

PERA Continues Meetings with Governor's Staff as Five Weeks Remain in Legislative Session

PERA has met several times with the Governor's staff on PERA's proposals to help maintain the pension funds' actuarial soundness in a balanced and reasonable way. The Governor supports several elements of PERA's proposed legislative package, but also wants a defined contribution (DC) plan option for new state employees hired after a certain date.

In the meantime, PERA's bill (SB 04-132) to suspend the MatchMaker Program and lower the interest rate credited to member contribution accounts had been held up pending the introduction of the bill (see page 2) that would include the DC plan option. The Governor's Office had asked Sen. Ken Arnold (Westminster) to hold SB 132 until the other legislation is introduced.

However, all parties agreed to get this bill moving again so that it can be considered by the full Senate and the House and sent to Governor Owens. The Senate passed SB 132 on Second Reading on March 29.

This bill was amended at Sen. Arnold's and PERA's request to include the changes for new employees hired on or after July 1, 2005. These changes would limit the post-retirement increase and eliminate full retirement benefits at age 50 with 30 years service. In addition, the reallocation of .08 percent of salary from future employer contributions to the pension trust funds instead of the Health Care Trust Fund was added to SB 132. As amended, SB 132 would have a positive impact on the PERA trust funds, and would have no cost impact on employers.

A DC option for new state employees would have some costs for PERA as explained below:

- New employees who elect to join PERA probably would be higher-cost members for PERA benefits than the current average PERA member. They would probably be older and more likely to work until retirement. This would lead to higher costs to PERA associated with choice.
- If the number of members covered by PERA declines due to the DC option, then PERA will have less ability to pay off or contain the unfunded liability. Currently, the unfunded liability is paid off by allocating a portion of the employer contribution toward the unfunded liability in each Division's trust fund. If the payroll salaries that are covered by PERA decline, then less money will be allocated toward the unfunded liability.

- If employer contributions to PERA are increased, and they are increased by an equivalent amount for the accounts of DC plan participants, then the new state employees who are choosing between PERA and the DC plan will be "driven" into the DC plan. They would have a very strong incentive to join the DC plan if the employer is contributing 13.15 percent of salary into the DC plan, versus an employer contribution to PERA that has deductions for past unfunded liabilities.

PERA's actuary believes that the full increase in employer contribution rates should be applied to PERA's unfunded liability. The contribution by the State to the DC plan for new state employees who elect that plan would be about 9 percent of salary, the same as the cost of benefits being earned by new hire PERA members.

The Board strongly indicated that it would oppose any proposal that does not adequately contribute toward the existing PERA unfunded liability if new state employees are allowed to choose a DC plan outside of PERA. PERA's actuary told the Board that in other states in which a DC plan option has been introduced, the contributions toward unfunded liability have been based on total payroll, not just the payroll for employees covered by the defined benefit (DB) plan.

PERA staff will continue to talk with the Governor's Office and with legislators to try to agree on legislation we all can support.



Legislation of Interest to PERA

PERA Benefit and Contribution Changes

This bill would have several elements that were approved by the PERA Board to help preserve PERA's financial soundness via a package of moderate, balanced changes. Sen. Dave Owen (Greeley) intends to sponsor the bill, and Rep. Brad Young (Lamar) is interested in sponsoring the bill in the House.

Status: The bill probably will be introduced as soon as the features of the DC plan option are developed. Sen. Owen supports the features listed below, but recently indicated that he was considering including in the bill an increase in PERA member contribution rates to 8.5 percent of salary. Sen. Owen also has suggested limiting PERA members and retirees to serving one six-year term on the Board of Trustees. PERA would oppose the bill if it contains these elements, but it isn't clear whether Sen. Owen plans to include them.

PERA's Position: Support, if the bill includes the following provisions that would:

- Require PERA contributions on Cafeteria Plan (Internal Revenue Code Section 125), Transportation Equity Act (IRC Section 132), and Retirement Health Savings Plan deferrals.
- Reallocate 0.08 percent of salary of future employer contributions to the PERA pension trust funds rather than to the PERA Health Care Trust Fund.
- Require employer contributions on salary paid to PERA retirees who return to work for PERA employers.
- Provide that members hired on or after July 1, 2005:
 - Would not be eligible for full retirement benefits at age 50 with 30 years service.
 - Would receive annual post-retirement increases of 3 percent or the actual change in the Consumer Price Index, whichever is lower.
- Increase employer contribution rates, phasing in increases of 0.5 percent of salary per year for a total of 3 percent by 2010.
- Provide choice between PERA and a defined contribution plan for new state employees hired in 2006 or later.

