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FISCAL IMPACT REPORT

		ORIGINAL DATE	1/29/2019		
SPONSOR	Ingle/Salazar	**LAST UPDATED**	2/4/2019	**HB**	
SHORT TITLE	Educational Retirement Changes			**SB**	14
				ANALYST	Jorgensen

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY20	**FY21**		
$248,300.0	-	Nonrecurring	General

(Parenthesis ( ) Indicate Expenditure Decreases)

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY20	**FY21**	**FY22**		
$248,300.0	-	-	Nonrecurring	General
$21,400.0	$42,800.0	$64,200.0	Recurring	General
$4,000.0	$4,000.0	$4,000.0	Recurring	General
$7,132.0	$7,132.0	$7,132.0	Recurring	Federal/Other State

(Parenthesis ( ) Indicate Revenue Decreases)

Companion to House Bill 360.

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 Bill

Senate Bill 14 makes the following changes to the Education Retirement Act:

1. Increases employer contributions by one percent per year for three years to bring the final contribution from 13.9 percent to 16.9 percent.
2. Reduces the time employees must refrain from working for a public educational employer in order to become eligible to return to work while collecting a pension from 12 months to 6 months.
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.
4. Requires Public Employees Retirement Association (PERA) retirees working for ERB-affiliated employers to make ERB contributions. Employer contributions are already paid for PERA retirees.
5. 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 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.
6. Reduces “pay spiking” by not allowing salary increases over 30 percent per year to be accounted for in the final average salary calculation.
7. Requires short-term substitute teachers working over quarter time and their employers to make contributions to ERB.
8. Includes a one-time appropriation of $248.3 million to the ERB fund.

SB14 was presented to and endorsed by the Investments and Pensions Oversight Committee (IPOC) during the 2018 interim.

FISCAL IMPLICATIONS

The appropriation table shows the cost of the $248.3 million one-time appropriation from the general fund to the education retirement fund. Because the cost of the employer increase is not appropriated in SB14, it does not appear in the table.

The revenue table shows the one-time appropriation of $248.3 million in the first line. The second line shows the $21.4 million general fund cost of the 1 percent employer increase in FY20, 2 percent in FY21, and 3 percent in FY22. The third line of the table is the $4 million resulting from return to work changes and requiring contributions from short-term substitute teachers. The revenue also includes $7.1 million in non-general fund made up of $3.1 million from return to work changes and substitute teacher contributions and $4 million from the non-general fund portion of the employer contributions.

Increasing the employer contribution will cost the state approximately $25.4 million per year, with $16.9 million coming from the public schools and $8.4 million from higher education institutions. Increasing the employer contribution by 3 percent (1 percent per year for 3 years) would require an additional $76.3 million with approximately $64.2 million of this amount

coming from the general fund.

The $248.3 million nonrecurring appropriation from the general fund to the educational retirement fund was requested as part of a settlement between labor unions and ERB to remedy the effects of contribution swaps and delayed contribution increases enacted in 2005. The settlement agreement requires ERB to request this funding from the Legislature, but there is no obligation for the Legislature to appropriate these funds.

In addition to the one-time appropriation and the direct costs of increasing the employer contributions to the fund, SB14 creates additional general fund costs by requiring employer contributions from employees not previously required to contribute to ERB. Specifically, SB14 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 will increase costs for those employers, costs that 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.

Summary of General Fund Impact of SB14
(in millions)

	FY20	FY21	FY22	Total
Employer Contribution Increase	$ 21.4	$ 42.8	$ 64.2	**$ 128.4**
Lump-Sum Appropriation	$ 248.3	$ -	$ -	**$ 248.3**
Return to Work Changes	$ 2.3	$ 2.3	$ 2.3	**$ 6.9**
Substitute Contributions	$ 1.7	$ 1.7	$ 1.7	**$ 5.1**
Total	**$ 273.7**	**$ 46.8**	**$ 68.2**	**$ 388.7**

Source: ERB and LFC Files

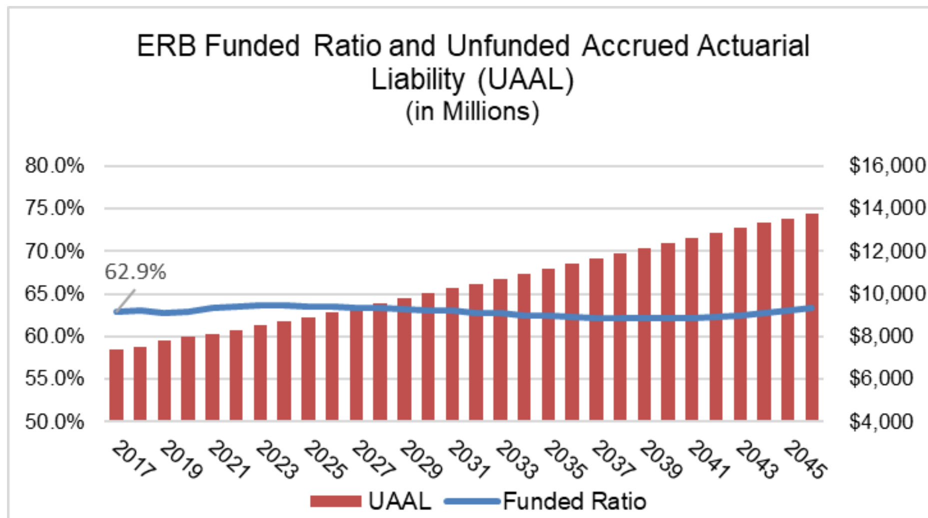
SIGNIFICANT ISSUES

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.

