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

ORIGINAL DATE 02/11/09
SPONSOR Smith **LAST UPDATED** 2/23/09 **HB**

SHORT TITLE Retiree Health Care Fund Contributions **SB** 366

ANALYST Archuleta

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY09	FY10		
	($3,000.0)	Recurring	Tax Administration Suspense Fund
	$3,000.0	Recurring	RHCA Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

The HAFC recommendation for general appropriations includes reductions in some areas where federal funds can be used. These reductions will have to be made up to maintain the current level of appropriations in FY11 and FY12. In FY11, $150 million will have to be restored and in FY12, $330 million will have to be restored. This is in addition to other appropriation increases required in FY11 to maintain current service levels or to implement statutorily scheduled funding increases, such as ERB contributions, instructional material funding replacement, and restoring Medicaid funding from the general fund instead of the tobacco settlement program fund. These add up to $80 million to $100 million.

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY11	FY12	FY13		
$23,500.0	$34,500.0	$45,500.0	Recurring	RHCA Fund
$3,000.0	$3,000.0	$3,000.0	Recurring	RHCA Fund
($7,800.0)	($11,500.0)	($15,200.0)	Recurring	General Fund
($7,800.0)	($11,500.0)	($15,200.0)	Recurring	Other State Funds

(Parenthesis ( ) Indicate Revenue Decreases)

*Revenue estimates prepared by RHCA

Duplicate of House Bill 351 – Retiree Health Care Fund Contributions

SOURCES OF INFORMATION
LFC Files

Responses Received From
Retiree Health Care Authority (RHCA)
Taxation and Revenue Department (TRD)

