MAPERS

Chairman Poleski and members of the House Committee on Financial Liability Reform:

On behalf of the 117 independent public pension system members of the Michigan Association of Public Employee Retirement Systems (MAPERS), we appreciate the opportunity to speak to the committee today about creative solutions to the challenges of funding retiree benefits.

First, allow us to formally introduce the association. MAPERS is recognized as the principal educational forum for trustees, plan administrators, and other retirement and financial professionals in the State of Michigan. MAPERS was established to provide educational training and legislative access for the more than 670,000 members and retirees of public pension plans across the state. Applicable Federal and Michigan law mandates that fiduciaries of governmental pension retirement plans in the State of Michigan meet required fiduciary obligations. In the State of Michigan, independent local retirement plans are administered by a Board of Trustees. The Board of Trustees typically consists of elected government officials, appointees of the governing political body, and active and retired members elected by the respective groups, representing both union and non-union members.

Public retirement systems are responsible for the prudent investment of pension funds established for the sole purpose of providing retirement benefits to retirees and beneficiaries and providing disability benefits to employees disabled in the course of employment.

Trustees of public retirement systems are obligated to act consistent with prudent and fiduciary standards of conduct in the administration of their pension plans; that prudence and level of transparency was reinforced in the signing of PA 347 of 2012. Trustees are fiduciaries of the plans they serve and are accountable for their actions to the point that their own personal assets are "on the line" if it is found they acted imprudently, unethically, or illegally and the plan suffered as a result. Trustees are ultimately responsible for the day-to-day operation of the plan including administrative policies, granting of the benefits, investment of the assets, and ensuring that the plans are funded as required by law.

MAPERS listened with interest to the American Legislative Exchange Council's recent presentation regarding municipal pension reform. While it is true that some state and municipal plans have indeed chosen to move new employees to defined contribution plans, it is important to note that that is not the only solution to reducing liabilities and saving money. If it is the solution that works for a particular municipality, after careful and prudent consideration of many options, then municipalities should always retain the local control of being able to make that move on their own. In other words, MAPERS urges caution on a "one size fits all" approach to benefits structure. For instance, the following municipal

Michigan Association of Public Employee Retirement Systems

525 E. Michigan Ave. #409 • Saline, MI 48176
Phone: (734) 944-1144 or 1-800-475-4200 • Fax: (734) 944-1145
E-mail: info@mapers.org • Web site: www.mapers.org

plans offer a defined benefit plan but are funded at or near (or above) 100%, just to name a few:

- Livonia Employee Retirement System (99%)
- Bay County Employee Retirement System (99.8%)
- Detroit Police and Fire (99.9%)
- Monroe Employee Retirement System (101.7%)
- Kent District Library (102.0%)
- Pontiac General Employee Retirement System (153.5%)

That said, it hasn't just been the markets that have caused funding ratios to slip in some areas. Many municipalities had early retirement incentives to reduce the workforce. This saved on the total budget for the municipality, but increased the liability and costs associated with running the system. In a simple example, a city's pension contribution may have increased by $500,000 year over year, but their payroll declined by $750,000, resulting in a net cost savings of $250,000 to that city. Sensible workforce reductions that save money can lead to the perception that there is increased liability.

Many municipal plans have periodically made other sensible changes to their plan structure so they can "keep their promise" to their employees now and into the future. Some of those plans have opted for moving new hires to defined contribution plans, some have offered the hybrid plans outlined in ALEC's presentation, and some have found some other solutions to be able to keep their promises to their employees in the long term. Some examples include:

- Modifying service credit purchase requirements,
- Changing components of the defined benefit formula,
- Re-bidding contracts with service providers to systems, and
- Updating asset allocation for funds.

Again, what these last few sets of examples illustrate is that a blanket requirement for all plans to shift from defined benefit or hybrid to defined contribution is not necessarily the most prudent course of action; in fact, there may be smarter choices for a plan so long as it still retains the ability to control its own destiny. But a flat mandate to defined contribution can result in *increased* cost to a plan. When a defined benefit system is open and enrolls new hired, it can pay off the liability over 28 years as a level percent of payroll. If the system closes to new hires, it must be paid over 30 years as a level dollar amount, which increases costs for the first 14 years following the change. Additionally, there are one-time transition costs. Further, a blanket legislated requirement that specifies or directs any pension or benefit-related matter severely ties the hands of those involved in negotiating local labor contracts. Each employer needs the ability to craft and then negotiate a wage and benefit package that meets its individual workforce needs and its budget. By their structure, defined contribution plans support job transition at the early stage of one's career—thus sending an expensively trained employee to another employer-- and delayed retirement at what should be the end of one's working life, while defined benefit plans tend to do the opposite. Simply put, if an employee has not adequately saved for retirement in a DC plan, they will continue to work, often blocking employment opportunities for those new to the workforce and straining the budget of already beleaguered employers.

