equivalent in a PAYGO OPEB system) also has consequences, but those are arguably less severe or impactful. Promised pension benefits are protected by the Michigan Constitution, whereas retiree healthcare benefits (OPEB) are not and courts tend to rule in favor of the employer (the local government) in cases between retirees and/or employees and the local government-employer. The local government should carefully consider the pros and cons of closing its retirement plan, be it pension or OPEB. When done in a fiscally thoughtful manner, closing a plan can help a local government decrease debt over the long term without compromising service sufficiency or benefit quality to the employees. However, if a local government is sued by employees, a court ruling can also add uncertainty to future local finances.

Reducing Multipliers or Increasing Employee Contributions

These options involve shifting risk to the employees. Spreading risk to all stakeholders is safer than putting the risk mostly on the employee or mostly on the employer or taxpayer. If the risk is distributed fairly evenly, this has a better chance of making positive gains for the whole (because no one stakeholder is hit too hard).

5 The ability to deliver services is, itself, a boon to the local government as it helps create a safer community and one where the residents are taken care of and want to live. If people want to live in the local unit, perhaps the local government will not lose as much of its population (and tax base) to its neighbors.

6 Some additional questions might include: do new employees have no retirement benefits now; if the system is a police or firefighter system, are those officers covered by social security; with a closed system, where is the local government going to get the necessary funds to pay out those promised, constitutionally protected, pension benefits, as more employees become retirees without new hires to make contributions? There are many questions that should be asked if a local government reports closing a pension plan but fails to report the creation/opening of a DC or other 401(k) style plan.

Establishing an OPEB Trust

One of the most important OPEB actions reported was local governments establishing trust funds for OPEB. The Government Finance Officers Association (GFOA) recommends local governments prefund OPEB obligations as opposed to the local government making contributions at the same time the benefits and expenses become due (i.e. pay-go funding). GFOA considers establishing an OPEB trust fund a "best practice."[7] Pre-funding is not always possible or practical. However, if a local government can afford to prefund, then it may be an option worth considering.

Change in Projection

Local governments frequently offer/report data that causes a "change in projection" of the pension systems' funding level. A different projection methodology does not make substantive changes to actual pension assets and liabilities. Instead, it can mask the real challenge of funding pension liabilities and provide local policymakers with a false sense of security.

Use of Enterprise Funds

One of the triggers is ARC as a share of governmental revenues, with a higher share indicating more burdensome and less affordable retirement benefits. Some local governments argue that, when pensions are provided to employees who are supported by enterprise funds, local governments should be able to transfer enterprise funds to governmental revenues, which will lower the share of ARC and thus prevent the local government from triggering under PA 202. However, using enterprise funds to increase funded ratio may be a challenging change to implement. Not all local governments use enterprise funds to provide employees' benefits. Would the change in trigger be applied to all local governments or just local governments transferring enterprise funds? Would the change in trigger encourage local governments to use enterprise funds for governmental activities? Before making substantive trigger criteria changes, these sorts of questions and the accompanying policy implications should be considered.

Special districts

PA 202 applies to all local governments that have a defined benefit retirement plan; as such, it is applicable to special-purpose governments. However, given the fact that special-purpose governments have different revenue structures from general-purpose governments, the second trigger, that is, ARC as a share of governmental revenue, may not accurately reflect the funding sustainability of legacy cost for these governments. It calls for additional attention to whether different criteria should be used to assess the burden of legacy costs on special districts.

Reporting Issues

Overall, most local governments fully participated and completely filled out their CAPs by listing both prior and prospective actions. The majority of local governments took this exercise seriously. However, there were a handful that decided to be humorous and leave comments that were not only unconstructive, but also showed some local governments' lack of understanding when it came to the purpose and use of the CAPs.

Local governments reported prior actions at a much higher rate than they reported prospective actions. Arguably, prospective actions are more important than prior actions, therefore the lack of actions, or perhaps just the lack of *reporting* of those actions, to be taken in the future is interesting and somewhat concerning. Prior actions are actions taken years prior to the local government triggering due to a low funded ratio; if those prior actions successfully improved the financial health of these local governments' pension or OPEB systems, the local governments likely would not have triggered. Therefore, local governments should concentrate on actions they plan to take in the wake of triggering, as opposed to relying on past actions to solve future problems.

That said, the fact that prior actions are reported with a much higher frequency than prospective actions can also imply that they have exhausted possible solutions in their toolboxes. Should some local governments still be determined underfunded in the next year despite their approved CAPs, they may not have any further means to cope with the challenge. PA 202 is effective for raising awareness of the challenges associated with funding retirement benefits and for motivating local governments to examine their finances, but it is only a first step toward addressing these challenges. Further discussion with stakeholders and additional resources are needed to ensure sustainable funding for legacy costs.

Further, the actions local governments listed in the Other Considerations category demonstrated a concerning trend. It seems some local governments have shifted their focus away from making their pension and OPEB systems healthy, with a funded ratio around 80 percent or higher, to making their pension systems just healthy *enough* in order to avoid triggering under PA 202 (*60 percent* for pension and *40 percent* for OPEB). Simply put, the goal has shifted from getting pension systems as healthy as possible to getting them

7 "Establishing and Administering an OPEB Trust," Government Finance Officers Association, September 2016 *at* https://www.gfoa.org/establishing-and-administering-opeb-trust.

healthy or providing enough updated data or projections to avoid triggering. One way to address this is to add an "exit criteria," that is, to add new criteria to remove the local government from the PA 202 trigger list that does not only have to do with reaching a certain funded ratio.

Recognizing the problem with unfunded legacy costs and having an action plan are a great start. However, to ensure effective implementation, local governments need to be able to actually *afford* to implement those actions. There are a handful of local governments in serious fiscal crisis and largely cannot afford to implement the remedial actions listed in their CAPs. More policy questions thus arise: does PA 202 need to be amended or interpreted (via judicial review and case law or internal policy or procedures) to grapple with the issue of affordability (or lack of affordability) in a more comprehensive way? What can be done for those local governments, should they fill out CAPs and, if so, what is the ultimate goal of submitting a CAP when all parties know (or are reasonably certain) the actions listed on the CAP will never be implemented? If PA 202 is "given teeth" (such as an enforcement mechanism added to the law to punish noncompliance) how would that work for local governments unable to afford to implement actions listed in their CAP? For a local government in this type of situation, a reporting requirement, especially one with "teeth," could become punitive in nature and deviates from the goal of PA 202, that is, to increase transparency, increase funded ratios, and gather information regarding pension and OPEB liabilities in Michigan.