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

SPONSOR SFC **ORIGINAL DATE** 01/30/12 **LAST UPDATED** 02/13/12 **HB**

SHORT TITLE Educational Retirement Changes **SB** 150/SFCS

ANALYST Smith

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY14	**FY15**	**FY16**	**FY17**	**FY18**		
$6,687,500.0	$13,375,000.0	$40,125,000.0	$64,200,000.0	$77,575,000 .0	Recurring	ERB

(Parenthesis ( ) Indicate Revenue Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Educational Retirement Board (ERB)

SUMMARY

Synopsis of Bill

The Senate Finance Committee substitute for Senate Bill 150 makes significant certain changes and increases employee contributions for current and prospective members. The bill also spreads out employer increases over a longer time frame than currently called for in statute.

Retirement Eligibility Requirements for Persons Who Become Members On or After July 1, 2012 ("Tier 3"). Tier 3 would require persons who become members of the educational retirement system on or after July 1, 2012 to: (1) have not less than eight years of contributory employment to be eligible for retirement benefits (a/k/a "8 year vesting"; and; (2) be at least age 55 to be eligible for retirement benefits ("Minimum Retirement Age 55"). Tier 3 members would be eligible for retirement benefits after satisfying one of the following: (a) Age 55 and 30 or more years of earned service credit; (b) Age 55 and sum of member's age and years of earned service credit equal 80 ("Rule of 80); or, (c) Age 67 and 8 years earned service credit. Benefits of member retiring under the Rule of 80 who are not Age 65 at retirement would be permanently reduced based on the age at retirement. This is the same as for Tier 2 members and similar to the permanent reduction in benefits for Tier 1 members who are not Age 60 at retirement.

The substitute does not include a minimum retirement age requirement for persons in ERB Tier 1 (members before July 1, 2010), or Tier 2 (new members on or after July 1, 2010 and on or before June 30, 2012).

The changes in employee and employer rates are the essence of this bill and are shown under the “FISCAL IMPLICATIONS” and “PERFORMANCE ISSUES” sections.

The committee substitute leaves intact the COLA that ERB retirees Age 65 or older receive. The COLA is based on changes in the Consumer Price Index (“CPI”). ERB’s COLA has two levels: (1) Change in CPI is less that 2% - the COLA is equal to the actual change in CPI when the increase is less than 2%; and (2) Change in CPI is 2% or greater - the COLA is ½ of the change in CPI, up to a maximum COLA of 4%. SB 150 as originally introduced reduced the COLA by one-eighth, in effect limiting it to a maximum of 1.75% if the increase in the CPI was less than 2% and a maximum of 3.5% when the CPI was 2% or greater.

FISCAL IMPLICATIONS

ERB has provided an actuarial analysis of the current and proposed plan which is shown that the bill would improve the plan’s funded ratio by 5.4 percent to 92.2 percent by 2040. However, the Senate Finance Committee heard testimony that asserted that the liability discount assumptions used by actuaries are too permissive. If this assertion is true, the changes proposed in the bill might be insufficient.

The bill produces significant nonrecurring savings to employers by spreading out the contribution rates and significantly shifting the burden to employees. Table 1 shows the bills affect on employer contribution rates. For ease of exposition, the rates for earners below $20 thousand are ignored. These numbers are negative since they reduce ERB *income and should be thought of as a temporary reduction in appropriations.* The General Fund impact assumes the fund bears 90 percent of the total cost.

Table 1
Proposed and Scheduled Employer Contribution Rates & Revenues

	150/SFCS	**Scheduled**	**General Fund**	**Other Sources**	**Total**
FY13	10.90%	10.90%	0	0	0
FY14	11.40%	13.15%	(42,131,250)	(4,681,250)	(46,812,500)
FY15	11.90%	13.90%	(48,150,000)	(5,350,000)	(53,500,000)
FY16	12.40%	13.90%	(36,112,500)	(4,012,500)	(40,125,000)
FY17	12.90%	13.90%	(24,075,000)	(2,675,000)	(26,750,000)
FY18	13.40%	13.90%	(12,037,500)	(1,337,500)	(13,375,000)
FY19	13.90%	13.90%	0	0	0
FY20	13.90%	13.90%	0	0	0

The nonrecurring nature of these savings is a concern. They represent a simple deceleration of rates, and are therefore unsuitable for budgeting against any recurring program. However, the ERB's need for these funds is acute. Given the bill's modest improvement to the fund's solvency, it might be wise to consider restoring these revenues to ERB.

