



# CRC MEMORANDUM



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## MICHIGAN STATE AND LOCAL GOVERNMENT RETIREMENT SYSTEMS

### IN BRIEF

This CRC Memorandum is a summary of Citizens Research Council Report No. 356, which describes Michigan's 138 state and local pension systems in aggregate, provides details for several of Michigan's major state and local public pension systems, compares key metrics to national averages, and explores the possible ramifications of the current economic situation on public defined benefit plans and on state and local governments.

In Michigan, state and local government pension plan benefits are protected by Article IX, Section 24 of the 1963 State Constitution, which provides that "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities." Benefits that have been earned by covered employees for work performed are a contractual obligation of that unit of government.

The State "guarantees" the pension benefits that have been earned by employees of local governments, but the Michigan Attorney General opined in OAG, 1975-1976, No. 5076, p. 563 (August 9, 1976) that the State is not a funding or benefit guarantor for local government pension obligations; those payments remain the obligation of the local public employer. Michigan public employers are required to set aside funds to pay pensions as those pensions are earned. Future pension benefits may be changed, both for new hires and for the future service of current employees, as long as benefits accrued are not impaired or diminished.

### Defined Benefit and Defined Contribution Plans

Defined benefit pension plans promise benefits to members based on a proportion (generally from 1.5 percent to 2.5 percent) of average final compensation for each year of service, payable for life. Nationally, 84 percent of state and local government workers have a defined benefit plan available (compared to 22 percent of private sector workers).

Defined contribution plans transfer all or part of the cost, and the risk, of the retirement plan from the taxpayer to the employee. Defined contribution plans set up individual retirement accounts in which the account balance, and the payout, is dependent on the investment return. There can be no unfunded accrued liabilities in defined contribution plans.

In the past 10 years, a dozen states have introduced defined contribution plans for state employees, but

only the state governments of Michigan and Alaska now require all new hires to join the defined contribution plan. Michigan state employees hired after March 31, 1997, may only be members of the defined contribution plan. A number of local governments have also adopted defined contribution benefits only: in Oakland County, for example, all employees hired on or after July 1, 1994, belong to a defined contribution plan.

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## State and Local Government Pension Systems

In 2007, there were 2,547 state and local pension systems in the United States. Michigan is one of only five states that have over 100 state and local government retirement systems. In Table I, multiple employer systems such as the Municipal Employees Retirement System of Michigan, are considered one system.

Michigan’s 138 government employee retirement systems had 448,984 members (416,292 active and 32,692 inactive) and 293,370 beneficiaries.

**Table I**  
**States with the Largest Number of State and Local Government Pension Systems**

<u>State</u>	<u>Number of Systems</u>
Pennsylvania	903
Illinois	370
Florida	162
<b>Michigan</b>	<b>138</b>
Massachusetts	100
Minnesota	89
Indiana	71
Missouri	62
Connecticut	61
Colorado	60
California	59
Texas	48

Source: U.S. Census Bureau, State and Local Government Employee-Retirement Systems, Table 5, Number and Membership of State and Local Employee-Retirement Systems by State, 2006-2007

## Selected Michigan Retirement Systems

The Office of Retirement Services in the Michigan Department of Management and Budget manages the state pension systems for state employees, public school employees, state police, and judges. This CRC Report provides specific information on Michigan State Employees’ Retirement System

(MSERS) and Michigan Public Schools Employees’ Retirement System (MPERS), as well as the Municipal Employees Retirement System (MERS), an independent, voluntary, multi-employer system that represents over 720 cities, village, townships, counties, county road commissions, special au-

thorities, special districts, and other qualified groups. Additionally, the civilian and uniformed pension systems for the cities of Detroit and Grand Rapids are included. These seven selected pension systems have a total of nearly 660,000 members.

## Revenues

Pension system revenues are generally derived from three sources: investment earnings, employer contributions, and employee contributions (some plans are “non-contributory,” meaning that they require no

employee contributions). In Michigan, the Public Employee Retirement System Investment Act (PERSIA), PA 314 of 1965 as amended, authorizes and limits the investment of assets of state and local government employee

retirement systems. Data indicate that prior to the market crisis of 2008, Michigan pension systems were more reliant on investment returns, and less reliant on employer contributions, than the national average:

**Table 22**  
**Receipts of State and Local Retirement Systems, Fiscal Years Ending in 2007**  
**(Dollars in Millions)**

