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

		ORIGINAL DATE	02/05/11		
SPONSOR	Asbill	**LAST UPDATED**	02/22/11	**HB**	
SHORT TITLE	Educational Retirement Contributions			**SB**	265
				ANALYST	Aubel

REVENUE COMPARED TO CURRENT STATUTE (dollars in thousands)*

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY12	**FY13**	**FY15**		
($3,779.0	($7,597.9)		Nonrecurring	ERB
Additional Employee (EE) Contribution over Current EE Rate		$51,100.6	Recurring	ERB

(Parenthesis ( ) Indicate Revenue Decreases)

*For the complete table From FY12 to FY17, see Fiscal Impact.

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT* (dollars in thousands)

Compared to:	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Statute	($44,823.1)/($39,892.5)	($51,980.9)/$46,262.9)	($135.8) million/ ($120.9) million	Nonrecurring	All funds/89% General Fund
FY11	$12,995.2/$11,565.7			Recurring	All funds/89% General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

*See Fiscal Impact

Relates to Appropriation in the General Appropriation Act
Conflicts with Senate Bill 248, Senate Bill 265 and Senate Bill 303
Relates to Senate Bill 87 and Senate Bill 88

SOURCES OF INFORMATION
LFC Files

Responses Received From
Educational Retirement Board (ERB)

SUMMARY

Synopsis of Bill

Senate Bill 265 amends Section 21-11-21 NMSA 1978 to restructure current statutory contributions rates to bring the ERB funded status to a projected 80 percent funded ratio within thirty years in the face of budgetary constraints. The structure maintains the tiered contribution rates for employees based on salary, increasing the employee rate over four years from 7.9 percent to 8.4 percent for those making $20,000 or less and 9.9 percent for those making more than $20,000. The employer rate is increased over six years to a final 13.9 percent for all employees regardless of salary, but steps it up according to the $20,000 demarcation.

Effective date for provisions of this act would be July 1, 2011.

FISCAL IMPLICATIONS

The following fiscal analysis is based on the FY10 actual salary and contribution amounts provide by ERB:

Table 1 – FY10 Actual Reported Contributions for ERB

Employee Tiers	Salary	Employee (EE) Contribution	Employer (ER) Contribution
≤$20,000	$ 176,045,276	$ 13,907,576.86	$ 21,829,614.30
>$20,000	$2,511,018,337	$ 236,035,791.22	$ 273,700,998.62
TOTAL	$ 2,687,063,612.65	$ 249,943,368.08	$ 295,530,612.93

Compared to Statutory Rates Set for July 1, 2011 – Revenue

The current statutory rates for all employees effective July 1, 2011 is 7.9 percent. SB 265 raises the employee contribution rate according to the following schedule, which would increase revenue coming into ERB over this period as indicated:

Table 2 – SB265 Employee (EE) Contribution Rates and Amounts FY12-FY15

FY12	Rate	EE Contribution		EE Contribution	Rate	DIFF to Current Statute
FY12	7.9%	$ 212,278,025.40	<$20k	$ 14,127,633.45	8.025%	$ 41,024,104.56
			>$20k	$ 239,174,496.50	9.525%	
FY13	7.9%	$ 212,278,025.40	<$20k	$ 14,347,690.05	8.150%	$ 44,382,934.07
			>$20k	$ 242,313,269.42	9.650%	
FY14	7.9%	$ 212,278,025.40	<$20k	$ 14,567,746.64	8.275%	$ 47,741,763.59
			>$20k	$ 245,452,042.34	9.775%	
FY15	7.9%	$ 212,278,025.40	<$20k	$ 14,787,803.24	8.400%	$ 51,100,593.10
			>$20k	$ 248,590,815.26	9.900%	

The ending employee increase of $51.1 million would be additional recurring revenue over current statute. For employees greater than $20,000, the aggregate rate by end of the schedule is 2 percentage points higher than current statutory rates for most employees:

