Responsible Retirement

Lowering the Assumed Rate of Investment Return for the State of Michigan Retirement Systems

Office of Retirement Services

March 2, 2017

MICHIGAN DEPARTMENT OF TECHNOLOGY, MANAGEMENT AND BUDGET

BOI and Actuary Recommendation

The Bureau of Investments (BOI) and the retirement systems' actuary recommend *decreasing* the assumed rate of investment return (AROR) used in the State Employees', Judges, and Military Retirement Provisions' annual actuarial valuations for defined benefit (DB) pension and retiree healthcare.

BOI and Actuary Recommendation

Their shared professional assessment that supports this decrease is based on:

- Market Data
- Actuarial Standards of Practice (ASOPs)

This is a view shared by nearly all industry experts, as the market is expected to deliver lower returns in the long-term due to historically low government bond yields.

Assumed Rate of Investment Return

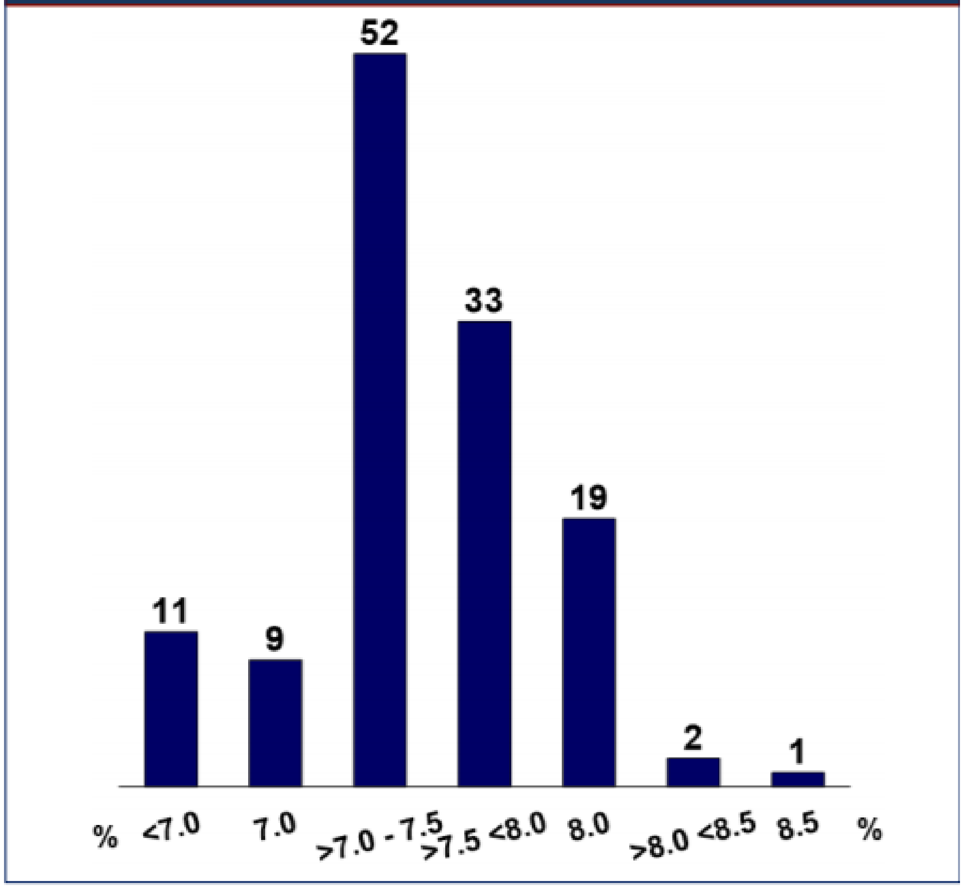
- The current long-term AROR for the pension and retiree health care plans is **8%.**
- The peer median is 7.50%[1] as of February 2017.
- ORS recommends reducing the AROR from **8%** to **7.5%** effective with the FY16 and following valuations for the State Employees' pension and retiree healthcare plans, and for the Military pension provisions.
- ORS further recommends reducing the AROR from **8%** to **7.5%** for the FY17 and following valuations for the Judges pension plan.

[1] National Association of State Retirement Administrators

Assumed Rate of Investment Return

- 7.5% is prudent and consistent with other public plans.
- 28% of other public plans use an 8% or higher AROR.
- 63% are less than 8% but greater than 7%.

Figure 5: Distribution of investment return assumptions



Source: NASRA Public Fund Survey, updated February 2017.

Assumed Rate of Investment Return (AROR)

Expected Benefits of Lowering the AROR

- Increases likelihood of achieving target investment gains, making projected contribution rates more stable.
- Reduces risk of growth of future Unfunded Actuarial Accrued Liability (UAAL).
- Increases sustainability of the funds.

Fiscal Implications

The Risk of Inaction

Maintaining the 8% AROR but not achieving it over the long-term would have several negative impacts:

- Additional UAAL added annually.
- Higher state contributions into the system near the end of the current amortization period—2036.
- UAAL contributions would continue beyond 2036.

Fiscal Implications

Because investment income plays a large role in determining the required contributions for the retirement systems, a reduction in the AROR requires a corresponding increase in employer contributions.

The basic retirement system funding equation:

Contributions + Investments = Benefits + Expenses

Fiscal Implications

Below is the additional employer contributions that will be needed to fund the reduction in the AROR.

- Contributions for SERS and MRP begin in FY19).
- Contributions for JRS will in FY18.

System	Valuation Year	Budget Year	Contributions Needed for 8% AROR	Additional Contributions Needed for 7.5%
SERS	2016	2019	$1,304,964,265	$83,650,814
MRP	2016	2019	$6,848,781	$224,594
JRS	2017	2018	$2,138,379	$1,033,838

*Estimates based on the FY 2015 actuarial valuations

Fiscal Implications

Budget Notes

- The actuary determines employer contributions for the fiscal year ending 9/30/2016 after the CAFR is complete.
  - Available March – May 2017
- For JRS, funding for the contributions is statutorily authorized; separate legislative approve not needed
  - Single payment for JRS is transferred Spring 2017
- Funding for SERS and MRP contributions is approved through the legislative cycle.
  - Cycle spans 11/2017 – 5/2018
  - Payroll collections for SERS begin 10/1/2018
  - Single payment for MRP is transferred Fall 2018

*Estimates based on the FY 2015 actuarial valuations

Fiscal Implications

- The Governor, DTMB Director, and State Budget Director, are in support of additional contributions needed to achieve a 7.5% AROR going forward.
- The Governor recommended in his FY18 budget proposal making an extra payment of approximate $85 million across the SERS, MRP, and JRS systems.
  - The FY 2015 valuations, which set the FY18 contributions, will not be restated.

Implementation

- Changes to actuarial assumptions require approval by the retirement board and the DTMB director.
- DTMB Director David Behen approved the change on February 21, 2017.
- ORS is seeking this approval effective for MRP and for the SERS defined benefit and retiree healthcare plans for the FY 2016 and following valuations.
- ORS is seeking this approval effective for the JRS defined benefit and retiree healthcare plans for the FY 2017 and following valuations.

Recommendation

Approve the adoption of a 7.5% AROR for the FY16 and following valuations for the SERS defined benefit and retiree healthcare plans, and the Military Retirement Provisions.

Approve the adoption of a 7.5% AROR for the FY17 and following valuations for the JRS defined benefit plan.