Finally, as referenced above, and something that perhaps was not contemplated in ALEC's study, is PA 347 of 2012. Sponsored by Senator Mark Jansen, and assisted in large measure through the House by Chairman Poleski's involvement, PA 347 of 2012 is a much-needed update to the law that governs public municipal retirement plan allocations and behavior. The law now requires new reporting and transparency requirements for municipal plans, and included updates permissible asset allocation that will allow public pension plans, including local ones, to improve the diversification of investments (see attachment). The importance there is flexibility within modern markets. The market does not behave uniformly, and prudent plans need greater flexibility to shift assets in an evolving market, but not above limits sets within PA 347, which were contemplated in such a way as to help prevent plans from over- or under-investing and intelligently manage their risk.

Thank you for your time and consideration; these are valuable discussions to have as we all work to take care of our retirees.

MAPERS

Comparison - Proposal vs. Current PA
As of 3/9/2012

Asset Class	Plan Size	Current Limits	Proposed Limits
High Yield (17)	0 < $250,000,000 $250,000,000 < $1,000,000,000 >$1,000,000,000 State Treasurer	Allowable only under Basket Clause limits	15% 15% 15% 15%
Real Estate (19)	<$100,000,000 >$100,000,000 State Treasurer	5% 10% No Limit	10% 20% No Limit
Private Equity (19A)	0 < $250,000,000 $250,000,000 < $1,000,000,000 >$1,000,000,000 State Treasurer	Current draft is silent.	Silent 5% (MI Only) 15% (10% plus 5% MI only) 30%
Basket Clause (20D)	0 < $250,000,000 $250,000,000 < $1,000,000,000 >$1,000,000,000 State Treasurer	5% 10% 15% 20%	15% 20% 25% 30%
Domestic Equity now Global Equity	All Plans	70% (Domestic Only)	70% (Global)
Foreign Securities (20K)	<$2,000,000,000 >$2,000,000,000	20% 20%	20% 30%

Plan Size	Asset Class	Current Limits	Proposed Limits	Impact
$50,000,000	Foreign Equity	20%	70%	50%
	Foreign Securities (Bonds)	20%	20%	0%
	High Yield	5%	15%	10%
	Basket Clause	5%	15%	10%
	Real Estate	5%	10%	5%
$150,000,000	Foreign Equity	20%	70%	50%
	Foreign Securities (Bonds)	20%	20%	0%
	High Yield	5%	15%	10%
	Basket Clause	5%	15%	10%
	Real Estate	10%	20%	10%
$500,000,000	Foreign Equity	20%	70%	50%
	Foreign Securities (Bonds)	20%	20%	0%
	High Yield	10%	15%	5%
	Basket Clause	10%	20%	10%
	Real Estate	10%	20%	10%
$1,000,000,000	Foreign Equity	20%	70%	50%
	Foreign Securities (Bonds)	20%	20%	0%
	High Yield	15%	15%	0%
	Basket Clause	15%	25%	10%
	Real Estate	10%	20%	10%
$2,000,000,000	Foreign Equity	20%	70%	50%
	Foreign Securities (Bonds)	20%	30%	10%
	High Yield	15%	15%	0%
	Basket Clause	15%	25%	10%
	Real Estate	10%	20%	10%

Submitted by
Peggy Korzen
(MAPERS)

Changes to PA 314 through PA 347 '12, which applies to ALL public pension plans, including local plans, in Michigan, include:

1) Requires written policies regarding ethics and professional training & education to be prepared and maintained for all plan fiduciaries.

2) Requires expansion of summary annual report to include among other things, assets, liabilities, funded ratio, performance net of fees on plan year basis for previous 1,3,5,7, & ten year periods, administrative & investment expenditures including soft dollars, budget, actuarial cost method, and amortization information.

3) Limits amounts that can be spent on professional training, including travel, based on plan size.

4) Requires that any investment service providers provide written disclosure of all fees or other compensation both prior to their initiation and also on an annual basis.

5) Prohibits "pay to play" by service providers.

6) Requires that any fiduciary or service provider who has committed a felony or misdemeanor arising out of his service to a system to reimburse the system for any legal costs the system may have made in his or her defense.

7) Clarifies requirements to retain records for 6 years (same as other public bodies)and increases disclosure requirements.

8) Summary annual reports must be available to plan participants, beneficiaries and citizens of political subdivision—on a website if the system has one or on the sponsoring unit of government's, if not.

9) Establishes a mechanism for local pension boards to remove a trustee for either incapacitation or conviction of a violation of law, when removal is in the interest of the plan or its members.

PA 347 just became effective in March of 2013.

Note: the expanded summary annual report information in #2, above, will allow the creation of a statewide database that will permit systems to compare themselves with their peers and improve their own performance, based on what they see others are doing.