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

SPONSOR Rawson **DATE TYPED** 03/01/05 **HB**

SHORT TITLE Public Employee Defined Contribution Plan **SB** 1041

ANALYST Geisler

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	**FY06**	**FY05**	**FY06**		
			Significant, see narrative	Recurring	Public Employees Retirement Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

Conflicts with: SB 266 &, SB 507
Relates to: SJM 17 and HJM 9.

SOURCES OF INFORMATION
LFC Files
Public Employees Retirement Association (PERA)

SUMMARY

Synopsis of Bill

Senate Bill 1041 will require that employees initially employed by a public affiliated employer on or after July 1, 2006 shall be a member of a defined contribution plan, to be administered by PERA. SB 1041 will require the PERA Board to submit an operational plan for establishing a defined contribution plan to the Office of the Governor and the legislature on or before December 15, 2005.

Significant Issues

Replacing the current defined benefit pension plan with a defined contribution plan would represent a major change in state employee benefit package. 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 and to keep account proceeds in their estate. 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 poorly. The popularity of defined contribution plans tends to track closely to the performance of the stock market—if long term market performance is strong, a defined contribution plan might provide a greater benefit than a traditional pension. If long term market performance lags, or the employee invests poorly, the defined contribution plan benefit will lag compared to a traditional defined benefit pension.

The state will incur costs to create a new defined benefit plan for employees hired on or after July 1, 2006 and it will have to continue to support the existing pension plan as well. See additional discussion below under fiscal impact and other substantive issues.

FISCAL IMPLICATIONS

There is no appropriation under the legislation. PERA notes that it will require additional staff and a budgetary adjustment to finance administration of the new defined contribution plan. Under a traditional defined benefit plan, contribution rates are adjusted to absorb administration costs to the retirement system. In a defined contribution plan, administrative costs cannot be factored into contribution rates because monies are deposited directly into the individual employee account. Employers may be required to be responsible for administrative costs associated with a defined contribution plan.

There will be a negative fiscal impact to the existing defined benefit plan. A defined contribution plan such as PERA is dependent on an ongoing active membership, which provides a continuing revenue stream of revenue in the form of member contributions to finance future accrued liabilities. While "closing" the existing defined benefit plan to future participants will end future liabilities, current contribution levels may be insufficient to fund existing accrued liabilities.

The initial cost increase of setting up a defined contribution plan and the cost of continuing to maintain the current defined benefit plan for all hires before July 1, 2006 would likely be offset by long term savings to the state by: 1) the likely lower cost of employer contributions to the plan; and 2) the elimination of state liability for future benefit payments for defined contribution plan members.

ADMINISTRATIVE ISSUES

SB 1041 would present significant administrative burden to PERA. SB 1041 provides a six-month period for designing a defined contribution plan structure, including, but not limited to: establishing contribution rates, plan options, procurement for a third-party administrator and educational plan for new employees and existing PERA members. PERA will be required to work with its actuaries and investment consultants to develop a viable alternative retirement plan that will be actuarially sound and attractive to new public employees.

PERA is currently converting to an integrated pension administration system. PERA management and the staff are tasked with the successful implementation of the pension administration system project. Final conversion to the integrated pension administration system and all compliance issues will not be resolved until December 2005. Diversion of staff to undertake a project of the magnitude of designing a defined contribution plan and procurement of a third-party administrator will adversely impact implementation of the pension administration system.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

Senate Bill 266 creates a new coverage plan with enhanced retirement benefits for juvenile correctional officers employed by the Children, Youth and Family Department ("CYFD") (juvenile correctional officers accrue 18 months of service credit subsequent to July 1, 2006 to be eligible for enhanced benefits).

SB 507 adds conservation officer members employed by the Department of Game and Fish to those employee groups eligible for enhanced retirement benefits provided under State Police Member and Adult Correctional Officer Coverage Plan 1. (To be eligible to retire with enhanced benefits, he or she must accrue 36 months of service credit in the plan subsequent to July 1, 2006).

SJM 17 and HJM 9 are 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.

OTHER SUBSTANTIVE ISSUES

<u>The Role of the Defined Benefit Plan in Employee Compensation</u>

PERA provides that for decades, state retirement systems like New Mexico PERA have relied on the defined benefit model to create strong and reliable retirement plans that represent a significant employment benefit for public employees. A defined benefit plan is a guaranteed (and defined) benefit from the retirement system after reaching vesting, age and service requirements. Under such a plan design, the participant assumes less investment risk because the retirement system, not the individual employee, assumes the investment responsibility. A defined benefit plan, by its fundamental design, encourages early retirement with a guaranteed benefit structure. Many plans, like PERA's, allow workers to retire in their 50s or early 60s, well before Social Security's normal retirement age. Unlike some other state retirement systems nationwide the State of New Mexico has resisted the impulse to achieve short-term budgetary savings by shifting to a defined contribution pension system that would have shifted the burden of investment risk to participating public employees individually. Given the protracted economic downturn of the market, the retention of a defined benefit plan and the avoidance of the personal risk inherent in a defined contribution plan have immeasurable value for present or potential public employees in New Mexico.

The PERA retirement system represents a strong recruitment tool for qualified people seeking a career in public employment in New Mexico. Historically, public employees receive less compensation than employees in the private sector. A defined benefit plan is not designed to fix short-term problems in state and local governments such as retention and recruitment in lieu of pay increases. Altering New Mexico's public pension plan design to accomplish conflicting objectives will only weaken a successful and generous plan that serves as a powerful incentive to public employment.

Nationally, public retirement systems that have moved from defined benefit to defined contribution plans have experienced mixed results. One example, the State of Nebraska has returned to a mandatory defined benefit plan after a struggling optional defined contribution plan was deemed unsuccessful (approximately 6% of new employees opted for the defined contribution option).

ALTERNATIVES

The bill could be amended to also authorize a hybrid pension plan, which offers a guaranteed retirement benefit (similar to a defined benefit plan), but have an investment account feature (similar to a defined contribution plan).

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL?

PERA will continue to provide retirement security to public employees of the State of New Mexico under a defined benefit structure. The PERA board will continue to administer the PERA retirement system in a prudent and actuarially sound manner.

GGG/yr