F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 02/14/10
SPONSOR SFC **LAST UPDATED** **HB**

SHORT TITLE Public Employee Pension Contribution Increase **SB** 246/SFCS

ANALYST Aubel

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
	FY11	FY12		
Delay 0.75% Employer Contribution Increase	($18,292.0)	See fiscal impact	Nonrecurring	ERA**

(Parenthesis ( ) Indicate Revenue Decreases)

**Education Retirement Act fund

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Contribution Shift	($43,811.0)*		($43,811.0)*		General Fund*
Delay 0.75% Employer Contribution Increase	($18,292.0)**	See fiscal impact	($18,292.0)	Nonrecurring	ERA-affiliated Employers
RIO/IRIS Computer Changes	$.01	$.01	$.01	Nonrecurring	PERA,ERA

(Parenthesis ( ) Indicate Expenditure Decreases)

ERA=Educational Retirement Act PERA=Public Employees Retirement Association

*Based on reductions in Section 4 of Laws 2009, Chapter 124, pursuant to Laws 2009, Chapter 127, for state agencies and estimates based on the Legislative Finance Committee 2010 Volume III – Public Employee Compensation Table for ERA-affiliated employers.

**Represents a reduction in the obligation of ERA-affiliated employers to pay the 0.75% increase, which is not funded in House Bill 2.

Relates to Appropriation Reductions in the General Appropriation Act
Relates to SB91, SB207
Relates to Laws 2009, Chapter 127
Relates to Laws 2007, Chapter 28
Relates to Laws 2006, Chapter 109

Actuarial Impact (dollars in thousands)*

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY10	**FY11**	**FY12**		
Contribution Shift	Negative		N/A	PERA, MRA,JRA
Contribution Shift	Limited		N/A	ERA
Delay 0.75%	Minimal Negative		N/A	ERA

(Parenthesis ( ) Indicate Revenue Decreases)

*See Fiscal Implications

SOURCES OF INFORMATION
LFC Files

Responses Received From (For Senate Bill 246)
Public Employees Retirement Association (PERA)
Educational Retirement Board (ERB) (Also includes response for Senate Bill 91)
Department of Transportation (DOT)
Administrative Office of the Courts (AODA)
New Mexico Corrections Department (NMCD)
Attorney General's Office (AGO)
Administrative Office of the Courts (AOC)
Department of Finance and Administration (DFA)
State Personnel Office (SPO)

SUMMARY

Synopsis of SFC Substitute

The Senate Finance Committee substitute for Senate Bill 246 temporarily increases the public employee contribution to the state retirement funds for FY11 by 1 percent and reduces the employer contribution by the same amount. This effectively is a contribution "swap." The bill retains an exemption for employees making $20,000 or less as enacted by Laws 2009, Chapter 127.

The shift affects the Educational Retirement Board (ERB) and the following plans under the Public Employees Retirement Association (PERA):

- State General Member Plan 3 (applicable to most state employees)
- State Police and Adult Correctional Member Plan 1
- State Hazardous Duty Member Plan 2
- Judicial Retirement Act
- Magistrate Retirement Act

In addition, the bill includes a one-year delay for implementing the 0.75 percent increase to the employer contribution for the Education Retirement Board currently scheduled for FY11 pursuant to Laws 2005, Chapter 273.

A temporary provision provides for actuarial studies be prepared by September 30, 2013, for ERB and PERA to determine the actuarial impact of the contribution rate shifts due to this bill and Laws 2009, Chapter 127, and allows the boards of each pension plan to submit requests for supplemental appropriations to rectify any adverse actuarial effect pursuant to Subsection C of Section 22 of Article 30 of the constitution of New Mexico aimed at preserving the actuarial soundness of the funds.

Another temporary provision defines the exemption for employees making $20,000 or less by the base hourly wage of $9.579.

The effective date of the bill is July 1, 2010. After June 30, 2011, employer and employee contribution rates would revert to the percentage rates currently specified in the affected provisions. The 0.75 percent employer contribution increase would also resume in FY12.

FISCAL IMPLICATIONS

The fiscal analysis is separated into two components: those related to the contribution shift and those related to delaying the ERB contribution rate increase for employers.

