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

SPONSOR Larranaga **ORIGINAL DATE** 02/12/14 **LAST UPDATED** **HB** 291

SHORT TITLE Deferred Retirement Option Plan Act **SB**

ANALYST Hanika Ortiz

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY14	FY15	FY16		
	($2,150.0)		Recurring	PERA/State Police
	($9,850.0)		Recurring	PERA/Municipal Police
	$12,000.0		Recurring	proposed DROP fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY14	FY15	FY16	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$300.0			Recurring	PERA

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Public Employees Retirement Association (PERA)
Department of Public Safety (DPS)

SUMMARY

Synopsis of Bill

House Bill 291 creates the Deferred Retirement Option Plan (DROP) Act to provide an incentive for experienced police officers that are eligible to retire to continue their employment.

More specifically,

Sections 1 and 2 cite the title of the new act and purpose which includes providing an incentive for a police officer eligible to retire to continue employment with an affiliated public employer.

Section 3 includes definitions used in the act including *affiliated public employer* to include any public employer affiliated with PERA and not with the judicial or magistrate retirement plans.

Section 4 provides that the new act be administered by PERA.

Section 5 provides for 1) separate accounting funds that manage contributions, pension benefit payments, and interest earned; 2) an annual actuarial valuation and reporting requirements including to the LFC; and 3) expenses related to administration paid from investment income.

Section 6 establishes eligibility requirements for participation in DROP:

- meet age and service requirements for normal retirement;
- requires irrevocable consent to participate and immediate, continued employment;
- participant and employer make applicable nonrefundable contributions;
- participant does not earn service credit for the period of continued employment;
- participation must not exceed 60 consecutive months;
- participant contributions made prior to participation in DROP become nonrefundable;
- participant will not earn service credit during the continued employment;
- participant DROP accounts earn interest at 5 percent annually; and
- upon exit from DROP, participant may apply for disbursement by lump sum or roll-over.

Section 7 requires irrevocable consent to the terms of participation.

Section 8 reiterates that contributions are nonrefundable; the pension benefit deposited to DROP must be one hundred percent of the benefit the participant would have received had they retired; and, upon exit from DROP the pension benefit shall not be adjusted for any additional merit.

Section 9 provides that benefits, including health, be provided during the continued employment.

Section 10 provides that upon retirement and exit from DROP the balance of pension benefits, contributions, and interest accrued be paid to the participant either by lump sum payment, roll-over payment to an eligible tax qualified retirement plan, or a combination of both.

Section 11 provides for a beneficiary designation and their applicable rights.

Section 12 amends Section 10-11-2 NMSA 1978 of the PERA Act to include definitions for *continued employment*, *option plan* and *participant* as it applies to the DROP Act.

Section 13 amends Section 10-11-132 NMSA 1978 to require PERA to invest and reinvest DROP funds in accordance with the Prudent Investor Act.

FISCAL IMPLICATIONS

The bill provides that expenses related to the administration of the DROP act shall be paid from investment income. However, if participation is lower than projected, or if investments do not perform as well as expected, the plan may not generate enough revenue to cover these costs.

PERA reports its actuaries performed a limited actuarial study on the proposed DROP plan.

Based on an assumption of 100 percent participation, the total PERA unfunded actuarial accrued liability will increase $48.0 million. The State Police Division actuarial accrued surplus would decrease by about $8.6 million and the funded ratio would decrease from 111 percent to 110 percent. The Municipal Police Division's unfunded actuarial accrued liability would increase by about $39.4 million and the funded ratio would decrease from 75 percent to 74 percent. The table above reflects the fiscal impact if 25 percent of eligible retirees participate in the new plan.

The bill creates the deferred retirement option plan fund in the state treasury, to consist of money received from participant pension benefit payments, employer and participant contributions on behalf of a participant and investment earnings on the fund's balance.

This bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities

SIGNIFICANT ISSUES

The DROP provides an alternative method for payment of retirement benefits for up to 60 months for police officers eligible to retire under PERA and employed by PERA affiliated employers. Under the proposed plan, the police officer would stop earning service credit toward a future benefit; have his or her retirement benefit calculated at the time the DROP period begins; and allow his or her monthly retirement benefit including the cost-of-living adjustment (COLA) to accumulate in a DROP account and earn interest of five percent while the police officer continues to work. At termination of employment, the police officer's DROP account would be paid to them as a lump sum, a rollover or a combination of both, at their discretion.

PERA reflected that Senate Bill 27 (Chapter 225) was based on projections of future improvements in funded status. The cost of benefits for new members (in Tier 2) is less than those members hired before July 1, 2013 (Tier 1). PERA's actuarial projections for 2013 pension reform legislation replaced current members that are expected to leave active service with lower cost new members. Over time, as the lower cost Tier 2 members enter the plan, funded ratios improve. If the bill's proposed DROP is implemented, current Tier 1 members could stay in DROP for up to five years and delay the entry of lower cost Tier 2 members and the resulting improvements to the funded ratios.

In 2013, SB 27 (Chapter 225) also raised the pension maximum for all members to 90 percent of final average salary to incentivize members to work longer.

PERFORMANCE IMPLICATIONS

The DPS reports it is having a difficult time filling vacancies, a large number of officers are or will be eligible for retirement soon, and they are seeing higher than normal rates of retirement.

The DPS notes that DROP may help retain retirement-eligible officers for up to five years. These officers would not lose their COLA benefits despite continued employment, as do most other state employees under current return-to-work rules, and would receive five percent interest on the contributions to their participant accounts. Further, the draw of a sizable lump sum payment at the end of the five year period may appeal to a large number of officers.

There could be a negative impact to morale when specific employee groups are granted the opportunity to return to work under better conditions that other employees in similar situations.

TECHNICAL ISSUES

PERA commented that the accounting for and transfer of contributions is unclear.

The definition of *affiliated public employer* does not exclude non-public safety employers.

OTHER SUBSTANTIVE ISSUES

At the present time, retirement benefits for police officers in New Mexico are more generous then most all other PERA retirement plans except for the judicial and magistrate plans.

The average retirement age for a municipal police officer is 49 years with a pension of $36,624. The average retirement age for a state police officer is 52 years with a pension of $30,360.

ALTERNATIVES

Until the degree of participation is known, the new plan should consider suspending the retiree's COLA during their participation in DROP and applying the same rate of interest earned as is applied to other PERA member accounts, which is currently 2 percent.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Municipal police members will continue to be eligible to receive up to 90 percent of his or her final average salary after 27.1 years of service and state police members will continue to be eligible to receive up to 90 percent of his or her final average salary after 25 years of service.

AHO/jl