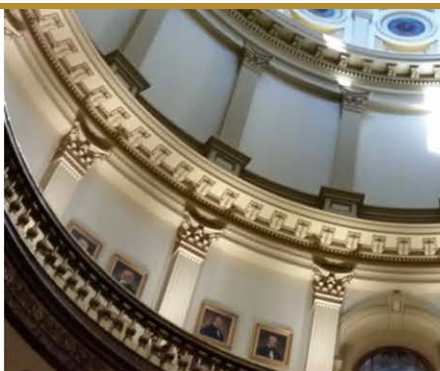


Final Report to the General Assembly

Pension Review Commission and Subcommittee
December 2024 | Research Publication 819



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December 2024

To Members of the Seventy-fourth General Assembly:

Submitted herewith is the final report of the Pension Review Commission. This commission was created pursuant to Article 51.1 of Title 24, Colorado Revised Statutes, to study and review the two major pension plans in the state – the Fire and Police Pension Association (FPPA) for police officers and firefighters employed by local governments and the Public Employees' Retirement Association (PERA) pension for state and local government employees. The commission may propose legislation and to report back to the legislature and general public on these pension plans.

At its meeting on October 15, 2024, the Legislative Council reviewed the report of this commission. A motion to forward this report and the bills therein for consideration in the 2025 session was approved.

Additionally, this document serves as the final report of the Pension Review Subcommittee. Pursuant to Section 24-51.1-101 (3)(a), the Pension Review Subcommittee consists of legislative and public members that convene to focus on the financial health of PERA and make recommendations to the Pension Review Commission and the PERA Board.

Sincerely,

/s/ Rep. Julie McCluskie
Chair

Table of Contents

Committee Charge	2
Pension Review Commission	2
Pension Review Subcommittee.....	2
Pension Review Commission Activities.....	3
PNYX Group’s Independent Review of PERA.....	3
Pension Review Subcommittee.....	4
Public Employees’ Retirement Association Update	4
Fire and Police Pension Association Update.....	4
Pension Review Subcommittee Activities.....	4
PNYX Group Independent Review of PERA.....	4
Public Employees’ Retirement Association Overview and Response.....	5
Committee Recommendations and Letter to Citizens.....	6
Summary of Recommendations.....	7
Resource Materials	8
Meetings and Topics Discussed	8
Pension Review Subcommittee.....	8
Pension Review Commission	8

This report is also available online at:

<https://leg.colorado.gov/committees/pension-review-commission/2024-regular-session>

Committee Charge

Pension Review Commission

Pursuant to Section 24-51.1-101, C.R.S., the Pension Review Commission is required to study and develop proposed legislation relating to funding and benefit design of police officers' and firefighters' pensions administered by the Fire and Police Pension Association (FPPA). In addition, the commission must study and may develop proposed legislation relating to the Public Employees' Retirement Association (PERA). Specifically, 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.

The Pension Review Commission also hears any recommendations from the Pension Review Subcommittee, which is a year-round, 14-member body tasked with studying the financial health of PERA.

Pension Review Subcommittee

Pursuant to Section 24-51.1-101 (3)(a), the Pension Review Subcommittee focuses on PERA's financial health. Specifically, the subcommittee is responsible for:

- making recommendations to the Pension Review 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.

Pension Review Commission Activities

The commission held three meetings during the 2024 interim. Briefings and presentations were made by the PNYX Group, PERA, the Pension Review Subcommittee, and the FPPA. The following sections discuss the commission's activities during the 2024 interim.

PNYX Group's Independent Review of PERA

As discussed below in the Pension Review Subcommittee section of this report, every three years, the Pension Review Subcommittee is required to commission an independent review of assumptions used to model the financial situation of PERA. The Pension Review Commission started its first meeting of the 2024 interim with a presentation from the PNYX Group, who the subcommittee contracted to perform the review, in order to hear its report and ask questions about how the report was conducted. More information is available on this topic in the Pension Review Subcommittee section of this report.

Pension Review Subcommittee

The chair and vice-chair of the Pension Review Subcommittee discussed the subcommittee's work over the interim, culminating in recommendation letters to the commission, the PERA board, and required letters to the citizens of Colorado and to the Joint Budget Committee and others on PERA's funded status. The commission considered a bill recommended by the subcommittee to index the annual direct deposit made by the state to PERA to inflation, but it was not ultimately recommended by the commission.

Public Employees' Retirement Association Update

PERA's executive team presented an overview of the pension to the commission, including the 2023 Annual Certified Financial Report, 2024 legislation affecting PERA, and the schedule of the PERA board and upcoming reporting. PERA representatives responded to questions about PERA's actuarial assumptions, upcoming experience study, board decision-making, and similar topics. In a subsequent presentation, PERA addressed the independent review.

Fire and Police Pension Association Update

The FPPA's executive team presented an overview of the pension system to the commission. The team discussed FPPA's membership, plan organization, funded status, investments and returns, as well as recent and future legislative requests.

Pension Review Subcommittee Activities

The subcommittee held several meetings during the 2024 interim, Briefings and presentations were made by the PNYX Group and PERA. The following sections discuss the commission's activities during the 2024 interim.

PNYX Group Independent Review of PERA

The subcommittee selected the PNYX Group to perform the independent review of PERA's financial position. PNYX started work in February 2024 and issued its final report on August 2, 2024.

PNYX suggested changes that might improve the pension's funded ratio, as they outlined in their Final Report's executive summary, as follows:

"Position of the fund and actuarial and financial assumptions

- Our modeling indicates an expected portfolio return of 6.71%, materially below the current return assumption of 7.25%.
- The funding path presents material risks of reaching a funded ratio of less than 50%, that could be considered a point of no return, with an 18% probability of that outcome by 2048.

