State Notes

TOPICS OF LEGISLATIVE INTEREST

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Legislation Related to the Detroit Bankruptcy
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Legislation was enacted recently to provide for a State financial contribution of $194.8 million from the State's Budget Stabilization Fund (BSF) to the Detroit retirement systems to assist in the resolution of the City of Detroit bankruptcy case[1] and mitigate pension reductions to retirees. The 10-bill package also created the Michigan Settlement Administration Authority (MSAA) to facilitate the transfer of the State's financial contribution and verify that the required conditions are met, and established the Michigan Financial Review Commission (MFRC) to provide continued financial oversight to the City of Detroit. In addition, the package requires the deposit of $17.5 million annually from fiscal year (FY) 2014-15 through FY 2034-35 from tobacco settlement revenue received by the State to the BSF, an amount that will total $367.5 million. These provisions, new operating requirements for the City of Detroit and the Detroit pension systems, and implementing appropriations, are included in Public Acts 181 to 190 of 2014, which were signed by the Governor on June 16, 2014, and took effect immediately.[2] (Please see the Appendix for a brief summary of each bill in the package.) Many of the provisions in the enacted legislation parallel requirements in the plan of adjustment that will be considered by the bankruptcy court and claimants.

State Contribution

The State's direct financial contribution to the resolution of the bankruptcy case and related litigation is the use of $194.8 million from the State's Budget Stabilization Fund (or "rainy day fund") for a contribution to the Detroit retirement systems. The State contribution was calculated as the net present value of monthly payments that over 20 years total $350.0 million using a discount rate of 6.75%. The contribution, which is to be made directly into the City's pension funds, may only be used to fund payments to holders of pension claims. Public Act 188 transferred $194.8 million in FY 2013-14 from the BSF to the new Settlement Administration Fund. Public Act 187 appropriated $194.8 million from the Settlement Administration Fund in FY 2013-14 to the Detroit retirement systems (the general retirement system and the police and fire retirement system); however, the board of the newly created MSAA is responsible for determining if the requirements are met for the disbursal of the funds to the Detroit retirement systems. For the payment to occur, the MSAA must determine that the plan of adjustment has been approved by the bankruptcy court and the terms and conditions of the State Contribution Agreement have been satisfied. (The State Contribution Agreement is an agreement of the MSAA, the Detroit general retirement system, the Detroit police and fire retirement system, and the City of Detroit, which is part of the plan of adjustment. The plan of adjustment is the plan for adjustment of the city's debts, which a debtor is required to file with the court in a municipal bankruptcy case.)

These broad criteria encompass numerous other actions specified in the State Contribution Agreement that must occur to trigger disbursal of the State funds. Probably the most prominent is that the Detroit retirees had to vote to accept the bankruptcy plan of adjustment for the State contribution to be effective. For Detroit retirees, the plan of adjustment includes reductions to pension benefits and a release from further legal action against the State. This had to be approved

[1] United States Bankruptcy Court for the Eastern District of Michigan, Southern Division, In Re City of Detroit, Michigan, case no. 13-53846.

[2] A detailed description of this legislation can be found in the Senate Fiscal Agency's summaries of House Bills 5566-5570, 5573-5576, and 5600. The summaries describe the bills as they were passed by the House of Representatives, which are the same as the enacted versions. The summaries are available on the Michigan Legislature's website: www.legislature.mi.gov

by a majority of the retiree voters in each retirement system who represented at least two-thirds of the retiree financial claims. Retiree voting concluded on July 11, 2014, and the results were reported on July 21, 2014, indicating the necessary level of approval. If the retirees had disapproved the plan of adjustment, the State contribution could not be made.

