LEGISLATIVE EDUCATION STUDY COMMITTEE
BILL ANALYSIS

Bill Number: CS/SB 27a **51st Legislature, 1st Session, 2013**

Tracking Number: .193584.2

Short Title: Public Employee Retirement Changes

Sponsor(s): Senator George K. Munoz and Representative Luciano "Lucky" Varela

Analyst: Ian Kleats **Date: March 15, 2013**

SENATE FINANCE COMMITTEE SUBSTITUTE FOR SENATE BILL 27

AS AMENDED

The Senate Finance Committee amendments address minor technical issues in the title of the bill and in a section relating to cost-of-living adjustment (COLA) eligibility.

Original Bill Summary:

Effective July 1, 2013, CS/SB 27 amends multiple sections of the *Public Employees Retirement Act* to:

- allow municipal affiliated public employers to enter into a collective bargaining agreement through which the employer would pay an additional portion of employees' retirement contributions under certain conditions;
- change provisions relating to the purchase of service credit for certain members;
- suspend the cost-of-living adjustment (COLA) for previously retired members returning to work;
- change the calculation of pension benefit received when a member has service credit under multiple coverage plans;
- clarify eligibility requirements for disability retirement and survivor benefits under existing and proposed vesting periods;
- establish age and service requirements for new members[1] of certain coverage plans;
- modify and define the calculation of the amount of pension benefits for current and new members, respectively, under certain coverage plans;
- increase the employee contribution rates by 1.5 percent of certain coverage plans for members whose annual salary is greater than $20,000;
- increase the employer contribution rates by 0.4 percent for certain coverage plans beginning in FY 15;
- decrease the compounding COLA rate to 2.5 percent (from 3.0 percent) for certain retired members with an annual pension benefit of $20,000 or less and to 2.0 percent (from 3.0 percent) for all other retired members; and
- extend the qualification period before which a COLA may be applied to seven years (from two years) subject to a three-year phase in beginning in FY 15.

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[1] New member refers to those employees becoming members on or after July 1, 2013.

As explained under “Technical Issues” below, CS/SB 27 appears to alter an existing vested property right for certain current members who qualify for the “Rule of 80,” which includes members hired after June 30, 2010 under the State General Member Coverage Plan 3 or Municipal General Member Plans 1 through 4.

More details about the bill are presented under specific topics below.

Suspending COLA for Retirees Returning to Work

CS/SB 27 suspends the COLA for retirees returning to work with an Educational Retirement Act-affiliated, or with a PERA-affiliated employer when the retiree elects to become a member again. Current law allows retired members to accrue additional service at the same time that they receive a COLA. Although this change limits retired members to only the accrual of additional service credit, CS/SB 27 also increases the service credit factor in calculating pension benefits, which offsets some of the impact from removing the COLA.

This change would affect all return-to-work retirees beginning July 1, 2013, even if the member retired and returned to work prior to that date.

Calculating Pension Benefit under Multiple Coverage Plans

CS/SB 27 amends the calculation of pension benefits when a member has service credit, earned after July 1, 2013, under two or more coverage plans. The changes would still allow a member to benefit from the calculations in current law, but only for service credit earned prior to the bill’s effective date. For service credit earned after that date, the pension benefit will equal the sum of pensions attributable to each coverage plan in accordance with the calculations defined within those plans.

Purchase of Service Credit, Eligibility for Disability Retirement, and Survivor Benefits

CS/SB 27 adjusts certain minimum service credit requirements in sections relating to the purchase of service credit, eligibility for disability retirement, and survivor benefits in an apparent attempt to account for the changes to normal retirement requirements of new members across multiple coverage plans.

Age and Service Requirements

CS/SB 27 creates a separate tier of age and service requirements for new members of the certain coverage plans. New state police officer members would no longer receive a 20 percent service credit increase, although that increase would continue for those who were members prior to July 1, 2013.

CS/SB 27 amends the age and service requirements for certain employees hired and becoming members after June 30, 2010 but prior to July 1, 2013 to give them the same age and service requirements for those who became members prior to July 1, 2010 (see “Technical Issues,” below).

Amount of Pension Benefits

CS/SB 27 modifies the calculation of the amount of pension benefit for certain coverage plans. The bill sets the maximum pension for those plans at 90 percent of final average salary for both new and current members. However, new members within the following coverage plans will have an annual pension factor that is one-half percent lower than current members in the same coverage plan:

- State General Member Plan 3;
- Municipal General Member Plans 2, 3, and 4;
- Municipal Police Member Plans 2, 3, 4, and 5; and
- Municipal Fire Member Plans 2, 3, 4, and 5.

Contribution Rate Increases

CS/SB 27 increases employee contributions rates by 1.5 percent and employer contribution rates by 0.4 percent, resulting in a total contribution rate increase of 1.9 percent, for certain employees of certain coverage plans. The proposed employee contribution rate increase does not apply to members of those plans with an annual salary of $20,000 or less.

