LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS
55th Legislature, 2nd Session, 2022

Bill Number SB36 **Sponsor** Stewart

Tracking Number .221594.1 **Committee Referrals** SEC/SFC

Short Title Contributions to Educational Retirement Fund

Analyst Simon **Original Date** 1/24/2022 **Last Updated** 2/7/2022

FOR THE LEGISLATIVE EDUCATION STUDY COMMITTEE

BILL SUMMARY

Synopsis of Bill

Senate Bill 36 (SB36) would increase employer contributions to the educational retirement fund by an additional 1 percentage point in FY23 and by 1 percentage point in FY24, raising the rate for FY23 from 16.15 percent of salary to 17.15 percent of salary and raising the rate for FY24 and subsequent years the rate would be raised to 18.15 percent. The bill would also increase employer contributions to the educational retirement fund for employees participating in the alternative retirement program.

SB36 has no effective date; however, the bill specifies the dates to which each contribution rate applies.

FISCAL IMPACT

SB36 would increase benefits cost for school districts, charter schools, higher education institutions, and other employers covered by the Educational Retirement Act. The Educational Retirement Board (ERB) estimates the cost of a 1 percentage point contribution for all entities at $34 million.

The Public Education Department (PED) estimates to cost of a 1 percentage point increase to school districts and charter schools at $20.7 million; however, this does not include the cost associated with a scheduled increase of 1 percentage point. Laws 2021, Chapter 44 included a rate increase from 15.15 percent to 16.15 percent for FY23. As a result $41.4 million would need to be added to the SEG to cover the total cost of ERB rate increases, although only $20.7 million can be attributed to this bill. In addition, the bill will have a $20.7 million impact in FY24. The Legislative Finance Committee (LFC) estimate the costs of a 2 percentage point to ERB contributions at $40.2 million for public schools and charter schools.

The bill does not include an appropriation. However, the House Appropriations and Finance Committee Substitute for House Bills 2 and 3 includes an appropriation of $40.2 million to the state equalization guarantee distribution to cover the cost for school districts and charter schools. In addition, the bill includes $12.5 million to the Department of Finance and Administration for higher education institutions.

SUBSTANTIVE ISSUES

ERB provides a defined-benefit retirement plan for employees of school districts, charter schools, higher education institutions, and some employees of state agencies that provide educational services or hold a license issued by PED. ERB's plan is designed to pre-fund pension payments through employer and employee contributions, which are then invested by professional investing staff to generate returns. Contributions and investment returns accumulate over time to provide a source for pension payments for retired members. In FY21, ERB collected $330 million from ERB members and $452.9 million from employers.

Currently, ERB does not hold enough cash and investments to pay for all of the retirement benefits that have been promised. While ERB holds assets valued at $16.4 billion, as of June 30, 2020, the fund would need an estimated $23.4 billion to pay all benefits promised up to this point. The $7 billion difference is known as the plan's unfunded liability. ERB's actuaries estimate the fund holds 69.8 percent of the assets needed to pay all promised benefits.

While ERB estimates current contribution levels are sufficient to pay the costs of benefits currently being earned, a large share of the employer's contribution is still needed to pay off the unfunded liability. ERB projects that at the current contribution rate, it will take 42 years to pay off the unfunded liability, longer than the board's policy. Actuaries estimate the contribution would need to be 19.21 percent to meet the board's funding policy of paying off the unfunded liability by the end of FY49.

As with many pension plans, high projected rates of return in the late 1990s and early 2000s led the state to believe the plan had sufficient assets to pay promised benefits and even provide increased benefits. At the end of FY01, ERB's actuaries estimated the plan was 92 percent funded and would be fully funded by FY14. At that time, the plan assumed an average 8 percent return. As that assumption was lowered, the plan's unfunded liability increased. Currently, the plan assumes a 7 percent return on investments.

Alternative Retirement Plan. Some employees of higher education institutions are eligible to opt out of ERB's defined-benefit plan and choose to participate in the defined-contribution Alternative Retirement Plan. In the Alternative Retirement Plan, employees manage their own investment options and individually benefit or suffer from investment losses or gains. However, employers are required to pay a small percentage of the employee's salary to the educational retirement fund to help pay off the plan's unfunded liability, currently 4.25 percent, but scheduled to increase to 5.25 percent on July 1, 2022. As with the defined-benefit plan, the bill would increase employer contributions by 1 percentage point per year, to 7.25 percent of salary.

SOURCES OF INFORMATION

- LESC Files
- Educational Retirement Board (ERB)
- Public Education Department (PED)

JWS/mb