SB14 relies to a great extent on increasing employer contributions to the fund. The 3 percent employer contribution increase contained in SB14 will increase revenue generated by employer pension contributions by over 20 percent. The proposal does not increase the employee contribution as educational employees currently contribute a larger portion of their salary to ERB than PERA employees to their pension.

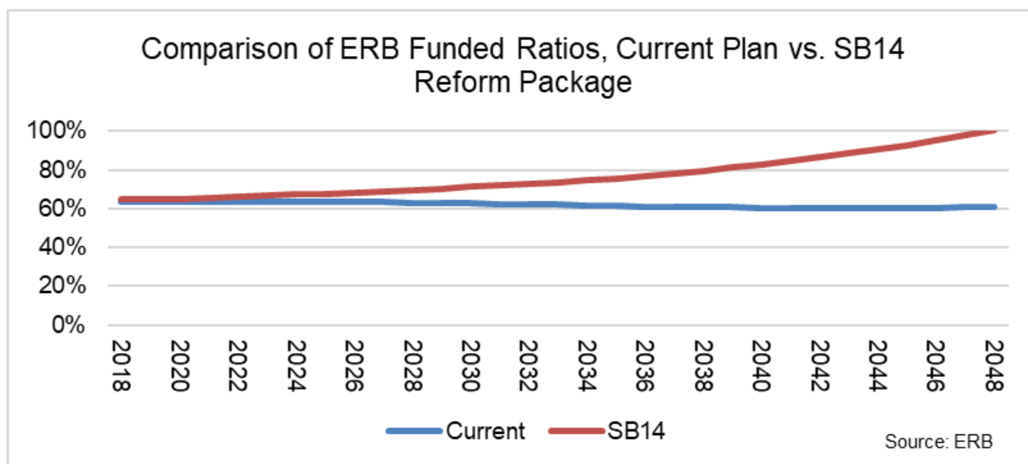
Transitioning from a set service credit multiplier to a tiered multiplier will have a significant impact on pension plan funding. The average ERB participant retires at age 62 with 20 years of service credit. Based on these averages, the current pension multiplier of 2.35 results in a pension worth 47 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, SB14 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 exception, requiring employee contributions from PERA retirees working at an ERB-affiliated employer, requiring contributions from short-term substitute teachers, and an anti-salary spiking provision. The estimated revenue increases to the fund are shown in the table below:

Effect of Loophole Closures
(in thousands)

	Employer	Employee	Total
Return to Work Changes	$2,300	$1,800	$4,100
PERA Retiree Employee Contribution		$2,200	
Short-Term Substitute Teacher Contributions	$1,700	$1,300	$3,000
Total	**$4,000**	**$5,300**	**$7,100**

Should SB14 be enacted, ERB estimates a significant increase in the funded ratio over time, reaching 100 percent funding by 2048, 30 years from passage.



OTHER SUBSTANTIVE ISSUES

SB14 significantly improves the funded status of the pension plan by closing loopholes and changing the service credit multiplier. However, the majority of the improvement to the funded status of the plan is due to the employer contribution increase as shown in the table below:

Effect of SB14 Provisions, by Element
(in millions)

Plan Change	Net Present Value of Change	30 Year Funded Ratio	Funding Period, in Years
Status Quo, No Change	**N/A**	**61%**	**70**
Change Multiplier and Set Retirement Age to 58	$300	67.9%	51
Increase Employer Contribution 3 Percent	$1,200	85.2%	38
Return to Work/PERA Employer Contribution Changes	$100	62.3%	65
One-Time Appropriation	$200	65.9%	59
All Element Impact	**$1,900**	**100.6%**	**30**

The majority of the reforms proposed by SB14 are paid by either taxpayers or future employees. Retirees make up 44 percent of total ERB membership but account for 60 percent of pension liability. Despite the disparity, the legislation does not include a measure to further alter or suspend cost-of-living adjustments. In 2013, the ERB retirees' cost-of-living adjustments were reduced until ERB is 100 percent funded. A one year freeze of the COLA would reduce the UAAL by $123 million over 30 years.

Additionally, the changes made to the return to work provision which reduce the layout period from 12 months to 6 months amount to a benefit enhancement and may serve as an inducement for more employees to retire early and resume employment. The return to work program is a net cost to ERB because the earlier individuals retire, the less time their contributions have to earn investment returns.

CJ/gb/al/gb