	<u>Michigan</u>		<u>United States</u>	
	<u>Dollars</u>	<u>Percent</u>	<u>Dollars</u>	<u>Percent</u>
<b>Total State System Receipts</b>	\$12,201.6	100.0%	\$486,784.5	100.0%
State Government Contributions	238.7	2.0	29,995.4	6.2
Local Government Contributions	1,092.1	9.0	26,450.0	5.4
Employee Contributions	440.2	3.6	29,086.8	6.0
Earnings on Investments	10,430.6	85.5	401,252.3	82.4
<b>Total Local System Receipts</b>	\$3,450.7	100.0%	\$93,666.7	100.0%
State Government Contributions	2.2	0.1	613.5	0.7
Local Government Contributions	364.8	10.6	15,854.7	16.9
Employee Contributions	111.7	3.2	4,967.5	5.3
Earnings on Investments	2,971.8	86.1	72,231.0	77.1

Source: U. S. Census Bureau; CRC Calculations

### Assets

In fiscal year 2006–2007, Michigan state and local government retirement systems had \$105 billion in assets.<sup>1</sup> In 2007, before the financial crisis, the actuarial value of assets in the seven selected Michigan systems was over \$71 billion.

The U.S. Census Bureau’s quarterly reports of the value of cash and security holdings 100 of the largest state and local public employee retirement systems indicate that as of December 31, 2008, the value of those systems’ assets declined 23.8 percent from the

prior year end. A review of the funded status of the largest 100 corporate pension funds revealed that their funded status declined by nearly 30 percentage points in 2008, eliminating all gains of the previous five years.<sup>2</sup>

Initial financial reports for some of the largest Michigan retirement systems for fiscal year 2008 reflect portfolio losses in the 20 to 25 percent range. If that experience extends to all of the public pension systems in the state, the resources available to fund constitutionally guaranteed pensions have deteriorated by \$21 to \$26 billion.

For the year ending September 30,

2008, total assets (pension and other post retirement benefits) of the Michigan State Employees’ Retirement System declined by \$3.1 billion, or 21.1 percent. Michigan Public School Employees Retirement System total (pension and OPEB) assets declined by \$12.6 billion (also 21.1 percent), also due to investment losses. The Municipal Employees’ Retirement System reported in February 2009 that calendar 2008 portfolio losses were 24.8 percent. The Detroit General Retirement System’s June 30, 2008 Financial Report reflected a decrease in net assets of \$429.2 million, or 11.1 percent (about 29 percent of the system’s assets are not publicly traded and therefore may not have a readily determinable market value). The Detroit Police and Fire Retirement System’ June 30, 2008 financial report showed that system had a

<sup>1</sup> U.S. Census Bureau, based on 2007 Census of Governments, Survey of Public Employee Retirement Systems. It should be noted that pension plans’ fiscal years and valuation dates vary, and that those variations will have significant effects on the date in volatile markets.

<sup>2</sup> Rob Kozlowski, Pensions&Investments, June 1, 2009, 5 Years of Corporate Funding Gains Gone

decrease in net assets of \$506.7 million. While taxpayer funded public pension systems are managed for the long term, investment

losses may well result in diverting resources that would otherwise provide services to residents, as well as accelerating the shift from

defined benefit to defined contribution plans, the reevaluation of other postretirement benefits, and other changes.

## The Impact

There are a number of pension practices that will ameliorate the immediate impact of asset losses. These include smoothing methods that recognize gains and losses over a period of years and amortization of unfunded accrued liabilities over periods of up to 30 years. Actuaries for defined benefit retirement plans calculate contribution rates using assumptions about retiree characteristics and expectations about the long-term return on investments, as well as assumptions about rates of inflation and the real rate of return on investments (investment return minus inflation). These assumptions are routinely adjusted to reflect actual conditions.

If not reversed in the near future, the current market crisis nonetheless will have very significant effects on state and local defined benefit retirement systems, on the public employers who administer them, and on the taxpayers who

fund them. It is too soon to know how long, and how severe the current economic downturn will be, and therefore how large the impact of this “economic tsunami” will be on state and local retirement systems. It is clear, however, that even those retirement systems that were in relatively good shape (funded at 80 percent or better) in 2007 will suffer significant adverse effects, and that policy makers and plan trustees will ponder proposals to protect state and local operating budgets from the immediate effect of large increases in pension funding requirements.

Historically, freezing defined benefit plans and shifting to defined contribution plans has been considered the best way to buffer state and local taxpayers from escalating pension funding requirements. However, the transition from closing a defined benefit plan to new entrants, and placing all

new hires in a defined contribution plan, normally requires ongoing contributions to both plans that may entail an increase in overall pension contributions for a number of years, so careful actuarial and budget analysis is critical to informed decision-making.

In response to the catastrophic losses of 2008, state officials may be inclined to increase statutory control of locally administered systems, or to reduce the relatively large number of locally administered systems, as a means of promoting fiscal responsibility. Local officials may seek to freeze defined benefit plans, reduce future benefits, change smoothing and amortization periods, or make other changes to reduce liabilities.

Employees who have seen the value of their homes and savings deteriorate may be expected to resist state and local efforts that reduce future pension benefits.