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## FISCAL IMPACT REPORT

ORIGINAL DATE 02/17/13

SPONSOR SFC LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE Public Employee Average Salary Calculations SB 86/SFCS

ANALYST Daly

### REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY13	FY14	FY15		
	Minimal*	Minimal*	Recurring	PERA Retirement Fund
	Limited*	Limited*	Recurring	ERB Retirement Fund

(Parenthesis ( ) Indicate Revenue Decreases)

\*Increase due to amounts not paid out in retirement benefits. See Fiscal Impact.

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY13	FY14	FY15	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>	\$20.0	\$0.0	\$0.0	\$20.0	Nonrecurring	PERA Retirement Fund
	NFI	\$80.0*	\$80.0*	\$160.0*	Recurring**	ERB Retirement Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

\*See Fiscal Implications.

\*\*Beginning in FY 16, recurring portion is estimated at \$60.0 per year; see Fiscal Implications.

Conflicts with SB 25  
Relates to SB 27

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Administrative Office of the Courts (AOC)  
Attorney General's Office (AGO)  
Department of Finance & Administration (DFA)

Educational Retirement Board (ERB)  
Public Employee Retirement Association (PERA)  
Department of Public Safety (DPS)  
New Mexico Corrections Department (NMCD)

## **SUMMARY**

### Synopsis of Bill

The Senate Finance Committee Substitute for Senate Bill 86 provides for a more restrictive calculation of final average salary (FAS) for PERA members and average annual salary (AAS) for ERB members for pension purposes. Effective July 1, 2013, any FAS or AAS in an amount greater than \$60 thousand shall exclude the salary paid in each 12-month period of the period used to calculate FAS (36 months) or AAS (five years) that exceeds the previous year by more than 20 percent. Beginning July 1, 2014, the \$60 thousand threshold is subject to adjustment based on increases in the consumer price index (CPI).

As it pertains to PERA, this more restrictive calculation applies to all current PERA members, including public safety members, but does not apply to judges covered by the Judicial Retirement Act or magistrates under the Magistrate Retirement Act.

The substitute bill also retains language in existing law that excludes from the calculation of salary for ERB retirees any lump sum payments made after July 1, 2010 for accrued sick leave or annual leave.

The bill is effective July 1, 2013.

## **FISCAL IMPLICATIONS**

The ERB provides this explanation of the impact of the substitute bill on ERB's Operating Budget: a modification of the existing ERB IRIS retirement information system would have to be required to implement the provisions of the bill, both as to the salary increase limit and the CPI adjustments. The estimated additional operating budget impact figures in the table above include changes to the existing IRIS system in FY14 (\$20,000) and additional programming in FY15 (\$20,000) for the new IRIS system that currently is being developed. In addition, it is estimated that one additional FTE will be needed to assist with calculating and audit the "average annual salaries" for purposes of determining retirement benefits to insure compliance with the requirements of the bill. The salary for that position is estimated at \$40,000, plus \$20,000 for benefits, etc. The recurring expenses beginning in FY 16 (once systems have been modified) is estimated to be \$60,000: 1 FTE salary - \$40,000 plus benefits, etc. \$20,000 = \$60,000/year.

As to the impact of the substitute on the ERB Retirement Fund, the ERB would have to estimate how many members might be affected and perform an actuarial study, but expects the impact to be limited since the large majority of members will have an AAS lower than \$60 thousand.

The PERA does not anticipate any significant budget or revenue impact to the PERA Fund.

The PERA, however, will be required to make significant changes to PERA's pension administration system (RIO) on or before July 1, 2013 to use the proposed calculation of final

average salaries. If the required revisions to the system are necessary in FY13, PERA will be required to seek a BAR to cover the costs of these system changes. PERA estimates the cost of such system changes to be approximately \$20 thousand.

### **SIGNIFICANT ISSUES**

Both the ERB and the PERA comment on the impact of this bill on SB 27/a. The PERA points out that this bill may conflict with SB27/a, the PERA Board's comprehensive pension reform legislation, endorsed by the Investments and Pensions Oversight Committee (IPOC). As drafted, this bill will not apply to PERA members first hired on or after July 1, 2013 who will be covered by the new tier benefit structure of SB 27/a.

Similarly, the ERB notes that this bill does not address the changes to the Public Employees Retirement Act proposed by SB 27/a, which creates a sixty month period to determine the final average salary for persons who are not PERA members as of June 30, 2013 (i.e., become members on or after July 1, 2013). If both bills were to become law, the provisions of this substitute bill would apply only to those who were PERA members as of June 30, 2013 and not to those who became members after that date.

The ERB provides these additional comments on the effect of the bill:

The salaries of some ERB members can fluctuate from year to year based on whether they teach additional courses during the regular academic year, teach summer courses, take on additional duties, work on a grant funded project, etc. This applies in particular in colleges and universities, but also can apply in K-12. The retirement benefit, and the planned retirement date, of those whose AAS is over the \$60 thousand threshold, and who had a change of greater than twenty percent limitation in year-to-year salary increases, would be affected by this bill. Some of those members may be able to address the bill's potential impact by changing a planned retirement date or changing course loads, etc., however it is not certain whether all members would be able to make adjustments like these.

