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

SPONSOR Rehm **ORIGINAL DATE** 2/19/19 **LAST UPDATED** **HB** 544

SHORT TITLE PERA Solvency Changes **SB**

ANALYST Jorgensen

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY19	FY20	FY21		
	$132,019.2	$132,019.2	Recurring	Various PERA

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
State, General Fund		$14,664.2	$14,664.2	$29,328.5	Recurring	General Fund
State, Other Funds		$13,161.6	$13,161.6	$26,323.3	Recurring	Other State Funds
Municipal		$38,183.8	$38,183.8	$76,367.5	Recurring	Municipal, Various

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates Appropriation in the General Appropriation Act

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Department of Public Safety (DPS)
Public Employees Retirement Association (PERA)

SUMMARY

Synopsis of Bill

House Bill 544 increases employer and employee contribution increases by 3 percent each for the state general plan, state police and adult corrections, municipal general plan, municipal police, municipal fire, and municipal detention employees. HB544 also removes the current maximum pension cap of 90 percent of final average salary. Under HB544, state and municipal general employees would receive a service credit multiplier of 1 percent for service credit accrued that would increase the value of the pension benefit over 90 percent of final average salary. State and municipal police, correctional officers, and fire fighters would receive a 1.5 percent multiplier for service credit accrued that would increase the value of the pension benefit over 90 percent of final average salary.

HB544 suspends cost-of-living adjustments (COLA) for one year for members whose pension is over $20 thousand per year or who are on disability retirement.

FISCAL IMPLICATIONS

HB544 would increase revenue to the PERA funds by $132 million per year as reflected in the revenue table. The breakdown of revenue generated by plan is shown in the table below:

	2018 Total Payroll	3% Employer Increase	3% Employee Increase	Total Increase
State General	927,528.6	27,825.9	27,825.9	55,651.7
Municipal General	928,666.2	27,860.0	27,860.0	55,720.0
Municipal Police	213,105.9	6,393.2	6,393.2	12,786.4
Municipal Fire	131,019.6	3,930.6	3,930.6	7,861.2
Total	**2,200,320.3**	**66,009.6**	**66,009.6**	**132,019.2**

Because HB544 does not contain an appropriation, employers would be forced to cover additional pension contribution requirements with their existing budgets. The estimated additional operating budget impact table shows the annual cost to the state and municipalities of the proposed legislation. The state share of the increase is $27.8 million of which approximately 53 percent, or $14.7 million comes from the general fund.

Municipalities would face increased costs of approximately $38.2 million annually.

The Public Employees Retirement Association (PERA) estimates that enactment of the provisions of HB544 will result in pension plans having a funded ratio of 102 percent in 25 years compared with a ratio of 74.4 percent without reform.

