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

SPONSOR Bratton | **ORIGINAL DATE** 02/22/11 | **LAST UPDATED** | **HB** 468

SHORT TITLE Public Retiree Retirement Contributions | **SB**

ANALYST Aubel

REVENUE (dollars in millions)*

Estimated Revenue-Impact of Delay 0.75% Increase Two Years					Recurring or Non-Rec	Fund Affected
Compared to:	**FY12**	**FY13**	**FY14**	**FY15**		
Current Statute	($20.1)**	($40.2)**			Nonrecurring	ERB
			$20.1**	$40.2**	Recurring	ERB

(Parenthesis ( ) Indicate Revenue Decreases)

**All funding sources based on ERB reported FY10 total salaries of $2.7 billion.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in millions)*

	FY12	**FY13**	**FY14**	**FY15***	**4 Year Total Cost**	**Recurring or Non-Rec**	**Fund Affected**
Continue 1.5% Contribution Shift for Two Years--Compared to Current Statute	($42.6)	($42.6)			($85.2)	Non-Recurring	General Fund
Reverse 1.5% Contribution Shift- Compared to FY11 Operating Budget			$42.6	$42.6*	$85.2	Recurring	General Fund
Temporary 2.0% Contribution Shift	($34.9) million	($34.9) million			($69.8) million	Nonrecurring	General Fund
Delay ERB Employer Increase	($18.7)	($37.4)			($56.1)	Nonrecurring	General Fund
Impose ERB Employer Increase			$18.7	$37.4*	$56.1	Recurring*	General Fund
RIO-PERA IT System		$25.0				Non-recurring	PERA

*See fiscal impact.

Relates to Appropriation in House Bill 3 and the General Appropriation Act
Conflicts with House Bill 133, Senate Bill 87, Senate Bill 88, Senate Bill 248 and Senate Bill 265
Relates to House Bill 58 and House Bill 142

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public Employees Retirement Association (PERA)
Educational Retirement Board (ERB)
Office of Attorney General (AG)
Department of Transportation (DOT)
New Mexico Corrections Department (NMCD)

No Response From
Department of Finance and Administration

SUMMARY

Synopsis of Bill

House Bill 468 makes three primary changes for pension contributions for state employee plans administered by the Public Employees Retirement Association (PERA) and the Educational Retirement Board (ERB), effective July 1, 2011:

1. Extends the 1.5 percent contribution shift from the employer to the employee for those employees making more than $20,000, which had been implemented for FY10 and FY11, for two more years through FY12 and FY13;
2. Makes a two-year contribution shift of 2 percent from the employer to the employee for those making more than $20,000 for PERA; for ERB employees making more than $20,000, the bill exempts Educational Assistants and teachers making more than $20,000 from the additional 2 percent shift; and
3. Delays the two remaining 0.75 percent increases for ERB, currently scheduled for FY12 and FY13, to FY14 and FY15.

HB 468 applies to the following coverage plans administered by PERA: State General Member Coverage Plan 3 (applicable to most state employees), State Police and Adult Correctional Officer Member Coverage Plan 1, State Hazardous Duty Member Coverage Plan 2, and the Judicial Retirement Act (JRA) and Magistrate Retirement Act (MRA). However, PERA points out that HB 468's 2 percent contribution swap does not apply to state employees covered by the Educational Retirement Act (ERA).

PERA also notes that the bill "clarifies that for purposes of determining whether an employee's annual salary is less than $20,000.00 per year, the employee's base hourly rate at the time the contribution is made shall be annualized as if the employee was employed full-time."

FISCAL IMPLICATIONS

1.5% Contribution Shift
Laws 2009, Chapter 127 (House Bill 854) made a temporary contribution shift of 1.5 percent

from the employer rate to the employee rate for those state employees making more than $20,000 in FY10 and FY11. Based on 2009 compensation information, this action was projected to save about $42.6 million general fund each fiscal year as part of a solvency package to address revenue shortfalls. This bill would extend the 1.5 percent shift for PERA and ERB members making more than $20,000 for two more years.

