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FISCAL IMPACT REPORT

SPONSOR Altamirano DATE TYPED 2/6/2004 HB _____

SHORT TITLE Amend Public Employee Retirement Act SB 426

ANALYST Garcia

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY04	FY05	FY04	FY05		
			(\$97.5)	Recurring	PERA Fund

(Parenthesis () Indicate Expenditure Decreases)

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY04	FY05			
	(Significant)	(Significant)	Recurring	PERA Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

Public Employees Retirement Association (PERA)

SUMMARY

Synopsis of Bill

The bill makes numerous changes to the Public Employees Retirement Act. The bill makes changes to the definition of “state legislator member,” creates a one-time election for certain elected officials to be excluded from membership, makes changes to purchase service credit, makes changes to contribution requirements for return-to-work retirees, and declares an emergency.

(1) The changes to the definition of “state legislator member” includes language that states: “a

person who is currently serving or who has served as a state legislator or lieutenant governor and who has elected to participate in a state legislator member retirement plan. A former state legislator or former lieutenant governor may be a state legislator member whether or not currently receiving a pension under a state legislator member coverage plan.”

(2) The bill amends the PERA Act to allow certain elected officials who are holding office on July 1, 2004 to “un-do” their previous option and exempt themselves from membership if they file a written exemption from membership no later than September 20, 2004. Under current law, elected officials may exempt themselves from PERA membership if they file a written exemption from membership within 30 days of first taking office.

(3) The bill allows members who have already purchased 12 months of military service credit under the PERA Act to purchase “air-time” as well, and will further allow members to use “air-time” to achieve their pension maximum under their applicable coverage plan. A vested member, under current law, may purchase up to one year of service credit for time not earned (air-time), subject to certain statutory limits.

(4) The proposed bill amends the PERA Act to eliminate the requirement of retired members remitting contributions for post-retirement employment until an earnings threshold of \$25 thousand is reached. The bill will also make retired member contributions refundable. The bill provides that the employer contribution for retired members may increase at the determination of PERA to cover the full actuarial cost of post-retirement employment. Under current law, if a public-affiliated employer subsequently reemploys a PERA retiree, the retired member who returns to work is required to pay his or her associated retired member contributions. In addition, the public-affiliated employer is required to remit employer contributions to PERA on the working retiree’s behalf, as adjusted for the full actuarial cost as determined by PERA.

SB 426 will provide an exemption from the requirement of remitting retired member contributions for post-retirement employment for chiefs-of-police and undersheriffs if the retiree files an exemption from membership within 30 days of being appointed. SB 426 also provides a specific exemption for retirees reemployed as legislative session workers.

(5) The bill allows a PERA retiree to voluntarily suspend his or her pension in order to accrue additional or reciprocal service credit under PERA or another state system in order to re-retire in the future with enhanced retirement benefits.

Significant Issues

1) According to PERA, allowing certain elected officials who are holding office on July 1, 2004 to “un-do” the previous election and exempt themselves from membership may violate Internal Revenue Code Section 415 prohibitions against in-service distributions and elective membership in a tax-deferred governmental plan.

Under current law, elected officials may exempt themselves from PERA membership if they file a written exemption from membership within 30 days of taking office. The filing of an exemption is for the term of office and bars the retired member from acquiring service credit for the period of the exemption from membership. The Internal Revenue Code and regulations restrict the ability of a tax-deferred governmental plan such as PERA to offer (1) elective membership and/or (2) “in-service” distributions. The bill amends the PERA Act to allow elected officials who were holding office on July 1, 2004 to exempt themselves from membership if they file a

written exemption from membership no later than September 30, 2004.

A 401(a) governmental plan, like PERA, may allow one-time, irrevocable elections upon commencement of employment or upon initial eligibility to receive accruals under the plan. Permitting an employee to revoke or “un-do” their election would violate this regulation, bringing the qualified status of all PERA plans into question. If a plan fails to meet the tax qualification requirements for a governmental plan, the tax advantages are lost--that is, the tax exempt status of plan earnings will be revoked, employer deductions for contributions will be deferred or eliminated, participants will have to include the value of vested plan contributions in gross income on their annual tax returns, and tax-free, rollover treatment will not be available. Obviously, a loss of any of these tax advantages would have a substantial, negative impact on PERA and its participants. Loss of tax-deferred status will result in PERA’s investment gains being taxable income to the retirement fund.

