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Memorandum

July 6, 2018

TO: Members of the Pension Review Commission

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SUBJECT: Pension Review Commission Overview and 2018 Interim Schedule

Summary

This memorandum provides the following information regarding the Pension Review Commission:

- a brief overview of pension terminology;
- an overview of the Fire and Police Pension Association of Colorado;
- an overview of the Colorado Public Employees' Retirement Association;
- the commission's statutory charge;
- the commission's membership;
- the Pension Review Subcommittee's statutory charge and membership;
- contact information for commission staff and website;
- 2018 interim meeting dates; and
- requirements for interim legislation.

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Pension Terminology

What are defined benefit and defined contribution plans? A defined benefit (DB) plan provides a specified monthly retirement benefit that is calculated using a plan formula that considers an employee's salary and years of service, among other factors. A defined contribution (DC) plan allows an employee to control his or her investments, and provides benefits based on the contributions that are made to the account by the employer and employee, and the level of investment earnings in the account over time. Investment risk in defined contribution plans is borne by the employee, while investment risk in defined benefit plans rests with the plan sponsor. State and local governments contribute the same percentage of an employee's salary to either plan, but contribution amounts vary for certain employees (for instance, the state contributes a higher percentage of salary for state troopers and corrections officers).

Funded status. For both DB and DC plans, the overall goal of the pension system is to ensure that, with contributions, investments, and interest earnings, there is sufficient revenue to pay for accrued (current) and projected plan liabilities. Governmental Accounting Standards Board regulations and state law currently require that pension obligations be amortized, or spread out, over a period of no more than 30 years. When the liabilities will take more than 30 years to pay, a plan is considered underfunded.

Overview of the Fire and Police Pension Association of Colorado

Overview. Prior to 1980, all fire and police pension plans in Colorado were administered individually by the municipalities or fire protection districts that employed police officers or firefighters. There was no requirement that these local plans be funded on an actuarially sound basis, and, in the mid-1970s, it became apparent that many plans were significantly underfunded. A 1977 study by the General Assembly concluded that these plans had an unfunded liability in excess of $500 million.

FPPA reform. In 1978 and 1979, the General Assembly enacted legislation to reform fire and police pension plan administration. First, legislation limited membership in existing local plans to firefighters and police officers who were hired prior to April 8, 1978. Between 1980 and 2013, the state contributed nearly $650 million in funding to stabilize these "old-hire" plans using insurance premium taxes that would have otherwise been credited to the General Fund. Nearly all participants in "old-hire" plans have retired.

Second, for police officers and firefighters hired on or after April 9, 1978 ("new-hire" plans), the General Assembly created the Statewide Defined Benefit Plan, and established the Fire and Police Pension Association (FPPA) to administer the plan.

FPPA plans. The FPPA administers the Statewide Money Purchase Plan, which is a defined contribution plan, and the Statewide Hybrid Plan, which has both defined benefit and defined contribution elements. In addition, some local governments cover their police officers under Social Security, but affiliate with the FPPA to provide a supplemental benefit. Since the reforms of the late 1970s, FPPA-administered plans are funded exclusively through member and employer contributions and do not receive state funding.

The FPPA also administers the statewide Death and Disability Plan, which provides disability and death benefits to police officers and firefighters. This plan was previously funded in part by the state, but now is funded entirely through member and employer contributions.

Elements of the administration of the plans are outlined in state law, including contribution rates for employers and employees, retirement age, return and transfer of contributions, the process for modifying benefits, and other factors affecting the plans. The FPPA annually brings requests for legislative changes related to the plans to the commission for review and approval.

Board of directors. The FPPA is political subdivision of the state. It is administered by a nine-member board of directors appointed by the Governor and confirmed by the Senate, consisting of the following members:

- two members representing Colorado municipal employers;
- one member representing full-time paid police officers;
- one member representing full-time paid firefighters;
- one member who is either a retired firefighter or a retired police officer;
- one member of a board of directors of a special district or the full-time paid professional manager of a special district who represents special districts having volunteer firefighters;
- one member from the state's financial or business community with experience in investments;
- one member from the state's financial or business community with experience in insurance disability claims; and
- one member of the state's financial or business community experienced in personnel or corporate administration in corporations of over two hundred employees.

Overview of the Colorado Public Employees' Retirement Association

Overview. Established by the Colorado General Assembly in 1931, PERA is a statutory public entity that manages retirement plans for public employees in Colorado. PERA members work in one of five PERA divisions, which are each held in a separate trust: the state division, the school division, the Denver Public Schools division, the local government division, and the judicial division.

PERA plans. PERA administers defined benefit pension plans and defined contribution plans, in addition to health care funds and a life insurance plan. PERA's defined benefit and defined contribution pension plans are funded through employee and employer contributions and investment earnings. The state is fiscally responsible for the state and judicial divisions, member local governments and school districts are responsible for the other divisions, and employer contributions sustain the health care and life insurance plans. Because the structure and requirements for PERA are established in state law, the General Assembly must pass legislation to make any changes in contributions, benefits, or other plan requirements for any of the PERA divisions.