Employee-Employer Contribution Shift

The bill would help the state address the budget shortfall for FY11 by reducing the amounts employers contribute to the pension funds by 1 percent. Employees would pay an additional 1 percent. The estimates general fund savings is $27.4 million.

Operating Budget Impact

This contribution swap will produce an estimated $27.4 million general fund savings based on total salaries over $20,000 for legislative agencies, reductions taken for state agencies in Section 4 of Laws 2009, Chapter 124 (pursuant to Laws 2008, Chapter 127), and estimated reductions for ERB affiliates. These education estimates are based on the Legislative Finance Committee 2010 Volume III – Public Employee Compensation Table adjusted for the $20,000 exemption:

	(in thousands)
Legislative:	$ 86.1
State Agencies:	$ 6,100.2
Public Education:	$14,966.6
Higher Education:	$ 6,228.9
TOTAL:	$27,381.8

While the DOT discussion related to Senate Bill 246, which had a higher 2.64 percent "swap", the agency provides relevant insight on how the substitute bill will affect that agency:

> NMDOT contribution to PERA for its employees from the FY09 Actuals (from the FY11 Request) was $16,389,382 based upon the 16.59% employer contribution level. This amount, adjusted to the FY 2010 15.09% rate is $14,907,521, for a savings to NMDOT of $1,481,861. The proposed FY 2012 employer contribution rate at 12.45% would further reduce the NMDOT contribution to $12,299,446. This results in total savings to the NMDOT of $2,608,075. These numbers take into account the 9 NMDOT employees who make less that $20,000 a year. Under this bill, the PERA rate would return to 16.59% in FY12.

The savings to DOT will be about 38 percent of those reported under this bill.

DOT lists the various funding sources that would be affected: State Road Fund, Transportation Funds, State Infrastructure Bank Funds, Aviation Funds, Highway Infrastructure Funds, Local Government Road Fund and Federal Funds Road Fund.

Similarly, AOC noted that the original SB246 would reduce judiciary general fund payroll expenditures in FY11 2011 by $2,095.7 thousand. Under this bill, the savings would be about $794 thousand.

Employee Impact

SPO specifies that there are 19,510 classified employees, of which 246 earn $20,000 or less per year. The average annual classified employee salary as of 7/1/2009 was $42,058.

AOC provides the following comparisons on biweekly take-home pay for various salary levels that include impacts of typical deductions based on the current federal and state tax rate schedules for a 1.6% shift, or an employee rate of 11.56 percent. While this bill would produce a lower employee rate of 10.52 percent, the table provides an example of how employee paychecks will be affected by the temporary increase in the PERA employee contribution rate. The fourth column compares a typical bi-weekly paycheck as of February 2010 to the paycheck an employee will receive under the specified PERA contribution rate shift. The fifth column reflects the estimated annual impact. The impacts would be less under this bill.

Table 1 - Public Employees Retirement Act (State General Plan 3)

Employee Category	PERA Rate @ 8.92%	New PERA Rate @ 11.56%	DIFF	Annual Impact
$30,536 Not-Married	$ 801.85	$ 786.80	$ (15.05)	$ (391.30)
$30,536 Married	$ 845.67	$ 829.35	$ (16.32)	$ (424.32)
$55,000 Not-Married	$ 1,342.91	$ 1,319.19	$ (23.72)	$ (616.72)
$55,000 Married	$ 1,411.29	$ 1,384.18	$ (27.11)	$ (704.86)
$65,000 Not-Married	$ 1,533.01	$ 1,504.97	$ (28.04)	$ (729.04)
$65,000 Married	$ 1,612.91	$ 1,580.87	$ (32.04)	$ (833.04)

ERB did not provide a similar table, but the proposed ERB employee rate would produce similar results. Typical pre-tax deductions may vary slightly for ERB-affiliates.

Actuarial Impact

PERA maintains that additional employee-employer contribution swaps would have a negative impact on its funds.