SIGNIFICANT ISSUES

The Despite the ERB's poor one-year investment performance, it still remains the only New Mexico fund to rank higher than the 25th percentile for the past five years; all other funds ranked well in the last quartile of their peer groups for the five-year period.

Table 2

Three-Year Trend of Funded Ratios FY09-FY11

Fund	June 30, 2009	June 30, 2010	June 30, 2011
ERB	67.5%	65.7%	61.6%
PERA	84.0%	78.5%	70.5%

Source: Pension Valuations

Realizing returns less than the assumed long-term rate adds to the plans' unfunded liabilities. In April, 2011, the ERB decreased the investment return assumption to 7.75 percent, down from 8 percent. As a result the unfunded accrued actuarial liabilities (UAAL) increased by $473 million, bringing the total UAAL for 2011 to $5.9 billion. Additionally, the PERA also decreased its assumed returns from 8 percent to 7.75 percent. The PERA had a substantial increase in its unfunded liability to nearly $5 billion.

While this bill only pertains to ERB, the LFC is acutely concerned about the solvency of both plans. Despite large investment gains for FY10 and FY11, both plans show weaker funded ratios – indicators of plan solvency that compare plan assets to pension obligations. Having 80 percent of obligations covered by assets (funded ratio) has traditionally been viewed as a minimum industry indicator of fund health. Neither plan meets that basic metric nor are they improving. Both plans go far beyond the recommended period of time to pay off the UAAL of 30 years established by the Governmental Accounting Standards Board. Both the ERB and PERA sit on an aggregate period that is now infinite, meaning – given all assumptions holding true – the debt would never be paid off for all its plans.

New Mexico offers a defined pension benefit plan, calculating benefits based on years of service and highest average salary. The benefits include cost-of-living adjustments (COLAs) that accrue automatically and are tied to the Consumer Price Index (CPI) for inflation. In light of the recent recession and continued growth of pension liabilities, many state legislatures are considering modifying contractually vested rights in the name of state solvency. As a sovereign power, a state has the right to adjust any long-term contract that is largely unfair to one party (taxpayers).
The Legislative Council Service hired Buck Consultants in 2010 as an independent actuarial firm to advise the task force. While the firm offered valuable recommendations for improving actuarial methods and assumptions for the PERA and the ERB, the firm found the ERB will become insolvent by 2039 and the PERA by 2058, because assets are not growing as fast as the benefits paid out.

PERFORMANCE ISSUES.

The bill's improvements to ERB solvency are borne solely on the backs of current and future employees. Table 3 shows the bills affect on employee contribution rates. Again for ease of exposition, the rates for earners below $20 thousand are ignored. The "Revenue" column should be read as income to ERB.

Table 3
Proposed and Scheduled Employee Contribution Rates & Revenues

	150/SFCS	Scheduled	Revenues
FY13	9.40%	9.40%	53,500,000
FY14	9.90%	7.90%	66,875,000
FY15	10.40%	7.90%	80,250,000
FY16	10.90%	7.90%	90,950,000
FY17	11.30%	7.90%	90,950,000
FY18	11.30%	7.90%	0
FY19	11.30%	7.90%	0
FY20	11.30%	7.90%	0

As the attachment shows, the final employee contribution rates would be one of the highest in the country.

