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

SPONSOR HAFC **ORIGINAL DATE** 03/12/11 **LAST UPDATED** 03/21/11 **HB** CS/644/HFL#1

SHORT TITLE Amending the PERA Act and the ERA Act **SB**

ANALYST Aubel

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
ERB		Measurable Potential For Reduced Employer Contribution or Reduced Contribution Increase			Recurring	All funds
PERA		Likely Potential for Reduced Employer Contribution or Reduced Contribution Increase			Recurring	All funds/state and municipal
			$40.0	$40.0	Nonrecurring	PERA/ERB

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with House Bill 58, House Bill 251, Senate Bill 87, Senate Bill 88, Senate Bill 204 and Senate Bill 303

Relates to Senate Bill 248, Senate Bill 268 and House Bill 628/HAFCS

SOURCES OF INFORMATION

LFC Files

Responses Received From
Educational Retirement board (ERB)
Public Employees Retirement Association (PERA)
Administrative Office of the Courts (AOC)

SUMMARY

Synopsis of HFL Amendment #1

The Senate Floor amendment #1 exempted PERA "uniformed" employees from the provision in the bill setting a minimum age of 65 to receive the COLA to address concerns regarding the lower longevity rates reported for this employee class. The amendment adds the following employees to be treated like vested employees for when the COLA would start (two calendar years after retirement):

- Peace officers in State General Plan 3;

- Members of the State Police Member and Adult Correctional Officer Plan 1;
- Members of Municipal Police Member Plans 3-5;
- Members of Municipal Fire Plans 3-5;
- Members of Municipal Detention Officer Plan 1; and
- Members of State Hazardous Duty Plan.

The computation of the COLA for non-vested employees in these uniform groups, however, would still be based on the CPI rather than a straight 3 percent.

Synopsis of Original Bill

The House Appropriations and Finance Committee substitute for House Bill 644 amends the Public Employees Retirement Act and the Educational Retirement Act by increasing the age and service requirements for certain non-vested employees and reducing the cost-of-living adjustment (COLA) for all non-vested PERA-qualified pension recipients.

Specifically, new eligibility requirements would apply to non-vested employees under the following plans:

- State General Plan 3: minimum age of 55 with age and service equal to 80;
- Municipal General Plans 1-4: minimum age of 55 with age and service equal to 80; and
- Educational Retirement Act:
  - Tier 1b - non-vested members that entered ERB prior to June 30, 2010: minimum age of 55, Rule of 75; and
  - Tier 2 members – non-vested members who entered ERB after June 30, 2010: minimum age of 55 with age and service equal to 80.

The following PERA non-vested members are exempted from the new age 55 requirement:

- All uniform employees (public safety);
- Peace officers under State General Plan 3;
- Legislative members; and
- Judicial and magistrate plan members.

The new age requirement does not apply to vested members in any plan, as defined by having five or more years of service credit on or before July 1, 2011 for the PERA plans and before July 1, 2011 for ERB. The dates are based on how each plan recognizes service credit. Also, the bill does not affect retirees.

House Bill 644/HAFCS reduces the COLA for all non-vested PERA employees from the automatic 3% beginning two calendar years after retirement to one based on 0.75% of the CPI starting at age 65 with a one-calendar-year retirement requirement. The COLA has a floor of 0% and a cap of 3%.

House Bill 644/HAFCS also adds a new section that allows vested ERB employees to purchase up to one year of service credit as long as the employee pays the actuarial rate within 60 days of being informed of the amount. PERA employees already have this provision.

FISCAL IMPLICATIONS

Pension Solvency and Employer Contributions

The HAFC substitute for HB 644 would most likely improve the funding measures for both ERB and PERA by reducing the liability associated with non-vested members affected by the bill, which also provides the potential for savings to pension plan sponsors by reducing the cost of the plans. The potential seems most significant for the age 55 requirement. In regards to the PERA COLA, prior analysis and testimony suggests that fiscal impact could be measurable for reducing this benefit as proposed, although significantly less than if it was applied to retirees and vested members. At the very least, the bill offers an option to relying solely on contribution increases, as being requested by both plans, as a means of addressing deteriorated funding status. The bill might reduce the need for contribution increases, thereby reducing the employer's obligation.

ERB

ERB provides the following background information regarding the potential actuarial impact of the bill:

> ERB has approximately 17,500 Tier 1 members (members who have entered the plan prior to June 30, 2010) who would not have five years of contributory services as of July 1, 2011. Those Tier 1 "non-vested" members and all Tier 2 members (those who entered the plan after June 30, 2010) would earn the bulk of their retirement benefits under the Minimum Age 55 requirement, which would have a positive effect on the 30-year funding level of the Educational Retirement Fund. Even though the bulk of ERB members are over age 55 when they retire, HB644/HAFCS would eliminate receipt of retirement benefits before age 55 and pension benefits would continue to be reduced based on the age of retirement.