Among the other requirements in the State Contribution Agreement are:

- Cessation of litigation by partners to the agreement (including the City of Detroit) against the State, and release of potential claims by retirees against the State and State entities, related to the Local Financial Stability and Choice Act, Public Act 436 of 2012 (which provides for local emergency managers in some situations) or the enforcement of Article IX, Section 24 of the Michigan Constitution as it relates to Detroit[3].
- Approval of the settlement regarding the Detroit Institute of Arts (DIA), to ensure sufficient funding to the pension funds, namely:
  - Commitments from a group of major foundations to donate at least $366.0 million over 20 years to the pensions systems.[4]
  - Commitment from the Detroit Institute of Arts to raise at least $100.0 million or the net present value of that amount for the pension funds.[5]
  - Approval of the retirees and the court.
- Changes in the governance of the Detroit retirement systems.
- Implementation of an income stabilization program for retirees, which will provide supplemental pension payments to eligible retirees to maintain certain minimum levels of income.

In addition, the contribution agreement may be amended by agreement and signature of all of the parties, and the confirmation order approving the plan of adjustment must be final by December 31, 2014, with an effective date not later than April 1, 2015. All of the required conditions must be met by April 1, 2015.

The State contribution will reduce the balance in the BSF from an estimated $585.6 million to $390.8 million at the close of FY 2013-14. Pursuant to Public Act 186, the BSF will receive deposits from tobacco settlement revenue of $17.5 million per year over 21 years from FY 2014-15 through FY 2034-35, a total of $367.5 million, which approximates the value of the State's $194.8 million contribution now, compounded with interest over the next 21 years.

Michigan Settlement Administration Authority

Public Act 187 created the MSAA to facilitate the transfer of funds to the retirement systems. The Settlement Administration Fund will receive the $194.8 million transferred from the BSF and the MSAA will determine if the requirements are satisfied for the payment of $194.8 million from the Settlement Administration Fund to the Detroit retirement systems. The Authority is governed by the

[3] Article IX, Section 24 of the Michigan Constitution of 1963 reads as follows: Sec. 24. 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.

[4] These parties conditioned their financial commitments on the transfer of the assets of the DIA to the nonprofit DIA Corp, to be held within the Detroit city limits in perpetual charitable trust, to benefit residents of the city, counties, and State.

[5] Ibid.

Michigan Settlement Authority Board, a three-member board consisting of the State Treasurer, the State Budget Director, and a member with expertise in bankruptcy law appointed by the Governor with the advice and consent of the Senate. The payment to the retirement systems requires that the Authority board determines that the plan of adjustment has been approved by the bankruptcy court and the terms and conditions of the contribution agreement have been met. If the board determines that one or both of the criteria (and the underlying requirements) are not met by May 1, 2015, the money will be returned to the BSF. The Authority will dissolve effective May 2, 2015. Public Act 187 also exempts the State, State-related entities, State officials, agents, the Authority board, and advisors from any liability related to certifications or determinations concerning the plan of adjustment or the contribution agreement.

Michigan Financial Review Commission

Public Act 181 created the MFRC to monitor the finances of a qualified city, which is a city with a population of more than 600,000 that is subject to a plan of adjustment approved by a bankruptcy court. The Commission will have nine members, consisting of the State Treasurer, the mayor or chief executive officer of Detroit, the president or chairperson of the Detroit City Council, and the Director of the Department of Technology, Management, and Budget (each of whom is authorized to appoint a designee), as well as five members appointed by the Governor, of which one member is appointed from nominations provided by the Senate Majority Leader and one member is appointed from nominations provided by the Speaker of the House of Representatives. Appointees must meet qualifications in terms of financial and legal expertise and residency.

The Commission will review and approve four-year financial plans submitted by the City of Detroit, and may require changes to those plans. Collective bargaining agreements, budgets, consensus revenue estimates, and debt issuance requests also will be subject to review and approval by the Commission. The Commission is authorized to review and approve certain contracts: those with a value over $750,000 or a higher amount determined by the Commission, contracts with one vendor that over a 12-month period total more than $750,000 or the higher amount determined by the Commission, and those with a term of more than two years. In addition, the Commission will approve the appointment of the city's chief financial officer. The Commission is required to submit a written report on June 1 and December 1 annually and certify by October 1 annually that Detroit is in substantial compliance with the plan of adjustment and other requirements.

