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

SPONSOR Wallace **DATE TYPED** 1/31/04 **HB** HJM 9

SHORT TITLE Study Changing Educational Retirement System **SB**

ANALYST Geisler

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
			Indeterminate	Non-Recurring	Educational Retirement Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates: SJM 17
Relates to: SB 181, HB 270

SOURCES OF INFORMATION
LFC Files
Educational Retirement Board (ERB)

SUMMARY

Synopsis of Bill

House Joint Memorial 9 is Legislative Finance Committee sponsored legislation that will require the Educational Retirement Board (ERB) to study the implications of moving to a defined contribution plan for new education employees and submit its findings to the Legislative Finance Committee by September 30, 2005.

Significant Issues

The purpose of the study is to find out if a defined contribution plan for new education employees would result in a more financially sound retirement system that would provide the same or better retirement benefits than the current defined benefit plan as provided for in the Educational Retirement Act.

FISCAL IMPLICATIONS

The cost of the study is unknown**.**

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Duplicates Senate Memorial 17. Relates to HB 270 and SB 181, both of which propose increasing employer contributions. SB 181 also proposes a new defined benefit plan for future hires.

OTHER SUBSTANTIVE ISSUES

ERB Actuarial Position

ERB's actuarial position, which represents its long-term ability to pay promised pension benefits with projected assets, has slipped in recent years. ERB's funded ratio, the actuarial value of assets as a percentage of actuarially accrued liabilities, declined from 81 percent to approximately 75 percent as prior-year investment losses were factored into their June 30, 2004, actuarial study.

The fund's unfunded actuarial liability (the dollar difference between actuarial liability and the actuarial value of its assets based on assumptions regarding investment income return and demographic projections), has increased from $1.7 billion to $2.4 billion in the past year. The fund's amortization period, which the Governmental Accounting Standards Board states should be less than 30 years, is infinity. During FY04, contributions of $356 million were $95 million less than distributions of $451 million.

Rationale for Study

The cost of bringing the current ERB plan back within the 30 year funding period is well over $100 million. For example, HB 270 proposes increasing the employer contribution from 8.65% to 16.15% over 8 years at a cost of $152 million. While the defined benefit model is popular, it remains to be seen if it remains affordable for the State. A defined contribution model (similar to a private sector 401K retirement plan and the federal employee retirement plan) offers the advantage of limiting the future liability of the state for benefit payments as well as providing the member with portability to take their account from employer to employer. The disadvantage of a defined contribution plan is that the member is responsible for allocating their account investments among plan choices (typically stock, bond, and fixed income mutual funds) and may do so poorly. The popularity of defined contribution plans tends to track closely to the performance of the stock market.

A number of states and cities moved from defined benefit plans to defined contribution models during the 1990's with mixed results. As a result, hybrid plans have been in development, which offer a guaranteed retirement benefit (similar to a defined benefit plan), but have an investment account feature (similar to a defined contribution plan). As part of the study on a defined contribution plan for new employees, the Legislative Finance Committee encourages ERB to look at these hybrid plans to see if it is possible to provide a fair retirement benefit to future educational employees at a manageable cost to state taxpayers.

GGG/yr