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FISCAL IMPACT REPORT

ORIGINAL DATE 2-27-07

SPONSOR Stewart LAST UPDATED _____ HB 1091

SHORT TITLE EDUCATIONAL RETIREMENT BENEFITS & CALCULATION SB _____

ANALYST Aubel

APPROPRIATION (dollars in thousands)

| Appropriation | | Recurring or Non-Rec | Fund Affected |
|---------------|--------------|-------------------------|------------------|
| FY07 | FY08 | | |
| | Significant* | Recurring | ERA |

(Parenthesis () Indicate Expenditure Decreases)

* See narrative

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY07 | FY08 | FY09 | 3 Year Total Cost | Recurring or Non-Rec | Fund Affected |
|--------------|------|--------|------|----------------------|-------------------------|------------------|
| Total | | \$50.0 | | \$50.0 | Non-Rec | ERA |

(Parenthesis () Indicate Expenditure Decreases)

Conflicts with SJM 6

SOURCES OF INFORMATION

LFC Files

Responses Received From

Educational Retirement Board (ERB)

New Mexico Higher Education Department (HED)

Public Education Department (PED)

SUMMARY

Synopsis of Bill

House Bill 1091 amends the Educational Retirement Act to increase retirement benefits, as follows:

An increase in the multiplier would be phased-in over three years:

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- A member age 60 who is retiring between January 1, 2008 and December 31, 2008 to be calculated with a .0240 factor rather than the current .0235 factor;
- For members over 60 retiring between January 1, 2009 and December 31, 2009, the multiplier will be increased to .0245
- For members over 60 retiring between January 1, 2010 and December 31, 2010, the multiplier will be based on a .0250 factor.

In addition, the legislation changes the method of calculation for the Final Average Salary (FAS) from a five-year to a three-year period beginning January 1, 2008, based on the last three years for which contributions were made or upon the basis of any consecutive three years for which contribution was made by the member, whichever is higher.

FISCAL IMPLICATIONS

ERB's actuary has indicated significant fiscal impact associated with the separate portions of this legislation as follows:

Change in Multiplier

The estimated Unfunded Actuarial Accrued Liability is \$479.3 million. If funded in accordance with the GASB Actuarial Required Contribution (ARC) as a percent of payroll, an increase of 2.26 percent, or \$52.7 million, would be needed as a contribution rate increase.

| Item | Current Plan | Proposed HB 1091 | Difference |
|---|-------------------|-------------------|-----------------|
| Unfunded Actuarial Accrued Liability (UAAL) | \$3,622.4 million | \$4,101.7 million | \$479.3 million |
| Normal Cost % | 13.56% | 14.64% | 1.08% |
| Funded Ratio | 68.3% | 65.6% | (2.7%) |
| GASB 25 Annual Required Contribution (ARC) | \$347.2 million | \$399.9 million | \$52.7 million |
| GASB 25 ARC as % payroll | 14.51% | 16.77% | 2.26% |

Three-Year Final Average Compensation (FAC)

The estimated Unfunded Actuarial Accrued Liability is \$307.2 million. If funded in accordance with the GASB ARC as a percent of payroll, an increase of 1.32 percent or \$31.6 million would be needed as a contribution rate increase.

| Item | Current Plan (5-Year FAC) | Proposed HB 1091 (3-Year FAC) | Difference |
|---|------------------------------|----------------------------------|-----------------|
| Unfunded Actuarial Accrued Liability (UAAL) | \$3,622.4 million | \$3,929.6 million | \$307.2 million |
| Normal Cost % | 13.56% | 14.12% | 0.56% |
| Funded Ratio | 68.3% | 66.5% | (1.8%) |
| GASB 25 Annual Required Contribution (ARC) | \$347.2 million | \$378.8 million | \$31.6 million |
| GASB 25 ARC as % payroll | 14.51% | 15.83% | 1.32% |

ERB has indicated that the change in benefit calculation and tracking the three-year retirements during the phase-in period would require changes to its computerized pension system. Such change orders in the past have cost up to \$50 thousand.

SIGNIFICANT ISSUES

Preserving the actuarial soundness of the ERA fund to meet the current and future obligations of retirement benefits is a primary issue regarding HB 1091. The two main calculations used as indicators of fund solvency are the Funding Ratio and Funding Period.

Funded Ratio. The funded ratio is the actuarial value of assets (AVA) expressed as a percentage of actuarially accrued liabilities. On June 30, 2006 ERB's funding ratio was 70 percent. Generally, a funded ratio of at least 80 percent is considered satisfactory.

Funding Period. The unfunded actuarial liability (UAAL) is the dollar difference between a plan's actuarial liability and the actuarial value of its assets based on assumptions regarding investment income return and demographic projections. The Governmental Accounting Standards Board (GASB) states that the amortization period for any UAAL should be less than 30 years. On ERB's UAAL at June 30, 2006 was \$3.1 billion with a funding period of infinity.

Article XX Section 22 of the Constitution of the State of New Mexico requires that an increase in benefits under the retirement system be adequately funded to preserve the ERA fund's actuarial soundness. HB 1031 does not provide for an appropriation for the actuarial liability that the enhanced retirement benefits will cause. Nor does it provide for a combined employee and employer contribution rate that is sufficient to amortize the combined increase in the UAAL of \$686.5 million over 30 years, given actuarial assumptions hold.