The LFC and Executive budget recommendations do not fund the extra 1.5 percent employer currently set in statute, which is based upon the contribution shift sunset date of June 30, 2011. Thus, if this or similar legislation to amend current statute is not passed and signed by the governor, additional general fund appropriations of about $42.6 million would need to be made to cover the added cost to employers for paying the extra 1.5 percent pension contributions, increasing the budget deficit for FY12. Alternatively, if the Legislature chose not to fund the statutory rates set for July 1, 2011, the agencies and educational entities would need to reduce operating budgets elsewhere to absorb the added costs.

This general fund amount will once again be recurring starting in FY14, and an additional $42.6 million general fund will be required to fully fund the employer contribution rates for both plans.

<u>2% Temporary Contribution Shift</u>

The bill also makes a two-year 2 percent contribution shift from the employer to the employee for FY13 for PERA employees making more than $20,000. The preliminary general fund savings based on the 1% Compensation Table and prior assumptions regarding employees >$20,000 is approximately $37.9 million, which would be non-recurring.

The original Executive proposal applied the 2 percent shift to all PERA employees, regardless of salary. The bill, as currently drafted, applies both the 1.5 percent and the additional 2 percent only to those employees making over $20,000 – exempting employees making $20,000 or less from both shifts. The reduction in general fund savings for this difference is about $1.2 million. DFA did not provide an estimate of the amount associated with the $20,000 exemption for the 2 percent shift; the $1.2 million estimate is based on the 2009 estimate prepared for House Bill 854 and prorated from 1.5 percent to 2 percent. The general fund savings is further reduced by another $99.6 thousand due to exempting teachers working in state agencies. This number is based on the FY12 1% table for Executive exempt teachers, which shows a general fund 1% amount of $49.8 thousand. It should be noted that this reported amount is more than twice what would be computed from the ERB reported state teacher salaries for FY10 ($21.0 thousand) and may be overstating the deduction. However, the difference is not material.

The original Executive proposal applied the 2 percent shift to all ERB employees except teachers and Educational Assistants (AEs) working in a grade level from pre-kindergarten through grade 12, regardless of salary. The bill, as currently drafted, applies both the 1.5 percent and the additional 2 percent only to those employees making over $20,000 – exempting employees making $20,000 or less from both shifts and exempting the teachers and EAs making more than $20,000 from the 2 percent shift. The resulting contribution rate schedule for FY12-FY13 is as follows:

ERB Employees	Employee	Employer
Employee≤$20,000	7.9%	12.4%
Member>$20,000 and not a Teacher or EA	11.4%	8.9%
EA or Teacher>$20,000	9.4%	10.9%

The reduction in general fund savings from exempting employees making $20,000 or less is $2.9 million based on the ERB FY10 actual salaries associated with employees making $20,000 or less.

<u>Delaying the ERB Employer Contribution Increase</u>

Laws 2005, Chapter 273 implemented a schedule of employee and employer contribution increases to improve the funded status of the ERB fund, including a seven-year annual incremental increase of 0.75 percent for ERB employers ending at a final rate of 13.9 percent in FY12. It should be noted that Senate Bill 181, as originally drafted, implemented a four-year schedule of 0.75 percent increases ending at in FY09 at 11.65 percent. The additional 3 percent employer contribution, going from 8.65 percent to 11.65 percent, met ERB's actuarial recommendation designed to address solvency concerns at that time. A House Floor Amendment increased the schedule an additional three years to a final 13.9 percent, presumably to add a "cushion" for the educational plan to improve funded status.

