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

SPONSOR Munoz **ORIGINAL DATE** 01/25/11 **LAST UPDATED** **HB**

SHORT TITLE Judicial Employee Retirement Contribution **SB** 88

ANALYST Aubel

REVENUE (dollars in thousands)*

Estimated Revenue				Recurring or Non-Rec	Fund Affected
FY12	FY13	FY14	FY15**		
$260.8 - $273.2	$521.7 - $546.4	$782.5 - $819.7	$1,043.4 - $1,092.9	Recurring**	PERA- Judicial
$70.4 - $74.8	$140.8 - $149.7	$211.2 - $224.4	$281.6 - $299.3	Recurring**	PERA-Magistrate

* Each 2% increment would generate recurring revenue between $261 thousand and $273 thousand for JRA and between $70 thousand and $75 thousand for MRA.
**The final recurring revenue from FY15 going forward would be just over $1 million for JRA and around $300 thousand for MRA.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY12	FY13	FY14	FY15**	4 Year Total Cost	Recurring or Non-Rec	Fund Affected
Employer Contribution Increase - JRA	$173.9 - $182.1	$347.8 - $364.3	$521.7 - $546.4	$695.6 - $728.6	$1,738.9 to $1,821.5	Recurring**	General Fund
Employer Contribution Increase - JRA	$46.9 - $49.9	$93.9 – $99.8	$140.8 - $149.6	$187.7 – $199.5	$469.3 - $498.8	Recurring**	General Fund
RIO	$25.0					Non-Rec	JRA/MRA

*Each increment equates to between $174 thousand and $182 thousand general fund for JRA and between $47 thousand and $50 thousand for MRA.
**The recurring amount from FY15 going forward would be around $700 thousand for JRA and about $200 thousand for MRA.

Relates to Senate Bill 87 and House Bill 58
May conflict with Senate Bill 204

Senate Bill 88 is sponsored by the Investment Oversight Committee.

SOURCES OF INFORMATION
LFC Files

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

SUMMARY

Synopsis of Bill

Senate Bill 88 amends both the Judicial Retirement Act (JRA) and the Magistrate Retirement Act (MRA) to increase the statutory contribution rates to address actuarial concerns regarding plan solvency.

Senate Bill 88 (SB88) incrementally increases the total statutory contribution rate for each plan by 2 percent per year for four consecutive years (total of 8 percent) beginning July 1, 2011 (FY12-FY15). SB88 allocates each 2 percent annual statutory contribution increase one-third to the employee rate and two-thirds to the employer contribution rate, which equates to an annual increase of 0.67 percent to the employee and 1.33 percent to the employer. By FY15, the overall employee contribution rate for both plans will increase from the FY12 statutory rate of 7.5 percent of salary to 10.17 percent. The JRA employer rate will increase from the FY12 statutory rate of 12 percent to 17.33 percent, and the MRA employer rate will increase from 11 percent to 16.33 percent.

FISCAL IMPLICATIONS

Senate Bill 88 increases the employer and employee contribution rates according to the following schedule:

Table 1 – Rate Increase Schedule

	Current Statute	SB88 Judicial				
	FY12	FY12	FY13	FY14	FY15	FY12-FY15 Change
Employer	12.00%	13.33%	14.66%	15.99%	17.33%	5.33%
Employee	7.50%	8.17%	8.84%	9.51%	10.17%	2.67%
Total Contribution	**19.50%**	**21.50%**	**23.50%**	**25.50%**	**27.50%**	
Incremental Increase		2%	2%	2%	2%	8%

	Current Statute	SB88 Magistrate				
	FY12	FY12	FY13	FY14	FY15	FY12-FY15 Change
Employer	11.00%	12.33%	13.66%	14.99%	16.33%	5.33%
Employee	7.50%	8.17%	8.84%	9.51%	10.17%	2.67%
Total Contribution	**18.50%**	**20.50%**	**22.50%**	**24.50%**	**26.50%**	
Incremental Increase		2%	2%	2%	2%	8%

Revenue

Each 2 percent incremental increase represents additional recurring revenue to the JRA and MRA pension plans.

Based on the June 30, 2010 valuation reported FY10 payroll of $13 million for JRA and $3.5 million for the MRA, the first 2 percent increment will generate additional recurring revenue streams of $260.8 thousand for JRA and $70.4 thousand for MRA.

