Barbarians Still at the Gate – Legislative Efforts to Erode Benefits

2017 Public Safety Employees Pension & Benefits Conference

Ronald A. King
(517) 318-3015
rking@clarkhill.com
NATIONAL PICTURE – PENSIONS

- Approximately 4,000 state and local pension systems in the United States covering over 20 million employees and retirees
- Estimated to owe an unfunded liability of over $3 trillion
  - Overall average funding level has dropped to 80% which is considered to be just in the safe level
  - Increase in unfunded liabilities is likely due to the less than expected investment returns during the 2009-09 recession
NATIONAL PICTURE – OPEB

- Scale of problem is rapidly approaching the state and local pension situation
- Best estimate of total unfunded liability is at $862 billion
  - Thus, exceeding OPEB liabilities by a factor of three to one
THE PLAN SPONSOR BURDEN

- Outcry for pension reform
- Job cuts / retention issues
- States and municipalities seek legislative solutions
- In some instances, options are limited (AK, HI, MI, IL, AZ, LA, NY)
- Burden is increasingly shifted to plan participants
- All of this despite clear promises made to public safety employees
DALLAS POLICE AND FIRE (NEGOTIATED REFORMS)

- Pension fund approximately 36% funded
- Cap DROP at 10 years
- Retirees cannot continue to defer payments
- DROP payments paid out as annuity rather than lump sum
- Interest based on a Treasury-based rate
- Pension fund Board could claw back interest earned by DROP participants
- Increase payroll contributions to 13.5% from 8.5%
- Raises city’s contribution to 34.5% of pay annually from 27.5% (plus $13 million annually until 2024)
ILLINOIS PENSION REFORM

- PA 100-0281 signed by Gov. Bruce Rauner August 24, 2017
- Municipalities required to design 401(k) style plans for police
- Officers with 10 years of service – change police forces – option to enroll in 401(k) style plan
- New police officers who retire and return to service enrolled in 401(k) style plan
ARIZONA DILEMA

- Public Safety Personnel Retirement System (PSPRS) – Estimated $7.7 billion underfunded
- Strong Constitutional Protection (Art. 29)
- Favorable court rulings – 2011 pension reforms struck down by AZ Supreme Court
- 2016 overwhelming passage (by referendum) of Proposition 124
  - Among other things replaced permanent benefit increase (PBI) with COLA linked to CPI with annual 2% cap
- Recent efforts by AZ mayors calling for additional reform – PSPRS Mayoral Summit
- Call for nuclear option
MICHIGAN LEGISLATIVE EFFORTS
OVERVIEW OF PENSION AND OPEB FISCAL STRESS TEST

- Task Force agreed the creation of a system that would enable decision-makers to have data and transparency for a full understanding of the fiscal stability or stress of local units.

Five Basic Stages of Proposed Local Unit Pension/OPEB Fiscal Stress System:

1. Stage 1: Transparency, Reporting, and Requirements
2. Stage 2: Identify Potential Problem
3. Stage 3: Review for Fiscal Stress
4. Stage 4: Corrective Action Plan
5. Stage 5: Plan Implementation

Responsible Retirement Reform For Local Government Task Force/Report of Findings and Recommendations For Action/Prepared for Governor Rick Snyder July 2017
STAGE 1: TRANSPARENCY, REPORTING, AND REQUIREMENTS

- Three parts
  - Transparency and Reporting
    - Pension and OPEB data should be reliably produced, collected in a central depository (Treasury) and widely available
  - Uniform Reporting
    - All local units should recalculate its plans funded ratios using a range of assumptions set annually by Treasury
  - Minimum Funding Requirements
    - Pension: Task Force did not believe any new additional funding requirements were needed
    - OPEB: New legislation should be adopted to require (1) payment of retiree health care premiums and (2) payment of the normal cost for new hires
STAGE 2: IDENTIFY POTENTIAL PROBLEM

- Use of initial criteria to determine the general fiscal health of the local unit’s pension and OPEB systems as well as the fiscal stress, if any, that may be put on the local unit’s overall ability to provide services