According to the ERB actuarial analysis, imposing the minimum age requirement as proposed under this bill would bring the fund into an 80 percent funding status by 2040, given the following assumptions:

- 1.5% annual increase in the number of active members;
- Average annual investment return of 8%;
- The sunset of the 1.5% employer-employee contribution shift as currently scheduled;
- No additional 1.75% contribution shift for FY12 or FY13; and
- The two 0.75% increments are added to the employer rate as currently scheduled in statute.

Adjusting the analysis to include additional employer-employee contribution shifts for FY12 and FY13 should have a minimal impact. However, lowering the 8% investment assumption to 7.75% or reducing the assumed growth in active employees would significantly impact valuing the unfunded actuarial accrued liability (UAAL—or amount of the pension obligations that remain unfunded). Either assumption change would increase the UAAL, thereby lowering the projected funded ratio (value of assets divided by the value of the liabilities or pension obligations). Thus, more conservative assumptions would reduce the improvement in the projected funded ratio by 2040.

Despite this caveat, the fact that simply implementing the minimum age of 55 for certain employees moves the funded ratio from its current rate of 65.3% to 80.4% by 2040 shows it is a powerful driver for pension funding. Holding all assumptions constant, the bill would have a significant impact to lowering the UAAL over time and might mitigate the need for additional contribution changes beyond those already scheduled. Because it applies only to non-vested and new members, however, it is less likely to actually reduce contribution needs.

PERA

PERA did not present an actuarial analysis covering the impact of the bill. However, a 2009 analysis on moving the PERA COLA to one mirroring the ERB COLA (age 65 and based on CPI) for all PERA members in State General Plan 3 produced a remarkable reduction in the total contribution needed to fund the normal cost (day-to-day accumulation of benefits) plus amortize the UAAL over 30 years.

State General Plan 3 June 30, 2009, COLA Study

	UAAL ($Million)	UAAL% (1)	Normal Cost (2)	Total Contribution (1+2)	Statutory Rate	Short fall
Baseline June 30, 2009	$1,547.7	8.49%	19.65%	28.14%	24.01%	4.13%
Increase/(Decrease) For:						
Current Retirees	($552.6)	(3.03)%	0.00%	(3.03)%		
Current Vested actives	($335.6)	(1.84)%	(1.32)%	(3.16)%		
Current Unvested Actives	($20.2)	(0.11)%	(0.62)%	(0.73)%		
Total Increase/(Decrease)	($908.4)	(4.98)%	(1.94)%	(6.92)%		
Total After Proposal (Based on 30 Year Amortization)	$639.3	3.51%	17.71%	21.22%	24.01%	none

Source: 2009 COLA Actuarial Study

A number of fiscal implications can be inferred from this analysis relevant to this bill.

- The PERA COLA is very expensive. It accounted for almost 60% of the UAAL. Changing it to the ERB COLA for all members would have reduced the normal cost by about 10% and the total contribution needed by about 25%.
- Current retirees accounted for most of the UAAL (36%).
- Vested members accounted for the second largest section of the UAAL (22%).
- Including all members in the COLA reduction would have eliminated the 4.13% shortfall reported at that time, leaving the plan with almost a 3% cushion to hasten the amortization of the UAAL sooner than 30 years.
- Applying the COLA reduction (at that time) to new non-vested members would have reduced the UAAL by 0.11% and the normal cost by 0.62%.

As of June 30, 2010, there were 20,867 active members in State General Plan 3, down from the 22,479 reported as of June 30, 2009. Of the 2010 total, 7,560 had less than five years of service, or 36 percent. Of the 20,584 municipal general plan members, 9,045 members were reported with less than five years of service, or 46 percent. It would seem that the bill would have a significant actuarial impact due to these high percentages. However, as can be seen from the prior analysis, the impact would most likely be fairly small initially because actives and retirees account for most of the plan's cost and UAAL. As with applying any pension reform to new hires, applying the revised COLA to only non-vested members will take time to have a significant actuarial impact. However, the positive impact on the plan would be higher than applying a revised COLA to *only* new hires as an isolated change, and making the change now would start these PERA plans down a firmer road toward improved funding.

The impact of instituting a minimum age of 55 for the proposed members requires an actuarial analysis, although the adequacy study performed for developing PERA's "ideal plan" (Senate Bill 268) included this provision as part of the final recommendations. It is reasonable to assume that the dynamics working under the ERB plan would have a similar impact to the PERA plans under consideration. The ratio of non-vested ERB members of about 28 percent compares with the 36 percent reported for PERA. The implication that the impact could, therefore, be even more pronounced might be offset by the generally higher turnover rate for State General Plan 3.

Operating Impacts to ERB and PERA

PERA notes that it will incur additional operational costs to revise its pension information system, RIO, and has noted a cost of $25 thousand in prior analyses.