Increasing employee contributions may have a negative effect on recruiting and retaining highly qualified teachers. In 2003, in response to recruitment and retention issues, the Legislature passed the three-tiered licensure system, which established large minimum salary increases for licensees as they moved up in licensure level. The average returning teacher salary in New Mexico for the 2011-2012 school year is estimated at approximately $46 thousand. Research conducted by the National Education Association in 2009, Rankings & Estimates, ranked New Mexico as 37th national in terms of average salaries of instructional staff. Many school employees have not received raises over the past 4 years, and in fact have seen take-home pay decrease 2.25 percent as a result of retirement contribution swaps. Further increasing the employee's contribution rate and decreasing take-home pay may result in prospective teachers looking for education employment outside of the state where salaries are on average higher than in New Mexico, and decreases to take home pay from retirement contributions aren't as high.

SUGGESTED AMENDMENTS

As noted above, the sponsor might wish to consider restoring the (currently scheduled) employer contributions to the substitute.

SS/svb

CONTRIBUTION AND VESTING REQUIREMENTS

	State	Fund Name	Social Security	Employee Contribution	Employer Normal Cost or Statutory Contribution	Vesting Period
1	Alabama	ERS	Yes	5.00%	4.90%	10 years
2	Alabama	TRS	Yes	5.00%	6.39%	10 years
3	Alaska	PERS	No	8.00%	5.00%*	5 years
4	Alaska	TRS	No	8.00%	7.00%*	5 years
5	Arizona	SRS	Yes	9.00%	6.45%	Immediate
6	Arkansas	PERS	Yes	5.00%	12.54%	5 years
7	Arkansas	TRS	Yes	6.00%	12.87%	5 years
8	California	PERS	Yes	5.00% or 6.00%	10.55%	5 years
9	California	TRS	No	8.00%	8.25%	5 years
10	Colorado	PERA	No	8.00%	10.15%	5 years
11	Connecticut	SERS	Yes	2.00%	4.70%	5 years
12	Connecticut	TRS	No	6.00%	4.40%	10 years
13	Delaware	SEPP	Yes	3.00% above $6,000	6.85%	5 years
14	Florida	FRS	Yes	Non-contributory	8.69%	6 years
15	Georgia	ERS	Yes	1.25%	6.80%	10 years
16	Georgia	TRS	Yes	5.00%	7.96%	10 years
17	Hawaii	ERS	Yes	6.00%	5.85%	5 years
18	Idaho	PERS	Yes	6.23%	10.39%	5 years
19	Illinois	SERS	Yes	4.00%	16.56%	8 years
20	Illinois	TRS	No	9.40%	9.15%	5 years
21	Illinois	MRF	Yes	4.50%	7.58%	8 years
22	Indiana	PERF	Yes	3.00%	6.26%	10 years
23	Indiana	TRF	Yes	3.00%	4.97%	10 years
24	Iowa	PERS	Yes	3.90%	6.05%	4 years
25	Kansas	PERS	Yes	4.00%	7.39%	10 years
26	Kentucky	ERS	Yes	5.00%	3.55%	5 years
27	Kentucky	CRS	Yes	5.00%	3.85%	5 years
28	Kentucky	TRS	No	9.86%	9.86%	5 years
29	Louisiana	SERS	No	7.80%	7.31%	10 years
30	Louisiana	TRSL	No	8.00%	15.5% min	5 years
31	Maine	SRS	No	7.65%	17.01%	5 years
32	Maryland	SRS	Yes	2.00%	8.86%	5 years
33	Massachusetts	SERS	No	9.00%	3.80%	10 years
34	Massachusetts	TRS	No	11.00%	1.96%	10 years
35	Michigan	SERS	Yes	Non-contributory	8.30%	10 years
36	Michigan	MERS	Yes	Varies by plan	Varies by plan	6, 8, or 10 yrs
37	Michigan	PSERS	Yes	3.00% to 4.30%	5.60%	10 years
38	Minnesota	MSRS	Yes	4.50%	4.50%	3 years
39	Minnesota	PERA	Yes	6.00%	6.50%	3 years
40	Minnesota	TRA	Yes	5.50%	5.50%	3 years
41	Mississippi	PERS	Yes	7.25%	11.85%	8 years
42	Missouri	SERS	Yes	Non-contributory	12.75%	5 years
43	Missouri	LAGERS	Yes	0%-4.00%	Varies by plan	5 years
44	Missouri	PSRS	No	10.86%	10.86%	5 years
45	Montana	PERS	Yes	6.90%	6.94%	5 years

