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

SPONSOR: Romero DATE TYPED: 2/19/03 HB

SHORT TITLE: Amend Educational Retirement Act SB 174/aSFl #1

ANALYST: Neel

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	**FY04**			
	NFI			

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to:
SB 136, Educational Retirement Benefits
SB 169, Increase Educational Retirement Multiplier
SB 174, Amend Educational Retirement Act
HB 22, Educational Retirement Benefits

SOURCES OF INFORMATION

LFC files

Responses Received From

Educational Retirement Board (ERB)

SUMMARY

Synopsis of Senate Floor Amendment

The Senate Floor amendment changes the requirement for actuarial reports from every five years to every three years. Currently ERB conducts an actuarial report every year.

Synopsis of Original Bill

SB-174 amends the Educational Retirement Act (ERA) to: 1) Change the method of setting interest rates for refunds and purchase of withdrawn service credit; 2) Brings the ERA into compliance with the Internal Revenue Code; 3) Clarifies the distribution of pension assets in a division of community property; and 4) Creates a statute for permanent disability status.

TECHNICAL ISSUES

ERB notes the following issues regarding interest rates:

Significant Issues

1) Setting interest rates.
   The current method of setting interest rates pegs rates to the book yield of the ERA portfolio. This method has become very volatile and erratic over the past few years due to the downturn in the financial markets.

   There are three rates used. One is for refunding a member's contribution if they leave ERA employment and wish to withdraw their contributions. Another rate is used in the repurchase of withdrawn contributions. The last rate is used to refund contributions for a member who dies prior to retirement.

   This last year our annual book yield rate was .24% (that is one-fourth of one percent). This rate is used in calculating interest when a member dies prior to retirement. If a member died in 2002 he/she would have their contributions compounded at .24%. If the member had died in 2000, he/she would have their contributions compounded at 16.5%.

OTHER SUBSTANTIVE ISSUES

Actuarial Valuation. The unfunded actuarial accrued liability (UAAL) calculation is used to help assess a pension fund's status and progress toward accumulating the assets needed to pay benefits as due. It is the difference between total actuarial liabilities and the total actuarial value of assets. The funding period (or amortization period) is measured in years and is the time it takes to finance the unfunded actuarial liabilities under the current funding policy. General Accounting Standards Board (GASB) Statement No. 25 states amortization periods for UAALs should not exceed the estimated total service life of the employee group. GASB believes that period, for most employee groups, is not more than 30 years.

As the below table illustrates ERB's funding period now stands at 27.2 years, up from last year's funding period of 12.5 years. The increased funding period is due in part to a combination of higher salaries and investment losses. ERB's percent funded declined from 91.9 percent to 86.8 percent as of June 30, 2002, while the UAAL increased from 652 million to $1,152.8 million.
At the end of FY02 ERB's actuarial report deferred $1.58 billion in investment losses. This

Actuarial Valuation

Year Ended June 30	UAAL (In Millions)	Funding Period (In Years)	Percent Funded
1999	$ 983.10	16.7	86.0%
2000	$ 624.80	8.2	91.6%
2001	$ 652.00	12.5	91.9%
2002	$ 1,152.80	27.2	86.8%

equates to approximately $395 million in losses being absorbed the Educational Retirement Fund (ERF) for each of the next four years. Based on the ERF value of $5.6 billion, the fund will need to return 7 percent to maintain its current value not to mention the long-term actuarial growth assumption of 8 percent.

Compounding ERB's investment and liability losses are cash-flow constraints with being a mature fund. Designation as a mature fund is defined as paying out more in benefits than the fund receives in contributions from its members. ERB received $328.6 million in FY02 contributions, while paying $396 million in benefits and refunds. Therefore, there was a net loss of $68 million for normal operation of the fund.

SN/prr