Board of trustees. PERA is governed by a 16-member board of trustees. The board has 15 voting members including:

- three members representing and elected by the state division;
- four members representing and elected by the school division;
- one member representing and elected by the local government division;
- one member representing and elected by the judicial division;
- two elected PERA retirees;

- three members appointed by the Governor; and
- the State Treasurer.

The board also has one non-voting member representing the Denver Public Schools division who serves as an ex-officio member.

Members of the PERA board are fiduciaries, obligated under Colorado law to act solely in the interests of members and benefit recipients to provide pension benefits, and to defray expenses of pension administration.

PERA reform. Over the past few decades, the General Assembly has enacted legislation to address fiscal opportunities and challenges related to PERA.

Surplus years for PERA. During the 1990s, the General Assembly increased cost-of-living adjustments (COLAs) for PERA retirees from 3 percent to 4 percent and allowed for early retirement at age 50 for members with 25 years of service. It also allowed members to purchase years of service credit and established matching for 401(k) plans.

Fiscal challenges for PERA and the state. In response to two recessions in the 2000s, the General Assembly passed legislation to strengthen the fiscal condition of PERA.

In 2004, it eliminated state-matching contributions to 401(k) plans, increased the mandatory years of service and age requirements to retire, and implemented new employer contributions through amortization equalization disbursement (AED) payments.

In 2006, it increased contributions to PERA by establishing supplemental amortization equalization disbursement (SAED) payments to be made from funds that would have otherwise been provided as employee salary increases.

In 2010, it passed legislation to reform PERA, which temporarily increased member contributions by 2.5 percent of salary, increased AED and SAED payments for certain PERA divisions, adjusted how salary is used to calculate benefits (known as anti-spiking), and capped the cost of living adjustment at the lesser of 2 percent or the rate of inflation.

In 2014, the Joint Budget Committee sponsored a bill to create and fund three independent assessments of PERA specific to the value of PERA benefits, cost and effectiveness of PERA's plan design, and PERA's actuarial assumptions. All three studies were completed in 2015.

In 2018, the state legislature passed a reform bill to address PERA's underfunded status. Among its many provisions, the bill required an increase in employer and employee contributions, an annual allocation to PERA from the state budget of $225 million per year, and a three-year freeze on cost of living adjustments for retirees followed by a reduced 1.5 percent adjustment. The bill also created automatic rate adjustments to respond to funding thresholds and increased retirement eligibility requirements for future PERA members. It also expanded the charge of the Police Officers' and Firefighters' Pension Review Commission to the Pension Review Commission and created a subcommittee within the commission to oversee PERA.

Commission Charge

Pursuant to Section 24-51.1-101, C.R.S., (formerly Section 31-31-1001, C.R.S.) the Pension Review Commission has the responsibility to study and develop proposed legislation relating to funding of police officers' and firefighters' pensions in this state and benefit designs of such pension plans. In addition, the commission must study and may develop proposed legislation relating to PERA. The law directs the commission to study, review, and propose legislation related to the following subjects including, but not limited to:

- normal retirement age;
- payment of benefits prior to normal retirement age;
- service requirements for eligibility;
- rate of accrual of benefits;
- disability benefits;
- survivors' benefits;
- vesting of benefits;
- employee and employer contributions;
- post-retirement increases;
- creation of an administration board;
- creation of a consolidated statewide system;
- coordination of benefits with other programs;
- the volunteer firefighter pension system; and
- state laws related to each pension system.

Commission Membership

2018 interim membership. There are currently 15 members on the Pension Review Commission. In even years, the chair is appointed by the President of the Senate and the vice-chair is appointed by the Speaker of the House. In odd years, the chair is appointed by the Speaker of the House and the vice-chair is appointed by the President of the Senate. The 2018 interim membership of the Pension Review Commission is as follows:

Senator John Cooke, Chair
Senator Leroy Garcia
Senator Daniel Kagan
Senator Ray Scott
Senator Jack Tate

Representative Joann Ginal, Vice-Chair
Representative Perry Buck
Representative Phil Covarrubias
Representative Jessie Danielson
Representative Tony Exum, Sr.
Representative Dominique Jackson
Representative Jovan Melton
Representative Donald Valdez
Representative Kevin Van Winkle
Representative Dave Williams

Membership after 2019. Beginning in the first regular session of the 72nd General Assembly, which begins January 4, 2019, the Pension Review Commission will be comprised of five Senators and five Representatives. The President of the Senate and the Speaker of the House will each appoint three members, and the minority leaders of each house will each appoint two members.