PERA:

Any further reduction in employer contributions will negatively impact the PERA, MRA and JRA Funds. Employee and employer contribution rates are statutory by member coverage plan. Rates of separation from active membership are used to measure the probabilities of active members terminating that status and requesting a refund of their employee contributions. Rates of withdrawals of active members differ among the demographics of the employee groups. Conversely, employer contributions are nonrefundable and remain with the respective retirement funds. If the total contributions are kept the same, but some of the contributions are shifted from employer to employee, the amortization period for that plan will increase. For the most part, the increase should be small. However, the more poorly funded a group is, the bigger the impact will be (such as in the Judicial Fund). In addition, the closer the normal cost is to the total contributions coming in, the greater the impact will be (such as in the Magistrate Fund).

PERA actuaries state that every $100 increase in employee contributions will decrease employer contributions by approximately $95. The reason there is not a 1-to-1 relationship is that employee contributions are refundable upon termination, where the employer contributions are not. Under the PERA, JRA and MRA Acts, the actual relationship will vary from group to group depending on the rates of terminations. The higher the rates of termination, the farther from a 1-to-1 relationship the group will be. For example, the Hazardous Duty group would most likely be less than a 95-to-100 relationship because of their high turnover rates. As a result, PERA will experience a net loss to its retirement funds to the benefit of the General Fund.

Using the 95-to-100 ratio (every employer dollar is worth 95 cents employee contribution) provided by PERA produces an approximate ($2.2) million fiscal impact to the fund when considering employee refunds. However, this number does not represent the actuarial impact, which was not provided. The economic downturn and the resulting reduction in private sector jobs may slow the turnover rates for PERA members, reducing the effect of member refunds on the fund.

ERB:

An actuarial study would have to be performed to determine the effect of the cumulative shift on the Educational Retirement Fund. If the combined shift is in effect only during FY 11, the actuarial effect should be limited. Shifting contributions from employers to employees increases the amount of contributions plus interest that employees who terminate before retirement can withdraw from the pension funds. Employers' contributions remain in the funds. In addition, the "death payment" made to retirees who select a full retirement option, rather than a reduced option with a survivor benefit, would be increased in the case of those retirees selecting such an option who died before they receiving all of their contributions in retirement benefits. The number of persons affected in second instance is not expected to be significant.

ERB has previously indicated that due to the low turnover in its employee population, the impact due to employee refunds is not substantial as long as the contribution shifts do not go above a threshold and are not in place for a sustained period of time.

Negative actuarial impacts would be measured by the increase in the unfunded actuarial accrued liability (UAAL), decrease in the funded ratio or an increase in the funding period. The bill contains a provision for the actuarial impact of contrition shifts to be calculated by September 30, 2013. Further, the boards of both funds may request supplemental appropriations to cover any impact. The fifty-first legislature will be responsible for considering the appropriation.

Delay 0.75 Percent Employer Contribution One Year

Operating Budget-FY11

Laws 2005, Chapter 273, increased the employer contribution rate 0.75 percent annually from FY06 through FY12 to a final 13.9 percent (Attachment A – Table A.) FY11 represents the sixth year of this schedule. Based on the appropriation included in Laws 2009, Chapter 124 (Attachment A – Table B), going forward each of these 0.75 percent increments equates to an approximate additional $18.3 million general fund appropriation. SB91 proposes to suspend the 0.75 percent increase for FY11, which represents an estimated $18.3 million reduction in the obligation for the ERB-affiliated employers for one year.

Neither the LFC nor the Executive budget recommendations for FY11 include funding for this 0.75 percent employer contribution increase. Thus, without this bill or similar legislation, the ERB-affiliates would have to absorb the increase obligated through current statute totaling about $18.3 million within the FY11 operating budgets, or additional general fund would need to be appropriated for this purpose.

Operating Budget-FY12

This bill has a one-year impact. The bill preserves current statute that provides the 0.75 percent contribution increase pursuant to Laws 2005, Chapter 273, will continue in FY12. In addition, pursuant to Laws 2009, Chapter 127, the 1.5 percent employee-employer swap will sunset June 30, 2011. Thus, under current statutory provisions, the employer contribution rate will increase a total of 2.25 percent from FY11 to FY12 for employees making more than $20,000 (0.75% + 1.5%). Including this bill, the rate would increase another 1 percent. As shown in Attachment A - Table D, the employer rate would increase from 9.9 percent to 13.15 percent for these employees.

