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

SPONSOR: Sanchez, B. DATE TYPED: 02/10/03 HB

SHORT TITLE: Increase Educational Retirement Multiplier SB 374

ANALYST: Gilbert

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY03	**FY04**	**FY03**	**FY04**		
	$157,000.0		($0.1 See Narrative)	Recurring	Educational Retirement Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to: HB 22, SB 137, SB 174, SB 283
Duplicates: SB 169

SOURCES OF INFORMATION

LFC Files

Response Received From
Educational Retirement Association (ERA)
New Mexico Commission on Higher Education (NMCHE)
New Mexico State Department of Education (SDE)

SUMMARY

Synopsis of Bill

Senate Bill 374 increases the educational retirement service credit multiplier to three percent for those members who retire on or after July 1, 2003. It also changes the formula used for calculating a member's average annual salary for retirement purposes and changes the employer's contribution rate.

Significant Issues

SB 374 requires the employer to bear the entire funding burden for these retirement benefit increases. Employee contributions will remain at 7.6% of annual salary. The employer's contribution requirements, however, will increase from 8.65% to 16.59%, with the provision that the Educational Retirement Board's (ERB) actuary calculates the rate necessary to fund the plan. If this number should differ from the 16.59%, the ERB will certify the new rate to the state superintendent of public instruction.

The average annual salary calculation for retirement purposes will be computed using the highest three consecutive years for those members who retire on or after July 1, 2003. The three percent multiplier will only affect those employees who retire on or after July 1, 2003. Any employee who retires before this date, but after July 1, 1991, will earn the rate of 2.35% for every credited year.

Currently there is no maximum retirement benefit. Under SB 374, the retirement benefit shall not exceed 80% of the final average annual salary.

FISCAL IMPLICATIONS

ERB indicates that an increase of $157.0 million per year in recurring contributions from employers is needed to fund the enhanced retirement benefits provided by this bill.

Actual salaries paid to ERA members would determine future year increases. Therefore, the base cost of $157.0 million would increase proportionally with salary increases.

NM Const., Art. XX, Section 22 provides that no benefits may be enhanced unless the costs of such benefits are properly funded in accordance with actuarial standards. Although ERA does not reference a formal actuarial study regarding the impact of this bill, it appears that with the increased employer contributions, SB 374 would not violate the Constitution of New Mexico (see discussion on ERB's UAAL under Other Substantive Issues).

ADMINISTRATIVE IMPLICATIONS

If this bill is adopted, ERB must amend its regulations and retiree and member publications.

OTHER SUBSTANTIVE ISSUES

Actuarial Valuation. The unfunded actuarial accrued liability (UAAL) calculation is used to help assess a pension fund's status and progress toward accumulating the assets needed to pay benefits as due. It is the difference between total actuarial liabilities and the total actuarial value of assets. The funding period (or amortization period) is measured in years and is the time it takes to finance the unfunded actuarial liabilities under the current funding policy. General Accounting Standards Board (GASB) Statement No. 25 states amortization periods for UAALs should not exceed the estimated total service life of the employee group. GASB believes that period, for most employee groups, is not more than 30 years.

As the table below illustrates, ERB's funding period now stands at 27.2 years, up from last year's funding period of 12.5 years. The increased funding period is due in part to a combination of higher salaries and investment losses. ERB's percent funded declined from 91.9 percent to 86.8 percent as of June 30, 2002, while the UAAL increased from 652 million to $1,152.8 million.

Actuarial Valuation

Year Ended June 30	UAAL (In Millions)	Funding Period (In Years)	Percent Funded
1999	$ 983.10	16.7	86.0%
2000	$ 624.80	8.2	91.6%
2001	$ 652.00	12.5	91.9%
2002	$ 1,152.80	27.2	86.8%

At the end of FY02 ERB's actuarial report deferred $1.58 billion in investment losses. This equates to approximately $395 million in losses being absorbed the Educational Retirement Fund (ERF) for each of the next four years. Based on the ERF value of $5.6 billion, the fund will need to return 7 percent to maintain its current value not to mention the long-term actuarial growth assumption of 8 percent.

Compounding ERB's investment and liability losses are cash-flow constraints with being a mature fund. Designation as a mature fund is defined as paying out more in benefits than the fund receives in contributions from its members. ERB received $328.6 million in FY02 contributions, while paying $396 million in benefits and refunds. Therefore, there was a net loss of $68 million for normal operation of the fund.

SB 374 increases the service credit multiplier and final average salary, but does not address the differences in COLA between the PERA and the ERA. These differences are significant in the amount and the ages at which COLAs begin. The PERA COLA provides a larger benefit to retirees than ERA's COLA, primarily because it commences as early as $2^{1/2}$ calendar years after retirement. The ERA COLA begins at age 65.

RLG/prr