ERB notes the same concern but appears to indicate that the costs could be born within its budget:

> In addition, ERB would have to inform the unvested Tier 1 members and the Tier 2 members of the Minimum Age 55 requirement to receive immediate retirement benefits. The ERB anticipates that it would accomplish this by including notices with annual member statements, revising the member handbook (which the agency does periodically in any event), posting notices on the ERB website, mailing e-mail notices to the 190+ ERB employers, sending notices to unions and other groups representing educational employees, including the NEA, AAUP, American Federation of Teachers – New Mexico, and the Albuquerque Teachers Federation, and issuing press releases. In addition, the ERB would have to revise enrollment materials for new Tier 2 members who join after the July 1, 2011 effective date of HB 644cs. A large portion of these costs should be borne out annual budget, but there is a possibility that a BAR might be required to cover a portion of the cost.

SIGNIFICANT ISSUES

The pension solvency measures for both ERB and PERA are below industry standards. The pension plans could be considered unsustainable given current assumptions, contributions and benefit levels, and actuaries project continued deterioration unless action is taken to address the shortfall in the funding status.

As of June 30, 2010	Funded Ratio	Funding Period	Unfunded Liabilities
Educational Retirement board (ERB)	65.7%↓	62.5 years ↓	$4.9 billion ↑
Public Employees Retirement Association (PERA)-combined plans	78.5%↓	Infinite↓	$3.4 billion ↑
Minimum Industry Standards	80%	30 years	

Source: Pension Actuarial Reports

To address the pension solvency issues recorded by PERA and ERB, the Legislature has two options:

1) Increase contributions or
2) Reduce the value of the pension obligations.

$$\textbf{(I)nvestments} + \underbrace{\textbf{(C)ontributions}\uparrow}_{} \overset{(1)\uparrow}{} < \overset{(2)\downarrow}{\textbf{(B)enefits}\downarrow} + \textbf{(A)dministrative Expenses}$$

Reducing pension obligations entails benefit plan changes; this is called pension reform. The HAFC substitute for HB 644 is a pension reform bill that looks to reduce the cost of the benefit plans and make them sustainable as defined by the ability and willingness of plan sponsors to make the pension contributions. By introducing a minimum age and reduced COLA, the bill tracks with similar legislation passed in other states to improve the deteriorated funding status for pension plans in the face of states' impaired ability to increase contributions due to the economic recession.

A core issue is the plans, particularly the PERA plans, with their current eligibility requirements and pension formulas, are extremely expensive. As defined by how much the "normal cost" or day-to-day value of each employee's earned benefit, PERA ranks at the top of comparable plans for all five divisions (see Attachment A.)

The question of whether the plans align with demographic trends, such as people living longer, is also important. Laws 2009, Chapter 288, increased the required years of service from 25 years to 30 years for non-uniform members for new hires as of July 1, 2010. This bill supplants that legislation. The new eligibility requirements are applied according to those members who remain unvested after July 1, 2011. Vesting occurs at five years of service for both plans.

Requiring non-vested members to work until they are 55 will most likely have a secondary positive actuarial impact for the Retiree Health Care Authority (RHCA) because some retirees – who might have retired prior to age 55 – would have to wait until they met the new minimum age and service requirements. This would reduce the number of years in RHCA before qualifying for Medicare. In addition, the likelihood of carrying dependents for any length of time on the RHCA system after age 55 is also reduced.

ERB

For ERB the bill would create the following tiers of members:

<u>Tier 1: ERB Member Prior to June 30, 2010</u>

- Tier 1a for vested employees, where retirement eligibility remains at the Rule of 75 (combination of age and service equals 75) or any age with 25 years; and
- Tier 1b for non-vested employees, where the new age minimum age 55 would apply to the Rule of 75, creating a "modified Rule of 75."

The combination of age 65 and five years of service eligibility remains for both Tier 1a and 1b members. Also, the bill retains ERB's "early retirement" pension reductions of 0.6 of 1% for each one fourth of a year, or portion thereof (2.4%/year), for retiring before age 60 and by an additional 1.8% for each one fourth year, or portion thereof (7.2%/year), prior to age 55. Tier 1a ERB members who are vested can still retire at any age under a "25 and out" provision, whereby members would be considered to be age 60 (regardless of actual age) and would not be subject to the benefit reductions.

Tier 2: ERB Member After June 30, 2010
Members who joined ERB after June 30, 2010, or who had refunded all member contributions, are considered in a Tier 2. These members can retire under two provisions:

- Age 67 and five years or more of earned service credit; and
- A modified "Rule of 80", where the member has to be at least age 55 with age and service credit equal to 80.
- The "early retirement" reductions are modified as follows: For Tier 2, benefits of members retiring below age 65 are reduced by 0.6% per quarter or part thereof for each quarter they retire before Age 65 (2.4%/year), and by 1.8% per quarter or part thereof for each quarter that they retire before age 60 (7.2%/year) Laws 2009, Chapter 288 moved the age reduction factors up for Tier 2 members from 55 and 60 to 60 and 65, which would not be changed by this bill (Section 22-11-30 (H) NMSA 1978).