Revenue to ERB

The following discussion provides more detail by comparing the employer contributions set under current statute to that which would occur as proposed by this bill. Using the FY10 appropriation of $18.3 million and assuming zero salary increases, Table 1 shows the estimated incremental and cumulative funding requirements under Scenario 1 – the original funding schedule – and under Scenario 2 – as contemplated by this bill. These numbers represent revenue to ERB.

Table 1 – Revenue to ERB Due to Annual Employer Contribution Increase

Scenario 1 - Current Statute	**FY11**	**FY12**	**FY13**
FY11	$18,292	$18,292	$18,292
FY12		$18,292	$18,292
FY13			N/A
Total Increase Revenue	$18,292	$36,584	$36,584
Scenario 2 – SB18	**FY11**	**FY12**	**FY13**
FY11	$0	$0	$0
FY12		$18,292	$18,292
FY13			$18,292
Total Increase Revenue	$0	$18,292	$36,584
DIFFERENCE	($18,292)	($18,292)	

ERB has noted the fiscal impact of delaying the incremental $18.3 million revenue increase for FY11 until FY12 represents an opportunity cost to the fund that would depend on investment returns over this period. The ERB analysis estimates a reduction in the Market Value of Assets by $177 million on a projected total fund value of $17.4 billion by 2030.

The Legislature attempted to pre-fund the annual ERB increase though an accelerated contribution appropriation as a "rainy day" measure twice, once in Laws 2006, Chapter 109—which was vetoed—and Laws 2007, Chapter 28—which was also vetoed.

Actuarial Impact of One-Year Delay

Table 2 shows the projected impact of delaying the employer contribution increase on actuarial solvency measures, the funded ratio (actuarial value of assets compared to the actuarial value of liabilities) and funding period (the amount of time estimated to pay off the unfunded liability). The impact appears deminimus.

Table 2 – Impact on Actuarial Solvency Measures*

Fiscal Year	**Without One-Year Delay**		**With One-Year Delay**	
	Funded Ratio	**Funding Period**	**Funded Ratio**	**Funding Period**
FY10	67.3%	48.7	67.3%	48.7
FY11 (delay)	63.3%	55.1	63.3%	94.3
FY12	59.3%	61.5	59.1%	infinite
FY13	54.9%	infinite	54.6%	infinite
FY24	53.5%	infinite	53%	infinite
FY25	53.6%	113.8	53.1%	186.4
FY38	61%	34.2	60.3%	35.6

*Source: ERB

Minimum industry standards require 80 percent for the funded ratio and 30 years for the funding period. The bill's impact primarily influences the funding period, extending the fund's infinite funding status by one year in FY12. In both cases the indicators fall substantially below industry standards, portraying a situation where the obligations promised to current retirees and active members are being pushed out to future generations to fulfill. Delaying the employer contribution increase for one year will not substantially alter this picture. However, deviations from assumptions, such as over or under performing the 8 percent assumed rate of investment return, could materially impact this dynamic.

SIGNIFICANT ISSUES

A proposed 2 percent salary cut for public employees has not been adopted as one of the measures to cut state expenditures to meet reduced revenue projections for a balanced FY11 state budget. This bill provides an alternative measure.

The following tables compare current rates to those proposed by the bill. The FY11 rates are adjusted pursuant to Laws 2009, Chapter 127, which "swapped" contributions by 1.5 percent.

	ERB		
	FY11	FY11*	FY12
Employer Contribution			
Over 20K Salary	11.65%	9.9%	13.15%
Under 20K Salary	12.4%	12.4%	13.15%
Employee Contribution			
Over 20K Salary	9.40%	10.4%	7.90%
Under 20K Salary	7.90%	7.90%	7.90%

*Under the SFC Substitute for Senate Bill 246

The various PERA plans have different rates. The following table compares the contribution rates for State General Plan 3, which has the most members.