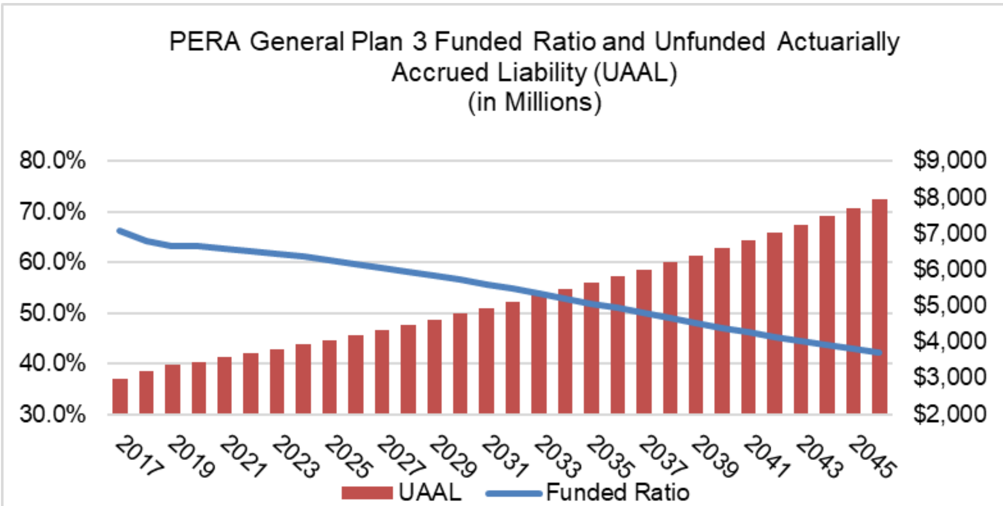
SIGNIFICANT ISSUES

Pension benefits are determined by three factors: final average salary, years of service (or service credit), and a pension multiplier with a formula that looks like:

Pension = Final Average Salary X *Service Credit* X *Pension Multiplier*

Because retirement payments are fixed regardless of investment returns or contribution levels, the soundness of the retirement funds are judged on their ability to meet not only current obligations but also the obligation to future retirees. For a pension plan to remain solvent, the employer and employee contributions and investment returns must be able to cover the cost of benefit payouts and the administrative expenses of the fund. The financial health of a defined benefit pension plan is often measured using metrics including: the funded ratio which divides the plan assets by the total plan liabilities; the unfunded actuarially accrued liability (UAAL) or amount of liabilities attributable to paying future obligations minus plan assets; and the funding period, or the amount of time it would take for current levels of contributions and investment income to pay down the entire amount of the pension liability.

PERA has a UAAL of $6.1 billion and has sufficient assets to pay for 71.6 percent of the total liabilities. Of the two pension plans managed by PERA that serve employees of the State of New Mexico, state general plan 3 and the police and adult correctional officers plans, the state general plan is the most underfunded. The graph below illustrates the plan's unfunded liability and funded ratio over time:



Based on current contributions and an investment return assumption of 7.25 percent per year, PERA will never achieve 100 percent funding. The inability to achieve full funding is referred to as an infinite funding period. The longer a pension plan's funding period is, the more sensitive the plan will be to changes in investment returns. Should the fund fail to meet the assumptions, the funded ratio could quickly get significantly worse. Recognizing this, PERA set a policy requiring the pension plan to attain 100 percent funding within by 2043.

The declining funded ratio of PERA's state general plan 3 suggests the plan is significantly underfunded. Much of the underfunding of the plan is due to the richness of the benefit; the PERA plan offers employees hired before July 1, 2013, 90 percent income replacement for a 30 year career and employees hired after July 1, 2013, earn 90 percent income replacement for a 36-year career. *This benefit is in addition to social security eligibility*. Additionally, the fund liability increased significantly in 1995 when the service credit multiplier was increased by 0.5 percent and applied to all service credit already earned by active employees. The retroactive increase in benefits resulted in a number of retirees receiving an enhanced benefit for which contributions were never made.

PERFORMANCE IMPLICATIONS

The compensation package offered by the state of New Mexico is already heavily skewed toward benefits, with the state offering approximately 58 percent of total compensation through salary while private industry offers approximately 70 percent in salary. Increasing employee contributions to pension funds will further diminish employee take-home pay while increasing employer contributions may crowd divert funds which otherwise could be used for salary increases.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The General Appropriations Act of 2019 contains language providing funding for a 0.5 percent increase for both PERA and ERB.

HB501 and HB338 make changes to the PERA plans.

OTHER SUBSTANTIVE ISSUES

HB544 improves the pension plan funded status almost entirely through employer increases with few cost controls. PERA estimates a one-year COLA freeze will generate approximately $240 million in savings over 30 years and improve the funded ratio by 2 percent. A 1 percent increase from both employer and employee would generate approximately $354 million over 30 years.

Removing the cap on the pension benefit may induce more PERA members to work longer than they would have otherwise and would therefore be a benefit to the fund. However, the number of workers who will extend their careers as a result of this change is not known so the impact from this change is unknown. Further, the service credit multiplier of 1 percent for state and municipal general plan members and 1.5 percent for police, fire, and corrections members are both less than the current COLA.

CJ/gb/sb