ERB provides a summary of the remaining two provisions in the bill:

Deferred Retirement. HB 644 would continue the deferred retirement provisions in Sec. 22-11-27, amending the section so that the Minimum Age 55 requirement clearly applies. Under deferred retirement, ERB members who stop working and leave their member contributions in the Educational Retirement Fund, can begin receiving benefits when they meet Tier 1 and Tier 2 retirement eligibility requirements.

Purchase of Service Credit or "Air Time." HB 644 would allow ERB members to purchase up to one year of service credit, in calendar quarter increments, at any time prior to retirement, provided that the member has at least five years of service credit as the result of employment by a local administrative unit (a/k/a, earned service credit). The member would have to pay the full actuarial present value of the increase in the member's pension as a consequence of the purchase within sixty days of being informed of the cost of the purchase. The service credit purchased could be treated as earned service credit for the purposes of determining eligibility for retirement or disability benefits, but could not be used to determine the member's final average salary for purposes of determining pension benefits.

PERA members currently have the ability to purchase up to one year of "air time," service credit that is not associated with actual work time. The bill would allow ERB members to do the same. While the calculation is meant to be cost-neutral to the plan, this provision should more appropriately be considered a plan enhancement rather than a pension reform change that would encourage members to work longer.

PERA-State and Municipal General Plans
Tier 1 would keep current eligibility requirements for vested employees in State General Plan 3 and the four Municipal General plans. The new Tier 2 eligibility requirement for non-vested employees in these plans would be age 55 years or older and at least 25 years of service credit (Rule of 80). Note that peace officers in State General Plan 3, as defined in the bill, would not be subject to this minimum age requirement. The bill retains the various combinations of age and service available for those over 60 for Tier 1 employees. For Tier 2 employees, the bill retains the ability to retire at age 67 with five or more years of service credit in addition to the minimum age 55 and Rule of 80.

Minimum Age Requirements

The bill would increase the disparity for PERA members between non-uniform members, which would have a minimum age 55 requirement, and uniform members, which would not. New Mexico is one of the few states that do not have a minimum age requirement for all public employees. Other states that have already implemented a minimum age requirement and have raised it in the last couple of years to address pension solvency include the following:

California: raised from age 55 to 60 for most employees
Colorado: raised from 55 to 60 for future retires
Illinois: raised from 60 to 67 for new employees (the highest of any state)
Montana: raised from 60 to 65
Rhode Island: from 60 to 62 for new hires
Under Senate Bill 268, PERA's proposed "ideal" plans for new hires in both uniform and non-uniform plans proposes a minimum age of 55 for non-uniform and 50 for uniform members. Both minimum ages remain below many states age requirements.

Cost-of-living Adjustment

PERA provides a summary of the bill's changes to the PERA COLA:

- Reduces the cost-of-living adjustment (COLA) for retirees from 3% each July 1st and instead provides a COLA increase equal to three-fourths of the percentage increase in the consumer price index (CPI) between the next preceding calendar year and the preceding calendar year; Provides for a maximum COLA of 3%; pensions are not reduced in the event of a decrease in the CPI;
- Delays receipt of COLAs by defining "qualified pension recipient" as a normal retirement member who has reached age 65 and has been retired for one full calendar year; and
- Applies to all qualified pension recipients not vested on or before July 1, 2011, including current PERA, Judicial Retirement Act (JRA), Magistrate Retirement Act (MRA) and Legislator plan members.

As seen in the fiscal impact section, the PERA COLA is one of the most expensive parts of the pension, allowing a compounded 3 percent regardless of age or inflation, once the two-calendar-year period is met. Attachment B shows the impact of moving the PERA COLA to one more like the ERB COLA, which starts at age 65. The analysis, completed in 2009, would have completely eliminated the funding shortage that has grown since that report and will continue to compound unless addressed. It is that shortfall in the amount needed to amortize the unfunded liability over a reasonable period (30 years is standard) that has prompted PERA (and ERB) to request higher contribution rates. PERA is requesting 8 percent over four years, split 1/3 employee and 2/3's employer. ERB is requesting another 2 percent over its current total statutory rates.

Impact of Non-Action in Addressing Pension Funding Issues

In light of the state's budget constraints, the use of employer-employee contribution shifts to meet budget shortfalls, and the lack of salary increases, it is unlikely that employees or employers are readily able to pay more into the plans. Due to the compounding nature of the UAAL, absent continued outstanding investment returns, the plans will likely continue to deteriorate without taking any action to address the funding status.

Another way to look at this issue is that the cost of cost of doing nothing, neither increasing contribution rates nor implementing pension reform, goes up with time. The table below, provided by PERA's actuaries, shows the impact of not doing anything to address pension funding for the five plans for which PERA is requesting additional contributions (Senate Bill 87) over the next four years. Under current assumptions and plan structures, the additional cost of paying off the added UAAL accruing due to non-action totals over $1 billion.