The Commission will provide detailed financial supervision for three years, after which it will have to waive some of the supervision requirements if certain conditions of financial stability (including deficit-free budgets and compliance with required accounting and budget procedures), transparency, and retirement plan operations are met by the City and certified by the Commission. The Commission will be dissolved if the financial supervision requirements are waived for 10 immediately preceding fiscal years and the plan of adjustment has expired.

City of Detroit Operations

Public Act 182 requires Detroit to employ a chief financial officer (CFO) who is appointed by the mayor subject to approval by the Financial Review Commission. The Act specifies experience requirements for the CFO, who must have a background in finance, government restructuring, labor relations, employee benefits, and local government. The CFO is responsible for financial and budgetary activities, participation in the required consensus revenue estimating process, and compliance with State law and the Michigan Financial Review Commission Act (Public Act 181).

Public Act 182 also requires the city to have a financial plan that covers the current fiscal year and the next three fiscal years. The financial plan must have a general reserve fund of at least 5.0% of the projected spending for each fiscal year. The Act authorizes the mayor, with approval of the city council, to reduce spending during a year by executive order reduction if spending exceeds revenue. Transparency requirements include a requirement to post all contracts to which the city is a party on the city website within 30 days of award.

Public Act 184 limits the options available to Detroit under the Publicly Funded Health Insurance Contribution Act, Public Act 152 of 2011. In general, that Act limits the contributions of a local unit of government for employee medical benefits to 80% of the cost of the medical benefits plan or a capped amount set annually by the State. A local government has an alternative to opt out of these limitations annually by a two-thirds vote of its governing body. Under Public Act 184, this "opt out" is no longer allowed for the City of Detroit.

Public Act 189 requires an arbitration panel to consider information filed by the Financial Review Commission related to a labor dispute involving the Detroit police or fire department.

Retirement System Operations

Public Act 183 places limitations on the Detroit public retirement systems. Except as otherwise provided in a plan of adjustment, for years of service accrued beginning in 2015 and thereafter, pension benefits will be calculated using base pay only, and additional benefit payments based on the rate of investment return are prohibited. The Act also limits retirement plans that will be offered to employees first hired after July 1, 2023. At that time, the city is required to offer retirement plans that cost not more than 7.0% of the employee's base pay or the retirement plan provided in the plan of adjustment. Contributions for retirement health care are limited to the greater of 2.0% of the base pay or the percentage contribution made by the State of Michigan under the State Employees' Retirement Act for retiree tax-deferred accounts (currently up to 2.0%), except as provided in a plan of adjustment. Annually, the city must submit certification of compliance with these provisions to the Financial Review Commission, beginning not later than January 1, 2024.

Public Act 185 establishes requirements and limitations for a "large sponsored system", which is a public employee retirement system created by a city that has more than 600,000 in population or has discharged in bankruptcy at least $1.0 billion in pension liabilities, or both. The Act requires, subject to the plan of adjustment, each large sponsored system to establish an investment committee to make recommendations to the governing board of the retirement system in many areas, including investment goals, performance standards, selection and evaluation of investment services, asset allocation, audits, and other activities. If the investment committee and board disagree, the investment committee may make certain decisions. The Act also adds limitations on out-of-State travel and additional reporting requirements, including itemized reports of travel paid by the pension fund in part with public funds. In addition, the Act requires a large sponsored system to submit its annual report to the Financial Review Commission.

Appropriations

The package of enacted legislation included implementing appropriations in FY 2013-14 and FY 2014-15, which are summarized in Table 1. In addition to the appropriations, Public Act 186 amended the Michigan Trust Fund Act to require that $17.5 million from the State's tobacco settlement revenue be deposited into the BSF each year from FY 2014-15 through FY 2034-35.