Further, many elected officials who contribute to PERA are also employed fulltime by other affiliated public employers. They make PERA contributions based on their salary as an elected official, allowing them to combine both salaries to maximize their final average salary for PERA pension purposes, commonly referred to as “salary stacking.” Because both salaried positions are considered for PERA pension calculation purposes, the member is statutorily required to terminate “with all employers covered by any state system or the educational retirement system prior to the selected date of retirement.” NMSA 1978, Section 10-11-8(A)(2) (2003). Allowing a member to terminate their employment with one affiliated public employer and continue in their elected position would amount to an “in-service” distribution with adverse tax consequences for the Fund. If the member is in service as an elected official and a non-elected employee of one or more affiliated public employers, then the member must terminate from both positions in order to receive a benefit distribution or a refund of contributions. This rule applies regardless of whether the member has PERA coverage for the elected position.

It is important to note that the elected official exemption serves the limited purpose of encouraging people who have accumulated experience and wisdom in their years of public service to run for elected office after retiring from their former positions. The legislature did not intend to encourage those who are already serving to simultaneously collect a salary and retirement benefits earned in the same position. Rainaldi v. Public Employees Retirement Bd., 115 N.M. 650, 857 P.2d 761 (1993).

2) Remitting retired members contributions for post-retirement employment until an earnings threshold of \$25 thousand is reached and making those contributions refundable will likely pose an actuarial liability to the fund. The liability is created where early retirements will likely increase.

Currently, the PERA Act allows a PERA retiree who complies with the 90-day waiting period to return to work on a full-time basis and continue to receive his or her pension, irrespective of earnings. The bill requires remitting retired member contributions by PERA retirees when post-retirement earnings reach \$25,000 and will make such contributions refundable. From PERA’s perspective, if retired member contributions are to be refunded, they serve no actuarial purpose for the PERA Fund. The requirement for remitting retired member contributions was to offset any adverse actuarial impact to the PERA Fund resulting from retirees returning to the workforce without an earnings limit. If the retired member contributions are to be refundable, it will create a significant administrative burden on PERA and essentially be a temporary “savings” program

for retirees who are required to remit contributions and will then refund upon termination of employment.

3) The flexibility to allow members to purchase "air-time" after 12 months of military service credit is purchased reduces the actual service credit of a member.

The PERA Act now allows a vested PERA member to purchase up to one year of service credit for time not earned ("air-time"). "Air-time" is permissive service credit as allowed under Section 415(n) of the Internal Revenue Code and is not tied to any service requirement. As written, there are certain statutory limitations of the purchase of airtime that were unintended and without merit. Specifically, the aggregate of 12 months of air-time must be reduced by any period already purchased as permissive service under the PERA Act. For example, if a member has already bought 12 months or more of military service credit, he or she cannot purchase air-time. In addition, air-time cannot be used to achieve the pension maximum. For example, under state general member coverage plan 3, service can be purchased up to 26 years 7 months, but not the maximum of 26 years 8 months. PERA maintains that these restrictions are unnecessary.

4) Creating additional exemptions for retirees who return-to-work as chiefs of police, undersheriffs, and legislative session workers may be unnecessary. If the earning limit for post-retirement is removed the additional exemptions are likely not needed.

Under current law, all retired PERA members who return to work with a PERA-affiliated public employer are required to make contributions to the PERA Fund. The bill will allow a member to simultaneously retire and be appointed chief-of-police or undersheriff if the retiree files an exemption from membership within 30 days of being appointed. Legislative session workers are also specifically excluded. In light of the removal of the earnings cap from post-retirement employment, it is a policy question for the legislature whether further exemptions to the requirement of remitting contributions are appropriate.

5) Allowing a PERA retiree to voluntarily suspend his or her pension in order to accrue additional or reciprocal service credit under PERA or another state system to re-retire in the future with enhanced retirement benefits can create an actuarial problem for the pension system. Adding benefits that are not fully paid for from the beneficiary may create a net liability to the fund.

When the legislature removed the PERA Act's earnings cap, it deleted the provision that allowed a PERA retiree to voluntarily suspend his or her pension in order to accrue additional or reciprocal service credit under PERA or another state system and re-retire in the future with enhanced retirement benefits. As a result, the PERA Act precludes reciprocity for PERA retired members who want to suspend their pension and return to work. The bill allows a PERA retiree to voluntarily suspend his or her pension in order to accrue additional or reciprocal service credit under PERA or another state system and re-retire in the future with enhanced retirement benefits.