Impact of Waiting Four Years to Address Pension Funding

	Additional UAAL (in millions)	Additional % of Payroll to Pay Extra UAAL over 30 Years	Sum of Additional Payments (in millions)
2011	$19.0	0.11%	$61.0
2012	$60.0	0.35%	$199.0
2013	$126.0	0.71%	$430.0
2014	$222.0	1.23%	$774.0
2015	$329.0	1.79%	$1,177.0

Source: PERA

Protection of Pension Benefits as a Property Right

The policy issue is whether to place pension solvency entirely on the employer and non-vested and future employees, leaving the vested employees and retirees with no participation in shoring up the plans, or whether to foster the concept of "shared sacrifice" that is prompting other legislation in other states, such as Colorado. South Dakota, Colorado and Wisconsin enacted legislation that impacted current employees and also retirees—such as reducing the cost of living adjustment (COLA). Lawsuits filed in these states are being closely watched for how courts will view pension rights.

Selected COLA Changes – 2010

	From	To	Members
Colorado PERA	3.5% per year	Lesser of 2.0% CPI of negative return in last 3 years, with funded ratio rules	All members
Illinois	3.0% per year	Lesser of 3.0% per year or 50% of CPI	New members on or after January 1, 2011
South Dakota RS	3.1% per year	3.1% if funded ratio (FR)>90%, 2.6% if 90%, 2.6% if FR between 80%-90%,2.1% if FR<60%	All members

Source: Buck Consultants

The primary issue is that the New Mexico Constitution (Article XX, Section 22) states that vested employees acquire a property right to pensions. However, the Legislature might have some flexibility to alter benefits given the additional language contained in Article XX, Section 22 (E) that states that "Nothing in this section shall be construed to prohibit modifications to retirement plans that either enhance or preserve the actuarial soundness of an affected trust fund or individual retirement plan."

ERB comments on this issue, as follows:

> Tier 1 ERB members who are not "vested" as of July 1, 2011 (do not have five years of contributory employment) might object to HB 644's modification of retirement eligibility requirements as a violation of a right in their pension benefits. However, the provisions of Subsection D of Section 22, Article XX of the New Mexico Constitution do not provide members would not have met the minimum service requirement of a state pension plan to be eligible for retirement benefits. As neither the New Mexico Constitution nor statute protect pension rights until member has met the minimum service requirements of a given pension plan, it would be difficult for such an objection to a change in retirement eligibility requirements to prevail.

Policy Issue of Fairness

Even though the Constitution does not grant non-vested members a property right to pension benefits, undoubtedly the issue of fairness arises where employees in both tiers are paying the same contribution rates for various levels of benefits. In this case, the 3% COLA is a significant benefit reduction, particularly because the Tier 2 employees will have to wait until age 65 and have one calendar year of being retired to begin the COLA while a Tier 1 retiree waits only two calendar years at any age. PERA expands upon this point:

> Reducing and delaying the receipt of a COLA increase for non-vested members is a significant reduction from the existing COLA benefit provided to PERA members. HAFC Sub/HB 644 has no commensurate adjustment of statutory contribution rates for the affected members. Essentially non-vested members will pay the same contribution rates as their vested coworkers for a reduced benefit. COLA reduction under the bill will affect all non-vested PERA, JRA, MRA and LE members. As a result, municipal police and fire members, whose average retirement ages are 48 and 46 years of age respectively, will be required to wait 18+ years to first begin receiving a COLA increase. It is assumed that the loss of purchasing power of such pension recipients will be substantially pared.

However, members who retire at a relatively young age could have second careers, receiving a pension that compounds every year by 3 percent as well as a second salary. Based on PERA demographics, for a 2009-2010 retiree, the 3 percent COLA would about double the average monthly pension from $2,335 to $4,747 over her expected lifetime. Raising the COLA to age 65 aligns with the primary intent of preserving the purchasing power of the retiree rather than providing a final pension greater than the original salary. It is important to note, however, that the demographic profile for ERB members varies significantly from some PERA plan members, particularly for those under public safety plans. ERB members, on average live 2 years longer than State General Plan 3 members, with an average age of 81 for men and almost 85 for women. According to the International Association of Fire Fighters Mortality Study, fire fighters/fire paramedic life expectancy is between 52 and 63 years of age. A mortality study has been proposed for New Mexico's fire fighters to see how they compare to this national average.

A final concern regarding fairness arises from changing the pension structure "mid-stream" for non-vested employees, even if legally viable. Having different pensions for similar employees challenges the concept of equal treatment.

ADMINISTRATIVE IMPLICATIONS

Most likely the bill would have similar administrative impacts as PERA indicated in its analysis for HB 251, as follows:

- PERA will incur operating costs related to printing, postage and dissemination of information associated with implementing the new retirement eligibility and the reduced COLA benefits. In addition, PERA will require increased staff utilization to review age and service requirements, COLA calculations and 1099 reporting will require revisions to PERA's pension administration system ("RIO"). PERA will be required to seek a BAR to cover the costs of these system changes.

