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

		ORIGINAL DATE	3/04/19		
SPONSOR	HAFC	**LAST UPDATED**	3/15/19	**HB**	360/HAFCS/aSFC
SHORT TITLE	Educational Retirement Changes			**SB**	
				ANALYST	Jorgensen

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**		
$8,558	$14,058	$14,058	Recurring	ERB Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Companion to SB14

SOURCES OF INFORMATION
LFC Files

Responses Received From
New Mexico Attorney General (NMAG)
Education Retirement Board (ERB)
Office of the State Auditor (OSA)
Higher Education Department (HED)

SUMMARY

Synopsis of SFC Amendment

The Senate Finance Committee Amendment makes the following changes:
1. Reduces the employer contribution to 0.25 percent in fiscal year 20.
2. Eliminates the employer contribution increases for fiscal years 21 and 22.
3. Delays the effective date for employer and employee contributions for retirees working 0.25 FTE or less until July 1, 2020.
4. Delays the effective date for employer and employee contributions for all substitute teachers working more than 0.25 FTE until July 1, 2020.

These change increase the funding period to 44 years, compared to 30 years in the bill as introduced.

Synopsis of Bill

The House Appropriations and Finance Committee Substitute for House Bill 360 (HB360) makes the following changes to the Education Retirement Act:

1. Increases employer contributions by 0.5 percent in FY20, 1.5 percent in FY21, and 1 percent in FY22 to bring the final contribution from 13.9 percent to 16.9 percent.
2. Increases the annual salary threshold for the maximum employee contribution of 10.7 percent from $20 thousand to $24 thousand.
3. Requires employee and employer contributions from individuals who return to work under the return to work exception rule, which covers retirees who earn the greater of $15 thousand or who work quarter-time or less. The employee contributions are non-refundable, similar to participants in ERB's Return to Work program.
4. Requires Public Employees Retirement Association (PERA) retirees working for ERB-affiliated employers to make non-refundable ERB contributions. Employer contributions are already paid for PERA retirees.
5. Requires police who retire under PERA and who return to work on or after July 1, 2019 at ERB employers as certified law enforcement officers at a higher education institution to pay non-refundable employee contributions to ERB.
6. Creates a new pension benefits tier for employees who begin ERB employment on or after July1, 2019. For these employees, the service credit multiplier will be based on duration of service. Employees in their first 10 years of service receive a multiplier of 1.35 percent, from 10.25 to 20 years, a multiplier of 2.35 percent, from 20.25 to 30 years, a multiplier of 2.35 percent, and 2.4 percent for years in excess of 30 with no cap. These employees will have a minimum retirement age of 58 with actuarial reduction of benefits for retirements before age 58.
7. Reduces "pay spiking" by not allowing salary increases over 30 percent per year to be accounted for in the final average salary calculation for compensation paid on or after July 1, 2019.
8. Requires short-term substitute teachers working over quarter time and their employers to make contributions to ERB.

HB360 was presented to and endorsed by the Investments and Pensions Oversight Committee (IPOC) during the 2018 interim.

FISCAL IMPLICATIONS

The revenue table shows the cumulative impact of additional contributions to the fund. In the first year of implementation, the ERB fund will receive an additional $8.6 million to the fund, largely driven by the employer contribution rate increase of 0.25 percent. Other revenue will be generated through requiring all substitute teachers to pay contributions, requiring contributions from PERA retirees working for an ERB employer, and requiring contributions from ERB retirees returning to work for ERB employers. These changes will take effect in FY21 and subsequent fiscal years.

The additional revenue by source is shown in the table below:

	FY20		FY21		FY22	
Increased Employer Contributions	$	6,358	$	6,358	$	6,358
Substitute Contributions	$	-	$	1,400	$	1,400
Return to Work Contributions	$	-	$	4,100	$	4,100
PERA Retiree Employee Contributions	$	2,200	$	2,200	$	2,200
Total	**$**	**8,558**	**$**	**14,058**	**$**	**14,058**

HB360 creates additional general fund costs by requiring employer contributions from employees not previously required to contribute to ERB. Specifically, HB360 requires member and employer contributions from short-term substitute teachers and ERB retirees working under the return to work exception rule at ERB-affiliated employers. These changes will increase costs which will presumably be paid from general fund appropriations. PERA retirees working for ERB employers will also be required to pay employee contributions. Their employers are already required to pay employer contributions.

