Rockefeller Institute of Government

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# Michigan State Employees' Retirement System Has Little Risk of Becoming Severely Underfunded Over Next Three Decades

## *Remains a source of fiscal stress for the state of Michigan during any potential fiscal crises*

Albany, NY—As part of its unique program of public pension investment-risk analysis, the Rockefeller Institute of Government released its latest report examining investment return volatility and its impact on the Michigan State Employees' Retirement System (MISERS).

MISERS was one of five public pension plans across the nation that the Rockefeller Institute's Public Pension Simulation Project is analyzing in detail, each for a different reason. The Institute chose MISERS because it is a "closed" plan that does not allow new entrants. It thus has special characteristics that set it apart from other plans, such as a large number of retirees relative to the number of active members. It is poorly funded by public pension plan standards.

The report found that:

- MISERS has relatively little risk of becoming severely underfunded in the next 30 years if the plan's investment-return assumption of 8 percent is approximately correct over the long run and it strictly follows its current funding policy that amortizes unfunded liability over an increasingly shortened time period.

- Under plausible alternative investment-return assumptions, such as a long period of low expected returns or high volatility in investment returns, MISERS would face much greater risk of severe underfunding and the state of Michigan would face a much greater risk of sharp increases in required contributions.

- If the governor of Michigan's current recommendation to lower MISERS' assumed rate of return from 8 percent to 7.5 percent is implemented, the required employer contribution will increase by about 10 percent in the short run. Lowering the return assumption would reduce the risk of severe underfunding and the risk of large increases in contributions, but the positive effect is likely to be relatively small, if the investment assumption of 7.5 percent is approximately correct.

- MISERS, as a closed plan, is shrinking in size over time and will eventually stop being a potential source of fiscal stress for the state of Michigan. However, that is far in the future: MISERS will remain a relatively large plan for the next 30 years, and could still create significant fiscal stress for the state government when future fiscal crises hit, particularly under the current funding policy, which requires quick repayments of investment shortfalls.

The Institute's analysis of MISERS found that a very conservative contribution policy can protect a plan closed to new members from becoming severely underfunded. However, for large closed plans like MISERS, the sponsoring governments may face a risk of substantial contribution increases if the plan invests in risky assets and if large shortfalls must be recouped in short periods of time.

This is the seventh report of the Pension Simulation Project at the Rockefeller Institute of Government of SUNY. The project examines the potential consequences of investment-return risk for public pension plans, governments, and stakeholders in government. The project was developed by Donald J. Boyd, the Institute's director of fiscal studies. The MISERS study was led by programmer and research analyst Yimeng Yin and co-authored by Boyd. Kathleen Tempel, project manager and researcher, made significant contributions to the study. The project is supported by the Laura and John Arnold Foundation and The Pew Charitable Trusts.

This analysis is independent of, and neither sponsored nor approved by, MISERS. The report's authors communicated with MISERS staff early in the study, but conducted the analysis entirely with publicly available data.

To read the report, go to www.rockinst.org/pdf/government_finance/2017-03-30_MISERS_Report.pdf.

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