PERFORMANCE IMPLICATIONS

PED notes that HB 1091 has the potential to attract more people to the education field and brings the education retirement benefits closer to those provided by the PERA plan.

HED also points out that the Educational Retirement Act relates to retirement for many university and college personnel and suggests strengthening the Act and the fund will have a positive impact on those faculty and staff covered through this plan.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with SJM 6, which proposes a 2-year moratorium on benefit enhancement legislation affecting the Public Employees Retirement Association (PERA) and ERB through December 31, 2008.

TECHNICAL ISSUES

HB 1091 conflicts with the New Mexico Constitution that requires retirement enhancements to be funded.

OTHER SUBSTANTIVE ISSUES

A comparison between the ERB and PERA General Plan 3 is as follows:

| ERB | PERA – State Plan 3 | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|---|--|-----------------|-----------------|---------|------|-------|---------|--------|------|---------|-------|--------|---------|--------|-------|---------|------|--------|---------|------|-------|---------|------|--------|---------|------|-------|--|
| <p>Pension Factor</p> <p>2.35%</p> | <p>Pension Factor</p> <p>3.0%</p> | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Contributions</p> <p>Employee and employer contributions increasing 2 and 5 more years per SB 181:</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 20%;"></th> <th style="width: 40%; text-align: center;"><u>Employee</u></th> <th style="width: 40%; text-align: center;"><u>Employer</u></th> </tr> </thead> <tbody> <tr> <td>FY 2005</td> <td style="text-align: center;">7.6%</td> <td style="text-align: center;">8.65%</td> </tr> <tr> <td>FY 2006</td> <td style="text-align: center;">7.675%</td> <td style="text-align: center;">9.4%</td> </tr> <tr> <td>FY 2007</td> <td style="text-align: center;">7.75%</td> <td style="text-align: center;">10.15%</td> </tr> <tr> <td>FY 2008</td> <td style="text-align: center;">7.825%</td> <td style="text-align: center;">10.9%</td> </tr> <tr> <td>FY 2009</td> <td style="text-align: center;">7.9%</td> <td style="text-align: center;">11.65%</td> </tr> <tr> <td>FY 2010</td> <td style="text-align: center;">7.9%</td> <td style="text-align: center;">12.4%</td> </tr> <tr> <td>FY 2011</td> <td style="text-align: center;">7.9%</td> <td style="text-align: center;">13.15%</td> </tr> <tr> <td>FY 2012</td> <td style="text-align: center;">7.9%</td> <td style="text-align: center;">13.9%</td> </tr> </tbody> </table> | | <u>Employee</u> | <u>Employer</u> | FY 2005 | 7.6% | 8.65% | FY 2006 | 7.675% | 9.4% | FY 2007 | 7.75% | 10.15% | FY 2008 | 7.825% | 10.9% | FY 2009 | 7.9% | 11.65% | FY 2010 | 7.9% | 12.4% | FY 2011 | 7.9% | 13.15% | FY 2012 | 7.9% | 13.9% | <p>Contributions</p> <p>7.42% Employee 16.59% Employer</p> <p>Note: PERA has 29 other plans with employee contributions ranging from 7% to 16.65% and employer contributions ranging from 7% to 25.72%.</p> |
| | <u>Employee</u> | <u>Employer</u> | | | | | | | | | | | | | | | | | | | | | | | | | | |
| FY 2005 | 7.6% | 8.65% | | | | | | | | | | | | | | | | | | | | | | | | | | |
| FY 2006 | 7.675% | 9.4% | | | | | | | | | | | | | | | | | | | | | | | | | | |
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| FY 2012 | 7.9% | 13.9% | | | | | | | | | | | | | | | | | | | | | | | | | | |
| <p>Benefit Calculation</p> <p>Final Average Salary of highest 5 consecutive years of service X Years of service X .0235</p> <p>No maximum benefit. 80% benefit is reached after 34 years of service.</p> | <p>Benefit Calculation</p> <p>Final Average Salary of highest 3 consecutive years of service X Years of service X .03</p> <p>Benefit maximizes at 80% with 26 yrs. and 8 months of service.</p> | | | | | | | | | | | | | | | | | | | | | | | | | | | |

ERB and PERA Sample Retirement Comparison

| | | | |
|----------------------|-----|----------|--|
| Final Average Salary | YR1 | \$42,000 | High 3 year average (PERA) = \$48,000 |
| | YR2 | \$44,000 | High 3 year average (ERB) per HB 1091 = \$48,000 |
| | YR3 | \$46,000 | |
| | YR4 | \$48,000 | |
| | YR5 | \$50,000 | High 5 year average (ERB) = \$46,000 |

PERA Retirement Benefit: \$48,000 x 25 years of service x .03 = \$36,000

Current ERB Retirement Benefit: \$46,000 x 25 years of service x .0235 = \$27,025

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Under HB 1091, the retirement benefit would increase for ERB retirees over 60, as follows:

| | |
|---------------------------------------|----------|
| Retire January 1 – December 31, 2008: | \$28,800 |
| Retire January 1 – December 31, 2009: | \$29,400 |
| Retire January 1 – December 31, 2010: | \$30,000 |

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The Educational Retirement Act would remain the same as currently administered.

MA/nt