	PERA		
	FY11	FY11*	FY12
Employer Contribution			
Over 20K Salary	15.09%	14.09%	16.59%
Under 20K Salary	16.59%	16.59%	16.59%
Employee Contribution			
Over 20K Salary	8.92%	9.92%	7.42%
Under 20K Salary	7.42%	7.42%	7.42%

*Under the SFC Substitute for Senate Bill 246

The following summary provides the employee contribution comparison for the other affected PERA plans for employees making over the $20,000 threshold:

	PERA		
	FY11	FY11*	FY12
Employee Contribution			
State Police & Cor Plan 1	9.10%	10.7%	7.60%
Haz Duty	6.28%	7.88%	4.78%
JRA	9%	10.6%	7.50%
MRA	9%	10.6%	7.50%

*Under the SFC Substitute for Senate Bill 246

PERFORMANCE IMPLICATIONS

The AGO voiced a concern that further reductions to state salaries may encourage employees in certain positions, such as attorneys, to leave state employment for the private sector where salaries may be higher. However, given the current state of the economy, it is uncertain whether this one-year reduction would adversely affect the state's ability to provide critical services.

AOC indicated a similar concern, maintaining that "Judiciary employees are already working with less staff to meet increasing caseloads. The majority of courts have reduced operational hours to the public as a result of these general fund decreases and one court has implemented employee furloughs as well. Judiciary employee take-home pay will be reduced by this bill. This reduction in take-home pay may further deteriorate employee morale in the courts."

ADMINISTRATIVE IMPLICATIONS

PERA notes that the administrative impact on that agency will be in modifying its computer pension administration system (RIO). If the required revisions to the system are necessary in FY10, PERA will be required to seek a budget adjustment to cover the cost of these system changes. ERB makes similar claims, noting that additional expenses to undo the change would also occur in FY12.

CONFLICT, RELATION

PERA maintains that the bill conflicts with Article XX, Section 22 of the Constitution of New Mexico.
The SFC substitute for Senate Bill 246 relates to House Bill 2, the appropriation bill, Section 10 (D) and (E), which reduces appropriations commensurately.
The SFC substitute for Senate Bill 246 conforms to sections relating to ERB in Senate Bill 91, which would defer the 0.75 employer contribution increase (Laws 2005, Chapter 273) for FY11.
The SFC substitute for Senate Bill 246 relates to the return-to-work bill (SPAC substitute as amended for Senate Bill 207) because that bill would also have a negative actuarial impact to the PERA fund.
Relates to Laws 2006, Chapter 109, which pre-funded the ERB .75 increase (vetoed).
Relates to Laws 2007, Chapter 28, which pre-funded the ERB .75 increase (vetoed).

TECHNICAL ISSUES

<u>AGO:</u>

> As was true for HB 854, which was passed in the 2009 Legislative session, Senate Bill 246 consistently excludes those employees who make less then $20,000 per year from the retirement contribution swap. Instead, House Bill 2, the General Appropriation Act of 2009, defined "no employee shall be deemed to have an annual salary greater than twenty thousand dollars unless the employee's full-time-equivalent base annual salary is greater than that amount or unless the employee's base hourly wage is greater than nine dollars fifty-seven and nine-tenths cents ($9.579)." Ch. 124, Laws 2009, House Bill 2.
>
> A court employee brought a writ petition against LFC, DFA and the Office of the Governor, contending that the language in HB 2 substantively changed the legislation in HB 854. The AGO prevailed on the petition and the New Mexico Supreme Court denied the writ. However, that decision was based on the premise that HB 2 was merely explaining the $20,000 annual salary definition, not revising it, since the bills were contemporaneous legislation. The Supreme Court clearly has a preference, as is correct, for the definition for language to be in the same statute as the language, not in an appropriation act, and it is not certain that the same decision would be reached by the

> court this year, when the legislature is already on notice that the definition should be in the statute, not an appropriations act. The legislature should amend HB 246 to include the definition used last year in HB 2: "no employee shall be deemed to have an annual salary greater than twenty thousand dollars unless the employee's full-time-equivalent base annual salary is greater than that amount or unless the employee's base hourly wage is greater than nine dollars fifty-seven and nine-tenths cents ($9.579)."

The bill now contains language with this definition. ERB-affiliates, whose employees are not based on a standard full-time 2,088 hour schedule applicable to state employees, may find the language defining the $20,000 exemption difficult to apply without direction from ERB or language added directed at the full-time schedules based on a school year.

