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# Memorandum

November 7, 2018

TO: Interested Persons

FROM: Erin Reynolds, Senior Fiscal Analyst, (303) 866-4146

SUBJECT: Overview of the Colorado Public Employees' Retirement Association and Changes Made by Senate Bill 18-200

## Summary

This memorandum provides an overview of the Colorado Public Employees' Retirement Association (PERA) and the changes made to PERA by Senate Bill 18-200.

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## Legal Authority and Governance

PERA was established by the state legislature in 1931, predating the federal Social Security Act of 1935, to provide a pension benefit to state and local government employees. PERA is administered under Article 51 of Title 24 of the Colorado Revised Statutes and also governed by rules adopted and revised by the PERA Board of Trustees. Because the structure and requirements for PERA are established in state law, the state legislature must pass legislation to make any changes to contributions, benefits, or other requirements for any of the PERA divisions.

The PERA board serves as the administrators and fiduciaries of PERA. Board members are legally oobligated under Colorado law to act solely in the interests of PERA beneficiaries to provide pension benefits and to defray expenses of pension administration. The PERA board is required to adopt and promulgate rules for the administration of PERA and to specify the factors to be used in actuarial determinations or calculations.

The PERA board is comprised of 16 members serving four-year terms, as shown in Table 1. Of these, 12 board members are elected to represent PERA's divisions; 3 are appointed by the Governor and confirmed by the Senate; 1 is a non-voting member representing the Denver Public Schools (DPS) division; and 1 is the State Treasurer or his or her appointee. Trustees elect a chairman and any other officers necessary for the board to carry out its duties.

**Table 1**
**Composition of the PERA Board of Trustees**

| Trustees | Representing | Type of Appointment |
|---|---|---|
| 1 | State Treasurer | Ex-officio |
| 3 | State division | Elected |
| 4 | School division | Elected |
| 1 | Local government division | Elected |
| 1 | Judicial division | Elected |
| 2 | Retirees | Elected by division groupings |
| 3 | Pension expertise | Governor-appointed, Senate consent |
| 1 | DPS division | Elected, non-voting |

*Source: Section 24-51-203, C.R.S.*

## PERA Membership

PERA members are employed by the state or local governments in one of five divisions:

- the state division;
- the school division;
- the local government division;
- the judicial division; and
- the DPS division.

**State division.** All state employees receive retirement benefits through PERA, with a few exceptions at institutions of higher education. Employees of the Judicial Department and independent judicial agencies belong to the state division, while judges belong to the judicial division, as discussed below. State troopers employed by the Department of Public Safety and corrections officers employed by the Departments of Corrections and Human Services are in the state division, but fall into a higher contribution rate structure with reduced retirement ages.

**School division.** The school division contains school district employees in 177 of 178 school districts in the state. DPS employees are in a separate division, as discussed below.

**Local government division.** The local government division is comprised of employees of 1 county, 27 municipalities, and 120 special districts.

**Judicial division.** The judicial division is comprised of judges, including the Colorado Supreme Court justices, the Court of Appeals judges, district judges, county judges, and magistrates.

**Denver Public Schools division.** The Denver Public School district is in a separate division as a result of merging its retirement system with PERA in 2009.

## Plan Options

PERA administers a defined benefit plan and a defined contribution plan, as well as the following optional plans: a 401(k) and a 457 plan (PERAPlus); health benefits (PERACare); and life insurance. The assets of each of the five PERA divisions are held in separate trust funds. Most PERA members do not contribute to Social Security; a Social Security benefit through a spouse or other employment may be reduced because of a PERA membership.

**Defined benefit plan.** PERA's hybrid defined benefit (DB) plan is a pension plan in which contributions are invested by PERA on an individual's behalf, retirement benefits are guaranteed for the individual's lifetime, and individuals qualify for survivor and disability benefits. Retirement benefits are calculated using an individual's highest average salary, age at retirement, and years of service. The interest rate on member contributions is 3 percent compounded annually. This plan is designed for career public servants. Individuals who terminate employment with a PERA-covered employer can retrieve contributions plus interest, or leave their account with PERA until they reach retirement.

**Defined contribution plan.** In PERA's defined contribution (DC) plan — which was made available to certain members of the state division hired after 2006 and expanded to the remaining state division members and local government division members hired after 2020 — individuals direct their investments to a variety of fund options and retirement benefits are contingent upon the success of these investments. This plan is comparable to a 401(k). The plan is designed for individuals who are interested in working in PERA-covered employment for only a short duration. PERA allows members eligible for the DC plan a one-time option between month 13 and month 72 of participation to switch plans.

**Differences between the defined benefit and the defined contribution plan.** Both the DB and DC plans are considered 401(a) plans under the Internal Revenue Code. Table 2 provides an overview of the elements available in each plan.