Table 2 – Cumulative Revenue Impact to JRA and MRA

JRA

	FY12	FY13	FY14	FY15
FY12	$ 260,839.60	$ 260,839.60	$ 260,839.60	$ 260,839.60
FY13		$ 260,839.60	$ 260,839.60	$ 260,839.60
FY14		$ 521,679.20	$ 260,839.60	$ 260,839.60
FY15			$ 782,518.80	$ 260,839.60
	Total Added Revenue Going Forward			$ 1,043,358.40
	Cumulative Revenue Added Over 4 Years			$ 2,608,396.00

MRA

	FY12	FY13	FY14	FY15
FY12	$ 70,391.40	$ 70,391.40	$ 70,391.40	$ 70,391.40
FY13		$ 70,391.40	$ 70,391.40	$ 70,391.40
FY14		$ 140,782.80	$ 70,391.40	$ 70,391.40
FY15			$ 211,174.20	$ 70,391.40
	Total Added Revenue Going Forward			$ 281,565.60
	Cumulative Revenue Added Over 4 Years			$ 703,914.00

The revenue generated by each 2 percent increment according to the AOC analysis is slightly higher at $273.2 thousand for JRA and $74.8 thousand for MRA. The AOC analysis assumes the full complement of participating judges and magistrates at all times in the plans. Thus, the AOC numbers produce the upper range in the fiscal tables.

The recurring annual revenue from FY15 going forward for JRA will be about 1 million under this bill, with the cumulative revenue over the four years totaling $2.6 million. The additional annual revenue from FY15 going forward for MRA will be about 281.6 thousand under this bill, with the estimated cumulative revenue over the four years totaling $703.9 thousand.

Employer Contributions

Each 1.33 percent annual employer rate increases equates to about $174 thousand general fund appropriation for the JRA and $47 thousand for the MRA. These contributions are recurring. By FY15, they will aggregate to a final added $695.6 thousand for JRA and $187.7 thousand for MRA. The bill does not appropriate general fund to the courts to pay for the increased contributions.

Table 3 - Cumulative Fiscal Impact for Employers (General Fund)

JRA

	FY12	FY13	FY14	FY15
FY12	$ 173,893.07	$ 173,893.07	$ 173,893.07	$ 173,893.07
FY13		$ 173,893.07	$ 173,893.07	$ 173,893.07
FY14		$ 347,786.13	$ 173,893.07	$ 173,893.07
FY15			$ 521,679.20	$ 173,893.07
	Total Added Contribution Going Forward			$ 695,572.27
	Total Value of Contribution Increases Over 4 Years			$ 1,738,930.67
AOC	$182,148	$364,296	$546,444	$728,592

MRA

	FY12	FY13	FY14	FY15
FY12	$ 46,927.60	$ 46,927.60	$ 46,927.60	$ 46,927.60
FY13		$ 46,927.60	$ 46,927.60	$ 46,927.60
FY14		$ 93,855.20	$ 46,927.60	$ 46,927.60
FY15			$ 140,782.80	$ 46,927.60
	Total Added Contribution Going Forward			$ 187,710.40
	Total Value of Contribution Increases Over 4 Years			$ 469,276.00
AOC	$49,877	$99,755	$149,632	$199,509

SIGNIFICANT ISSUES

Note: Actuarial projections use various assumptions, such as the anticipated return on investment of 8 percent. All fiscal implications related to pension solvency assume experience meeting these actuarial assumptions as well as all actuarial assumptions holding constant.

The Judicial Plan covers Metropolitan judges and all judges of the district courts and justices of the Supreme Court and Court of Appeals. The June 30, 2010 valuation reports 121 active members in the Judicial Plan and 46 active members in the Magistrate Plan. Retirees total 110 and 69, respectively. As of June 30, 2010, the average normal retirement pension was $64.8 thousand for JRA and $45.1 thousand for MRA.

Pension Solvency

Senate Bill 88 is a pension solvency measure endorsed by the Investments Oversight Committee. For a sustainable fund, contribution rates must cover the normal cost associated with members as well as pay off any unfunded liabilities (also called the unfunded accrued actuarial liabilities or UAAL). The time to amortize any UAAL, called the funding period, should be 30 years or less according to the Governmental Accounting Standards Board (GASB). In addition, the industry standard for the ratio of assets to liabilities sets a minimum of 80 percent, with an increasing trend. The JRA and MRA solvency indicators, noted in the table below, do not meet these basic metrics. An infinite funding period means, given current contribution rates and all assumptions holding, the UAAL would never be paid off.

The June 30, 2010 valuation shows both plans fail another key solvency test: neither have assets sufficient to cover the projected cost of current retirees.