FISCAL IMPLICATIONS

PERA experienced historically heavier end-of-year retirements for the year 2003 (-/+ 400). The number of back-to-work-retirees has escalated from 363 on October 31, 2003 to 815 on December 31, 2003. The number of retirees who have returned to work correlates very closely with the increased retirements in 2003 and represents approximately 4% of annuitant payroll. PERA ac-

tuaries cannot determine what the full actuarial cost of removal of its earnings limit for post-retirement employment will be without experience and thus cannot predict what effect removal of the earnings limit for retirees will have on the PERA Fund. PERA actuaries, however, have indicated that if removal of the PERA Act's earnings limit triggers earlier retirements, there will be a cost to the PERA Fund since the actual contributions made on behalf of PERA members during their careers will not cover the normal cost of their retirement.

The provisions of the bill that make retiree member contributions refundable will have a significant fiscal impact on PERA. Currently, PERA's Administrative Services Division employs 2 FTEs to process termination/request for refunds of contributions. PERA annually budgets approximately \$75,000 for these 2 FTEs. If retired members contributions are refundable, PERA will be required to add a 3rd FTE to its current staff to process the additional refund of contributions, which can be made either directly to the retiree or rolled over to eligible retirement plans such as an IRA. In addition, PERA's Office of General Counsel has one exempt attorney position that dedicates 50% of its workload processing refunds for divorced members whose retirement funds are subject to community property laws of the State of New Mexico. Currently, legal review is required of approximately 90 divorce-related refund applications monthly. PERA anticipates this workload will increase 50% over current levels if retired member contributions are refundable. Consequently, an additional attorney will be necessary at roughly \$60 thousand.

ADMINISTRATIVE IMPLICATIONS

The provisions of the bill that make retiree member contributions refundable will have a significant administrative impact on PERA. Contributions that are made to the Fund on behalf of retired members post-retirement earning are currently remitted to the retirement reserve account, although they are tracked individually on behalf of retired members. Retired members no longer have an individual "contribution account" because they are statutorily barred from accruing additional service credit. If the retired member contributions are to be refundable, it will create a significant administrative burden on PERA and essentially be a temporary "savings" program for retirees who are required to remit contributions that will then be refunded upon termination of employment.

RELATIONSHIP

HB 14 proposes to exempt retired members who return to work for the legislature to perform legislative session work from the requirement of remitting retired member and employer contributions.

TECHNICAL ISSUES

PERA suggests the following amendment eliminating the provision that retired member contributions be refundable:

C. Except as provided in Subsection D or E of this section, a retired member may be subsequently employed by an affiliated public employer if the following conditions apply:

- (1) the member has not been employed as an employee of an affiliated public employer for at least ninety consecutive days from the date of retirement to the commencement of employment or re-employment with an affiliated public employer. If

the retired member returns to employment without first completing ninety consecutive days of retirement [~~the retired member shall remove himself from retirement~~]:

(a) the retired member's pension shall be suspended immediately and the previously retired member shall become a member; and

(b) upon termination of the subsequent employment, the previously retired member's pension shall be calculated pursuant to Paragraph (2) of Subsection E of this section;

(2) effective the first day of the month following the month in which the retired member's earnings total twenty-five thousand dollars (\$25,000) during a calendar year, a retired member who returns to employment shall be required to make contributions to the fund as specified in the Public Employees Retirement Act [~~The affiliated public employer's contributions as specified in that act or as~~];

(3) until the subsequent employment is terminated, the affiliated public employer that employs the retired member shall make contributions to the fund in the amount specified in the Public Employees Retirement Act or in a higher amount adjusted for full actuarial cost at the determination of the association; [~~shall be paid to the fund; and(3)~~]

(4) a retired member who returns to employment during retirement pursuant to this subsection is entitled to receive retirement benefits but is not entitled to acquire service credit or to acquire or purchase service credit in the future for the period of the retired member's re-employment with an affiliated public employer.

OTHER SUBSTANTIVE ISSUES

The June 30, 2003 actuarial valuation indicates that PERA funding resources are sufficient to fund the Normal Cost and finance the UAAL over an aggregate period of 17 years. It should be noted, however, that the funding of assets uses a smoothing technique that spreads investment gains and losses out over a 4-year period. One quarter of this year's investment loss has been recognized in last fiscal years funding value and one quarter of it will be recognized in each of the next 3 years. Past gains have already been fully realized in the funding value. In aggregate, the system had an experience loss for the year ending June 30, 2003 of \$546 million, due to rate of return on funding value of assets less than assumed (3% vs. 8%) and retirements greater than assumed. Specifically, PERA's actuaries reported a loss of \$511 million for 3 of the 4 years of investment activity that will flow into the recognized gain/loss in next year's actuarial valuation. If a loss of this magnitude occurs next year, the effect would be that the overall PERA funding ratio will drop to 92% and PERA UAAL will increase to approximately 36 years.

DG/yr