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

SPONSOR SFC

ORIGINAL DATE 01/29/13
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HB

SHORT TITLE Public Employee Retirement Changes
SB CS/27/aSFC

ANALYST Hanika-Ortiz

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY13	**FY14**	**FY15**		
	$30,722.8	$38,915.6	Recurring	PERA

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total			$2,288.0		Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee amendment to Senate Bill 27 makes minor changes to the title and language in the body of the substitute bill.

Synopsis of Original Bill

The Senate Finance Committee Substitute for Senate Bill 27 amends the Public Employees Retirement Act and incorporates most aspects of the original Public Employees Retirement Association (PERA) Board’s proposal endorsed by the Investments and Pensions Oversight Committee. The bill affects all current members and retirees, and adds a new tier of benefit structure for new members on or after July 1, 2013.

The substitute bill implements the following changes:

Cost of Living Adjustment (COLA)

- Reduces the COLA from 3 percent to 2 percent for most retirees.
- Delays COLA eligibility from 2 to 7 full years, subject to a 4-year phase-in period.

- Provides a 2.5 percent COLA for members retired 25 or more years and disability-retired members, whose annual pensions are $20,000 or less.
- Suspends the COLA for return-to-work retirees during reemployment with Educational Retirement Board (ERB) or PERA-affiliated employers.

Employee and Employer Contribution Rates and Other

- Increases the statutory employee contribution rate 1.5 percent for employees that earn $20,000 or more in annual salary.
- Increases the statutory employer contribution rate 0.4 percent beginning FY15.
- Increases the pension maximum from 80 percent to 90 percent of final average salary.
- Provides municipal employers participating in an employee contribution "pick-up" relief from the employee contribution increase.
- Adjusts proportionately the earned service credit under different PERA plans for a "blended" pension benefit.

New Benefit Structure after July 1, 2013

- Increases age and service requirements:
  - General employees: Rule of 85
  - Public safety employees: 25 years and out
- Lengthens the final average salary from 3 years to 5 years.
- Increases the vesting period from 5 years to 8 years for state general and from 5 years to 6 years for public safety members.
- Lowers the annual service credit by 0.5 percent for most plans.

FISCAL IMPLICATIONS

The table above reflects new revenues from increasing the employee contribution 1.5 percent beginning FY14 and increasing the employer contribution 0.4 percent beginning FY15.

The proposed changes in the substitute bill are in response to the PERA's increasing unfunded liability and deteriorating funded status. Last year, the PERA's unfunded liability increased from $4.9 billion to $6.2 billion and its funded status decreased from 70.5 percent to 65.3 percent. These dramatic changes were due to the recognition of investment losses since 2008, contributions for some that do not support the generous benefit, a compounded 3 percent COLA awarded annually no matter the rate of inflation and the lack of a minimum retirement age.

The PERA COLA accounts for about 30 percent of the plan's liabilities. Reducing the COLA from 3 percent to 2 percent will immediately reduce the PERA's unfunded liability by more than $1 billion. As most of the benefit reductions are limited to new employees, the proposed changes will slow the growth in liabilities going forward but have little impact on the existing liability.

The PERA estimates the plan will reach a funded ratio of about 90 percent by 2042 under the substitute bill, assuming the Legislature funds the 0.4 percent employer contribution rate increase and the plan earns 7.75 percent on investments long-term. If neither is realized, the other changes proposed in the bill may not go far enough to ensure long-term solvency.

SIGNIFICANT ISSUES

The Legislative Finance Committee (LFC) has noted concerns in the past that the assumptions used in the valuations may overstate the positive impact of any proposed changes. In future years, it is likely that further legislation may be necessary to achieve solvency.

The PERA reports that the contribution increase for employees would be accomplished by removing the sunset on the 1.5 percent contribution swap scheduled to end June 30, 2013. However, the House Appropriation and Finance Committee Substitute for House Bill 2 for the 2013 legislative session provides an appropriation for personal services and employee benefits that would allow the contribution swap to sunset per law. The net effect would be that as expected, take home pay increases for some employees would not be realized.

