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

SPONSOR Smith **DATE TYPED** 3/18/05 **HB**

SHORT TITLE Educational Retirement Employer Contribution **SB** 181/aSFC/aHEC/aHAFC/aHFl#1

ANALYST Geisler

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
			$17.4	Recurring	General Fund, Other Funds

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY05	FY06			
	$17.4	See Narrative	Recurring	Educational Retirement Fund
	$1.8	See Amendments	Recurring	Educational Retirement Fund

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to: HB 270

SOURCES OF INFORMATION
LFC Files
Educational Retirement Board (ERB)

SUMMARY

Synopsis of HFl#1 Amendments

House Floor Amendment #1 to Senate Bill 181 as amended strikes the proposed change to a rule of 80 from the rule of 75 (years + service) for retirement eligibility and adjusts employee and employer contributions as follows:

1) Adds a sixth and seventh year of .75% increases in the employer contribution. This will take the employer contribution from 8.65% currently to 13.9% in FY12 (an increase of 5.25% percent over seven years). Total cost of the employer contribution increase will increase from $94.6 million for five years to $138.1 million for seven years.
2) Reduce the employee increase from 1% to .30% over 4 years. As amended, the employee

contribution will increase .075% for 4 years, which will take the employee contribution from 7.6 percent currently to 7.9 percent in FY 09. As amended, this contribution increase will bring in $1.8 million in FY 06. When the .30% increase is fully implemented in FY09 it will bring in revenue of $7.8 million. This is a reduction of $18.3 million in revenue from the $26.1 million of revenue that would have been brought in by a 1% increase in the employee contribution in FY09.

Note on Actuarial Impact: as amended by the House Floor, the combined employer/employee contribution will increase from 16.25% currently to 21.8% by FY12, an increase of 5.55% compared to the 4.75% increase as proposed by SB 181 as amended by HAFC. Assuming that actuarial assumptions hold true (including projected investment return of 8%), the educational retirement fund will meet the 30 year GASB standard for amortization of the unfunded actuarial liability by FY 11. By 2019 ERB would reach the benchmark of an 80% funding ratio (assets as a percentage of liabilities).

<u>Synopsis of HAFC Amendments</u>

1) The House Appropriations and Finance Committee amendments to Senate Bill 181 as amended strike the House Education Committee amendments. The bill as amended now is the same as version of the bill which passed the Senate, which will require a .25 percent yearly increase in the employee contribution for four years (employee contribution rate will increase from 7.60 percent currently to 8.6 percent in FY 09). This increase would bring in approximately $5.8 million in revenue in FY 06 increasing to $26.1 million by FY 09.

<u>Synopsis of HEC Amendments</u>

The House Education Committee amendments to Senate Bill 181 as amended <u>reduce the increase in employee contribution rate from .25 a year for four years to .05 a year for four years</u>. The contribution rate will go from 7.60 percent currently to 7.80 percent in FY 09. (This compares to the bill as amended by the Senate Finance Committee, which had proposed taking the contribution from 7.60 percent currently to 8.60 percent in FY 09).

This change will reduce the revenue from the contribution increase from $5.8 million in FY 06 to $1.2 million. Over four years, it will reduce revenue from $26.1 million to $5.2 million. The actuarial impact of this change would be to extend the time it will take the fund to meet the 30 year GASB standard for amortization of the unfunded liability from 2009 to 2014. (Note: all actuarial estimates always assume 8% investment return on pension fund assets).

<u>Synopsis of SFC Amendments</u>

The Senate Finance Committee amendments to Senate Bill 181:

2) Add a fifth year of employer contribution increases of .75 percent. The total increase in the employer contribution rate is 3.75 percent over 5 years, from 8.65 percent currently to 12.4 percent in FY 10. Adding a fifth year of employer contribution increases would cost approximately $19.4 million in FY 10. Total cost of the 3.75 percent increase in the employer contribution would be $94.6 million.

3) Require a .25 percent yearly increase in the employee contribution for four years (employee

contribution rate will increase from 7.60 percent currently to 8.6 percent in FY 09). This increase would bring in approximately $5.8 million in revenue in FY 06 increasing to $26.1 million by FY 09.

Synopsis of Original Bill

Senate Bill 181 would increase the employer contribution for state employees covered under the Educational Retirement Act .75% each year from FY 06 through FY 09. The employer contribution would increase from the current 8.65% to 11.65% at the start of FY 09.

For members employed after July 1, 2005, retirement eligibility would begin when the sum of the member's age plus his/her years of service equal 80, or upon reaching age 65 and completing five years of service credit.

Significant Issues

Senate Bill 181 seeks to help improve the deteriorating actuarial position of the educational retirement fund. For example, the ERB funding ratio, the actuarial value of assets as a percentage of actuarially accrued liabilities, has declined to 75.9% at June 30, 2004, down from 91.6% at June 30, 2000. A common benchmark for the funded ratio is 80 percent. The Governmental Accounting Standards Board (GASB) has a 30-year standard for amortization of the unfunded actuarial liability of a pension fund. ERB's funding period at June 30, 2004 was infinity. According to ERB's actuaries, under current assumptions with no changes, ERB's actuarial shortfall will increase from $2.4 billion at June 30, 2004 to $9.4 billion in 20 years. The funded ratio would be only 59%.

The 3% increase in the employer contribution proposed by Senate Bill 181 ties to the recommendation in the special study on ERB solvency completed during November 2004 by Mellon Consulting Group. According to ERB's actuaries, a 3% contribution will improve solvency of the fund—a 20 year projection shows assets would be $3 billion higher, the funded ratio would be 73%, and the funding period would be of 73 years.

Changing retirement eligibility to the Age + Years of Service = 80 for members employed after July 1, 2005 increases the years of service for a full retirement from the present retirement eligibility standards of Age + Years of Service = 75. ERB's actuaries state that changing the benefit structure as proposed would have a modest impact on solvency, in part due to the fact that most of the savings from the benefit changes are in the out-years.

FISCAL IMPLICATIONS

The recurring cost of the phased-in 3% increase in employer contributions over the next 4 fiscal years is shown below:

Fiscal Year	**Employer Contribution Rate**	**Cost**
FY 06	9.4%	$17.4 million
FY 07	10.15%	$17.8 million
FY 08	10.90%	$18.2 million
FY 09	11.65%	$18.7 million
Total		**$72.1 million**

In FY 06, the Legislative Finance Committee budget recommendation counted the increased spending for the higher employer contribution to ERB as part of the overall compensation package for public and higher educational employees.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Relates to HB 270, which seeks to increase the current employer contribution of 8.65% of salary by .75 percent each year from July 1, 2005 until the contribution rate equals 16.15%, an increase of 7.50% in the total employer contribution.

OTHER SUBSTANTIVE ISSUES

ERB notes: this bill would further separate the ERB contributions and benefits from the PERA contributions and benefits by increasing the number of years educational employees must work before being eligible to retire. Both funds now have a 25 and out retirement eligibility option. This bill would sunset that provision for any new ERB employees employed after July 1, 2005.
The employer contributions to educational employees have been considerably below that of state employees for many years. The current employer contribution to state employees is 16.59% vs. the contribution to educational employees of 8.65%.

ALTERNATIVES

Increase employee contributions and pension bonds are other alternatives for improving ERB solvency. On January 24, Governor Richardson appointed a task force of legislators and finance experts to recommend solutions to the educational retirement shortfall in 30 days.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

The unfunded liability of the educational retirement fund will continue to increase. The number of years needed to pay off the liability will increase and the percentage of funding will decrease.

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