Table A – Laws 2005, Chapter 273 (Senate Bill 181)

Fiscal year	Employee Contribution Rate	Employer Contribution Rate	Incremental Change in Employer Rate
FY05	7.6%	8.65%	
FY06	7.675%	9.4%	0.75%
FY07	7.75%	10.15%	0.75%
FY08	7.825%	10.9%	0.75%
FY09	7.9%	11.65%	0.75%
FY10	7.9%	12.4%	0.75%
FY11	7.9%	13.15%	0.75%
FY12	7.9%	13.9%	0.75%

In the 2006 session, the Legislature attempted to prefund one of the 0.75 percent increments for FY07, but the extra $19.3 million general fund appropriation was vetoed as noted in the LFC 2006 Post Session Report:

> "GAA included an extra $19.3 million ($13.6 million for public schools and $5.7 million for higher education) to double the employer contribution increase planned for FY07. Doubling the contribution increase in FY07 would have eliminated the need for a contribution increase in a future year when the state could have less funding available than this year… However, the governor vetoed this extra funding."

The funding shortfall foreseen in 2006 came to pass in 2010 when Laws 2010, Chapter 67, (Senate Bill 91) delayed the 0.75 percent employer increase scheduled for FY11 to FY12 due to budget concerns.

The FY12 LFC budget and Executive recommendations for K-12 and higher education do not include this 0.75 percent increase and do not fund it. Thus, if this or a similar bill is not enacted, $18.7 million (from the FY12 Executive Recurring Budget Recommendation, page 13, line 99200) would need to be appropriated to education entities to cover the added cost - or they would need to absorb the cost by making reductions elsewhere in their budgets for FY12. The next scheduled 0.75 percent increment, valued at another $18.7 million for FY13, would make the cumulative general fund savings around $56 million for the two-year period.

If this bill is enacted, the savings for FY12 and FY13 would be non-recurring as the schedule resumes in FY14. House Bill 468 will provide recurring $40 million revenue to ERB FY15 going forward and means a recurring cost to the general fund of about $37.4 million for FY15 forward. The revenue is based on 0.75 percent of the ERB actual total salary data of $2.7 billion.

Incorporating the first part of the bill that sunsets both the 1.5 percent contribution shift and 2 percent contribution shift as of July 1, 2013, the final ERB-affiliated employer contribution rate in FY14 for all employees would be 13.15 percent and then 13.9 percent as the final rate for all employees beginning in FY15. The corresponding employee rate for all employees beginning in FY14 is the default rate of 7.9 percent.

Combined Fiscal Impact

If HB 468 or similar legislation does not pass, other options to reduce costs or increase revenues will be needed to offset about $43 million for the sunset of the 1.5 percent swap in FY12, about $19 million to fund the 0.75 percent ERB contribution increase, and almost $35 million in new general fund savings due to not using the added 2 percent shift as part of the state solvency package for FY12. This totals about $97 million.

Impact to Employees

PERA notes the employee rates under the bill, as follows:

> For State General Coverage Plan 3 members, the increase in the employee contribution rate from 7.42% to 10.92% represents a47% increase in employee contributions. For State Police and Adult Correctional Officer Coverage Plan 1 members, the increase in the employee contribution rate from 7.6% to 11.1% represents a 46% increase in employee contributions. For Hazardous Duty Coverage Plan 2 members, the increase in the employee contribution rate from 4.78% to 8.28% represents a 73% increase in employee contributions.

ERB also provides the contribution schedule as outlined by HB 468:

> Insofar as the ERB is concerned, the 2% contribution shift would apply only to ERB employee members who are making more than $20,000/year annualized and are not preK-12 teachers or PED-licensed educational assistants. The shift would affect all members of the PERA plans who are making more than $20,000/year. This shift is in addition to the 1.5% contribution shift made in FY10 and FY11 for employers earning more than $20,000/year annualized. That 1.5% shift would be continued.

The fiscal impact to employees of an additional 2 percent contribution shift will be somewhat offset by the 2011 reduction in the federal social security tax of -2 percent. Assuming normal pretax deductions, the 18-month impact is minimal when compared with the baseline salary as of December 2010. (See Attachment A for the detail of an average PERA salary employee.)

	Change in Net Wages Compared to Baseline				
Salary	**Jan - Jun 2011**	**Jul - Dec 2011**	**Jan - Jun 2012**	**Cumulative**	**Cumulative Change as Pct of Salary**
30,000	208.26	-32.04	-240.30	-64.08	-0.21%
41,505	300.42	-32.04	-332.46	-64.08	-0.15%
60,000	392.56	-28.04	-420.60	-56.08	-0.09%
100,000	672.96	-28.04	-701.00	-56.08	-0.06%

There would be not offset for employees in FY13.