The attachment, "PERA Member Contribution Rates," details the current and proposed contribution rates for each coverage plan. The 0.4 percent incremental employer contribution rate increase would go into effect at the start of FY 15.

COLA Rate and Qualification Period

CS/SB 27 amends the COLA rate to 2.0 percent per year, down from 3.0 percent, and clarifies the language relating to compounding to ensure that the compounding increase is inclusive only of prior *cost-of-living* adjustments, rather than *all* prior adjustments. The rate decrease will affect current and future retirees, regardless of coverage plan.

The bill phases in, over the course of three years beginning in FY 15, an increase to the COLA eligibility period up to seven years from two years in current law. It provides that members under any coverage plan:

- retiring on or before June 30, 2014 must wait two years before COLA eligibility;
- retiring between July 1, 2014 and June 30, 2015 must wait three years before COLA eligibility;
- retiring between July 1, 2015 and June 30, 2016 must wait four years before COLA eligibility; and
- retiring after July 1, 2016 must wait seven years before COLA eligibility.

CS/SB 27 also cleans up statute in the *Public Employees Retirement Act*, without altering the substance of the law. Included in this category of changes is renaming the "state hazardous duty" member to "juvenile correctional officer" member.

Finally, the effective date of the provisions of this bill is July 1, 2013, but some components are phased in over a several years as noted above.

Fiscal Impact:

CS/SB 27 does not carry an appropriation, but the employer contribution increases would require adequate funding beginning FY 15 pursuant to Article XX, Section 22 of the state constitution.

Fiscal Issues:

During the interim, testimony to the Legislative Education Study Committee (LESC) by Legislative Council Service staff for the interim Investments and Pensions Oversight Committee (IPOC), indicated:

- the industry standard for actuarial soundness of a pension fund suggests that any funded level below 80 percent carries increased risks; and
- based on accounting and financial statement requirements from the Governmental Accounting Standards Board (GASB), ratings agencies could begin downgrading the bond rating of governments unless steps are taken to improve actuarial standing of public pensions.

The Public Employees Retirement Association (PERA) projects that, if the bill is enacted, the retirement fund's funded ratio will reach approximately 90 percent by 2042.

Substantive Issues:

Economic Implications

According to the PERA Comprehensive Annual Financial Report for FY 12, PERA's annual covered payroll for FY 12 was approximately $1.994 billion. Based on that figure:

- LESC staff estimate the 1.5 percent increase to the employee contribution rate could result in reduced pre-tax income of $29.9 million per year relative to current law;
- the employer contribution increase of 0.4 percent could result in reduced government spending on goods and services other than retirement funding of approximately $8.0 million per year relative to current law;
- the combination of those decreases in spending, totaling $37.9 million, could have substantial implications for economic growth and government revenues; and
- these estimates do not consider possible payroll growth, which could further increase the total economic impact.

The possible contractionary economic impact of the increased contribution rates could be partially offset if PERA were to make investments of those contributions in companies that operate wholly within the state, but the current composition of PERA investments suggests a significant portion of investments are made out of the state.

As a final point on this topic, in written testimony provided to a joint session of the Senate Judiciary Committee and the House Labor and Human Relations Committee during the 2013 legislative session, Dr. Dean Baker[2] stated that "[i]f we overfund our pensions by having [higher] tax rates than would otherwise be necessary in the present, then we will be causing unnecessary losses of economic output."

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[2] Dr. Dean Baker is co-director of the Center for Economic and Policy Research in Washington, DC. He previously worked as a senior economist at the Economic Policy Institute and an assistant professor at Bucknell University. He has also worked as a consultant for the World Bank, the Joint Economic Committee of the U.S. Congress, and the OECD's Trade Union Advisory Council.

Differences between Funded Ratio and Solvency

To put Dr. Baker's statement in context, it is important to make the distinction between funded ratio and plan solvency which, although related, should not be confused for the same concept.

Funded ratio is:

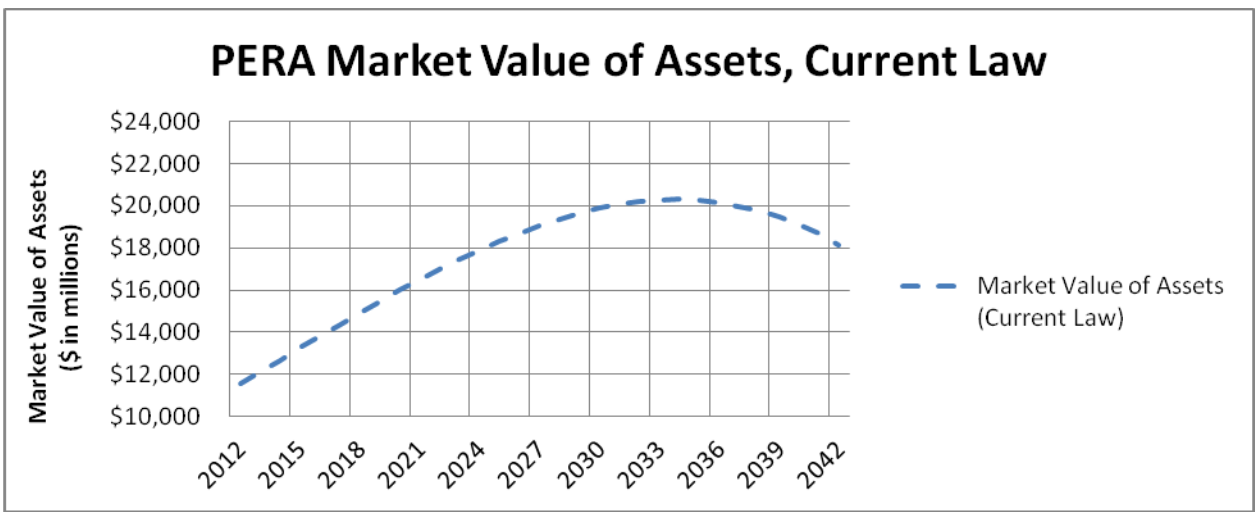
- the actuarial value of assets ("what we have today") divided by the actuarially accrued liability ("what we might owe in the future for today's workers");
- dependent on accrual basis accounting ("putting future expenses or income on today's books"); and
- dependent on actuarial methods ("statistically weighting by possibilities").

Solvency is:

- the ability to meet maturing obligations as they come due; or
- "being able to pay our bills today for what we promised yesterday."

Consequently, it is entirely possible for the state to meet its pension obligations through PERA, that is to say the fund could remain solvent, indefinitely into the future even with a funded ratio persistently less than 100 percent. Programs with this feature could be characterized as partially or fully pay-as-you-go.

The graph below, of market value of assets, illustrates the amount PERA has available to pay out benefits and other costs in future periods. As such, when net assets drop below $0, the fund would be insolvent; and when these assets display a long-term downward trend, it would indicate that potential corrective action might be necessary to prevent insolvency.



Source: PERA

Under current law, the PERA fund's market value of assets would peak in calendar year 2034 and thereafter start declining. Although not shown on this graph, the market value of assets would continue to decrease until approximately 2055 when the fund would become insolvent. The changes proposed by CS/SB 27 appear to prevent insolvency indefinitely, but it is possible that the trajectory of the market value of assets might be steeper than necessary to do so.

As noted in "Fiscal Issues" above, the provisions of CS/SB 27, although improving the fund status, are not structured in such a way to target a funded ratio of exactly 100 percent; instead, these provisions target a funded ratio much higher. A funded ratio of more than 100 percent provides little more protection against insolvency than a ratio of 100 percent. A funded ratio exceeding 100 percent could be considered overfunding, which according to Dr. Baker's testimony, could cause unnecessary loss of economic output.

Technical Issues:

By removing the "Rule of 80" option for normal retirement from certain current members, CS/SB 27 appears to alter an existing vested property right for those members. This could affect members hired after June 30, 2010 under the State General Member Coverage Plan 3 or Municipal General Member Plans 1 through 4.

Article XX, Section 22, Subsection D of the Constitution of the State of New Mexico states:

> "Upon meeting the minimum service requirements of an applicable retirement plan created by law for employees of the state or any of its political subdivisions or institutions, a member of a plan shall acquire a vested property right with due process protections under the applicable provisions of the New Mexico and United States constitutions."

Under the "Rule of 80," a member qualifies for retirement at any age if the sum of the member's age and years of service credit equals at least 80. The question then follows: how many years is the minimum service requirement under this option? Members having this option could satisfy the minimum service requirement as early as their first year of earned service[3]. Therefore, it appears that those members have a vested property right that CS/SB 27 would alter.

This issue, which correspondence with Attorney General's Office staff indicates might merit legislative discussion, could possibly be addressed through an amendment that would allow certain current members to continue to use the "Rule of 80" provisions in some form. It appears that the rule could be changed to a "Rule of 85," "Rule of 90," or even "Rule of 100" without altering the underlying vested property right so long as a different minimum service requirement is not imposed.

It appears that page 12, line 15 should include the phrase "or executed collective bargaining agreement" immediately following "the filing of the resolution." As written, an *executed collective bargaining agreement* would only become effective the first pay period following the filing of a *resolution*, which might not be the intended meaning and might result in collective bargaining agreements never becoming effective.