Table 1

Appropriations in the Detroit Package, Public Acts 181, 182, & 187 of 2014				
House Bill	**Public Act**	**Fiscal Year**	**Amount**	**Purpose**
5566	181	FY 2013-14	$900,000	Appropriated from General Fund/General Purpose (GF/GP) revenue to the Department of Treasury for the cost of the MFRC.
5575	187	FY 2013-14	$194,800,000	Appropriated from the Settlement Administration Fund to the City of Detroit retirement systems if conditions are met for the transfer. (Public Act 188 transferred $194.8 million from the BSF to the Settlement Administration Fund.)
5567	182	FY 2014-15	$100,000	Appropriated from GF/GP revenue to the Department of Treasury for Detroit compliance requirements

Conclusion

The Legislature authorized a State contribution of $194.8 million from the Budget Stabilization Fund to assist in the resolution of the Detroit bankruptcy case. If necessary terms and conditions are satisfied, the State funds will be deposited into the Detroit general retirement system and the Detroit police and fire retirement system to reduce the cuts to pensions that will occur due to the bankruptcy. The State's contribution is contingent on approval of the plan by Detroit retirees (which has now occurred), the related contribution by major foundations of $366.0 million to the retirement systems, approval of the plan of adjustment by the bankruptcy court, and that court's issuance of the final order in the bankruptcy case. These actions will trigger the release of the State funds to the Detroit general retirement system and the police and fire retirement system. If the plan of adjustment is not approved or the terms and conditions in the State Contribution Agreement are not satisfied, the MSAA will return the $194.8 million State contribution to the BSF.

Assuming that the plan of adjustment is approved, the expenditure of these State funds will reduce the amount available in the BSF for unexpected State needs. The use of tobacco settlement revenue to repay the BSF over 21 years will constrain the amount of tobacco settlement revenue available for other State budget priorities. The State's contribution to the retirement systems will make possible other outside contributions that, if the plan of adjustment is approved, will ameliorate the negative impacts of the bankruptcy on Detroit retirees. The plan also will release the State from potential claims against the State, including Detroit-related litigation involving Article IX, Section 24 of the Michigan Constitution or challenges under the Local Financial Stability and Choice Act.

Appendix

Bills in the Detroit Package, Public Acts 181 to 190 of 2014			
House Bill	**Public Act**	**Act Amended or Created**	**Subject in Brief**
5566	181	Michigan Financial Review Commission Act (new)	Creates the MFRC; appropriates $900,000 in FY 2013-14 to the Department of Treasury; requires semi-annual report.
5567	182	Home Rule City Act	Requires Detroit to have a chief financial officer; sets planning and compliance requirements; appropriates $100,000 in FY 2014-15 to the Department of Treasury.
5568	183	Home Rule City Act	Provides for limitations to Detroit pension systems.
5569	184	Publicly Funded Health Insurance Contribution Act	Prohibits Detroit from exempting itself from the Act.
5570	185	Public Employee Retirement System Investment Act	Sets requirements for a newly defined "large sponsored system"; requires investment committee, limits out-of-State travel.
5573	186	Michigan Trust Fund Act	Requires the deposit of $17.5 million annually from tobacco settlement revenue to the BSF from FY 2014-15 through FY 2034-35.
5574	188	Management and Budget Act	Transfers $194.8 million in FY 2013-14 from the BSF to the Settlement Administration Fund.
5575	187	Michigan Settlement Administration Authority Act (new)	Creates the MSAA; appropriates $194.8 million in FY 2013-14 from the Settlement Administration Fund to City of Detroit retirement systems; requires the Authority to determine if the conditions for the transfer are met.
5576	189	Public Act 312 of 1969	Requires an arbitration panel to consider information submitted by the Financial Review Commission.
5600	190	Public Act 566 of 1978	Allows the Detroit mayor, CEO, or city council member to serve on the MFRC.