COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 2271-02
Bill No.: SB 628
Subject: State Employees; Retirement - State
Type: Original
Date: March 7, 2007

Bill Summary: Modifies provisions relating to vested members of the Missouri State Employees Retirement System

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
General Revenue	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)
Total Estimated Net Effect on General Revenue Fund	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Road Fund	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)
Total Estimated Net Effect on Other State Funds	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 7 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Total Estimated Net Effect on FTE	**0**	**0**	**0**

☒ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☐ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2008	FY 2009	FY 2010
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

The **Joint Committee on Public Retirement** indicates that this legislation does represent a "substantial proposed change" in future plan benefits as defined in Section 105.660(5). Therefore, an actuarial cost statement as defined in Section 105.665 must be provided prior to final action on this legislation by either legislative body or committee thereof.

Pursuant to Section 105.670, this actuarial cost statement must be filed with 1) the Chief Clerk of the Missouri House of Representatives, 2) the Secretary of the Senate and 3) the Joint Committee on Public Employee Retirement as public information for at least (5) legislative days before final passage of the bill.

An actuarial cost statement for this legislation has not been filed with the JCPER. It would be impossible to accurately determine the fiscal impact of this proposed legislation without the actuarial cost statement prepared in accordance with Section 105.665.

Officials from the **Missouri State Employees' Retirement System** assume the proposal would, if enacted, allow any vested member of the Missouri State Employees' Retirement System (including members of the Missouri State Employees' Plan - MSEP and the MSEP 2000, members of the Administrative Law Judges and Legal Advisors' Plan, and the Judicial Plan) to make a one-time election to receive a lump sum payment equal to the present value of either (1) a deferred annuity or (2) a retirement benefit that is immediately payable, rather than receiving a monthly annuity payable for life.

There are also provisions that would allow all accumulated and unused sick leave to be credited to any vested member of the MSEP and MSEP 2000 who returns to employment in state service, regardless of the length of time that has passed since the person was last employed by the state. Presently, unused sick leave may be converted into retirement credit when vested members leave state employment and immediately retires under the MSEP (under the MSEP 2000, vested members are not required to immediately retire in order to be able to receive credit for unused sick leave); however, by Personnel Advisory Board (PAB) rule, unused sick leave is forfeited five years after termination of state employment. Restoration of the unused sick leave upon reemployment will most certainly result in higher benefit costs to the state.

As it relates to retirement costs, one of the ways MOSERS earns incrementally higher returns is by placing a portion of its assets in illiquid investments. Investors demanding liquidity are forced to pay up through lower expected returns. This legislation could have several negative implications for the trust fund including:

ASSUMPTION (continued)

1) Liquidation of existing illiquid investments. In order to deal with a large number of cash outs, MOSERS would need to sell assets, including some that are illiquid. The sale of these illiquid investments would likely result in MOSERS receiving a fire sale value well below what is currently being expected of the investments if held for their intended time period.

2) A likely change in MOSERS overall asset allocation to provide for greater liquidity given the option to cash out. Liquidity comes with an expected cost. As a result, the expected return on the MOSERS portfolio would likely need to be adjusted downward in the future to accommodate the need for a more liquid portfolio. While it would require a formal study beyond the scope of this legislation to know exactly how much lower the expected return on the portfolio would be, it is a known fact that any reduction in the expected rate of return will cause an increase in the future contribution rate from the state of Missouri. The last formal asset liability study completed by MOSERS concluded that for each 1% change in the expected return on the portfolio (i.e. a portfolio expected to earn 7.5% instead of 8.5%) the state's annual contribution would increase by $45 to $50 million.

3) Transaction costs to sell assets to generate cash to fund the cash outs. In a normal environment and given the current composition of the MOSERS portfolio, a fair estimate of transaction cost would be 50 basis points or 50 cents per $100 of cash out value. This cost should be absorbed by those participants wishing to cash out and should not be born by the state of Missouri.

4) Some of our investment strategies are capacity constrained. If we redeem from these managers' funds just because we have liquidity issues we may have trouble investing future funds with some managers who were selected because of their special skill sets. Managers want stable money and the best ones are positioned to demand it - if we portray less stability to them, they will eliminate us from consideration in exchange for investors who are more stable.

5) Assuming a meaningful percentage of our assets are affected by this change, our costs to manage the portfolio will increase because the fixed costs are spread over fewer assets. Salaries, custody, travel, software…any fixed costs would impact the cost per dollar of assets managed.

Officials from the **MoDOT & Patrol Employees' Retirement System (MPERS)** assume while the primary intent of the proposal appears to focus on administrative law judges, legal advisors, and judges who are in the MOSERS Year 2000 Plan, there is also an impact on certain

ASSUMPTION (continued)

terminated vested members in MPERS. More specifically, any individual who became a terminated vested member, under either the Closed Plan or Year 2000 Plan, after August 28, 1997 would be entitled to make a one-time election to be paid the present value of their deferred annuity.

Our actuary has provided the following cost impact data:

- Initial estimates from our actuary, GRS, put the possible payout from MPERS at $32.9 million for the current group of terminated vested members. As you would assume, each year as people terminate employment, that liability continues to grow. GRS has indicated that they could do a projection of the future costs but it will take several days to produce. The $32.9 million payout is in addition to our annual benefit payments of approximately $165 million. This would be an increase in cash outflows of approximately 20%. In a mature system like MPERS, which is already in a negative cash flow situation, (drawing down cash each month to pay benefits) this provision in addition to the large Backdrop payments we are already making will definitely have a negative impact on our ability to invest our assets in longer term investment.

- The cash liability needs to payout the additional $32.9 million would create liquidity issues necessitating asset allocation changes and ultimately portfolio changes. Having to move existing long-term investments to more liquid short-term investments could potentially have a negative impact on the investment return of the system, causing an increase in the contribution rate.

- MPERS is currently 55% funded and working diligently to improve that funded status by not endorsing any benefit changes that could adversely impact our funded status. If everyone covered by this proposal elected to cash out immediately, our funded status could drop from 55.5% to 54.9%.

- MPERS has never had a provision in either plan allowing terminated vested members to cash out. The plan goal of providing a stable monthly income for our members to retire on is not well served by allowing people to take their benefit in a lump sum. In addition to running contrary to the purpose of a defined benefit plan, giving this benefit provision to members of the Year 2000 Plan and Closed Plan members who terminated on or after August 28, 1997 could create an equal protection problem.

ASSUMPTION (continued)

Officials from the **Department of Transportation (MoDOT)** concur with the response given by the MoDOT & Patrol Employees' Retirement System.

FISCAL IMPACT - State Government	FY 2008 (10 Mo.)	FY 2009	FY 2010
GENERAL REVENUE			
Cost - Lump Sum Distribution	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**
ROAD FUND			
Cost - Lump sum Distribution	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)	(Unknown expected to exceed $100,000)
ESTIMATED NET EFFECT ON ROAD FUND	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**	**(Unknown expected to exceed $100,000)**

FISCAL IMPACT - Local Government	FY 2008 (10 Mo.)	FY 2009	FY 2010
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

No direct fiscal impact to small businesses would be expected as a result of this proposal.

FISCAL DESCRIPTION

The proposed legislation modifies provisions relating to vested members of the Missouri State Employees' Retirement System and will have an effect on the Unfunded Actuarial Accrued Liability and increase the employer contributions.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Joint Committee on Public Employee Retirement
Missouri State Employees Retirement Plan
MoDOT & Patrol Employees Retirement System
Department of Transportation

Mickey Wilson

Mickey Wilson, CPA
Director
March 7, 2007