ACTUARIAL REVIEW OF

RETURN TO WORK PROVISIONS IN

NEW MEXICO
PUBLIC EMPLOYEES RETIREMENT ASSOCIATION
For
THE CITY OF ALBUQUERQUE

William B. Fornia, FSA

January 2016

PTA PENSION TRUSTEE ADVISORS

January 13, 2016

Gerald Romero
Budget Officer
City of Albuquerque

Via email:

Return to Work Analysis

Dear Jerry:

As discussed, we have analyzed various actuarial issues pertaining to the Return to Work (RTW) provisions under New Mexico Public Employee Retirement Association (PERA) with respect to Albuquerque police officers.

Attached is our report on the RTW program.

I am a member of the American Academy of Actuaries and meet the Qualification Standards to provide this statement of actuarial opinion.

We are available to answer any questions you may have regarding our findings.

Sincerely,

William B. Fornia, FSA
President
Pension Trustee Advisors

Section 1 – General Findings

We have analyzed various actuarial issues pertaining to the Return to Work (RTW) provisions under New Mexico Public Employee Retirement Association (PERA) with respect to Albuquerque police officers. We understand that the City of Alb and other departments are currently finding it difficult to recruit police officers to replace those who retire. Consequently a proposed solution is to modify the provisions to add flexibility in Return-To-Work (RTW) provisions.

We have thoroughly reviewed the following:

- Current PERA provisions
    - Current PERA actuarial valuation
- Actuarial analysis (fiscal impact report, FIR) of previous RTW legislation
- Proposed legislation

We have also reviewed data provided by the City on the Albuquerque police force: birth dates, hire dates, and compensation.

Our key finding is that a Return-To-Work provision for public safety officers can be accomplished with no net actuarial impact on PERA. This could be done by limiting RTW to those retired prior to 2016.

Another reasonable solution to other variations of RTW could be for the employers such as the City of Albuquerque to pay the actuarial cost (if any) of RTW on a case by case basis. Based on our analysis and the PERA actuary's current actuarial assumptions, we would not expect these costs to be substantial in most cases. For some individuals RTW will result in increased costs to PERA, while for others RTW will result in savings to PERA.

This is for three basic reasons:

1. When members retire immediately rather than wait a few years, they lose out on additional pension accruals and increased salary in exchange for beginning to receive lifetime pension benefits early. This is a significant tradeoff which negates much of the cost of receiving benefits immediately.

2. The PERA actuary currently assumes that the vast majority of municipal police officers retire within a few years of meeting their 20-year eligibility requirement. All of those who currently retire early would have no additional cost should RTW be reinstated, because they are expected to retire anyway.

3. RTW generates savings to PERA if employees are required to make PERA contributions during their RTW period despite not earning additional pension benefits.

Section 2 – Actuarial Analysis and Findings

The PERA actuary currently assumes that the vast majority of municipal police officers retire within a few years of meeting their 20-year eligibility requirement. For example, the average Albuquerque officer enters the force at age 29, which would make him (most are male) eligible at age 49. The actuary assumes a 50% likelihood of retiring in the first year, 30% in the second year, and continuing with at least 30% likelihood in each subsequent year. This means that less than a quarter would still be on the force after two years.

We applied their assumptions to the City's current police force and find that

- There are currently 32 officers eligible to retire at this time. The assumptions predict that 13 of them will retire within a year.
- An additional 24 will become eligible to retire in one year. Of the 43 remaining and eligible (32 minus 13 plus 24), 19 of them will retire in the second year.
- This means that you are projected to lose 32 officers to retirement in the next two years.

We looked at individuals considering retirement with and without a RTW alternative. Our baseline assumptions were:

- Employee Retires under four alternatives:
    - Employee Retires after 23 Years
    - Return to Work Passes; Employee Retires Immediately at 20 Years & Returns to Work for 5-years
    - Return to Work Passes; Employee Works 3-years past 20-year retirement & Returns to Work for 5-Years
    - Retiree Retires after 20 Years
- Employee lives 30 years from retirement eligibility date
- Salaries grow by 4.75% in accordance with PERA actuary's assumptions
- Present Values calculated at 7.75% discount rate, in accordance with PERA actuary's assumptions
- PERA key benefit features:
    - 70% replacement income after 20 years
    - 3.5% benefit accrual per year
    - 2% annual COLA following 7 years of retirement
    - Highest 3-year average earnings

- Return to Work Provisions
    - Employee Contributions (5.57%) to PERA will continue
    - Employer Contributions to PERA will continue (but are not considered in the calculations below)
    - No additional benefits will accrue

The following table presents key values under these scenarios:

		NPV Impact to PERA per Employee	Difference vs. Retiring after 23 years no RTW
A	**Employee Retires after 23 Years**	**(467,807)**	
B	**Return to Work Passes; Employee Retires Immediately at 20 Years & Returns to Work for 5-years**	**(470,112)**	**(2,305)**
C	**Return to Work Passes; Employee Works 3-years past 20-year retirement & Returns to Work for 5-Years**	**(455,099)**	**12,708**
D	**Employee Retires after 20 Years**	**(483,944)**	**(16,136)**

This table illustrates several comparisons:

- Comparing scenarios A and B demonstrate that if an employee retires after 20 years and RTWs for five years, PERA is only $2,305 worse off (on a present value basis) than had the employee worked 3 years beyond the 20-year period and not returned. This is less than one-half of one percent. This could easily be offset by an additional contribution to PERA by the City for each officer that meets these criteria.
- Comparing scenarios A and C demonstrate that if an employee RTWs for five years after retiring 3 years beyond the 20 year period, PERA is $12,708 better off than had the employee not returned. This is equal to the contributions made by the employee during the RTW period. Although contributions are made by the employee, no benefits are accruing.
- Comparing scenarios B and D demonstrate that if an individual was going to retire anyway, then the existence of RTW will save PERA nearly $14,000 through employee contributions received during the RTW period when no benefits are accruing.
- Of the several employee behavior scenarios that could occur through the reemergence of a RTW program, some will generate costs to PERA, but others will generate savings to PERA. In either case, this could be absorbed by local governments.

I would be pleased to provide detailed calculations behind the table above, should the PERA actuary or others wish to review. It is my actuarial opinion that under the current PERA actuarial assumptions and methodology, a modification of RTW as proposed under SB0466 would not have only a modest actuarial impact on PERA. Under various scenarios, such costs could be offset by the City.

Section 3 – Analysis of Fiscal Impact Report

We have reviewed the Fiscal Impact Reports (FIRs) for various proposed legislation. The FIR for SB0466 indicated that the legislation adds $60.6 million to the unfunded accrued actuarial liability (UAAL) of the Municipal Police division of PERA. We have been unable to replicate this number, but find that it is a surprisingly high number. This is particularly because:

- The PERA actuary already assumes that a very high portion of those eligible to retire do so within a few years. So RTW could not be a significant incentive for others to retire early.
    - The cost to PERA of RTW is not the benefits which are being paid, because they will be paid anyway, whether an officer returns under this bill or not. The cost is if RTW encourages officers who would otherwise remain on the force to retire. But the actuaries' studies indicate that there are very few officers who do not elect to retire within a few years of becoming eligible
- The entire actuarial liability for active police officers in the Municipal Police Division of PERA is only $723 million. The FIR suggests that liabilities would increase by $60.6 million. This represents an increase the liabilities by more than 8%. This is inconsistent with the steep actuarial assumptions for early retirement.
- We made some estimates of RTW costs for specific individuals and find most circumstances where RTW costs very little money to PERA. This is because when an individual retires early due to RTW, they forgo an increase in benefits due to additional service and increased salary. Furthermore, PERA receives member contributions during the RTW period. These three factors (increased service, increased average salary, member contributions) can substantially offset (and even outweigh) the advantage of retiring early and collecting more years of pension through RTW.

In conclusion, we do not see a plausible reason for a calculation for a cost as high as $60.6 million. I would be pleased to review the detailed calculations behind this figure, to learn more of their approach. But absent such review, it is my actuarial opinion that under the current PERA actuarial assumptions and methodology, a modification of RTW as proposed under SB0466 would have only a modest actuarial impact.

Section 4 – Conclusions and Alternatives

Because RTW can be an effective incentive in rebuilding a police force, it would likely have some actuarial cost. Based on our analysis, however, we believe that this cost would be modest.

New Mexico PERA is not alone in tightening its RTW provisions. In order to assist cities such as Albuquerque in their police employment challenges, it is important to balance the needs of the cities with the integrity of the pension systems. Several approaches to proposed RTW legislation could meet those dual objectives. These might include:

1. Limiting RTW to those already retired as of a certain date in the past. There are dozens of currently retired Albuquerque police officers. Some of them may be employed as officers in Colorado, Texas, or other nearby states, and are not forfeiting their pensions. Many are likely employed in other non-PERA employment and not forfeiting their pensions. Encouraging them to return to Albuquerque would not increase the liability to PERA as long as their actions don't (A) encourage other earlier PERA retirements or (B) they would have returned anyway and forfeited their benefits.

2. RTW could also be limited based on service. For example, only those with 22 years could return. For this purpose, those who retired with less than 22 years could count time since retirement as this "service". This might encourage those on the force to work through 22 years, then retire and take advantage of RTW. Such a change might actually result in a net cost savings.

3. Many public safety plans around the country have a Deferred Retirement Option Plans (DROP). These can be designed in nearly a cost-neutral manner and can be a strong incentive to retain officers who would otherwise retire early. We could explore such alternatives if desired.

4. Because RTW is so important to employers such as the City of Albuquerque, there could be some mechanism to assign the costs to the particular employer. It was indicated that the average cost of recruiting and training a new officer including the first year is $150,000. This suggests that some kind of RTW cost could be absorbed by the department where the officers return.

5. It has also been suggested that the City have discretion over which officers are allowed to return. If this were the case, the actuarial impact of officers retiring with the expectation of RTW would be lessened.

Note also that the analysis above does not consider the impact of RTW on retiree health care. If retirees are earning health care benefits, then by returning, the total health costs will be lower than if they were replaced by new officers.

We understand the City's urgent need in terms of police officer employment. We hope that we can help craft and analyze a solution which meets the City's objectives with a minimal impact on PERA. We look forward to discussing this further at your convenience.