OTHER SUBSTANTIVE ISSUES

<u>PERA:</u>

> Due to the recent dramatic market downturn, PERA's funding status of all its retirement funds has declined. Legislative measures that have a further negative impact on the fund are contrary to the Legislature's desire for plan solvency. Unless significant gains are made to overcome recent market losses, statutory contribution rates across all coverage plans will need to be increased.
>
> SB 246 will not enhance or preserve the actuarial soundness of the retirement fund. The Constitution prohibits the Legislature from enacting any changes to the funding formula for a retirement plan unless adequate funding is provided. *See* Article XX, section 20, subsection C. Without an actuarial determination that a change to the existing statutory contribution rates is required to enhance or benefit the actuarial soundness of the retirement fund, reallocating contribution rates between the employee and employers may violate the constitution of New Mexico. *See* Article XX, section 20, subsection E.

A 25-member task force implemented by Laws 2009, Chapter 288, is studying solvency issues relating to PERA, ERB and the Retiree Health Care Authority. The task force is charged with reporting on its recommendations by October 2010.

<u>AGO:</u>

> In July of 2009, the AGO successfully defended litigation, on behalf of both the state and the Educational Retirement Board, brought by AFCME challenging the public employee retirement contribution shift legislation. The court denied the Plaintiff's request for preliminary injunction and the state and ERB have motions to dismiss currently pending. Plaintiffs have taken no action of any kind since the denial of the application for a preliminary injunction. However, there was never a final ruling on the merits in this case, and the possibility remains that AFCME could prevail on the merits at trial, if the lawsuit is not dismissed.

Several responding agencies expressed the concern of how further reductions in take-home pay will affect state employees.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The budget gap will not be closed by about $27.4 million general fund and other measures will need to be taken. Current contribution rates that include a 1.5 percent contribution shift implemented for FY10 and FY11 will remain in effect until FY12 when they revert to their original statutory rates. Unless Senate Bill 91 is enacted, the ERB affiliates will have an unfunded mandate of about $18.3 million to pay the employer 0.75 contribution increase scheduled for FY11.

MA/mt

Attachment A – ERB Contribution Rates

Table A – Laws 2005, Chapter 273

Fiscal year	Employee Contribution Rate	Employer Contribution Rate	Incremental Change in Employer Rate
FY05	7.6%	8.65%	
FY06	7.675%	9.4%	0.75%
FY07	7.75%	10.15%	0.75%
FY08	7.825%	10.9%	0.75%
FY09	7.9%	11.65%	0.75%
FY10	7.9%	12.4%	0.75%
FY11	7.9%	**13.15%**	0.75%
FY12	7.9%	13.9%	0.75%

Table B – Fiscal Impact of 0.75% increase in Employer Contribution Rate for FY10
(in thousands)

Public School Support *	
Program Costs	$12,073.2
Transportation	$194.8
Higher Education**	$6,024
TOTAL	**$18,292.0**

*Source: Public Education Department
**Source: Laws 2009, Chapter 124, page 188

Table C – Current Rates: Laws 2005, Chapter 273 and Temporary 1.5% Employer-Employee Swap
(Laws 2009, Chapter 127)

Fiscal year	Employee Contribution Rate > $20,000	Employer Contribution Rate	Incremental Change in Employer Rate
FY10*	7.9%+1.5% = 9.4%	12.4% - 1.5% = 10.9%	0.75%
FY11*	7.9%+1.5% = 9.4%	13.15% - 1.5% = 11.65%	0.75%
FY12	7.9%	13.9%	0.75%

*Laws 2009, Chapter 127

Table D – Effective Combined Rate Changes*

Fiscal Year	Employee>$20,000	Employer>$20,000	Employer<$20,000
*FY10	9.4%	10.9% (12.4%-1.5%)	12.4%
****FY11**	9.4%+**1%=10.4%**	13.15**-.75%-**1.5%-**1%** **= 9.9%**	**12.4%**
FY12	7.9%	12.4%+.75%=**13.15%**	**13.15%**
FY13	7.9%	13.15%+.75%=**13.9%**	**13.9%**

*Includes 1.5% employee-employer swap enacted by Laws 2009, Chapter 127.
**Effect of this bill on employer rates (in bold) and employee rate over $20,000 (in bold).