**Table 2**
**Comparison of PERA's DB and DC Plans**

| | DB Plan | DC Plan |
|---|---|---|
| Lifetime retirement benefit from investments made by PERA | ✔ | |
| Duration of retirement benefit dependent on personal investment choices | | ✔ |
| Potential cost-of-living increase to retirement benefit | ✔ | |
| Access to survivor and disability benefits | ✔ | |
| Access to PERACare upon retirement | ✔ | ✔ * |
| Access to life insurance | ✔ | ✔ |
| Access to PERAPlus 401(k) and 457 Plans | ✔ | ✔ |
| Investment advice available | ✔ ** | ✔ |
| Receive a percentage of employer contributions if account withdrawn | ✔ | ✔ |
| Direct fees | | ✔ |
| Social Security offset applies | ✔ | ✔ |

*Source: PERA.*

* *PERACare is available to DC plan members who purchase a lifetime annuity upon termination of PERA-covered employment.*

** *Investment advice available to all members of the voluntary PERAPlus programs.*

**PERAPlus 401(k) and 457 plans.** All members may enroll in PERA's 401(k) and 457 retirement savings plans at any time. Both plans offer both a pre-tax and Roth contribution option. In 2018, the total annual contribution limit for each plan is $18,500.

**PERACare health benefits.** A health benefit program is available to members retiring from the DB plan, as well as members of the DC plan who purchase a lifetime annuity. PERACare includes health care, dental, and vision plans.

**PERA life insurance.** PERA offers decreasing-term group life insurance where premiums are fixed and the death benefit amounts decrease with age.

## Prior PERA Reforms

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 annual cost of living adjustments (COLAs) for retirees to 4 percent and allowed for early retirement at age 50 for members with 25 years of service. Members were also permitted to purchase years of service credit at reduced rates and receive employer matches for contributions to a PERAPlus 401(k) plan.

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

*2001 recession.* After the 2001 recession, the legislature passed a number of PERA reform bills which eliminated matching contributions to 401(k) plans, increased the mandatory years of service and required retirement age, and implemented new employer contributions through mechanisms called the Amortization Equalization Disbursement (AED) and the Supplemental Amortization Equalization Disbursement (SAED). The AED is an additional employer contribution and the SAED is considered an employee contribution made from funds that would have otherwise been provided through salary increases.

*2007-2009 recession.* After the Great Recession, the legislature passed a major PERA reform bill in 2010, Senate Bill 10-001, which temporarily increased employee contributions by 2.5 percent of salary, increased AED and SAED payments for certain PERA divisions, adjusted how retirement benefits are calculated, and capped the COLA at the lesser of 2 percent or the rate of inflation.

*Independent PERA studies.* In 2014, the legislature passed Senate Bill 14-214, to create and fund three independent assessments of PERA that were completed in 2015:

- the Milliman Retirement Benefits Study incorporated the PERA benefit into the state's total compensation survey;

- the Gabriel, Roeder, Smith & Co. Plan Design Study compared the costs and effectiveness of PERA's defined benefit plan to alternative plans in the public and private sector; and

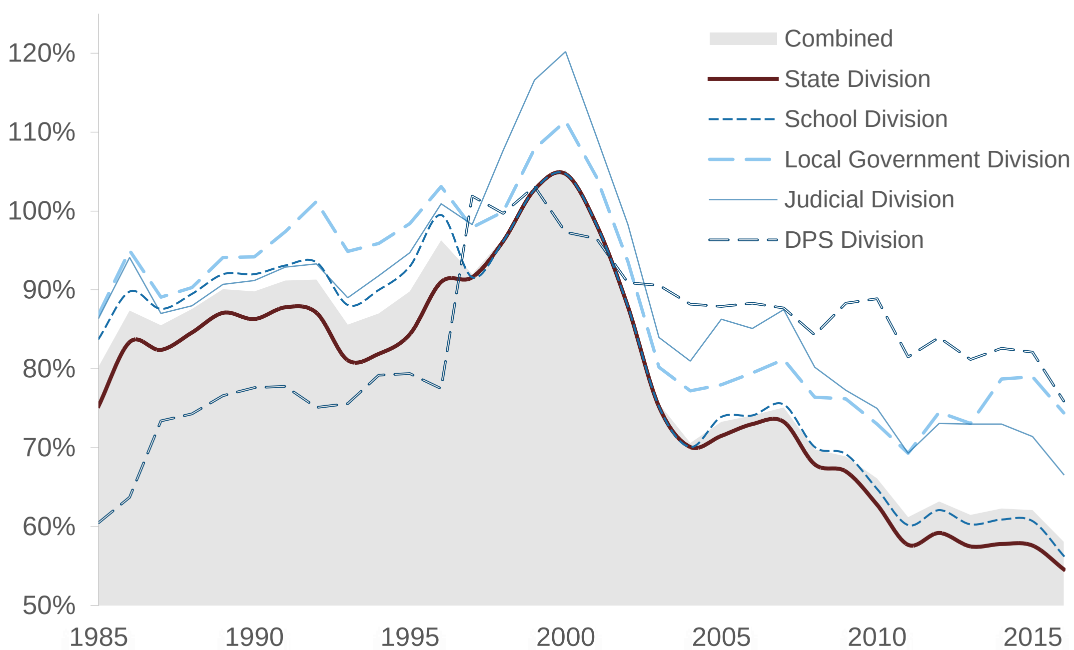
- the Pension Trustee Advisors Sensitivity Analysis performed a sensitivity analysis of PERA's assumptions and created a traffic light methodology to simplify communication related to the funded status of the PERA trusts.