Senate Bill 04-132. Suspension of MatchMaker Contributions

This bill is sponsored by Sen. Ken Arnold (Westminster) and Rep. Brad Young (Lamar). Cosponsors include Reps. Diane Hoppe (Sterling), Suzanne Williams (Aurora), Tambor Williams (Greeley), and Frank Weddig (Aurora). The bill would make no changes that would require increased appropriations, and its provisions would help improve the funding of the PERA trust funds. The PERA Board of Trustees initiated this bill.

Status: SB 132 was approved by the full Senate on Second Reading on March 29.

PERA's Position: Support. The provisions of this bill would:

- Suspend MatchMaker contributions no later than July 1, 2004.

- Reduce interest credit on member contributions to a maximum of 5 percent per year.
- Set the due date for PERA contributions at five business days after payroll date.
- Reallocate 0.08 percent of salary of future employer contributions to the PERA pension trust funds rather than to the PERA Health Care Trust Fund.
- Provide that members hired on or after July 1, 2005:
 - Would not be eligible for full retirement benefits at age 50 with 30 years service.
 - Would receive annual post-retirement increases of 3 percent or the actual change in the Consumer Price Index, whichever is lower.

House Bill 04-1011. Alternative Personnel System for Institutions of Higher Education

Sponsored by Rep. Keith King (Colorado Springs) and Sen. Norma Anderson (Lakewood), the bill would have allowed colleges and universities to drop the state classified personnel system for their employees and adopt an alternative personnel system.

Status: The bill was defeated March 12 on Second Reading by the full Senate.

Senate Bill 04-90. Confidentiality of Certain Information on PERA Private Equity and Other Alternative Investments

Sponsored by Sen. Norma Anderson (Lakewood) and Rep. Gayle Berry (Grand Junction), this bill was developed by the venture capital industry. The purpose of the bill is to clarify the confidentiality of information regarding PERA's private equity, private debt, and timber investments until the transaction is completed if PERA determines that disclosing such information would jeopardize the value of the investment.

Status: The full Senate passed SB 90 on January 26. The House Finance Committee approved the bill on March 3. A lobbyist representing the Pension Preservation Alliance, a trade group of private equity and private debt firms, testified in favor of the bill. On March 16 the full House of Representatives approved SB 90 on Third Reading. The bill has been sent to Governor Owens.

PERA's Position: Support. On March 3, Jennifer Paquette, PERA's Deputy Executive Director of Investments, testified on behalf of PERA in support of SB 90. She outlined PERA's alternative investment program and explained that the confidentiality that the bill provides will help ensure that venture capital funds and buyout funds will continue to share information with PERA. PERA needs information on these private companies in order to evaluate possible new investment opportunities and to keep a close eye on existing investments. She also outlined the information that PERA discloses on these funds, such as the name of each fund and the rates of return, which would not be confidential. PERA's "alternative investments" include investments in venture capital, leveraged buyout funds, timber, and "special situation" investments that include mezzanine debt. Alternative investments currently constitute about 10 percent of the total PERA investment portfolio.

Legislation of Interest to PERA

Senate Bill 04-165. Fiscal Analysis of Changes in the Employer Contribution Rate to PERA

Sponsored by Sen. Mark Hillman (Burlington), the bill, as introduced, would require that any fiscal note that the Legislative Council prepares on legislation that concerns a change in the PERA employer contribution rate include an estimate of the fiscal impact on the total state budget each year for 10 years after the change. Sen. Hillman's goal is to ensure that the Legislature considers the long-term impact on PERA and the state of any benefit or contribution change.

Status: PERA provided testimony on SB 165 on February 5 to the Senate Finance Committee. The bill was amended by the Senate Finance Committee on February 12, and passed by the Senate Appropriations Committee on March 26.

PERA's Position: Support. The funded status of PERA is regularly communicated to the General Assembly, as required by current law. As amended, SB 165 would put in statute PERA's practice of hiring a separate independent actuary every five years to review the regular actuary's work and comment on PERA's financial condition, assure that the projected impact of any legislation affecting PERA benefits or contribution rates will be analyzed by PERA's regular actuary and included in the fiscal note on the bill, and require that PERA meet with the Legislative Audit Committee and the Joint Budget Committee prior to the start of the legislative session.

Other Bills That PERA is Following

Senate Bill 04-94. High-Deductible Health Savings Accounts

This bill is sponsored by Sen. Bob Hagedorn (Aurora) and Rep. Lola Spradley (Beulah). SB 94 would conform state law to the new federal law enacted last fall that allows individuals under age 65 to contribute to a Health Savings Account (HSA) if they are covered under a health plan with a high deductible. Under federal law, the minimum annual deductible for individual coverage under eligible plans is \$1,000 and for family coverage, \$2,000. Contributions to an HSA are tax-free, and amounts used for eligible health premiums and medical expenses are not taxed. The account balance in a person's HSA can carry forward from one year to the next.

