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

SPONSOR Heaton **DATE TYPED** 03/07/05 **HB** 270/aHAFC

SHORT TITLE Educational Retirement Employer Contributions **SB**

ANALYST Geisler

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
			$17,800.0 (See Narrative)	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to: SB 181

SOURCES OF INFORMATION

LFC Files
Educational Retirement Board (ERB)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of HAFC Amendment

The House Appropriations and Finance Committee amendment to House Bill 270 strikes the Appropriation of $17.8 million.

Synopsis of Original Bill

The bill increases the employer contribution to the Educational Retirement fund by .75% each year from FY 06 to FY 15, increasing the employer contribution from 8.65 percent of salary currently to 16.15% by 2014 at a cost of $195.5 million over the ten year period. It contains an appropriation of $17.4 million general fund for the cost of increased contributions for public schools and higher education in FY 06.

Significant Issues

ERB's actuarial position, which represents its long-term ability to pay promised pension benefits with projected assets, has slipped in recent years. Major factors in the decline include increased liabilities, contribution levels that are inadequate for the benefit structure, and investment losses from 2001-2003.

ERB's funded ratio, the actuarial value of assets as a percentage of actuarially accrued liabilities, declined from 81 percent to approximately 75 percent as prior-year investment losses were factored into their June 30, 2004, actuarial study. The fund's unfunded actuarial liability (the dollar difference between actuarial liability and the actuarial value of its assets based on assumptions regarding investment income return and demographic projections), has increased from $1.7 billion to $2.4 billion in the past year. The fund's amortization period, which the Governmental Accounting Standards Board states should be less than 30 years, is infinity. During FY 04, contributions of $356 million were $95 million less than distributions of $451 million. The estimated one-time cost to put ERB within the 30-year funding period is a minimum of $120 million recurring.

After significant research and an audit by a second actuarial firm, the ERB's recommendation is to increase the employer contribution paid by the state by .75% for 10 years as proposed in House Bill 270. Assuming 8% investment return, these funding increases should bring the fund to into compliance with the 30-year funding period.

FISCAL IMPLICATIONS

The cost by year of the increase in employer contribution is shown below.

Cost of Increase in Employer Contribution, Per Year		
	Employer Contribution Rate	Cost in Millions (recurring)
FY 06	9.40%	$17.4
FY 07	10.15%	$17.8
FY 08	10.90%	$18.2
FY 09	11.65%	$18.7
FY 10	12.40%	$19.2
FY 11	13.15%	$19.7
FY 12	13.90%	$20.2
FY 13	14.65%	$20.8
FY 14	15.40%	$21.5
FY 15	16.15%	$22.1
Grand Total		$195.5

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 181 seeks to increase the current employer contribution of 8.65% of salary by .75

percent each year from July 1, 2005 until July 1, 2009 for a total increase of 3%. This increase is the minimum increase suggested by the independent Mellon study on ERB's funding problem. Senate Bill 181 also proposes a new retirement plan for new hires, changing eligibility requirements for retirement from requiring 25 years of service or Age + Years of Service = 75 to Age + Years of Service = 80

ALTERNATIVES

Employer contribution increases are just one of a number of possible actions that could be taken to improve ERB's actuarial position. Other possibilities include:

1. **Issue pension bonds.** Pension bonds are a taxable debt obligation of the state issued to provide financial support to a pension fund. Issuing debt now immediately improves ERB's actuarial position but there is a risk of loss if the investment return on the new funds is lower than the interest on the borrowed funds. Also, it could prove irresistible to follow a bailout with benefit increases. Although pension bonds are offered as an alternative to contribution increases, it is still possible that a structural problem will persist because the contribution levels are too low.

2. **Increase employee contributions or change plan design**. Increasing employee contributions offers the advantage that employees who will benefit from an ERB pension are helping to fix the solvency problem. However, a disadvantage of increasing employee contributions is that the fund does not retain every dollar of contribution increase due to employee withdrawals when they leave the plan. ERB estimates that the fund would retain only about 70 cents on every dollar increase in employee contributions. This would not be a problem with an employer contribution increase as these dollars always stay in the plan.

3. **Changing plan design.** The plan could be changed for future hires, either by reducing the benefit or increasing the retirement age (as proposed in SB 181). A defined contribution plan (like a 401K) could also be an option. Changing plan design offers the advantage of improving long-term solvency and limiting future state liability. However, savings from changing plan design are mostly in the out-years—the near term problem of funding the current plan remains. In addition, developing a plan design that is unappealing to new hires could make the New Mexico teacher benefit package less desirable and hamper recruiting of new educational employees.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

The unfunded liability and the years to pay off the liability will continue to increase.

GG/lg:njw