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

**SPONSOR** Stewart **ORIGINAL DATE** 3-13-07 **LAST UPDATED** 3-14-07 **HM** 92

**SHORT TITLE** Combine Educational & Public Retirement **SB**

**ANALYST** Aubel

## ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY07 | FY08 | FY09 | 3 Year Total Cost | Recurring or Non-Rec | Fund Affected |
|---|---|---|---|---|---|---|
| **Total** | | $25.0 - $50.0 | | | Non-Recurring | See Fiscal Impact |

(Parenthesis ( ) Indicate Expenditure Decreases)

**SOURCES OF INFORMATION**
LFC Files
Response Received From
Educational Retirement Board (ERB)
Department of Higher Education (HED)

No Responses Received From
Public Employees Retirement Association (PERA)
Public Education Department (PED)
Legislative Education Study Committee (LESC)

## SUMMARY

Synopsis of Bill

House Memorial 92 proposes the Legislative Education Study Committee and the appropriate interim committee investigate the feasibility of combing the two separate retirement systems for public employees and employees in the educational system. The memorial requests that the study be submitted to the Governor and to the Legislature on or before December 1, 2007.

## FISCAL IMPLICATIONS

To the extent the study can be incorporated into the normal work load for the LESC, PERA and ERB, the HM 92 will not initiate a fiscal impact. However, an actuarial report would be required to analyze the combined fund components, such as unfunded liability, funding ratio and funding period, as well as the new contributions required to bring the plans into parity. Given the scope of the study, such an actuarial report is estimated at $25 thousand, although this amount is subject to verification by PERA or ERB. Legal expertise would also be required. No appropriation is contained in the bill, nor is the cost of such actuarial or legal expertise allocated to a particular entity or entities.

**SIGNIFICANT ISSUES**

New Mexico has maintained separate retirement systems for public employees, one for its educational employees and one for other employees. Over the years the systems have developed different eligibility requirements, retirement benefits and contributions, as the chart below demonstrates.

| ERB | PERA – State Plan 3 |
|---|---|
| **Pension Factor**<br><br>2.35% | **Pension Factor**<br><br>3.0% |
| **Contributions**<br><br>Employee and employer contributions increasing 2 and 5 more years<br>Employee / Employer<br>FY 2005 7.6% 8.65%<br>FY 2006 7.675% 9.4%<br>FY 2007 7.75% 10.15%<br>FY 2008 7.825% 10.9%<br>FY 2009 7.9% 11.65%<br>FY 2010 7.9% 12.4%<br>FY 2011 7.9% 13.15%<br>FY 2012 7.9% 13.9% | **Contributions**<br><br>7.42% Employee<br>16.59% Employer<br><br>Note: PERA has 29 other plans with employee contributions ranging from 7% to 16.65% and employer contributions ranging from 7% to 25.72%. |
| **Membership Eligibility**<br><br>All public school and university employees working more than .25 of Full Time Equivalent are eligible for membership in ERB.<br>Certain 2 and 4 year community college and university employees may choose, within the first 90 days of employment, a defined contribution option.<br>Educationally certified employees in certain state agencies with an educational component may choose only the ERB plan.<br>Retirees from PERA may not participate in the ERB retirement plan. | **Membership Eligibility**<br><br>All State employees must be members of PERA <u>excluding</u> the following:<br>• Seasonal and temporary employees<br>• Part-time employees who work less than 20 hours in a 40-hour pay period<br>• Student employees<br>• Retired members from ERB, the Judicial Retirement System or the Magistrate Retirement System<br>• Retired legislative workers |