**Changing assumptions and longer life expectancies.** The overall goal of a 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 (GASB) standards 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.

In late 2016, the PERA board lowered PERA's expected rate of return on its investments to 7.25 percent. This assumption change, combined with planning for longer life expectancies, caused the unfunded liability of PERA's trusts to extend past 50 years in nearly all the divisional trusts. In response to this, PERA conducted a statewide outreach tour in 2017, which resulted in the PERA board's recommendation of a package of reforms to the state legislature for the 2018 session.

Figure 1 below shows the funded status of each PERA division, illustrating the decrease since the early 2000s.

**Figure 1**
**Funded Status by PERA Division**
*1985-2016*




*Prepared by Legislative Council Staff. Source: PERA.*

## Senate Bill 18-200

Senate Bill 18-200 made several changes to PERA in order to restore the pension to full funding within 30 years. As a result of the bill, PERA's actuaries estimate that all divisional trusts are within a 30-year amortization period as shown in Table 3.

**Table 3**
**Estimated Amortization Periods to Achieve Full Funding in PERA's Trusts**

| Division | Amortization Period Before SB 18-200 | Amortization Period After SB 18-200* |
|---|---|---|
| State | 57 years | 27 years |
| School | 77 years | 30 years |
| Local Government | 54 years | 15 years |
| Judicial | 53 years | 15 years |
| Denver Public Schools | 55 years | 17 years |

*Source: PERA.*
** Based on 2017 valuations. Change in salary definition and retirement eligibility changes could not be precisely modeled.*

Returning PERA to full funding within the amortization periods shown above is a result of revenue infusions and cost savings to PERA achieved through new requirements for the state budget, employers, employees, retirees, and future beneficiaries, as well as future automatic adjustments and supplements. The provisions of the bill are summarized in the bullets below and described further in the subsections that follow.

- *State and employer share.* Beginning in 2018, SB 18-200 requires an annual distribution of $225 million from state funds to PERA. In addition, the bill increases employer contributions by 0.25 percent in all divisions except local government beginning in 2019.

- *Current PERA members.* The bill phases in a three-year, 2 percent contribution rate increase for all employees who are members of PERA.

- *Retirees.* The bill freezes the cost-of-living adjustment for retirees for two additional years after retirement; combined with past legislation, the freeze is now three years for all new retirees. After that time period, the COLA is set at 1.5 percent.

- *Future PERA members.* For employees hired beginning July 2019, the PERA benefit will be assessed on gross salary instead of net salary after health- and transportation-related pre-tax payroll deductions. For employees hired after 2020, the bill changes the required number of service years and required age for retirement, as well as the way that retirement is calculated through adjustments to the Highest Average Salary (HAS) calculation.

- *Automatic adjustment mechanisms and DC supplement.* The bill creates an automatic contribution rate adjustment for employers, employees, and retirees that increases or decreases contribution and COLA rates depending on funding outcomes for the PERA trusts. The bill also requires employer contribution rates to be adjusted to supplement the DB trusts for employees electing the DC plan.

- *Other provisions.* SB 18-200 also expands the DC plan to local governments and institutions of higher education; reclassifies corrections officers to the state trooper rate; creates new legislative oversight of PERA through the Pension Review Commission and Subcommittee; and clarifies provisions related to local government employers terminating PERA affiliation.

## Direct Distribution of State Funds to PERA

Beginning in FY 2018-19, the bill requires the state to annually distribute $225 million to PERA until the unfunded liabilities of the state, judicial, school, and DPS divisional trusts are paid. The direct distribution is paid primarily from the General Fund, but may also come from cash funds and federal funds. The distribution must be included in the Governor's annual budget request and in the Long Bill each year. PERA is required to credit these funds proportionally to the relevant divisional trusts. By September 1 every year, PERA must determine the unfunded liability status of each division and notify the Office of State Planning and Budgeting and the Joint Budget Committee when the direct distribution is no longer required.