SUMMARY

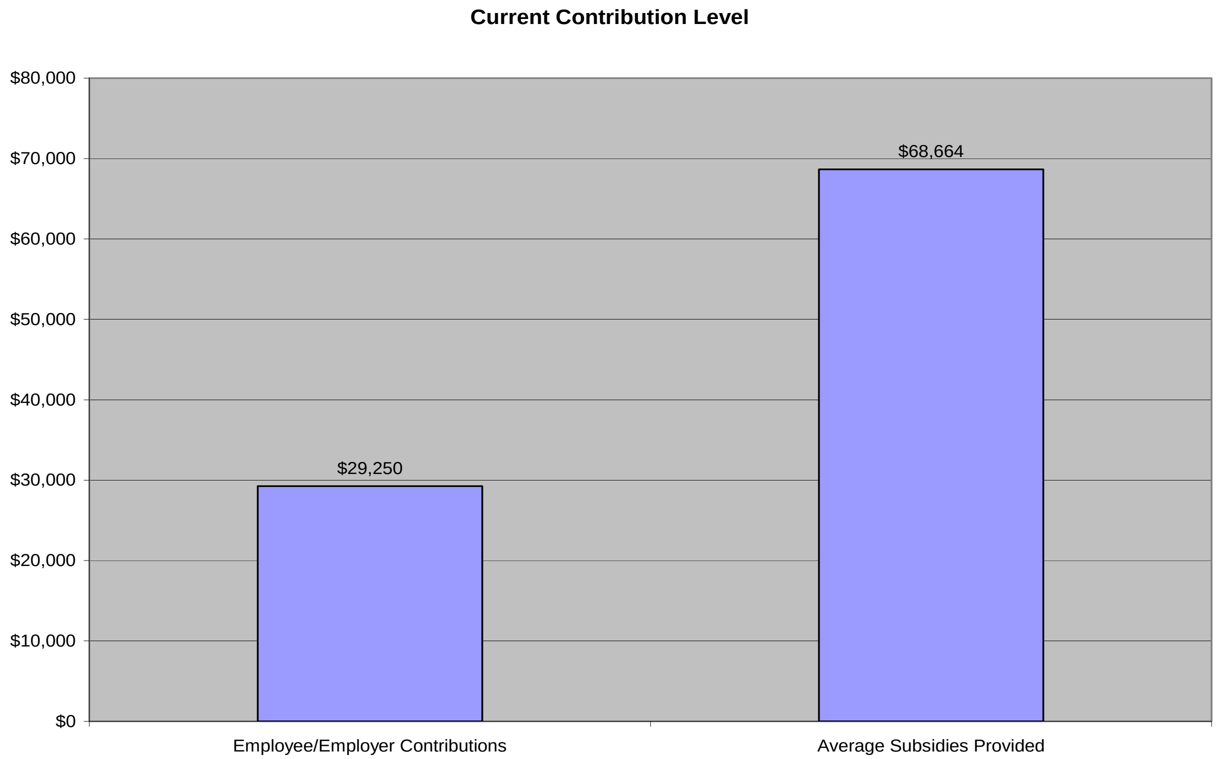
Synopsis of Bill

Senate Bill 366 increasing funding to the Retiree Health Care program by increasing employee and employer contributions from the current rate of 1.95 percent to 3 percent over a 4 year period. Senate Bill 366 would establish a higher contribution for employees who retire under a current enhanced plan (less than 21 years of service). The employer and employee increase for these employees would increase from 1.95 percent to 3.75 percent, again, graduated over a four year period with the increase in the first year deferred. The supplemental disbursement, approved by the Legislature in 2007 is scheduled to sunset on June 30, 2010. Lastly, Senate Bill 366 would also remove the sunset on a $3 million yearly supplemental disbursement from the TAA Fund.

FISCAL IMPLICATIONS

Senate Bill 366 would increase the employer and employee contribution from 1.95 percent (1.3 percent for the employer and .65 percent for the employee) to 3 percent (2 percent for the employer and 1 percent for the employee) by FY13. Senate Bill 366 would defer the start of the increase until FY11, and then phase it in over the next three years.

The example provided by RHCA illustrates the impact of the proposed change for an employee earning an average of $60,000 over a 25 year period:



Annual Employer Contribution - $780 (1.30 percent)
Annual Employee Contribution - $390 (0.65 percent)
Total Contribution (25 years) - $29,250

RHCA Subsidy: Non-Medicare (average) - $4,572 x 12 years = $54,864
Medicare (average) - $1,380 x 10 years = $13,800
Total RHCA Subsidy over Life of Average Retiree - $68,664
Contributions – Subsidies = $29,250 - $68,664 = ($39,414)

Annual Employer Contribution - $1,200 (2.0 percent)
Annual Employee Contribution - $600 (1.0 percent)
Total Contribution (25 years) - $45,000

RHCA Subsidy: Non-Medicare (average) - $4,572 x 12 years = $54,864
Medicare (average) - $1,380 x 10 years = $13,800
Total RHCA Subsidy over Life of Average Retiree - $68,664
Contributions – Subsidies = $45,000 - $68,664 = ($23,664)

According to CD, the increase in contributions in FY11 will cost CD $539,572 ($359,343 for employees who are in the enhanced retirement plan and $180,229 for employees who are not in the enhanced retirement plan). In FY12, the increase will cost CD $717,636 ($454,679 for employees who are in the enhanced retirement plan and $262,467 for employees who are not in the enhanced plan). In FY13, the cost will be $894,715 ($550,015 for employees who are in the enhanced retirement plan and $344,700 who are not in the enhanced plan).

SIGNIFICANT ISSUES

RHCA was created in 1990 to provide health care benefits for retired public employees. RHCA currently provides coverage to approximately 42,000 retirees and eligible dependents. RHCA offers comprehensive health, dental, vision and life insurance for Medicare and non Medicare eligible retirees. Currently, RHCA has 276 participating entities, including State agencies, cities, counties, public and charter schools, and universities.

RHCA's main revenue sources include employer and employee contributions, premiums paid by retirees, and investment income. In FY05, employer and employee contributions equaled approximately 46 percent of RHCA's revenue, while in FY10 employer and employee contributions is expected to equal 36 percent of RHCA's revenue. In FY19, employer and employee contributions will only account for 18 percent of RHCA's revenue.