A summary of increased general fund costs by source is shown in the table below:

Summary of General Fund Impact of HB360 as Amended

(in millions)

	FY20	FY21	FY22	Total
Employer Contribution Increase	$ 5.4	$ 5.4	$ 5.4	**$ 16.1**
Return to Work Changes	$ -	$ 2.3	$ 2.3	**$ 4.6**
Substitute Contributions	$ -	$ 0.7	$ 0.7	**$ 1.4**
Total	**$ 5.4**	**$ 8.4**	**$ 8.4**	**$ 22.1**

Source: ERB and LFC Files

The quarter percent employer contribution increase will take effect in FY20 and increase general fund costs by approximately $5.4 million per fiscal year. Changes to the return to work program and requiring contributions from substitute teachers will increase general fund costs to schools by an estimated $3 million, but these changes will not be implemented until FY21.

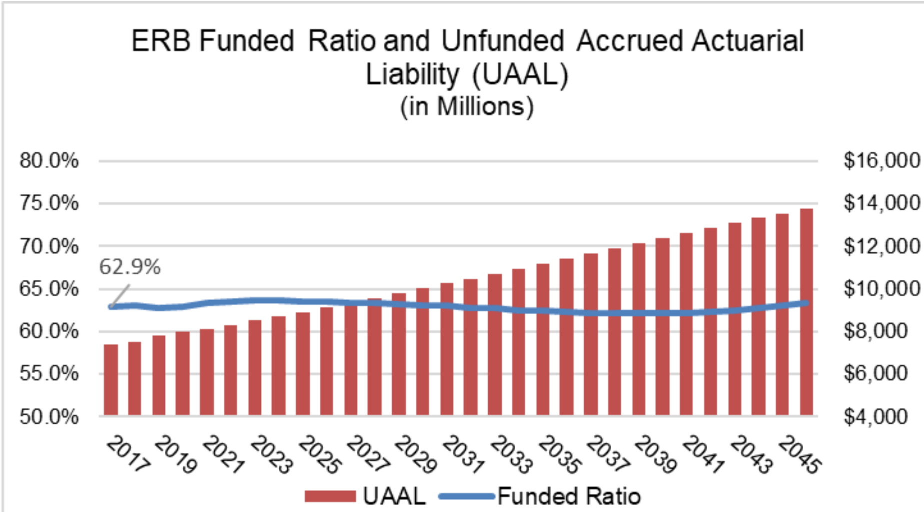
SIGNIFICANT ISSUES

Pension benefits are determined by three factors: final average salary, years of service (or service credit), and a pension multiplier with a formula that looks like:

Pension = Final Average Salary X *Service Credit* X *Pension Multiplier*

Because retirement payments are fixed regardless of investment returns or contribution levels, the soundness of the retirement funds are judged on their ability to meet not only current obligations but also the obligation to future retirees. In order for a pension plan to remain solvent, the employer and employee contributions and investment returns must be able to cover the cost of benefit payouts and the administrative expenses of the fund. The financial health of a defined benefit pension plan is often measured using metrics including: the funded ratio which divides the plan assets by the total plan liabilities; the UAAL or amount of liabilities attributable to paying future obligations minus plan assets; and the funding period, or the amount of time it would take for current levels of contributions and investment income to pay down the entire amount of the pension liability.

ERB has a UAAL of $7.4 billion and has sufficient assets to pay for 63 percent of the total liabilities. The graph below illustrates the plan's unfunded liability and funded ratio over time:



Based on current contributions and an investment return assumption of 7.25 percent per year, it will take ERB 70 years to achieve 100 percent funding. A funding period this long means that the fund is particularly sensitive to changes in investment returns. Should the fund fail to meet the assumptions, the funded ratio could quickly get significantly worse. Recognizing this, the ERB set a policy requiring the pension plan to attain 100 percent funding within 30 years.

HB360 as introduced achieved the 30 year funding target. However, the amended version would not achieve full funding within 30 years as the bill reduced the total employer contribution increase from 3 percent to 0.25 percent. ERB estimates the changes in HB360 as amended will result in a funding period of 44 years.

The majority of the improvement in the funding period is driven by changes in the benefit structure with the most important change being the transition to a tiered multiplier.

Transioning from a set service credit multiplier to a tiered multiplier will have a significant impact on pension plan funding over time. The average ERB participant retires at age 62 with 20 years of service credit. Based on these averages, the current pension multiplier of 2.35 results in a pension worth 47 percent of the final average salary. Under the tiered multiplier, the pension benefit would be worth 37 percent. However, if an ERB-affiliated employee completed a 30 year career, they would receive a pension of 70.5 percent under either the current or the tiered multiplier. The tiered multiplier provides a strong incentive for employees to work longer, resulting in pension funds having longer to earn income on investments.

In addition, HB360 includes several provisions meant to close loopholes and increase revenue to the fund. The changes include requiring employee and employer contributions to be made to the fund for retired individuals who return to work under the return to work rule exception, requiring employee contributions from PERA retirees working at an ERB-affiliated employer, requiring contributions from short-term substitute teachers working more than 0.25 FTE, and an anti-salary spiking provision.

CJ/al