Table 3 – Final SB265 Rates Compared to Current Statutory Rates

Tiers	Current Statute FY17	SB265 FY17	Difference in Rates
Employee <$20,000	7.9%	8.4%	+0.5%
Employee >$20,000		9.9%	+2%
Employer <$20,000	13.9%	13.9%	0%
Employer >$20,000			
Aggregate	21.8%	23.8%	+2%

The current employer statutory rate for ERB as of July 1, 2011 is 13.15 percent for all employees regardless of salary level. This 13.15 percent would generate about $353.3 million employer contributions (revenues) in FY12, based on the ERB reported total salaries of $2.7 billion for FY10. For FY13, the 13.9 employer contribution would equate to about $373.5 million. Senate Bill 265 would spread out the increases over six years according to the following schedule shown in Table 4, which reduces the revenue coming into ERB until the 13.9 percnet rate is matched in FY17.

Table 4 – SB 265 Employer (ER) Contribution Rates and Amounts FY12 – FY17

FY	ER%	Current Statute	Tier	ER Contribution	ER%	$ DIFF to Current Statute
FY12	13.15%	$353,348,865.06	<$20k	$22,269,727.50	12.650%	($44,823,047.26)
			>$20k	$286,256,090.30	11.400%	
FY13	13.90%	$373,501,842.16	<$20k	$22,709,840.69	12.900%	($51,980,819.49)
			>$20k	$298,811,181.98	11.900%	
FY14		$373,501,842.16	<$20k	$23,149,953.88	13.150%	($38,985,614.61)
			>$20k	$311,366,273.66	12.400%	
FY15		$373,501,842.16	<$20k	$23,590,067.07	13.400%	($25,990,409.74)
			>$20k	$323,921,365.34	12.900%	
FY16		$373,501,842.16	<$20k	$24,030,180.26	13.650%	($12,995,204.87)
			>$20k	$336,476,457.02	13.400%	
FY17		$373,501,842.16	All	$373,501,842.16	13.9%	$0.00

Thus, from the point of view of ERB, the bill would alter the expected revenue stream from that which would have been produced under current statute, as follows:

Table 5 – Net Impact to ERB Revenues from SB265

Fiscal Year	Net Impact (EE/ER)	Cumulative Impact
FY12	($3,798,942.71)	(3,798,942.71)
FY13	($7,597,885.41)	($11,396,828.12)
FY14	$8,756,148.97	($2,640,679.15)
FY15	$25,110,183.36	$22,469,504.21
FY16	$38,105,388.23	$60,574,892.44
FY17	$51,100,593.1	$111,675,485.55

While in the nearer term the fund would receive less revenue, over the six years the revenue would catch up and increase because the rates under the bill catch up and eventually surpass the total aggregate rate of 21.8 percent by 2 percentage points for most of ERB employees. The secondary fiscal impact due to not have these revenues earning investment returns in the early years would appear to be minimal.

Thus, pension solvency is reduced under this plan in the short term but will eventually improve pension solvency because the bill raises the employee contribution and maintains the employer's 13.9 percent over the longer term. ERB notes that if SB265 is enacted, ERB's actuaries project the Educational Retirement Fund would reach an 88.8 percent funding level and have an unfunded actuarial accrued liability of $5.714 billion in 30 years.

Compared to Statutory Rates Set for July 1, 2011 – Operating Budget Fiscal Impact
The employer revenue to ERB represents operational expenses to the ERB employers. From the perspective of comparing what the employers would pay under this bill to that which they would pay under current statute, all funding sources would be reduced by the equivalent amount. Using the 89 percent general fund proportion from the FY12 1% Table, this represents about a $39.9 million reduction in general fund expenditure for public education and higher education than what occur if no legislation is passed to change the effective rates that begin July 1, 2011. Table 6 shows the reduction in the general fund appropriation under SB 265 when compared with those needed to support the current statutory rates:

Table 6 – SB265 Fiscal Impact to General Fund Compared to Current Statutory Rates*

FY	GF Reduction
FY12	($39,892,512.06)
FY13	($46,262,929.34)
FY14	($34,697,197.01)
FY15	($23,131,464.67)
FY16	($11,565,732.34)
FY17	$0.00

*Using 89% GF from 1% Table

The Higher Education Department has commented on this issue as it related to another bill, HB133, which also postpones the full employer contribution increase, as follows:

> Delaying educational retirement contributions for New Mexico's public postsecondary institution budgets might be preferable to requiring institutions to pay the scheduled increased employer contribution to the ERB on behalf of employees. Without additional General Fund support for this purpose, HB133 provides a possible alternative to employee layoffs, furloughs or self-imposed vacancy savings which may result in reduced operations.

Compared to FY11 Operating Budget
However, when viewed from the perspective of incremental budgeting, that is, from the amount employers will have to pay in FY12 when compared to operational expenses incurred for FY11, there is a positive fiscal impact of about $13 million, of which about 89 percent is general fund.

Table 7 – Employer Contribution Difference FY11/FY12 Under SB265

FY	ER%	Current Statute	Tier	ER Contribution	ER%	$ DIFF to Current Statute	FY
FY11	12.40%	$ 21,829,614.30	<$20k	$22,269,727.50	12.650%	**$12,995,204.87**	FY12
	10.90%	$ 273,700,998.62	>$20k	$286,256,090.30	11.400%		
		$ 295,530,612.93	<$20k	$22,709,840.69	12.900%	$25,990,409.74	FY13
			>$20k	$298,811,181.98	11.900%		
			<$20k	$23,149,953.88	13.150%	$38,985,614.61	FY14
			>$20k	$311,366,273.66	12.400%		
			<$20k	$23,590,067.07	13.400%	$51,980,819.49	FY15
			>$20k	$323,921,365.34	12.900%		
			<$20k	$24,030,180.26	13.650%	$64,976,024.36	FY16
			>$20k	$336,476,457.02	13.400%		
			All	$373,501,842.16	13.900%	$77,971,229.23	FY17

While showing the FY12 fiscal impact due to HB133 has merit, it should be noted that this scenario through FY17 is unlikely given the apparent legislative intent to address pension solvency at least partially through increased employer contribution rates.

The primary point of this discussion is that neither the LFC nor the Executive recommended budgets for public education and higher education institutions incorporate any incremental increase in the education operational budgets to pay for any additional employer ERB pension contributions in FY12. No appropriation is included in the bill to cover the cost. Thus, either the employers would have to absorb this additional cost of $13 million by reducing expenditures elsewhere or additional funding would need to be provided for FY12. The approximate cost to the general fund would be 89 percent, or $12 million.

SIGNIFICANT ISSUES

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. The amendment also deleted a provision that required additional years of service for employees.

Table 8 – 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%

Various changes in the statutory rates over the last two years have altered this original schedule. Laws 2009, Chapter 126, initiated a two-year 1.5 percent contributions shift from the employer to the employee as a solvency measure to produce a balanced state budget. Then, Laws 2010, Chapter 67 (Senate Bill 91), delayed the 0.75 percent employer increase scheduled for FY11 to FY12 and the final 0.75 percent employer increase to FY13, also as a state solvency measure.

Thus, the culmination of these three pieces of legislation, if left intact, produces a 2.25 percent increase in the employer ERB contribution effective July 1, 2011: 1.5 percent due to the sunset of the employee-employer shift for those making over $20,000 and the 0.75 percent employer increase that had been delayed by one year. The rate would go from 10.9 percent for those making over $20,000, and from 12.4 percent for those making $20,000 or less, to 13.15 percent for all employees. In FY13, the rate would go from 13.15 percent to the final 13.9 percent.

