LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS
55th Legislature, 1st Session, 2021

Bill Number SB42/aSFC **Sponsor** Stewart

Tracking Number .218420.2 **Committee Referrals** SEC/SFC; HEC/HAFC

Short Title Increase Ed Retirement Contributions

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Analyst Simon **Last Updated** 3/17/2021

FOR THE LEGISLATIVE EDUCATION STUDY COMMITTEE AND THE INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE

BILL SUMMARY

Synopsis of HAFC Amendment

The House Appropriation and Finance Committee amendment to Senate Bill 42 (SB42/aSFC/aHAFC) reduces the increase in employer contributions from 1 percentage point each year for four years to 1 percentage point each year for two years. The amendment also adds the requirement that ERB produce a report on options to improve pension plan solvency without additional contributions from public employers for the Department of Finance and Administration, Legislative Finance Committee, the Legislative Education Study Committee, and other appropriate interim legislative committees.

Synopsis of SFC Amendment

The Senate Finance Committee Amendment to Senate Bill 42 (SB42/aSFC) extends the current return-to-work program for ERB members through January 1, 2024, from its current sunset of January 1, 2022.

Synopsis of Original Bill

The bill increases employer contributions for entities with employees covered by the Educational Retirement Board (ERB) by 1 percentage point each year for four years, beginning in FY22.

The bill has an effective date of July 1, 2021

FISCAL IMPACT

The bill increases benefits costs for school districts, charter schools, and higher education institutions beginning in FY22. Currently, ERB-covered employers make contributions of 14.15 percent of an ERB member’s salary. Under the bill, that would increase as follows:

- For FY22, to 15.15 percent of salary;
- For FY23 and subsequent fiscal years, to 16.15 percent of salary.

ERB reports their covered employers make contributions to ERB based on $3 billion in payroll, making a total cost from all entities from all sources of $34 million per year. Over two years, ERB estimates total revenue to the educational retirement fund of $68.1 million. Estimated costs to the general fund are $23.8 million per year, for a total of $47.6 million over two years. If no appropriation is provided to school districts, charter schools, higher education institutions, and other ERB-covered employers would need to cover this cost out of their current budgets.

Public schools represent a significant portion of ERB's membership. According to ERB staff, school districts and charter schools made total contributions of $304.5 million in FY20. Expenditure data from the Public Education Department (PED) shows state general fund sources accounted for 90 percent of school district and charter school contributions for retirement benefits.

The Senate Finance Committee amendment to House Appropriations and Finance Committee substitute for House Bills 2 and 3 includes $34 million to increase employer contributions to ERB in FY22, contingent on the passage of SB42/aSFC/aHAFC or similar legislation.

SUBSTANTIVE ISSUES

ERB provides a defined-benefit retirement plan for employees of school districts, charter schools, higher education institutions, and some employees of state agencies that provide educational services or hold a license issued by PED. ERB's plan is designed to pre-fund pension payments through employer and employee contributions, which are then invested by professional investing staff to generate returns. Contributions and investment returns accumulate over time to provide a source for pension payments for retired members. In FY20, ERB collected $328.1 million from ERB members and $444.6 million from employers.

Currently, ERB does not hold enough cash and investments to pay for all of the retirement benefits that have been promised. While ERB holds assets valued at $13.7 billion, as of June 30, 2020, the fund would need an estimated $22.7 billion to pay all benefits promised up to this point. The $9 billion difference is known as the plan's unfunded liability. ERB's actuaries estimate the fund holds 60.4 percent of the assets needed to pay all promised benefits.

While ERB estimates current contribution levels are sufficient to pay the costs of benefits currently being earned, a large share of the employer's contribution is still needed to pay off the unfunded liability. ERB projects the current contribution rate is insufficient to ever pay off the unfunded liability.

As with many pension plans, high projected rates of return in the late 1990s and early 2000s led the state to believe the plan had sufficient assets to pay promised benefits and even provide increased benefits. At the end of FY01, ERB's actuaries estimated the plan was 92 percent funded and would be fully funded by FY14. At that time, the plan assumed an average 8 percent return. As that assumption was lowered, the plan's unfunded liability increased. In April 2020, ERB's board lowered their assumed rate of return from 7.25 percent to 7 percent, adding $400 million to the plan's unfunded liability. ERB's recent investment performance has been below assumed levels, with a 1 percent loss in FY20, annualized gains of 4.7 percent over the last three fiscal years, and annualized gains of 5.7 percent over the last five fiscal years.

While state law requires employers to pay 14.15 percent of member's salary to the fund, ERB's actuaries estimate the employer contribution would need to be 21.24 percent to meet ERB's funding policy, which would pay off the unfunded liability by the end of FY49. Increasing the employer contribution rate to 18.15 percent would not meet ERB's funding policy but would make it possible to pay off the unfunded liability by the end of FY66, ERB estimates.

Alternative Retirement Plan. Some employees of higher education institutions are eligible to opt out of ERB's defined-benefit plan and choose to participate in the defined-contribution Alternative Retirement Plan. In the Alternative Retirement Plan, employees manage their own investment options and individually benefit or suffer from investment losses or gains. As with the defined-benefit plan, SB42/aSFC/aHAFC would increase employer contributions by 1 percentage point per year for four years, from the current 3.25 percent of salary to 7.25 percent of salary.

Return-to-Work Provisions. Generally, a retired ERB member is not allowed to provide services to an ERB-covered employer while still receiving retirement benefits, except in certain circumstances. In 2001, the Legislature enacted a program that allowed a retired ERB member to return to employment with an ERB-covered employer while still receiving retirement benefits if the employee retires and does not provide services to an ERB-covered employer for one year. Retired ERB members would not earn service credit for their time in the return-to-work program and were not required to make contributions to the educational retirement fund. However, employers were required to make contributions based on the salary of return-to-work employees. Initially, the return-to-work plan was scheduled to sunset in 2012, but in 2009 the sunset date was extended until 2022. SB42/aSFC/aHAFC would extend the program to 2024.

Under the initial return-to-work program, an employee who was eligible to retire had an incentive to retire early and return to employment. Doing so would eliminate the need for the employee to make contributions to the educational retirement fund. Even though that employee would not accrue service credit, they would receive payouts from the fund for a longer period of time. To address the fiscal impact of the return-to-work program, in 2011 the Legislature amended the statute to require employees participating in the return-to-work program to make nonrefundable contributions to the fund equal to what would have been paid if they were employees accruing service credit. ERB has reported that their analysis of the return-to-work program shows employees may be better off by continuing to accrue service credit and retiring later with a higher benefit.

Return-to-work programs have provided school districts and charter schools with an additional pool of employees from which to recruit qualified educators. According to the *2020 Educator Vacancy Report*, a publication of New Mexico State University's Southwest Outreach Academic Research Evaluation and Policy Center, many schools continue to struggle with educator vacancies, although the state has made progress in reducing vacancies in recent years. According to the report, the largest number of vacancies were for educational or instructional assistants, with 173 vacancies. Other areas with large vacancy numbers were 163 vacancies for elementary school teachers and 153 vacancies for special education teachers.

SOURCES OF INFORMATION

- LESC Files
- Educational Retirement Board

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