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FISCAL IMPACT REPORT

SPONSOR: Vaughn DATE TYPED: 1/29/03 HB 157

SHORT TITLE: Amend Police Retirement SB _____

ANALYST: Smith

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04			
	Significant (Actuarial Study Needed)		Recurring	PERA

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

Responses Received From

PERA

SUMMARY

Synopsis of Bill

House Bill 157 creates a new optional plan for a state police member who is eligible to retire, but may choose to remain a state police officer and have 100% of his or her pension paid into a deferred retirement account for up to five years. Under HB 157, the retirement eligible state police member will continue to make contributions to PERA under State Police Coverage Plan 1, but will earn no additional service credit while he or she participates in the deferred retirement option plan (“DROP”).

FISCAL IMPLICATIONS

PERA’s actuaries have not had an opportunity to study HB 157 to determine whether it is cost-neutral.

ADMINISTRATIVE IMPLICATIONS

The bill's administrative impact on PERA will be significant in that DROP plan administration is more complex and costly than other plans administered by PERA. HB 157 will add another plan that is completely different from the 27 other coverage plans that PERA currently administers. HB 157 will require PERA to set up individual accounts for DROP plan participants to track amounts deferred, interest accrued thereon, and the division of community property incident to divorce, if applicable. Given the October 1, 2003 effective eligibility date for the DROP plan, PERA would be unable to timely procure an outside vendor to serve as a third-party administrator for the plan. As a result, existing PERA staff would be required to absorb the added function of administering the plan.

It should be noted that this type of DROP plan moves PERA away from traditional pension administration and toward duties that are similar to those of a banking institution. For example, this DROP will have regular deposits with interest added. PERA will have to keep track of each member's "account" separate from his or her PERA retirement account. In addition, PERA will be required to administer court orders dividing the community interest in DROP plans, if applicable.

TECHNICAL ISSUES

HB 157 does not address how PERA will be required to administer court orders dividing the community interest in DROP plans, if applicable. Since New Mexico is a community property state, all retirement benefits accrued during the term of a marriage are considered community property. An ex-spouse's community share of a state police member's pension benefit cannot be calculated, however, until such benefits are otherwise payable. Similarly, the election to participate in a DROP plan will require the spousal consent if a state police member is married.

In addition, HB 157 does not address whether the retirement eligible state police officer is "retired" or not for purposes of disability benefits. There is a question regarding what other benefits, such as health insurance, for which the member is eligible depending on his or her status as a "member" or "retiree."

Page 2, line 1, refers to "executive director" and should be replaced by "association."

Page 2, line 16, refers to "executive director" and should be replaced by "association."

Page 3, line 6, "disability retirement" should be added. For purposes of the PERA Act, a member is "retired" if it is determined he or she is disabled.

OTHER SUBSTANTIVE ISSUES

PERA reports that an issue is whether a DROP plan will encourage retirement eligible state police officers to retire earlier than under current actuarial assumptions. As written, HB 157 may have a negative actuarial impact on the retirement fund. If the DROP plan creates an incentive for state police officers to retire earlier and "DROP", there will be a cost to the fund. True actuarial costs can only be measured with experience. As a result, the cost of the DROP plan can only be assumed on today's valuations; these costs may go up or down as experience dictates.

Unlike HB 157's proposal, many DROP plans are structured to pay less than 100% of the pension amount into the plan or offset interest rates earned on deferred amounts to achieve cost-

neutrality. Without a determination of cost-neutrality by PERA's actuary, HB 157 may be contrary to NM Const., Art. XX, Section 22 (no benefits may be enhanced unless the costs of those benefits are properly funded in accordance with actuarial standards).

For the period ending June 30, 2001, PERA's unfunded liability grew significantly, and the time to pay off its unfunded actuarially accrued liability (UAAL) increased from 4 years to 7 years. The June 30, 2002 actuarial valuation indicates that PERA funding resources are sufficient to fund the Normal Cost and finance the UAAL over an aggregate period of 10 years. It should be noted, however, that the funding of assets uses a smoothing technique that spreads increases and decreases out over a 4-year period. One quarter of this year's investment loss has been recognized in this year's funding value and one quarter of it will be recognized in each of the next 3 years. Past gains that have yet to be fully realized in the funding value partially offset this year's and last year's losses.

In aggregate, the system had an experience loss for the year ending June 30, 2002 of \$258 million, due to rate of return on funding value of assets less than assumed (5.5% vs. 8%) and retirements greater than assumed. Specifically, PERA's actuaries reported a loss of \$328 million for 3 of the 4 years of investment activity that will flow into the recognized gain/loss in next year's actuarial valuation. If a loss of this magnitude occurs next year, the effect would be that the overall PERA funding ratio will drop below 100% and PERA UAAL will increase to approximately 20 years.

SS/prr/njw