State Personnel Rules provide that, in the absence of the State Personnel Director's approval, salary increases for all employees covered under those rules are limited to fifteen percent per year. State Personnel Rules govern the state agencies. State Personnel rules do not govern secondary and higher educational institutions; the ERB does not know whether any of those institutions have limits on salary increases similar to those in State Personnel Rules.

Employees at mid and lower level pay ranges would not be affected by this substitute. Increasing the \$60 thousand threshold based on changes in the CPI would ensure that it tracks inflation and aid in applying the twenty percent salary increase limit to those employees over time.

CS/S 86 will not limit to twenty percent the salary increases an employer chooses to give employees at any time during their career. Employers would continue to be able to give raises or pay employees for extra work as they choose.

Further, in an earlier analysis, the AGO called attention to Article XX, Section 22(D) of the New Mexico Constitution, which 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.” The New Mexico Supreme Court has held that “any action by the legislature that serves ‘to terminate, diminish or alter’ the value of pension benefits...must be compensated for by providing an equal “greater benefit.” Pierce v. State, 121 N.M. 212, 228 (1995). 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 DPS in its earlier analysis expressed concern about the impact of the previous version of this bill:

The most significant issue presented by passage of the proposed legislation is the penalization of a lower retirement benefit for employees who legitimately are provided more than a 20 percent increase during the timeframes set forth in the bill. This scenario occurs frequently and legitimately when well qualified employees are underpaid relative to their background and accept promotional opportunities.

However, the AOC in an earlier analysis viewed the impact of the earlier version of this bill on current employees differently:

Any provision to improve the actuarial soundness of the retirement plan by addressing the equitable calculation of benefit payout to match the appropriate level of long-term contributions decreases the need for increasing current or future active employee contribution rates. This benefits employers by being able to recruit and retain employees.

Finally, in its earlier analysis, the NMCD pointed to what it believed will be an additional benefit to the employing agency when it asserts that this bill will likely encourage employees who have substantial experience and expertise who receive substantial pay raises to remain working (rather than immediately retiring), to the benefit of their employer. That agency would also be able to engage in better succession planning by having these experienced employees train others who will eventually take over their positions.

## **ADMINISTRATIVE IMPLICATIONS**

Both PERA and ERB anticipate administrative impact in order to make the necessary system changes and conduct training as necessary to implement CS/SB 86 by its effective date. The ERB notes that in addition, its staff will have to work with the over 210 different educational employers and affected state agencies to implement the new limits if this bill is enacted.

## **CONFLICT, RELATIONSHIP**

Conflicts with SB 25, which changes the calculation of final average salary under the Judicial and Magistrate retirement systems.

Conflicts with SB 27, comprehensive pension reform for PERA members and retirees, including:

reducing the cost-of-living adjustment (COLA) for all current and future PERA retirees, increasing employee and employer contributions, changing the eligibility period to first receive a COLA, and changing age and service credit requirements for all PERA members first hired on or after July, 2013.

## **TECHNICAL ISSUES**

The PERA points out these technical issues:

On page 2, line 23, the words “salary threshold” may be misinterpreted. In referencing Subsection B, “salary threshold” can refer to either “sixty-thousand dollars (\$60,000) or the “excess of twenty percent” that is excluded from final average salary (FAS). Clarification may be necessary to avoid confusion in the intent of the legislation.

On page 3, line 1, “consumer price index” is not a defined term in the PERA Act.

On page 3, line 1 “next proceeding calendar year” is not a defined term in the PERA Act.

On page 3, line 2 “preceding year” is not a defined term in the PERA Act.

## **OTHER SUBSTANTIVE ISSUES**

The PERA advises that currently, an employee’s final average salary is based on the highest salary the employee received for any consecutive 36-month period. The statutory restriction contained in this substitute bill is commonly used to prevent “salary spiking” in the last years of employment. Salary spiking is not a material problem under the PERA Act. In some states, employers increase pension benefits by giving employees lump sum payouts in their final year of employment, which inflates the final average salary used to calculate the pension. The PERA Act already has a very restrictive definition of salary which precludes windfalls in the form of lump sum pay-outs for accrued leave and overtime prior to retirement. Section 10-11-2 (U) NMSA 1978 specifically excludes “overtime pay, allowances for housing, clothing, equipment or travel, payments for unused sick leave and any other form of remuneration not specifically designated by law as salary.”

Conversely, the PERA notes, both the Judicial Retirement and Magistrate Retirement Acts calculate the amount of pension using the salary received during the last year of office prior to retirement. NMSA 1978, Sections 10-12B-9 and 10-12C-9. This substitute bill, however, does not apply to either JRA or MRA members.

MD/blm