Table 4 – Solvency Indicators

As of June 30, 2010	JRA	Trend	MRA	Trend
Funded Ratio (Assets/Liabilities)	61.20%	↓	65.80%	↓
Funding Period	Infinite	↓	Infinite	↓
UAAL	$51.8 mil	↑	$18 mil	↑
Value of Assets/Value of Pensions for Current Retirees, Survivors and Inactive Members	84.70%		83.60%	

Contribution Rates and Pension Solvency

Contributions for JRA and MRA are derived from three sources: employees, employers and docket fees. Table 2 compares the current FY12 statutory structure of these contributions to those computed by PERA's actuaries needed to fund the normal cost and amortize the UAAL over thirty years (Actuarial Required Contribution or ARC). The JRA and MRA have contribution shortfalls of -14 percent and -29 percent, respectively.

Table 2 – Actuarial Required Contribution (ARC)

As a % of Payroll	JRA	MRA
Normal Cost	31.92%	32.60%
Amortize UAAL*	19.87%	26.29%
Total (ARC)	51.80%	58.89%
Expected Contribution Rates	JRA	MRA
Employer	12%	11%
Employee	7.50%	7.50%
Docket Fees	18.34%	11.55%
Total	37.8%	30.05%
Shortfall	**-13.96%**	**-28.84%**

*Over 30 years

The contribution schedule proposed by SB88 is the maximum under PERA policy. The actuaries note that the 8 percent contribution increase proposed by this bill will not fill these shortfalls in the ARC to bring the plans into compliance with GASB standards. However, it will address one of the actuaries' greatest concerns by bringing the total contribution rate for MRA from 30.05 percent to 38.05 percent. Without an increase, the total contribution will not meet the normal cost of 32.6 percent, meaning the plan is falling further and further behind in funding and is on a probable path to insolvency. This issue has been noted for several years and is verified by the plan's decline in its funded ratio from 102 percent reported in 2003 to 65.8 percent as of June 30, 2010.

This is the third time in ten years that contribution rates have been increased to address the under-funding of the plans, primarily caused by basing a portion of the contributions on docket fees. Historically, there is a poor correlation between docket fees revenue and judicial or magistrate payroll. Thus, the value of benefits accruing under the plan outpaces the funding from the fees. To ensure plan solvency, the actuaries recommend replacing the docket fee revenue with employer contributions. House Bill 58 proposes to carry out this scheme in a way that would be neutral to the general fund by diverting the docket fees currently going to the pension plan to the general fund to pay for the higher employer contributions. However, it could be argued that the risk of underfunding experienced by the plans will be transferred to the employer, and the long-term impact to the general fund is potentially not being fully valued. Docket fees may not fully make up for the added employer contributions, particularly as salaries increase.

Plan Structure

The relatively high ARC of 52 percent to 59 percent of payroll may indicate that the plan benefits are relatively rich for the number of participants to spread the cost. Key components of the plans as listed in the June 30, 2010 valuations are included as Attachment A. It may be that plan solvency will require looking to reduce the plan costs (reduce the value of liabilities), such as reducing cost-of-living adjustment from an automatic 3 percent regarding of age or inflation.

ADMINISTRATIVE IMPLICATIONS

PERA notes that SB88 will have a minimal administrative impact on PERA; contribution rate adjustments will be required to PERA's pension administration system. In prior analyses regarding pension contribution changes, PERA has estimated the cost of changing its pension computer system at $25,000.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 88 relates to House Bill 58, which amends the Magistrate and Judicial Retirement Acts ("Acts") to set employer contribution rates as a statutory percentage of salary, paid from the general fund, rather than partially from docket fees. HB 58 provides for corresponding diversion of docket fees directly to the general fund to cover the increased employer contribution rate.

Senate Bill 88 relates to Senate Bill 87, which raises contributions by 8 percent for four other PERA plans.

Senate Bill 88 may conflict with Senate Bill 204, which restructures the cost-of-living adjustment (COLA) from the 3 percent automatic, compounded rate to one based on the CPI. Because reducing the COLA would reduce the value of the unfunded liabilities, SB204 would most likely reduce or even eliminate the need for any contribution increase for plan solvency.

OTHER SUBSTANTIVE ISSUES

PERA notes the following:

> In 2009, HB 854 imposed a contribution swap for 1.5% of the total statutory contribution rates to State employees whose annual salary exceeds $20,000. For the two-year period from July 1, 2009 to June 30, 2011, the employer contribution rates have been reduced by 1.5% and the employee contribution rates has been correspondingly increased by 1.5%. The contribution swap was not a pension solvency measure; rather, it was a measure that allowed the State to reduce its Actuarial Required Contribution (ARC).

