

City of Detroit


CITY COUNCIL

DAVID D. WHITAKER
Director
(313) 224-4946

DIVISION OF RESEARCH & ANALYSIS
Coleman A. Young Municipal Center
2 Woodward Avenue, Suite 216
Detroit, Michigan 48226
(313) 224-4946
FAX: (313) 224-0368

PEGGY ROBINSON
Deputy Director
(313) 224-4946

To: Honorable City Council

From: David D. Whitaker, Director 
Research and Analysis Division (RAD) Staff

Re: **STATE LEGISLATION REGARDING MUNICIPAL
PENSION SYSTEMS; HB 5976**

Date: March 25, 2010

Today Your Honorable Body scheduled a Committee of the Whole discussion at 11:00 A.M. tomorrow, Friday, March 26, regarding House Bill No. 5976 (2010), recently introduced by State Representative George R. Cushingberry, providing for the determination of distressed municipal pension systems, and establishing state-level procedures and remedies for such systems. RAD has reviewed the proposed legislation and provides the following preliminary report at this time.

General Overview

HB 5976 was introduced on March 23, 2010, and referred to the House Committee on Appropriations. It is entitled the "Distressed Municipal Pension System Act." The proposed legislation consists of thirteen untitled sections, essentially as follows:

- Section 1: Title
- Section 2: Legislative findings
- Section 3: Requirements of the Public Employment Retirement System Investment Act, MCL 38.1132 to 38.1140m
- Section 4: Definitions
- Section 5: Requirements for determining a local pension system is distressed
- Section 6: Events that "shall occur on the transition date"
- Section 7: Duties of current and former officers, employees and agents of a municipality for which a distressed pension system determination has been made
- Section 8: Accrued financial benefits
- Section 9: Non-Liability of the retirement system
- Section 10: Governing body's authorization to appropriate and grant funds

- Section 11: Severability (of remaining portions if any portion is found invalid by a court)
- Section 12: No diminution of rights (of a municipality determined to have a distressed pension system)
- Section 13: No standing to sue (other than the chief executive officer of a municipality sponsoring a distressed pension system)

The stated intent of this proposed legislation is to provide standards and procedures for state action to preserve the assets and pension obligations of “*distressed*” local municipal pension systems for the benefit of their members.

Procedures Provided by the Proposed Legislation¹

The operative provision of the proposed legislation is Section 5, which provides under Subsection (1) that the State Treasurer “*shall initially determine that a local pension system is a distressed pension system upon receiving written notification from a trustee of the system, its actuary, 10% of the members of the local pension system or an elected or appointed officer, or the governing body of, or the emergency financial manager for the municipality sponsoring the local pension system*” of two or more of the following conditions:

- The municipality’s failure to make its periodic payment toward the employer’s annual required contribution to the system for more than 120 days (with three mandatory requirements: 1) notification, 2) thirty days for the municipality to show that it has not failed to make such a payment, and 3) either the municipality’s failure to respond or the State Treasurer’s determination that the response fails to verify payment);
- The sum of the municipality’s annual required contribution plus the annual debt service on outstanding pension obligations exceeds 30% of “payroll”² for at least three consecutive years;
- The sum of the local pension system’s actuarial accrued liability plus the outstanding principal amount of any pension obligations allocated to the local pension system is 125% or more of the actuarial value of the assets of the local pension system;

¹ Actual proposed language of the sixteen-page legislation is quoted in italics, while some of the key operative provisions are paraphrased for brevity.

² “Payroll” is defined as the dollar amount used by an actuary in the annual actuarial valuation or summary report to determine an annual level percentage of payroll contribution rate. It should also be noted that this second referenced condition does not apply to a local pension system that is closed to new participants.

- The sum of the employer's annual required contributions plus the aggregate annual debt service on the outstanding pension obligations exceeds 15% or more of the budgeted general fund revenues for each of three consecutive prior fiscal years;
- An investment fiduciary³ of the local pension system has been convicted or pled "no contest" for a felony involving misuse of pension trust funds, bribery or other personal or financial benefit, arising out of his or her service for the pension system; and/or
- The local pension system's average rate of investment return for the last ten years is at least two percent less than its rate of return;

Under Subsection 5(2), upon the State Treasurer making such an initial determination, s/he must promptly notify the Mayor and the Board of Trustees of the distressed local pension system, and within ten days the Mayor may request a contested case hearing, to be conducted by the State Treasurer or a designee, under the Administrative Procedures Act.

Then (either after the hearing or the expiration of time allowed to request a hearing) under Subsection 5(3) "*the state treasurer shall confirm or revoke, in writing, the determination of a distressed pension system.*" Confirmation shall include a written report of the findings of fact providing the basis for the final determination, as well as a statement of the underlying facts.

Under Subsection 5(4), the State Treasurer's final determination "*shall be final and binding*" unless the Mayor appeals to the Court of Appeals within 21 days. The Court is required to affirm the State Treasurer, if the final determination "*is authorized by law and supported by competent, material, and substantial evidence on the whole record made before the state treasurer.*" This is a relatively deferential standard of appellate review.⁴

The consequences of the State Treasurer's determination would be to make the distressed local pension system a "*participating municipality*" in the retirement system, subject to

³ MCL 38.1132c defines "investment fiduciary" as "a person other than a participant directing the investment of the assets of his or her individual account in a defined contribution plan who does any of the following: (a) Exercises any discretionary authority or control in the investment of a system's assets. [or] (b) Renders investment advice for a system for a fee or other direct or indirect compensation."

⁴ Under Subsection 5(5), use of pension system funds to pursue such an appeal "is prohibited and punishable." It is clear that challenging the State Treasurer's determination would be disfavored.

the Municipal Employees Retirement Act of 1984, MCL 38.1501 to 38.1555.⁵ At that point, “*All powers formerly vested in the distressed pension system board*” become vested in the Mayor or his or her designee, “*and the distressed pension system board or other entity having responsibility for administration of the distressed pension system shall cease existence.*”

The state retirement system Board, in consultation with the Mayor, then would establish a “*reasonable transition plan,*” for the state retirement system to assume responsibility for administering the pension obligations, and assume custody of its assets.⁶ All officers, employees and agents of the local distressed pension system would “*have an affirmative and ongoing duty to cooperate with the retirement system.*” Violation of such duty would be a misdemeanor subject to a fine of \$2,000 and/or imprisonment for not more than one year.

Council will presumably seek information from the Fiscal Analysis Division regarding application of the conditions enumerated in Subsection 5(1) of the proposed legislation to the City of Detroit’s employee pension and retirement systems, as summarized above (other than the condition regarding a felony conviction of a fiduciary).

If Your Honorable Body has any other questions or concerns regarding this subject, RAD will be happy to provide further research and analysis upon request.

⁵ MCL 38.1536 establishes a retirement board to administer the Municipal Employees Retirement Act of 1984. The specific provisions of that statute are beyond the scope of this preliminary report.

⁶ Contracts or agreements entered into by the local distressed Board after the notification date would be “*voidable*” by court order sought by the state retirement Board, but not “*absolutely void.*”