Pension Review Subcommittee

Subcommittee oversight, responsibilities, and reporting. The Pension Review Subcommittee must focus on the financial health of PERA. Specifically, the subcommittee is responsible for:

- making recommendations to the commission regarding PERA;
- determining the necessity of continuing the annual direct distribution of $225 million in state funding to PERA;
- suggesting enhancements to PERA's analysis tools and determining whether PERA's model assumptions are meeting targets and achieving sustainability;
- reviewing the annual actuarial valuation of PERA and making comments as necessary;
- making recommendations to PERA's board regarding assumptions, funding policy, reporting practices, or other operational policy;
- semi-annually reviewing the overall financial health of PERA, including the levels of benefits, its sources of funding, and its overall financial viability based on both the assumptions of the board and the requirements of the Governmental Accounting Standards Board, and requesting that PERA adjust its assumptions as appropriate;
- reviewing annually the calculated normal costs that will cover current pension benefits and the share of contributions going to cover PERA's unfunded liability;
- reviewing semi-annually the planned reduction of PERA's unfunded liability, providing an annual report to the General Assembly regarding whether or not PERA is on track to achieve full funding by 2048, and making recommendations to rectify the shortfall as needed;
- providing an annual written report to Colorado citizens on whether PERA is on track to achieve full funding by 2048, and, if not, a report of the corrective actions recommended by the subcommittee or PERA to the legislature to rectify the shortfall;
- after full funding is achieved, making recommendations to the commission, the Joint Budget Committee, and the General Assembly during each legislative session regarding changes to the plan to maintain full funding;
- ensuring PERA's board is administering the association as mandated and making recommendations for the board's structure as warranted; and
- every three years, commissioning an independent review of the economic and investment assumptions used to model PERA's financial situation. The subcommittee shall use experts other than those already working on behalf of the association.

Meeting requirements for subcommittee members. Each subcommittee member is required to attend certain meetings each year, as follows:

- at least one PERA board meeting per year;
- the Legislative Audit Committee's meeting where it reviews the annual actuarial valuation that PERA is required to submit to its attention; and

- the State Measurement for Accountable, Responsive, and Transparent (SMART) Government Act hearing of the Joint Finance Committee when it reviews PERA.

Subcommittee members. The subcommittee consists of 14 members as follows:

- 4 legislators who are also members of the commission, appointed by the Speaker of the House, the President of the Senate, and the House and Senate Minority Leaders; and
- 10 public members with experience or knowledge of investment management, corporate or public finance, compensation and benefit systems, economics, accounting, pension administration, or actuarial analysis, with two individual appointments made by the Speaker of the House, the President of the Senate, and the House and Senate Minority Leaders, and one individual appointment to be made by the Governor and the State Treasurer.

Like the commission, the chair is designated by the President of the Senate in even-numbered years and the Speaker of the House in odd-numbered years, with the vice-chair being chosen by the other house. The chair and vice-chair must be chosen from the legislative members of the subcommittee.

Commission Staff and Website

Committee staff. Legislative Council Staff is charged with assisting the commission in its activities. If you have any questions or would like any additional information concerning the commission, please send an e-mail to PensionReviewComm.ga@state.co.us. You may also contact any of the following staff members:

- Erin Reynolds, Senior Fiscal Analyst, Erin.Reynolds@state.co.us, 303-866-4146
- Elizabeth Burger, Principal Research Analyst, Elizabeth.Burger@state.co.us, 303-866-6272

Fiscal note staff. Legislative Council Staff provides fiscal notes for commission legislation and other analyses requested by the commission. To discuss the fiscal impact of legislation or to request a fiscal analysis, please contact:

- Erin Reynolds, Senior Fiscal Analyst, Erin.Reynolds@state.co.us, 303-866-4146

Legal services staff. Additionally, attorneys at the Office of Legislative Legal Services provide legal and bill drafting assistance to the commission. For assistance in these areas, please contact:

- Nicole Myers, Senior Attorney, Nicole.Myers@state.co.us, 303-866-4326

Audit staff. The commission may receive support from the state auditor's office to fulfill its responsibilities.

Website. The commission's website is located at: leg.colorado.gov/committees/pension-review-commission/2018-regular-session.

Commission Meeting Dates

The commission will hold two meetings during the 2018 interim as follows:

- Wednesday, August 15 from 10 a.m. to 12 p.m.; and
- Wednesday, September 26 from 10 a.m. to 12 p.m.

Both meetings will take place in Room LSB-B on the first floor of the Legislative Services Building at 200 E. 14th Avenue, Denver.

Requirements for Interim Legislation

Commission approval. The commission may refer up to <u>five bills</u> to the Legislative Council, and bills must be approved at public meetings of the commission. The commission must approve any bills at its September 26 meeting. Bill drafts and fiscal notes will be sent to commission members at least three days prior to this meeting.

Legislative Council review. The Legislative Council will meet on Monday, October 15, to consider any bills approved by interim committees. Bills not approved by Legislative Council may be introduced during the regular session, but such bills will count against a member's five-bill limit. Commission bills must have prime sponsors prior to consideration by the Legislative Council.