SIGNIFICANT ISSUES

To address budget shortfalls, some states have skipped employer pension contributions, which is severely negative to pension solvency. House Bill 468 proposes balancing state solvency with pension solvency by using a contribution shift that keeps the total contribution going into the funds constant. While this does appear to have a negative pension impact as noted below, it is much less than skipping the employer contribution altogether.

State Solvency
The current estimated state revenue shortfall for FY12 ranges from the LFC projection of about $215 million to the executive's projection, based on differing assumptions, of $410.2 million. This shortfall will require additional solvency measures for FY12 to balance the state's budget as required by the New Mexico Constitution. This bill would prevent an increase in this budget shortfall by extending the 1.5 percent contribution shift for two years, saving about $43 million general fund each year, and by delaying the ERB 0.75 employer contribution increase for two years, saving about $19 million in FY12 and $39 million in FY13. This bill will help shrink the deficit by the estimated $35 million from the 2 percent employer-employee contribution shift for FY12 and FY13. Savings to the general fund when compared with statute total $96.2 million for FY12 and almost $115 million for FY13.

Pension Solvency
The actuarial impact of the contribution changes, and from delaying the ERB contribution increase for two years, is noted by ERB and PERA, as follows:

ERB (Updated actuarial report forthcoming:

> HB468 would negatively affect the Educational Retirement Fund in two ways. First, the bill will delay the scheduled increases in the combined employer and employee contribution rates to 21.8%. The delay in increasing the combined contribution rate will reduce the funds available for investment, decreasing the total investment revenue generated by the Fund. Second, contributions that members make are refundable if they should terminate employment and withdraw their contributions or, in certain cases, upon the death of a member or retiree. Interest also is paid on those refunds. Employer contributions, however, are non-refundable. The 2% increase in the contribution shift for some members for two years and the two year extension of the 1.5% contribution shift for members earning greater than $20,000/year annualized shifts additional dollars from being non-refundable category to being refundable. This will have an actuarial effect on the Fund; however it should be smaller than the effect of delaying the scheduled contribution increases.
>
> ERB requested an actuarial study of the HB 468's effect on the Fund. However, as noted above, salary data reported to the ERB by LAUs does not clearly breakdown salaries between preK-12 teachers and PED-licensed educational assistants who would not be affected by HB468, and other pre-K-12 employees who would be subject to the 2% contribution shift. The lack of data also means that the actuarial model of ERB's members may not accurately reflect the gender and age demographics of the members affected by the shift. This should affect the actuarial study. ERB actuaries are using salary data provided by the LFC to estimate the actuarial effect. When that study is received, this FIR will be updated.

There also will be some cost for the ERB to reprogram its retirement software program, and for employers to do the same. The cost to the ERB is expected to be incremental and largely, if not entirely, borne within ERB's maintenance system for its software.

PERA:

As PERA contribution rates are considered in the budget discussions, it is important to point out that increases to employee contributions **have an associated increase in the Plan's liability due to the corresponding increase in expected future refunds of contributions**. As a rule of thumb, roughly 5% of the increase in employee contributions is needed to satisfy this increase in the Plan's liabilities. Therefore, a 1.00% of payroll employee contribution impacts funding the same as approximately a 0.95% payroll employer contribution. The current shift of 1.5% of payroll from the employer statutory contribution rate to the employee required contribution rate results in approximately 0.08% of payroll increase to the actuarially required funding. This again may not seem like a significant impact to the Plan for the short-term, however using the State General Division Plan to illustrate, the approximate 0.08% shortfall in funding resulting from the shift adds approximately $725,000 to the unfunded actuarial accrued liability each year it is in effect. The current two-year shift of 1.5% of payroll will require in total approximately $5 million in additional contributions over the next 30 years and represents nearly 20% of the total amount of the contributions shifted. An increase to the amount of contributions shifted from employers to employees or extending the period the shift is in effect further exacerbates the decline in the funded status of PERA.