The federal law replaces Medical Savings Accounts (MSA) with the HSAs. The MSAs could only be used by employees of small private sector employers.

Sen. Hagedorn offered a broad amendment to the bill that was adopted by the Senate Business Affairs and Labor Committee. It includes a clarification that amounts deducted from PERA members' pay for contribution to a Health Savings Account or any retirement health savings account program would be subject to PERA contributions. The amendment also excludes from PERA salary any compensation for unused sick, annual, vacation, administrative, or other accumulated paid leave contributed to an HSA or a retirement health savings program. PERA supports the amendment.

Status: SB 94 was passed by the Senate and was passed by the House Business Affairs and Labor Committee on Thursday, March 18.

Senate Bill 04-107. State Deferred Comp Plan and Public Officials' DC Plan

This bill is sponsored by Sen. Mark Hillman (Burlington) and Rep. Dale Hall (Greeley). Hillman and Hall are the legislators appointed by the President of the Senate and the Speaker of the House, respectively, to sit on the state committee that administers both plans. This bill would ensure confidentiality of financial information for participants in those two plans, and would make other technical changes to the plans.

Status: SB 107 was passed by the House on March 4. The Senate concurred with the House's amendments and the bill will be sent to the Governor.

House Bill 04-1007. Obligations of Higher Education Governing Bodies that Have ORPs

Rep. Tambor Williams (Greeley) and Sen. Stephanie Takis (Aurora) are the sponsors. For colleges and universities that established Optional Retirement Plans (ORPs) for their faculty and top administrators in the early 1990s, the bill would upgrade the responsibilities and fiduciary duties of the governing boards concerning the ORPs. The bill arose from a performance audit of the ORPs by the State Auditor's Office in 2002, and is being proposed by the Legislative Audit Committee.

Status: Governor Owens signed HB 1007 on February 20.

House Bill 04-1171. Retirement Health Savings Trust

Sponsored by Rep. Frank Weddig (Aurora) and Sen. Bob Hagedorn (Aurora), this bill would allow the State Personnel Director to set up a trust arrangement in which an active state employee could elect to make voluntary contributions to an account that would be used for his or her future retiree health care expenses. According to testimony, a state employee could make tax-deductible contributions to the trust only if he or she made an irrevocable election to contribute a certain amount to the trust each month for the duration of his or her employment with the state. However, the IRS has not approved the tax-deductibility of such contributions, to PERA's knowledge.

Status: HB 04-1171 was approved by the House State Affairs Committee on February 3 and was sent to the House Appropriations Committee.

House Bill 04-1373. Modifications to the "State Personnel System Act"

This bill is sponsored by Rep. Rosemary Marshall (Denver) and Sen. Norma Anderson (Lakewood). It comes out of the Commission on Civil Service Reform that met last summer. Rep. Marshall and Sen. Anderson are also sponsoring House Concurrent Resolution 04-1005. If passed by two-thirds of the State House of Representatives and two-thirds of the State Senate, HCR 1005 would place certain changes to the Colorado Constitution that pertain to the civil service system for state employees on the November 2004 ballot.

Status: None of the provisions of HB 1373 or HCR 1005 would directly affect PERA. Among the features of HCR 1005 is a provision expanding the number of state employees who may be exempt from the classified personnel system to as much as one-half of 1 percent of the total state workforce. Both the bill and the resolution were passed by the House on March 9 and both are scheduled to be heard by the Senate State, Veterans, and Military Affairs Committee on March 30.

Projected PERA Funded Ratio

Below are three charts that project the funded ratio of the State and School Division through 2030 under three different rate of investment return scenarios. The charts also show how different legislative changes to benefits and contribution rates would affect the funded ratio. It needs to be emphasized that the projected ratios past 2010 are not very meaningful since the investment results during the next few years have considerable influence on the projected funded ratios in the decades to come.

Chart 1 is the projected funded ratio if PERA's investment return were 15 percent for each of the next three years through 2006, and then 8.5 percent thereafter. If PERA's 2004 legislative proposals were enacted, the funded ratio for the State and School Division is projected at 92.1 percent in 2030. If, in addition to PERA's proposals, the member contribution rate were increased by 0.5 percent to 8.5 percent of salary starting July 1, 2005, then by 2030, the funded ratio is projected at 93.8 percent. Increasing the member contribution rate does relatively little to increase PERA's funded status.