46	Montana	TRS	Yes	7.15%	7.47%	5 years
47	Nebraska	SERS	Yes	4.80%	156% of mbr contr	3 years
48	Nebraska	CERS	Yes	4.50%	150% of mbr contr	3 years
49	Nebraska	SPP	Yes	7.28%	101% of mbr contr	5 years
50	Nevada	PERS	No	11.25%	11.25%	5 years
51	New Hampshire	NHRS	Yes	5.00%	4.67%	10 years
52	New Jersey	PERS	Yes	5.50%	4.80% state; 3.44% local	10 years
53	New Jersey	TPAF	Yes	5.50%	1.8 billion (total varies)	10 years
54	New Mexico	PERA	Yes	7.42%	16.59%	5 years
55	New Mexico	ERB	Yes	7.90%	5.66%	5 years
56	New York	ERS	Yes	3.00%	9.60%**	5 years
57	New York	TRS	Yes	3.00%	7.63%	5 years
58	North Carolina	TSERS	Yes	6.00%	3.36%	5 years
59	North Carolina	LGERS	Yes	6.00%	4.80%	5 years
60	North Dakota	PERS	Yes	4.00%	4.12%	3 years
61	North Dakota	TRF	Yes	7.75%	8.25%	5 years
62	Ohio	PERS	No	10.00%	14.00%	5 years
63	Ohio	STRS	No	10.00%	14.00%	5 years
64	Oklahoma	PERS	Yes	3.00% to 3.50%	12.46%	8 years
65	Oklahoma	TRS	Yes	7.00%	9.00%	5 years
66	Oregon	PERS	Yes	6.00%	7.50%	5 years
67	Pennsylvania	SERS	Yes	6.25%	9.51%	5 years
68	Pennsylvania	PSERS	Yes	7.32% (average)	4.00%	5 years
69	Rhode Island	ERS	Yes	8.75% (9.50% teachers)	1.64% (2.33% teachers)	10 years
70	South Carolina	SCRS	Yes	6.50%	9.24%	5 years
71	South Dakota	SRS	Yes	6.00%	6.00%	3 years
72	Tennessee	CRS	Yes	Non-contributory	13.58%	5 years
73	Texas	ERS	Yes	6.00%	6.45%	5 years
74	Texas	TRS	No	6.40%	6.58%	5 years
75	Texas	MRS	Yes	5.00%, 6.00%, or 7.00%	5.00% to 14.00%	5 years
76	Utah	SRS	Yes	Non-contributory	11.62% to 14.22%	4 years
77	Vermont	SRS	Yes	5.10%	5.93%	5 years
78	Vermont	TRS	Yes	3.40%	3.54%	5 years
79	Virginia	SRS	Yes	5.00%	6.15%	5 years
80	Washington	PERS	Yes	4.61%; non-contributory	4.72%	5 yrs; 10 yrs
81	Washington	TRS	Yes	4.93%; non-contributory	5.70%	5 yrs; 10 yrs
82	West Virginia	PERS	Yes	4.50%	10.50%	5 years
83	West Virginia	TRS	Yes	6.00%	7.50%	5 years
84	Wyoming	WRS	Yes	5.57%	5.68%	4 years
85	Milwaukee	City	Yes	5.50%	11.22% (due in 2010)	4 years
86	Milwaukee	County	Yes	Non-contributory	$34,981,095	5 years
87	Wisconsin	WRS	Yes	5.00%	4.80%	Immediate

*Alaska PERS and TRS converted to a defined contribution plan on July 1, 2006

**Average rate for 2008