Any further reduction in employer contributions will negatively impact the PERA, MRA and JRA Funds. Employee and employer contribution rates are statutory by member coverage plan. Rates of separation from active membership are used to measure the probabilities of active members terminating that status and requesting a refund of their employee contributions. Rates of withdrawals of active members differ among the demographics of the employee groups. Conversely, employer contributions are nonrefundable and remain with the respective retirement funds. If the total contributions are kept the same, but some of the contributions are shifted from employer to employee, the amortization period for that plan will increase. For the most part, the increase should be small. However, the more poorly funded a group is, the bigger the impact will be (such as in the Judicial Fund). In addition, the closer the normal cost is to the total contributions coming in, the greater the impact will be (such as in the Magistrate Fund).

To address this potential impact, PERA suggests an amendment to commission actuarial studies to determine the cost to the funds and request supplemental appropriation to make them whole.

PERA makes its position on contribution shifts clear:

SB 246 will not enhance or preserve the actuarial soundness of the retirement fund. The Constitution prohibits the Legislature from enacting any changes to the funding formula for a retirement plan unless adequate funding is provided. *See* Article XX, Section 20, Subsection C. Without an actuarial determination that a change to the existing statutory contribution rates is required to enhance or benefit the actuarial soundness of the retirement fund, reallocating contribution rates between the employee and employers may violate the Constitution of New Mexico. *See* Article XX, Section 20, Subsection E.

ADMINISTRATIVE IMPLICATIONS

Both ERB and PERA have pension information technology systems that would need to be updated to reflect the contribution changes. Prior fiscal analyses from PERA have indicated a $25,000 fiscal impact from making system changes. ERB assumes the cost would be covered under the current maintenance contract.

TECHNICAL ISSUES

ERB points out that the language clarifying the $20,000 demarcation for the contribution shift would not apply to ERB members, as follows:

> HB 468 also contains a temporary provision defining the methodology for determining when salaries of PERA members whose annual salary is greater or less than $20,000/year. The temporary provision would not apply to the ERB. This is because of technical issues relating to how ERB salaries are annualized for purposes of the contribution shift.

This issue arose during the application of Laws 2009, Chapter 127, but ERB does not specify whether the bill needs amending to address this issue.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Conflicts with House Bill 133, Senate Bill 87, Senate Bill 87, Senate Bill 88 and Senate Bill 265. All these bills provide alternative contribution schedules.

Relates to House Bill 58, which would move contribution currently funded form docket and jury fees to the general fund for the Judicial and Magistrate plans.

Relates to House Bill 142, which would have ERB return-to-work employees pick up the employee portion of the contribution.

OTHER SUBSTANTIVE ISSUES

The existing 1.5% contribution swap is the subject of pending litigation in the Second Judicial District Court in the matter of AFSCME Council 18 et. al. vs. State of New Mexico, et. al, Case No. CV-2009-7148. The AOAG provides the following analysis regarding the potential impact pursuant to this case:

> There is a pending lawsuit stemming from the passage in 2009 of HB 468 which introduced the first 1.5% contribution shift. The State district court presiding over the case has dismissed nearly all of the claims raised by the plaintiffs, but the plaintiffs' takings claim has survived. Importantly, if the plaintiffs are successful on that claim, they would be entitled to the payment of damages as compensation for the taking. What this means for the State is that it might have to pay to all people employed by the State between 2009 and 2011 (or any portion thereof) the difference between what those employees actually paid into their retirement accounts pursuant to HB 854 and what they would have paid if HB 854 had not passed. In other words, a damage award would erase any savings the State realized from the passage of HB 854. Such an award would also

establish sufficient precedent to entitle State employees to the same type of award from the increased contribution shift that HB 468 mandates

PERA notes that its board opposes HB 468: "The PERA Board Resolution No. 11-02 specifically establishes the PERA Board's opposition to any legislation proposing statutory contribution rate swaps between employers and employees that do not comply with the Board's Benefit Policy and Contribution Policy adopted in 2008. HB 468 is a budget measure to save General Fund monies; conversely, it will have a negative impact on the solvency of the PERA, JRA and MRA Funds."