<table>
<tr><th>ERB</th><th>PERA –State Plan 3</th></tr>
<tr><td>Retirement Qualifications<br><br>25 years of service<br>Age + service = 75<br><br><br><br><br>Age 65 + 5 years of service</td><td>Retirement Qualifications<br><br>25 years of service at any age, or<br>Age 60 + 20 or more years of service<br>Age 61 + 17 or more years of service<br>Age 62 + 14 or more years of service<br>Age 63 + 11 or more years of service<br>Age 64 + 8 or more years of service<br>Age 65 + 5 years of service</td></tr>
<tr><td>Benefit Calculation<br><br>Final Average Salary of highest 5 consecutive years of service<br>X<br>Years of service<br>X<br>.0235<br><br>No maximum benefit. 80% benefit is reached after 34 years of service.</td><td>Benefit Calculation<br><br>Final Average Salary of highest 3 consecutive years of service<br>X<br>Years of service<br>X<br>.03<br><br>Benefit maximizes at 80% with 26 yrs. and 8 months of service.</td></tr>
<tr><td>Disability Retirement<br><br>Members with at least 10 years of earned service may apply for a disability retirement. The retirement is approximately 33% of the final average salary and a COLA (see below) begins in the third year of disability retirement.</td><td>Disability Retirement<br><br>• Duty disability – members are eligible for duty disability from the first day of employment.<br>• Non-duty disability – members are eligible for non-duty disability after being vested with 5 years of service credit.<br>•</td></tr>
<tr><td>Cost-of- Living Adjustment (COLA)<br><br>Annual, starting at age 65<br>½ of CPI with minimum of 2% (but 100% of CPI if lower than 2%), maximum of 4%<br>Average COLA increases over the last 20 years have been 2%.<br>There have been 3 Ad Hoc COLA’s in the last 20 years.</td><td>Cost-of-Living Adjustment (COLA)<br><br>3% each year after members have been retired 2 full calendar years (January 1 through December 31) effective July 1 of the following year. Disability retirees and retirees who are at least age 65 prior to their first COLA eligibility date have a reduced waiting period of 1 full calendar year.</td></tr>
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ERB points out several challenges pertaining to any ERB-PERA consolidation, as follows:

- The memorial correctly states that there are differences in eligibility and benefits between the PERA and ERB plans. However it is not clear whether the memorial assumes that combining the systems would automatically make the benefits equal. In reality, each fund as described by Section 22 of the New Mexico Constitution states that each fund can only be used for the benefit of the beneficiaries of that fund. This means that no contributions made for one system could be used to pay benefits to anyone who is a member of the other system.

- The other issue is the possibility of saving money by having one system as opposed to two. Both PERA and ERB currently own their own buildings (PERA will be building in a new location). If both were combined, a new facility would have to be secured and this would probably not translate to any significant savings. Similarly, combining the two systems with very different plans would not save personnel because administration of all of the plans would require similar number of FTE's to provide the service to plan participants.

- Finally, both systems recently purchased significantly different customized information systems that are not compatible.

As of June 30, 2006, ERB has an infinite funding period and a funding ratio of 68.3 percent. Usually a funding ratio of 80 percent and a funding period 30 years or less are considered satisfactory. As of the same date, PERA has a combined plan funding ratio of 92 percent and a funding period of 16 years. How the unfunded liabilities and assets of each plan would be affected by a consolidation would be a significant issue.

**ADMINISTRATIVE IMPLICATIONS**

HM 92 requests that the LESC and the interim Pensions and Investments Oversight Committee, or other such committee designated by the Legislative Council Service, study the feasibility of combining the two systems. Most likely ERB and PERA would also need to be involved; the administrative impact to their financial and legal departments is unknown.

No provision is made in the memorial for an actuarial report, which would be necessary to determine the combined fund valuation and fund solvency indicators. It is not known whether the LESC has the legal and financial expertise to adequately assess the plans as requested, or whether additional outside council would be required.

**OTHER SUBSTANTIVE ISSUES**

HM 92 mandates that the study include legal, practical and monetary consequences of combining the retirement systems. ERB specifies legal issues exist with regard to changing plan benefits to those already vested in each system.

The memorial suggests that there is no rational basis for maintaining two separate systems, although testimony has been provided during the interim that indicates having the state's permanent funds spread among the State Investment Council, PERA and ERB does provide greater diversification because the funds are separately managed and invested. Diversification reduces volatility and improves long term returns. This implication would also need to be part of the study.

## ALTERNATIVES

ERB suggests one option is to create new plans going forward that are more similar to each other.

## WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

A study investigating the feasibility of combing the two retirement plans will not be undertaken and the likelihood of such a combination will be diminished.

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MA/nt:mt