RHCA is facing a number of significant challenges including rising medical costs related to healthcare trends, an aging population, increased participation and unsustainable benefit plan options. According to the 2007 actuarial valuation, RHCA was projected to become insolvent by 2014. The valuation also placed the unfunded actuarial accrued liability (UAAL) of the program at nearly $5 billion with a nearly $400 million gap in contributions needed to support the plan and pre-fund future benefits as measured annually.

In 2007, House Bill 728 formed a work group comprised of legislative, executive and RHCA representatives to study long-term financing options and develop a set of recommendations to the Governor and Legislature addressing solvency issues. As a result of the recommendations made RHCA increased retiree premiums by an average of 9 percent across all plans on January 1, 2008. Then on July 1, 2008, RHCA increased the contributions paid by retirees on average of 15.5 percent across all medical plans. However, medical premiums are scheduled to remain flat until January 2010, despite medical trend increasing on an annual basis. Some retirees, particularly those in the richer, more heavily subsidized plans, saw their contributions increase by as much as 70 percent. This actions increased RHCA's solvency period, reduced the UAAL, and narrowed the gap in the annual required contribution.

Taken together, these actions have improved RHCA's financial outlook. Program solvency has been extended from 2014 to 2019. New Mexico's unfunded liability has now been reduced by more than a $1 billion to $2.9 billion, and the annual required contribution gap was decreased by $100 million.

For many years premium increases have lagged behind the rate of increase in the cost of providing medical care. RHCA had adopted a policy of using long-term investment income and fund balance to offset these costs.

PERFORMANCE IMPLICATIONS

Senate Bill 366 would increase RHCA's estimated solvency period from 2019 to 2027. Furthermore, it would also result in future decreases to the State's unfunded liability and annual required contribution to fund present and future benefits.

OTHER SUBSTANTIVE ISSUES

At the inception of RHCA in 1990, 16,058 retirees and their dependents were brought into the program and provided benefits after having paid into the system for only six months. Unlike New Mexico's Public Employee Retirement Authority which had a six year moratorium during which contributions were collected prior to any benefits being paid out, there was only six months pre-funding of RHCA.

RHCA estimates that if the program had been pre-funded by requiring 20 years of contributions by active employees and their employers prior to paying out benefits and all contributions since 1970 had been used to pre-fund the benefit, the funding ratio would be 84% as of December 31, 2006 and would represent 84 percent of New Mexico's UAAL.

At its inception, RHCA was expected to pre-fund or pay for, benefits for future retirees. However, as noted above, that has never happened and currently all of the active employer and employee contributions are being spent to provide benefits to current retirees and their families. For example, the active employer and employee contributions for FY06 made up 40.4 percent of RHCA's agency annual revenue.

The lack of any pre-funding of benefits puts the entire system at risk and calls into question whether today's employees will have access to a retiree healthcare benefit at all, even though they have paid into the system throughout their careers.

For an employee making $25,000, the increase to 3 percent would mean less than $100 per year in additional deductions for RHCA, and for an employee making $75,000 the increase would mean less than $263 per year in additional deductions for RHCA

According to RHCA, further increases to retiree premiums and adjustments to benefit plans must be considered as part of an overall solvency plan; however, it will be difficult to maintain future benefits absent an increase to the employer and employee contributions.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

RHCA will have to consider a significant increase to retiree health care premiums in excess of medical inflation and reducing benefits for retirees. According to RHCA, without an increase to the employer and employee contribution it is likely that the increases in costs to current retirees needed to prevent insolvency would be so drastic as to make the cost of insurance through RHCA cost prohibitive to current retirees and increasing the number of uninsured New Mexican's.

New Mexico, in total compensation, ranks above many of the states within the comparator market due to the impact of the state's benefit programs. Historically, the Legislature has sought to offset limited salary increases by shifting the cost burden for employee benefits from the employee to the state. This growth in indirect compensation is a significant recurring cost with implications for the future in the ability to attract and retain quality employees.

According to the Fiscal Outlook and Policy section of Volume I, the revenue forecast for the next 4 years indicates little to no growth. The February 2009 revenue forecast is expected to indicate even fewer dollars will be available over the next four years. Given this information, the prospect for pay increases for public employees is unlikely and passage of this bill would reduce employee take-home pay beginning in FY10.

DA/mc