A significant administrative impact to PERA that was not inherent in House Bill 251 is the "tiering" of PERA plans—the bill would set up additional plans for State General Plan 3, and the four Municipal General Plans to account for the new vested and non-vested rules. In addition, another tier of plans could arise under the "ideal plans" as proposed by SB 268. Perhaps the bills would be reconciled.

Although the bill has pulled vested members from benefit changes, it is still conceivable that the pension changes for non-vested members will lead to litigation.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 644/HAFCS might conflict with the bills calling for contribution increases (HB 58, SB 87 and SB 88) because a reduction in the COLA may mitigate or eliminate the need to increase contributions.

House Bill 644/HAFCS might also conflict with HB 51, which also proposes reduced COLA and increased age and service requirements for ERB and PERA.

House Bill 644/HAFCS, while similar in intent to Senate Bill 204 that also addresses PERA's COLA, the terms are slightly different. SB204 does not impose a minimum age for receiving the COLA, just the change to a CPI-based model.
House Bill 644/HAFCS relates to SB 248 and HB 628/HAFCS, which reduce the employer's burden for pension contributions due to state solvency concerns.

House Bill 644/HAFCS relates to PERA's "ideal" plan that uses a similar CPI-based COLA formula as part of its new proposed plan packages for new hires that reduce both plan benefits and plan costs. That bill also imposes minimum age requirements.

OTHER SUBSTANTIVE ISSUES

Pension Sustainability

Pension sustainability has been defined by Girard Miller, an industry expert, as the ability and willingness of pension sponsors to make contributions into the plans. Due to the recession, the state and municipal plan sponsors have seen a reduction in revenues to support contributions. State solvency measures in 2009 and 2010 partially depended on reducing the burden for state employers by shifting 1.5 percent of the employer contributions to the employee and delaying the ERB 0.75 percent employer increase by one year.

Given the projected budget deficit of at least $215 million for FY12 and reduced revenue projections for the foreseeable future as the economy recovers, it is questionable whether the sponsors have both the "ability and willingness" to support the plan benefits as currently structured in a sustainable manner. This bill would help address pension sustainability though pension reform rather than contribution increases.

PERA "Ideal" Plans

PERA remains concerned that the bill does not address pension reform for other PERA plans, as follows:

> HAFC Substitute for HB 644 does not address any changes to the 20-year retirement eligibility for municipal police and firefighters. As of June 30, 2010, the Municipal Police Division is funded at 80.1% and the financing period for its unfunded actuarial accrued liability (UAAL) based on current statutory contribution rates is an infinite period. The UAAL is $391.5 million. A 7.49% contribution increase to the annual statutory amount is needed to amortize the UAAL over a 30-year period. The story is worse for the Municipal Fire Division. As of June 30, 2010, it is funded at 68% and the financing period for its UAAL is an infinite period. The UAAL increased from $268 million to $360.6 million. An 11.04% contribution increase to the annual statutory amount is needed to amortize the UAAL over a 30-year period. The existing benefit structure for the Municipal Fire Division is unsustainable without substantive modifications to the benefit structure provided under the fire plans.

PERA maintains that it has acted on legislative direction to address the funding shortfall of the PERA retirement plans and to provide solution by sponsoring SB 268, which PERA notes still provides "a better retirement plan than most state public pensions are currently providing."

For comparison purposes, PERA's summary of its "ideal" plans is provided below.

> The PERA Board supports SB 268, the "Ideal Plan." The proposed Ideal Plan will provide a generous retirement plan for employees hired after June 30, 2011, with benefits and rates based on covering the long-term cost of the proposed plan. The new Ideal Plan is *actuarially sound* and *reduces the overall cost of benefits* because:
>
> - ✓ Pension factors are *reduced*.
> - ✓ Age and service credit for retirement eligibility are *increased*.
> - ✓ Total contribution amounts are calculated at 1/3 employee and 2/3 employer split.
> - ✓ The cost-of-living adjustment (COLA) is calculated tied to the Consumer Price Index, reflecting economic activity.

State and Municipal General Members (Non-uniformed)

- Retirement with 30 years of service credit with a minimum age of 55;
- Rule of 85 (age + years of service = 85) eligibility;
- Cost-of-living adjustment (COLA) based on three-fourths percent of the consumer price index (CPI) with a 0% floor and a 3% cap; and
- Two retirement-plan options for smaller municipalities to choose from.

State and Municipal Public Safety Members (Uniformed Police and Firefighters)

- Retirement with 25 years of service credit with a minimum age of 50;
- Rule of 80 (age 55 + years of service = 80) eligibility;
- Cost-of-living adjustment (COLA) based on three-fourths percent of the consumer price index (CPI) with a 0% floor and a 3% cap; and
- Two retirement-plan options for smaller municipalities to choose from.

3% COLA STARTED IN 1992

PERA provides a history of the COLA in a February 4, 2004 memo:

> Until 1992, the PERA Act's cost-of-living provisions contained an "adjustment factor," which reflected the change in the consumer price index (CPI), with a minimum and maximum range for any year. Calculation of the adjustment factor varied from year to year, but typically was determined by dividing the CPI for the preceding year by the CPI for the next preceding calendar year, with the result being rounded to three decimals. In 1992, the PERA Act was amended to remove all reference to the CPI and provided for a fixed-rate COLA at 3%.