PERA's comments underscore the basic conflict between pension solvency and state solvency. Relying on contributions solely to address pension solvency does not address the issue of sustainability as defined by the ability and willingness of the pension sponsors to pay the actuarial required contribution (ARC). The state faces a budget shortfall for FY12 of approximately $215 million. Because the state must produce a balanced budget, any increase in employer contributions means cutting expenses elsewhere in the budget or raising additional revenue. Thus, pension solvency is at odds with state solvency, and contribution increases potentially reduces services or increases taxes to pay for them.

PERA also explains what triggers requested contribution increases:

> The PERA Board's Benefit Funding Policy triggers an increase in statutory contributions rates for its existing members and employers in the event that funding levels dip**.** The PERA Board's policy is the amortization of unfunded liabilities over a 30-year period. PERA will recommend that the PERA statutory rates be increased under any of the following conditions:
>
> 1. Amortization period exceeds funding policy (on a divisional basis) for three consecutive years;
> 2. Amortization period exceeds funding policy by 15 years for two consecutive years
> 3. Amortization period exceeds funding policy by 10 years for 3 of the last 5 years
>
> Amortization periods for the Magistrate Retirement Fund and the Judicial Retirement Fund based on their respective statutory contribution rates **are an infinite period** for the second consecutive year and therefore does not satisfy the PERA Board's funding policy. PERA's actuaries have recommended a 2% annual increase in statutory rates for each year over a four-year period.

ALTERNATIVES

Options include revising benefit structures to make them more affordable.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Pension status of the plans will continue to deteriorate.

POSSIBLE QUESTIONS

1. **Did some magistrates move from MRA to JRA?**
2. **Did this move contribute to the plans' deteriorated funding status?**
3. **What have been the total contribution increases since 2003?**
4. **Why haven't prior contribution increases solved the problem?**
5. **If contributions remain partially dependent of docket fees, will contribution increases be sufficient to shore up the plans?**
6. **How did the plan benefit changes made in 2005 help the JRA?**
7. **Have benefit changes been explored?**
8. **Are employees willing to pick up more than 1/3 the contribution increase?**
9. **Would employees be willing to review benefit changes to salvage the plans?**
10. **What would be the impact of changing the COLA from 3% to one based on CPI and age?**

MA/bym

Attachment A – Judicial and Magistrate Benefit Structures

Judicial

Voluntary Retirement

A judge may voluntarily retire: 1) At age 64 with 5 or more years of service.
2) At age 60 with 15 or more years of service.
For members hired after July 1, 2005: 1) At age 64 with 5 or more years of service.
2) At age 55 with 16 or more years of service.

Retirement Pension

***Pre 7-1-80 plan*:** 37.5% of final average salary (FAS) plus 7.5% of FAS for each year of service in excess of 5 years. Maximum is 75% of FAS (10 or more years of service).
***Post 7-1-80 plan*:** 37.5% of FAS plus 3.75% of FAS for each year of service in excess of 5 years. Maximum is 75% of FAS (15 or more years of service).
***Post 7-1-05 plan*:** 3.75% of FAS for each year of service. Maximum is 75% of FAS (20 or more years of service).

Early Retirement Pension

Applicable to judges between the ages of 50 and 60 with 18 or more years of service. The pension is equal to 70% of FAS plus ½% of FAS multiplied by the number of complete years the age at retirement exceeds age 50. Members hired after July 1, 2005 are not eligible for early retirement.

Final Average Salary

The judge's salary received during the last 1 year in office prior to retirement.

Average Normal Retirement Pension $64,820.

Magistrate

Voluntary Retirement

A magistrate may voluntarily retire: (1) at age 64 with 5 or more years of service; (2) at age 60 with 15 or more years of service; or (3) at any age with 24 or more years of service. Magistrates with one of more ears of service in PERA, ERA or JRA may combine service credits to satisfy these voluntary retirement conditions.

Final Average Salary

The magistrate's salary received during the last 1 year in office prior to retirement.

Retirement Pension

Annual pension is 37.5% of final average salary (FAS) plus 3.75% of FAS for each year of service in excess of 5 years. Maximum is 75% of FAS (15 or more years of service).

Average Normal Retirement Pension $45,099

Both Plans

Cost-of-Living Increases

Pensions are increased each July 1 by 3% if retirement has been in effect for at least 2 full calendar years.