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The current statutory contribution rates for state PERA and ERB plans would require an estimated combined $62 million expenditure for FY12 to pay for the sunset of the 1.5 percent employer-employee contribution shift and the ERB 0.75 percent employer incremental increase currently scheduled. This expenditure is not funded by appropriations in the current HAFC House Bill 2. Thus, without this bill or a similar bill, either additional appropriations would need to be added as a Senate amendment or affected plan sponsors would need to make cuts elsewhere in their budgets to absorb the cost, or a combination. Other options to reduce the budget shortfall by almost $35 million for FY12 and FY13 by temporarily shifting the employer to the employee by 2 percent would need to be explored, which could lead to furloughs, salary reductions, or layoffs. Other alternatives to meet the budget crisis if this bill is not enacted could mean reduced critical services or increased taxes.

POTENTIAL AMENDMENT

1. On Page 17, line 7, insert the following new section:

SECTION 15. TEMPORARY PROVISION—ACTUARIAL STUDY—SUPPLEMENTAL APPROPRIATION REQUEST.—

A. No later than September 30, 2013, the retirement board of the public employees retirement association shall cause an actuarial study to be conducted for each retirement system administered by the retirement board. Each study shall analyze whether the higher contribution rates and lower employer contribution rates required by this act and Laws of 2009, Chapter 127 have had or will have an adverse actuarial effect on the retirement system in violation of the Section 22(C) of Article 20 of the constitution of New Mexico. The results of each study shall be submitted to the legislative finance committee and the governor.

B. If the study concludes that a retirement system has had or will have an adverse actuarial effect as a result of the higher employee contributions rates and the lower employer contribution rates required by this act and Laws of 2009, Chapter 127, the retirement board shall submit a request for a supplemental appropriation to the second session of the fifty-first legislature in the amount that will rectify the adverse actuarial effect.

2. Renumber succeeding sections accordingly.

MA/bym

Attachment A

Analysis Isolating Impact of Pension Swap vs. Federal Social Security 2% Tax Reduction

2%	Reduction in Social Security Payroll Tax, effective Jan 2011 - Dec 2011
1.75%	Proposed PERA swap, effective Jul 2011 - Jun 2012
41,505	Average NM State Employee Salary
106,800	Wage Cap on SS Deductions

Federal social security reduction for CY2011.
LFC recommendation proposes 1.75% PERA swap.
Income effect for unmarried individuals

	FY2011		FY2012	
	Baseline Jul - Dec 2010	Jan - Jun 2011	Jul - Dec 2011	Jan - Jun 2012
Gross	**20,753**	**20,753**	**20,753**	**20,753**
PERA Rate	8.92%	8.92%	10.67%	10.67%
PERA Deduction	1,851.12	1,851.12	2,214.29	2,214.29
Pre-Tax Medical Ins	2,000	2,000	2,000	2,000
FICA Gross	**18,752.50**	**18,752.50**	**18,752.50**	**18,752.50**
SS Rate	6.2%	4.2%	4.2%	6.2%
Medicare Rate	1.45%	1.45%	1.45%	1.45%
SS Deduction	1162.66	787.61	787.61	1,162.66
Medicare Deduction	271.91	271.91	271.91	271.91
Taxable Wages	**15466.81**	**15841.86**	**15478.69**	**15,103.64**
Federal Tax Rate of Excess	15%	15%	15%	15%
Federal Taxes	2,107.52	2,163.78	2,109.30	2,053.05
NM Tax Rate of Excess	4.9%	4.9%	4.9%	4.9%
NM Taxes	618.12	636.50	618.71	600.33
Net	**12,741.17**	**13,041.58**	**12,750.68**	**12,450.27**
Compared to Baseline		**300.42**	**9.52**	**-290.90**
Cumulative Impact				**19.03**