- The need for a higher-risk approach is driven by the need for a high rate of return given PERA's low funding status. This is exacerbated by PERA's negative cash flow position which makes the funding path particularly sensitive to portfolio performance.
- The fund's current financial modeling and risk measurement approach has important shortcomings that reduce the reliability of its projections, including in relation to asset and macro factor correlations and the recognition of return and risk asymmetry.
- The fund exhibits consistent annual actuarial losses of approximately 1%. This appears to relate to the partial (rather than full) application by Segal Group of the recommendations of the 2021 GRS report. Those recommendations were aimed at addressing the shortcomings in the assumptions of PERA's previous actuary and were only partly implemented.
- As a consequence, there is a material likelihood that PERA's reported actuarial accrued liability has been materially understated. As an estimate, actuarial accrued liability may be 10% higher than reported, though further analysis would be required to quantify this with precision.

Options for improving the funded ratio

- Various options are available to improve the funded ratio path. These include adjustment of the portfolio's positioning within the existing bands (or widening those bands); making a lump-sum contribution to the plan; or slightly increasing non-State contributions.
- These approaches can reduce the risk of reaching funding levels of less than 50% funded, to between 15% and 16% from the current 18%.
- A more innovative risk management option would be the creation of a Colorado wealth fund as a parallel and separate fund to contribute to covering shortfalls if PERA is underfunded in 2048. By decoupling it from a pension plan's liability constraints, such a fund could follow a distinct value-creation strategy that would be likely to materially outperform the PERA portfolio.
- A \$2 billion fund created in 2024 could grow to approximately \$21 billion by 2048 to cover funding shortfalls at PERA, and could cover a material proportion of projected PERA shortfalls even in low growth scenarios, while providing beneficial externalities to Colorado. On an aggregate basis it could reduce the horizon to full funding to 2043."

Subcommittee discussion. The subcommittee discussed the report and its assumptions in depth at several meetings.

Public Employees' Retirement Association Overview and Response

PERA's executive team and a representative from its actuarial contractor, Segal, provided the subcommittee with an overview of the pension's health and responded to the PNYX report. Subcommittee members asked for a substantial amount of additional information from the two entities, which was presented in a subsequent meeting. This information included a history

of contribution rates, detail on the asset-liability study findings currently underway, explanations of certain investment practices including benchmarks used and proxy voting policies, automatic adjustment provision amounts, and timelines of the PERA board's decision-making processes in upcoming years.

At the follow-up meeting, members asked questions about how retirement benefit payments were made from the investment portfolio; the number of automatic adjustments still available to PERA; how the Governmental Accounting Standards Board's requirements impact PERA's asset valuation and contribution rates; PERA's real estate portfolio; the actuarially determined contribution compared to the statutorily required contribution; the upcoming Asset Liability study; and the differing levels of retirement benefits paid out to retirees.

Committee Recommendations and Letter to Citizens

Subcommittee members discussed and voted on their recommendations to the PERA board and the Pension Review Commission.

The subcommittee requested that the PERA board consider the following three recommendations:

1. provide more granular benchmark details (e.g. asset classes, allocation, market cap, etc.) against which PERA measures its portfolio's performance;
2. ensure the PERA Board proceedings are readily available to the general public via recording; and
3. study the cost of unvested employees who choose to withdraw their money from PERA when they leave employment (i.e., being able to withdraw actual returns from all contributions instead of the current 3 percent guaranteed interest, and also what impact that would have on PERA's unfunded liability).

The subcommittee also recommended that the Pension Review Commission consider one bill proposal to index the \$225 million annual direct distribution to PERA by inflation in perpetuity until PERA is fully funded pursuant to Senate Bill 18-200.

Finally, the subcommittee issued its annual report to Colorado citizens explaining PERA's current unfunded liability and what measures are in place to ensure it will reach full funding by 2048.

Summary of Recommendations

As a result of the Pension Review Commission's discussions, it recommended two bills to the Legislative Council for consideration in the 2025 session. At its meeting on October 15, 2024, the Legislative Council approved both recommended bills for introduction. The approved bills are described below.

Bill A — Income Tax Credit for PERA Retirees

For tax years 2025 and 2026 only, this bill creates a \$700 refundable state income tax credit for qualifying public service retirees.

Bill B — PERA Risk-Reduction Measures

The bill requires the PERA Board of Trustees to conduct its actuarial experience study and periodic actuarial audit every four years. Beginning in 2027, and every four years thereafter, the Office of State Auditor must commission an independent review of the periodic actuarial audit conducted by the board in the prior calendar year.

Resource Materials

Meeting summaries are prepared for each meeting of the committee and contain all handouts provided to the committee. The summaries of meetings and attachments are available at the Division of Archives, 1313 Sherman Street, Denver (303-866-2055). The listing below contains the dates of committee meetings and the topics discussed at those meetings. Meeting summaries are also available on our website at:

<https://leg.colorado.gov/content/committees>

Meetings and Topics Discussed

Pension Review Subcommittee

January 26, 2024, and February 15, 2024

- Select and Greet Independent Review Contractor

July 19, 2024

- Independent Review Report

July 26, 2024

- Annual PERA Update from PERA and Segal

August 2, 2024

- Approval of Subcommittee Recommendations

September 23, 2024

- PERA Responses to the Subcommittee
- Overview of the PERA Audit Performed by the Office of the State Auditor
- Draft Letter to Coloradans

Pension Review Commission

August 9, 2024

- Presentation on the Independent Review of PERA
- Presentations from PERA and FPPA
- Presentation from the Pension Review Subcommittee

August 16, 2024

- Bill Draft Requests

September 27, 2024

- PERA Responses and Approval of Bill Draft Requests