The chart also shows that if no legislation were enacted, then PERA's funded ratio is projected to drop to 65.5 percent in 2030. A proposal was suggested earlier in the legislative session to increase the employer contribution 10.4 percent of salary, and to eliminate retirement before age 55 for all current members who are under age 40. The funded ratio in 2030 under this proposal is projected to be 70.3 percent.

Chart 2 shows the projected funded ratio if PERA's investment return were 5 percent for 2004–2006, then 8.5 percent thereafter. Chart 3 shows the projected funded ratio if PERA earns 8.5 percent return each year.

What do the charts and projections show? The PERA State and School Division funded ratio is projected to decline to the low 70 percent range in the next couple of years, regardless of what legislation is passed or what investment returns PERA earns. This is primarily a result of the smoothing of the prolonged bear market returns of 2000–2002.

Chart 1

Projected Funding Ratio 2002–2030
15% Annual Investment Return for 2004–06; then 8.5%
20% Return in 2003
State & School Division

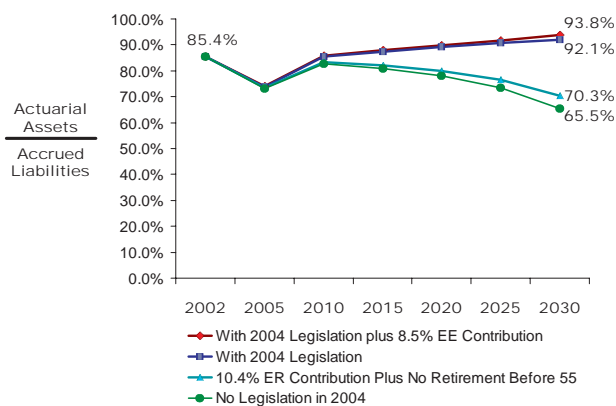


Chart 2

Projected Funding Ratio 2002–2030
5% Annual Investment Return for 2004–06; then 8.5%
20% Return in 2003
State & School Division

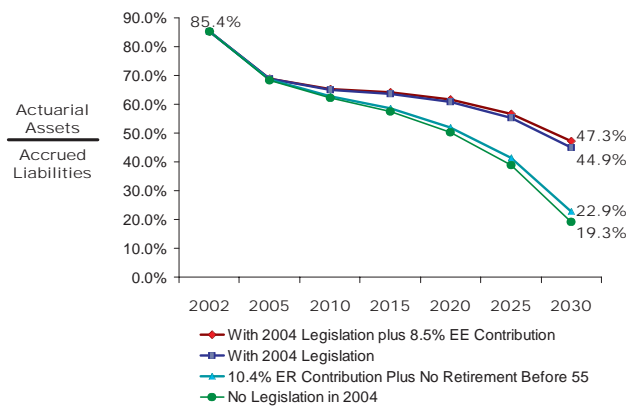
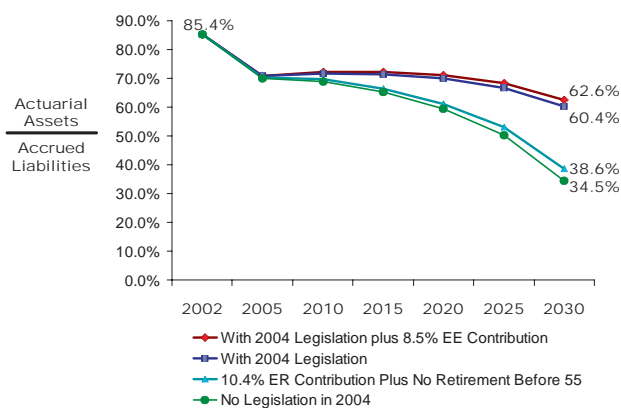


Chart 3

Projected Funding Ratio 2002–2030
8.5% Annual Investment Return from 2004 Forward
20% Return in 2003
State & School Division



Investment performance is the primary determinant of the funded ratio for the next 5 to 10 years. The 20 percent return in 2003 will help, and the performance of the markets and the fund in the next few years will be an important factor. Of course, in any projection that spans 20–30 years, the investment return in the early years has a big impact.

PERA's proposed legislation would lead to an improvement in PERA's funded status over the long term, compared to no legislation being passed for a decade or two. With PERA's proposed legislation, and an 8.5 percent investment return, the funded ratio would remain in the low 70 percent range for 20 years, before beginning to fall (Chart 3). If PERA were fortunate enough to earn an average return of 15 percent for 2004 through 2006, the projected funded ratio would climb into the 90 percent range in 20 years (Chart 1).