- Pension criteria
  - Pension funding level (assets/liabilities)
  - Employer contribution (ARC) as a percent of government wide revenue

- OPEB criteria
  - OPEB funding level (assets/liabilities)
  - Employer contribution (ARC) as a percent of government wide revenue
STAGE 3: REVIEW FOR PENSION AND OPEB FISCAL STRESS

- If a potential funding problem is determined for a local unit is Stage 2, Treasury should undertake a more individualized and comprehensive internal review of the local unit’s pension or OPEB fund, discuss changes or reforms that have been made with the local unit’s designated officials, and review actuarial projections.
STAGE 4: CORRECTIVE ACTION PLAN

- A full review of all pension and OPEB contracts and financials must take place

- Local unit will develop and submit a Corrective Action Plan to the proposed Municipal Stability Board (MSB) for review
  
  - MSB: comprised of appointed members representing state and local officials, as well as employee/retiree representative(s)
  
  - Corrective Action Plan Components: components will be determined by the local unit, approved by the local legislative body, and then must be agreed to by the MSB
STAGE 5: PLAN IMPLEMENTATION

• Action must be taken to assist the local unit in meeting the criteria of State 2 so that they become fiscally stable into the future
  
  – Option 1: MSB can provide plan design recommendation and technical assistance
  – Option 2: MSB can recommend Act 436\(^\text{22}\)
  – Option 3: MSB can implement limited plan design changes
  – Option 4: MSB can require mediation/arbitration
SIXTH CIRCUIT UPHOLDS CITY'S RETIREE HEALTH CUTS

- *Serafino v. City of Hamtramck*, Sixth Circuit Case No. 16-2370 (9/1/17), the Court upheld the District Court decision finding that the City of Hamtramck, Michigan could lawfully modify retiree health care benefits for a retired group of police officers and firefighters
  - Contracts under which the plaintiffs retired did NOT specifically state that the benefits were "vested for life"
SIXTH CIRCUIT UPHOLDS CITY’S RETIREE HEALTH CUTS

- Effective January 29, 2014, the emergency manager implemented a change in the plan whereby the retiree was responsible for the entire health care deductible

- The retirees objected to the change and filed a class action suit in federal District Court alleging various violations of the United States Constitution and breach of contract under Michigan law
SIXTH CIRCUIT UPHOLDS CITY'S RETIREE HEALTH CUTS

- In interpreting the contracts at issue, the Sixth Circuit noted that all the contracts had general durational clauses stating that the contracts began and ended on specific dates.

- The Court found nothing in any of the contracts that excluded the retirees' health benefits from this general duration clause. Thus, the Court found that the retirees' rights did not vest.

- Importantly, the Court went beyond merely holding that the emergency manager had the right to impose the cost of the deductibles on the retirees; the Court also implied that the City could have gone as far as eliminating the retiree benefits completely.
MECHANISMS TO REDUCE PLAN SPONSOR BURDEN

- Bonding
- Increase amortization periods as permitted
- Adjust multiplier
- Adjust or eliminate COLAs
- Revise definition of compensation
- Close or freeze DB in favor of DC – maybe hybrid
- Supplement funding
FURTHER RISK TO BENEFITS – PLAN SPONSOR FAILURE/INABILITY TO PAY

- Michigan MERS
  - MERS Board may suspend benefits to retirees/beneficiaries (upon appropriate notice) if plan sponsor is delinquent

- CalPERS
  - Board may reduce benefits in the event of voluntary or involuntary termination
THERE ARE NO OFF DAYS!

Clark Hill
THANK YOU

Ronald A. King

(517) 318-3015

rking@clarkhill.com
THANK YOU

Disclaimer: This information is not intended to be legal advice and may not be used as legal advice. Legal advice must be tailored to the specific circumstances of each case. Every effort has been made to assure this information is up-to-date. It is not intended to be a full and exhaustive explanation of the law in any area. It should not be used to replace the advice of your own legal counsel.

CLARK HILL