On page 33, lines 15 through 22, are provisions in current law that allow for the discontinuation of disability retirement payments. One of the conditions detailed by this section is for the disability retired member who has gainful earnings from employment greater than $15,000. Although this amount might be appropriate now, it is not tied to any measure of inflation. It is possible that in future years that amount may become too low as a threshold because of growth in the consumer price index. While making other changes to current law, it might be considered

[3] State General Coverage Plan 3 members appear to have a 1.5 year minimum service requirement even under the "Rule of 80" because of notwithstanding language in §10-11-26.7 NMSA 1978.

amending this section of law to tie the disqualifying amount to the same measure of inflation used by the federal Social Security program.

Background:

House Joint Memorial 19 (2012) requested that the PERA Board assess options for changes to public employee retirement plans to reduce unfunded accrued actuarial liabilities with the goal of reaching a 100-percent funded ratio by 2041.

The PERA Board endorsed the resulting proposal on June 22, 2013. PERA then took its board-approved proposal to interim legislative committees for discussion:

- IPOC endorsed the proposal on November 28, 2012; and
- LESC unanimously endorsed the proposal on January 14, 2013.

The provisions of CS/SB 27 contain many of the features of the bill endorsed by the PERA Board, IPOC, and LESC, but notable changes include:

- maintaining lower employee contribution rates for members with annual salaries of $20,000 or less;
- reducing the employer contribution rate increase to 0.4 percent from 1.5 percent; and
- providing a larger, but still reduced, COLA rate of 2.5 percent to retired members with an annual pension benefit of $20,000 or less.

The attachment, "PERA Member Contribution Rates," details the employee and employer contribution rates that will prevail on July 1, 2013 under current law. FY 13 is the final year of a 1.5 percent employee-employer contribution swap enacted by Laws 2009, Ch. 127, which increased the employee rate while decreasing the employer rate by the same amount in an effort to improve the fiscal position of the state.

Further solvency action through Laws 2011, Ch. 178, resulted in an additional employee-employer contribution swap of 1.75 percent. The duration of that swap was contingent on revenue forecasts not exceeding budgeted amounts by a certain amount, and year-end reserve levels under 5.0 percent of appropriations. At the end of FY 12, the contingency conditions were not fulfilled, resulting in a termination of the additional 1.75 percent swap beginning FY 13.

Committee Referrals:

SJC/SFC/HLC/HAFC

Related Bills:

CS/HB 95 *Judicial Retirement Changes*
CS/HB 147 *Public Employees Returning to Work Retirement*
HB 169 *Judicial Retirement Contributions*
CS/CS/SB 25a *Judicial Retirement Changes*
SB 26 *Supplemental Retirement Contributions*
CS/SB 71 *Retiree Health Care Contributions*
CS/SB 86 *Public Employee Average Salary Calculations*
SB 114a *Legislative Retirement Qualification*

SB 121 *Law Enforcement Returning to Work*
SB 168 *Public Safety Officers Returning to Work*

Educational Retirement Legislation:

HB 64 *Educational Retirement Changes*
HB 96 *Educational Retirement Sick Leave*
SB 115aa *Educational Retirement Changes*

ATTACHMENT

PERA Member Contribution Rates
CS/SB 27

	CS/SB 27				
	Employee (≤ $20k)	Employee (> $20k)	Employer[1]	Total (≤ $20k)	Total (> $20k)
State General					
Plan 3	7.42%	8.92%	16.99%	24.41%	25.91%
State Police and Correctional Officer					
Plan 1	7.60%	9.10%	25.50%	33.10%	34.60%
State Hazardous Duty					
Plan 2	4.78%	6.28%	26.12%	30.90%	32.40%
Municipal General					
Plan 1	7.00%	8.50%	7.40%	14.40%	15.90%
Plan 2	9.15%	10.65%	9.55%	18.70%	20.20%
Plan 3	13.15%	14.65%	9.55%	22.70%	24.20%
Plan 4	15.65%	17.15%	12.05%	27.70%	29.20%
Municipal Police					
Plan 1	7.00%	8.50%	10.40%	17.40%	18.90%
Plan 2	7.00%	8.50%	15.40%	22.40%	23.90%
Plan 3	7.00%	8.50%	18.90%	25.90%	27.40%
Plan 4	12.35%	13.85%	18.90%	31.25%	32.75%
Plan 5	16.30%	18.80%	18.90%	35.20%	37.70%
Municipal Fire					
Plan 1	8.00%	9.50%	11.40%	19.40%	20.90%
Plan 2	8.00%	9.50%	17.90%	25.90%	27.40%
Plan 3	8.00%	9.50%	21.65%	29.65%	31.15%
Plan 4	12.80%	14.30%	21.65%	34.45%	35.95%
Plan 5	16.20%	17.70%	21.65%	37.85%	39.35%
Municipal Detention Officer					
Plan 1	16.65%	18.15%	17.05%	33.70%	35.20%

[1] Employer contribution when fully phased in.