Thus, at this time there is no retiree who paid into PERA the full cost of the 3 percent COLA. At most, a recent retiree paid in 19 years.

In this memo, PERA provided a comparison of the impact of changing from a CPI-based COLA to the 3 percent COLA, indicating that at the end of the 10-year period from 1994 to 2004, "the annual 3 percent COLA gives the member a monthly benefit that is 6.2% higher than if the COLA was based directly off the CUI-U" (CPI-Urban). Thus, it is assumed that the cost of the 3 percent COLA is higher than the one in place prior to its adoption. Furthermore, it is questionable that all pension factors are being properly priced given the 8 percent discount factor. Some consider this value projected for investment returns as being overly optimistic.

The recent inflation rate, as measured by the Consumer Price Index, has been:

Year Ended June 30					Average for		
2009	2008	2007	2006	2005	Last 5 Yrs	Last 10 Yrs	Last 30 Yrs
(1.4%)	5.0%	2.7%	4.3%	2.5%	2.6%	2.6%	3.7%

Membership Data

Current benefits allow most current employees to work for 25 years and retire, which no longer aligns with demographics where people are living longer and drawing a pension longer. The tables below provide snapshots of PERA and ERB members as of June 30, 2010.

PERA MEMBERSHIP DATA – STATE GENERAL PLAN
(Dollars in millions)

STATE GENERAL PLAN	2000	2010	Change
Active Members	20,108	20,867	3.6%
Retired Members	8,089	12,981	37.7%
Ratio of Active/Retired	2.5/1	1.6/1	Ratio is declining
Employer Payroll	$607.4	$866.1	29.9%
Retiree Payroll	$133.1	$313.4	57.5%
Total Contributions	$143	$248.4	42.4%
Average age at retirement State General* State Police/Corrections		 57.91* 48.67	
Longevity Expectations* Men Women		At average retirement* 81.32 84.78	

ERB MEMBERSHIP DATA
(Dollars in millions)

	2000	2010	Change
Active Members	60,090	63,297	5.3%
Retired Members	21,186	33,749	59.3%
Ratio of Active/Retired	2.8 active/1 retired	1.9 active/1 retired	Ratio is declining
Employer Payroll	$1,795.7	$2,902.7	61.6%
Retiree Payroll	$312.2	$659.3	111.2%
Total Contributions	$295.9	$560.9	89.6%
Average age at retirement	59	59	0%
Longevity Expectations			
Men	82.8	83.7	3.8%
Women	85.8	86.7	3.4%

ALTERNATIVES

One option would be to simply add the non-vested PERA members to the "ideal plans" proposed by SB 268. The actuarial impact would likely be greater than applying just a minimum age of 55 and a COLA reduction to that group as proposed by this bill, although SB 268 does not impose a COLA threshold age of 65. Because the employee contribution is less, this would address the inequity currently inherent in this bill. Another option that might be more achievable, although producing less of an actuarial impact, would be to add those new members coming into PERA after June 30, 2010 on the basis that these members were aware of potential for pension reform.

Another alternative that would ensure the legislative intent to address pension solvency was clearly articulated as allowed under the Constitution would be to tie the COLA change to a solvency metric and/or investment returns, such as those put in place in for Colorado and South Dakota, and apply it to all PERA members.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

The pension plans will continue to show a deteriorated funding status absent other actions to reduce the liabilities or increase contributions, holding all other factors constant.