For employees, SB265 makes the 1.5 percent contribution shift permanent for employees >$20,000 and adds 0.5 percent for all employees, including those <$20,000. For employers, SB265, replaces the 1.5 percent shift in the employer rate and keeps the two remaining 0.75 percent employer increases (for a total of 1.5 percent), but spreads the implementation of the total 3 percent increase in contribution changes over six years rather than having them implemented more abruptly over the next two.

The current estimated 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.

Thus, this bill strives to balance the issue of state solvency by reducing the fiscal impact of contribution increases -- particularly for FY12 -- with ERB’s pension solvency. However, it still does potentially represent a hit to the general fund as described in the fiscal impact section of about $12 million.

The original SB 181 enacted in 2005 was attempting to address ERB’s funding status weakened by negative investment returns 2001-2003. Negative investment returns during the 2008-2009 financial crisis have further impaired the funding status of ERB.

As of June 30, 2010	Funded Ratio*	Funding Period**	Unfunded Liabilities***
Educational Retirement board (ERB)	65.7% ↓	62.5 years ↓	$4.9 billion ↑
Minimum Industry Standards	80%	30 years	

*Ratio of assets to liabilities — Note: Arrows indicate trend.
**Amount of time to amortize the unfunded liability
***Value of liabilities in excess of the actuarial value of assets

ERB’s actuaries recommended action to improve the funding status of the plan be taken, and the board reviewed various options. ERB notes that ”Senate Bill 265 is the result of ERB’s actuarial studies and public meetings on pension redesign, which were held as part of the Board’s commitment to insuring the long term actuarial soundness and financial health of the Educational Retirement Fund.”

After public input, the proposals for pension reform to increase retirement edibility or reduce benefits were dropped in favor of contribution increases.

Twenty states have implemented pension reform in 2010 to address pension solvency issues. Due to concerns regarding property and contractual rights, much of pension reform focuses on new hires. Such pension reform takes years to impact solvency and does little to address current pension liabilities.

Some states have taken more aggressive action to strengthen funds by aligning pension structures with new demographic and economic realities, such as the ability of pension sponsors to pay for benefits. 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.

The New Mexico Constitution (Article XX, Section 22) states that vested employees acquire a property right to pensions. However, Article XX, Section 22 (E) 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.”

Laws 2009, Chapter 288, established 30-year eligibility for new hires for ERB and PERA non public safety plans. This established what is termed a “second tier” to the plans. The legislation also set up a 25-member task force to study the plans and make recommendations for the 2011 legislative session to address pension solvency. The task force made few final recommendations.

Any challenges to pension reform applied in New Mexico will ultimately need to be resolved by the courts.

ADMINISTRATIVE IMPLICATIONS

ERB notes that the bill will require ERB reprogram its retirement information system to adjust the employer’s’ contribution rate but maintains that the cost is minimal and would be paid out of the ERB’s system maintenance contract with the software vendor.

CONFLICT

Conflicts with SB 248, which contains a different schedule of changes in employer contributions.
Conflicts with HB 133, which contains a different schedule of changes in employer contributions.
Conflicts with SB 303, which contains plan changes for both ERB and PERA.
Relates to SB 87 and SB 88, which also seek contribution increases to address pension funding status for seven PERA plans. The FY11-FY12 fiscal impact for all bills totals about $25.2 million to fund the contributions increases.

OTHER SUBSTANTIVE ISSUES

ERB provides the following breakdown of ERB-affiliated employers and the number of employees within each employer group:

TYPE	Number of Employees		Number of Employees
Charter Schools	1,785	K-12	49,714
Colleges/Universities	22,479	Higher Ed	22,479
Public Schools	47,929	Other	1,066
Special Schools	641		
State Agencies	425		

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Unless this or similar legislation to revise the current statutory rates is enacted, ERB employers will be facing a significant jump in pension contributions of about $45 million. Either additional funding will need to be provided to cover the cost or significant reductions in the operating budgets would occur elsewhere.

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