The bill increases the pension maximum to 90 percent which may create an incentive to work longer and decrease the time the employee is collecting a pension. A key criticism of employer-paid retirement benefits is the liability long after an employee has left the organization.

All service credit earned on or after July 1, 2013 will be subject to a "blended" pension benefit. Currently, if a PERA member earns service credit under one or more PERA member coverage plans, his or her pension is calculated under the coverage plan providing the highest benefit.

About 1,100 grandfathered-in reemployed retirees with the PERA, as well as the PERA retirees employed by ERB-covered employers, will have their COLA suspended effective July 1, 2013 for the duration of their reemployment.

PERFORMANCE IMPLICATIONS

Article XX, Section 22 of the New Mexico Constitution, (D) reads: "Upon meeting the minimum service requirements…a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States constitutions." However, Subsection E reads: "Nothing in this section shall be construed to prohibit modifications to retirement plans that … preserve the actuarial soundness of an affected trust fund or individual retirement plan." The PERA believes this test has been met because actuarial studies show the changes are necessary to maintain the actuarial soundness of the plans.

ADMINISTRATIVE IMPLICATIONS

The PERA will be required to modify its pension administration system to administer the proposed pension reforms.

OTHER SUBSTANTIVE ISSUES

The substitute bill includes a phase-in period to lessen the impact of a spike in retirement on public employers:

- retirees on or before June 30, 2014, 2 full calendar years
- retirees between July 1, 2014 and June 30, 2015, 3 full calendar years
- retirees between July 1, 2015 and June 30, 2016, 4 full calendar years
- retirees on or after July 1, 2016, 7 full calendar years

The bill makes no change to the one calendar year eligibility period for retirees that are age 65 or older or that retired under disability.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB 26 authorizes the PERA Board to change contribution rates and cost-of-living adjustments.
SB 121 allows retirees to be reemployed as undersheriffs and chiefs-of-police and requires employer and employee contributions.

SB 168 allows retirees to be reemployed as state police, adult correctional and municipal police officers and requires employer and employee contributions.

SB 86 amends the PERA Act's calculation of FAS for determining pension benefits.

SB 25 changes the age and service credit requirements in the Judicial and Magistrate Retirement Acts.

HB 95 amends the Judicial and Magistrate Retirement Acts by delaying and reducing the COLA, decreasing the pension multiplier July 1, 2013 and increasing age and service requirements.

ALTERNATIVES

The legislature may want to consider a minimum retirement age and COLA tied to inflation. For instance, the COLA could be awarded closer to eligibility for Social Security and equal to 75 percent of the change in CPI, with a ceiling of 1.5 percent and floor of 0.5 percent. That way, neither the retiree nor the taxpayer suffers too greatly from extremes. Some states are providing a COLA on the first $35,000 or $40,000 of benefits or only allowing it to compound after age 65.

Another option to reduce spending is to decrease the multiplier to 2 percent for new hires. That would allow an employee working 30 or 35 years to retiree at 60 or 70 percent of their final average salary. That amount in concert with Social Security providing a replacement income of 30 to 40 percent would provide a stable income at retirement approximating the income earned those final working years. There may be little support from the taxpayer for a public retirement system that eventually provides a public employee income greater than what was earned those final working years, when combined with social security and an automatic compounded COLA.

The PERA plan does not include a minimum retirement age or age-based reductions which may discourage retirement before age 60 or age 65. Under a new tier, the ERB proposal includes a minimum retirement age of 55 and reduces the benefit 2.4 percent if the member retires before age 65 and reduces it 7.2 percent if the member retires before age 60. A minimum retirement age might also go a long way in helping preserve retiree health care benefits for future retirees.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The credit ratings agencies could downgrade New Mexico because of its failure to improve pension plans fund balances which is important to credit analyses.

AHO/blm:svb