MA/mew:svb:bym

COMPARISON OF PERA BENEFITS TO COMPARABLE PLANS

Normal Retirement Benefit			
PERA	Non-Uniform	Eligibility	Any age with 25 or more years of service; or age 60 with 20 years; or age 61 with 17 years; or age 62 with 14 years; or age 63 with 11 years; or age 64 with 8 years; or age 65 with 5 years. For State General and Muncipal General (Plans 1-4) members hired after June 30, 2010: Age 67 with 5 years of service; Rule of 80; or any age with 30 years of service.
		Benefit	3.00% x FAS x credited service. Maximum Benefit: 80% of FAS
	Uniform (Municipal)	Eligibility	Any age with 20 or more years of service; or age 60 with 20 years; or age 61 with 17 years; or age 62 with 14 years; or age 63 with 11 years; or age 64 with 8 years; or age 65 with 5 years.
		Benefit	3.50% x FAS x credited service. Maximum Benefit: 80% of FAS
	State Police	Eligibility	Any age with 25 or more years of service; or age 60 with 20 years; or age 61 with 17 years; or age 62 with 14 years; or age 63 with 11 years; or age 64 with 8 years; or age 65 with 5 years.
		Benefit	3.00% x FAS x credited service. Maximum Benefit: 80% of FAS. Members receive 1.2 years of service credit for each year of service rendered.
Hawaii Employees Retirement System	Non-Uniform	Eligibility	Contributory: Age 55 with 5 years of service. Non-Contributory: Age 62 with 10 years of service; or age 55 with 30 years of service. Hybrid: Age 62 with 5 years of service; or age 55 with 30 years of service.
		Benefit	Contributory: 2.0% x FAS x credited service. Non-Contributory: 1.25% x FAS x credited service. Hybrid: 2.0% x FAS x credited service (with non-contributory service at 1.25%).
	Uniform	Eligibility	Age 55 with 5 years of service; or any age with 25 years of service.
		Benefit	2.5% x FAS x service. Maximum Benefit: 80% of FAS.
Iowa Public Employees Retirement System	Non-Uniform	Eligibility	Age 65 regardless of service; or age 62 with 20 years of service; or Rule of 88 with a minimum age of 55.
		Benefit	2.0% of FAS to 30 years + 1.0% for 5 years. Maximum Benefit: 65% of FAS.
	Uniform	Eligibility	Police: Age 55 regardless of service; or age 50 with 22 years of service. Fire: Age 55 regardless of service.
		Benefit	60% of FAS after completion of 22 years of service + 1.5% for years greater than 22 years. Maximum Benefit: 72% of FAS.
New Hampshire Retirement System	Non-Uniform	Eligibility	Age 60 regardless of service.
		Benefit	Prior to age 65, 1.67% x FAS x service. After age 65, 1.52% x FAS x service. Maximum Benefit: 100% of FAS or $120,000.
	Uniform	Eligibility	Age 45 with 20 years of service; or age 60 regardless of service.
		Benefit	2.50% x FAS x service. Maximum Benefit: 100% of FAS or $120,000.
Utah Retirement System	Non-Uniform	Eligibility	Age 65 with 4 years of service; or 30 years of service regardless of age.
		Benefit	Non-Contributory: 2.0% x FAS x service.
	Uniform	Eligibility	Age 65 with 4 years of service; or age 60 with 10 years of service; or any age with 20 years of service.
		Benefit	2.5% x FAS x service up to 20 years + 2.0% x FAS x service over 20 years. Maximum Benefit: 70% of FAS.
Wyoming Retirement System	Non-Uniform	Eligibility	Age 60 with 4 years of service; or Rule of 85.
		Benefit	2.125% x highest average salary x service to 15 years + 2.25% x highest average salary x service over 15 years.
	Uniform	Eligibility	Municipal Police: Age 60 with 4 years of service; or 20 years of service regardless of age. State Highway Patrol: Age 50 with 6 years of service. Fire: Age 50 with 4 years of service.
		Benefit	State Police / Municipal Police: 2.5% x highest average salary x service. Maximum Benefit: 75% of FAS. Fire: 2.8% for first 25 years of service. Maximum Benefit: 70% of FAS.

NEW MEXICO PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION
SUPPLEMENTAL VALUATION REPORT AS OF JUNE 30, 2009
COST-OF-LIVING ADJUSTMENT ACTUARIAL STUDY

reduces the normal cost - wd allow more $ to go toward UAAL - wd be under 30 yrs.

Actuarial Statement

The estimated impact on PERA system costs for the **State General** Division is illustrated below:

	UAAL ($Mill)	30 UAAL %	Normal Cost %	Total Contribution %	Statutory Rate	Short Fall
Total Prior to Proposal (Based on 30 yr amort)	$ 1,547.7	**8.49%**	**19.65%**	**28.14%**	**24.01%**	**4.13%**
Increase/(Decrease) For						
Current Retirees	$ (552.6)	(3.03)%	0.00%	(3.03)%		
Current Actives with 5 or More Years of Service	$ (335.6)	(1.84)%	(1.32)%	(3.16)%		
Current Actives with Less Than 5 Years of Service	$ (20.2)	(0.11)%	(0.62)%	(0.73)%		
Total Increase/(Decrease)	$ (908.4)	(4.98)%	(1.94)%	(6.92)%		
Total After Proposal (based on 30 yr amort)	$ 639.3	3.51%	17.71%	21.22%	24.01%	none

ARC

almost double what need.

wd be even less than 30 yrs

Comments:

1. If the proposal applied only to new hires, then the normal cost would decrease gradually over the next 20 years. The ultimate reduction in normal cost (once all the current active members have been replaced) would be approximately 1.65% of payroll (there would be no change in the unfunded accrued liability as a result of changing benefits for new hires only). 18%
2. Percents shown are percent of payroll for the division of $935,865,642.
3. If the change had been made to the plan as of June 30, 2009 and applied to ALL members, the amortization period as of June 30, 2009 would have been 22 years, presuming no change in the statutory contribution rate.
4. UAAL = Unfunded Actuarial Accrued Liability.
5. The shortfall is the amount of additional contributions necessary to meet the Board funding objective of 30-year financing. "None" means that the current statutory contributions result in a financing period less than or equal to 30 years.