## Employer and Employee Contribution Rate Increase

The amount of employee and employer contributions increases beginning in July 2019, as shown in Table 4 below. The employer contribution rate increases by 0.25 percent and the employee contribution increases by 2 percent over a three-year phase-in period. The increased employer contribution amount is credited to the appropriate divisional trust regardless of whether the member has elected the defined benefit or defined contribution plan.

**Table 4**
**Employer and Employee Contribution Rates to PERA**

| | State | Troopers | School | DPS | Local | Judicial |
|---|---|---|---|---|---|---|
| | | | **Employer** | | | |
| **FY 2018-19** | 10.15% | 12.85% | 10.15% | 10.15% | 10.00% | 13.66% |
| **FY 2019-20** | 10.40% | 13.10% | 10.40% | 10.40% | 10.00% | 13.91% |
| **+ AED/SAED** | 10.00% | 10.00% | 10.00% | 10.00% | 3.70% | 3.70% |
| **FY 2019-20 Total** | 20.40% | 23.10% | 20.40% | 20.40% | 13.70% | 17.61% |
| | | | **Employee*** | | | |
| **FY 2018-19** | 8.00% | 10.00% | 8.00% | 8.00% | 8.00% | 8.00% |
| **FY 2019-20** | 8.75% | 10.75% | 8.75% | 8.75% | 8.75% | 8.75% |
| **FY 2020-21** | 9.50% | 11.50% | 9.50% | 9.50% | 9.50% | 9.50% |
| **FY 2021-22** | 10.00% | 12.00% | 10.00% | 10.00% | 10.00% | 10.00% |

*Source: Section 24-51-401, C.R.S.*
* *The increased employee contribution amount passed in SB 18-200 is credited to an employee's account regardless of DB or DC plan election.*

## COLA Timeout and Rate Reduction for Retirees

The annual COLA for retirees is currently 2 percent. For the years 2018 and 2019, the bill eliminates the COLA. For each year thereafter, the bill sets the COLA at 1.5 percent. This amount may be adjusted automatically as explained below. The bill also requires that benefit recipients whose effective date of retirement is on or after January 1, 2011, and who have not received a COLA on or before May 1, 2018, not receive a COLA for at least three years following initial receipt of retirement benefits.

## Retirement Eligibility

For PERA members who are hired on or after January 1, 2020, the bill modifies the number of service years required for full service retirement, as shown in Table 5, and the number of service years required for reduced service retirement, as shown in Table 6.

**Table 5**
**Full Service Retirement Eligibility Under SB 18-200**
*(For members hired on or after January 1, 2020)*

| | Years of Service Required to Retire at Any Age | | Years of Service Required to Retire at a Specific Retirement Age | | Years of Service Required to Retire at Age 65 | |
|---|---|---|---|---|---|---|
| **Division** | *Current Hires** | *After 2020* | *Current Hires** | *After 2020* | *Current Hires** | *After 2020* |
| **State, Local, and Judicial** | 35 years | 35 years | Age 60, 30 years | Age 64, 30 years | 5 years | 5 years |
| **Troopers** | 30 years | 35 years | Age 50, 25 years<br>Age 55, 20 years | Age 55, 25 years | 5 years | 5 years |
| **School and DPS** | 35 years | 40 years | Age 58, 30 years | Age 64, 30 years | 5 years | 5 years |

*Source: Section 24-51-602, C.R.S.*
** Represents age and service requirements for members joining PERA on or after January 1, 2017.*

**Table 6**
**Reduced Service Retirement Eligibility Under SB 18-200**
*(For members hired on or after January 1, 2020)*

| | Pre SB 18-200 | | After 2020 | |
|---|---|---|---|---|
| | **Age Requirement** | **Service Credit Requirement** | **Age Requirement** | **Service Credit Requirement** |
| **All Divisions** | 50 years old<br>55 years old<br>60 years old | 25 years of service<br>20 years of service<br>5 years of service | 55 years old<br>60 years old | 25 years of service<br>5 years of service |
| **State Troopers** | 50 years old<br>60 years old | 20 years of service<br>5 years of service | 55 years old | 20 years of service |

*Source: Section 24-51-604, C.R.S.*
** Age and service requirements for a reduced benefit apply to all PERA members, regardless of membership date.*

## Highest Average Salary Calculation

Under current law, the retirement benefit paid to a PERA member depends on his or her date of hire, years of service credit, and age at retirement. It is calculated using a percentage of the member's highest average salary (HAS) over a period of time, including a base salary year. The bill changes the number of years factored into the HAS calculation for members who are not vested by or are hired on or after January 1, 2020, as shown in Table 7.

**Table 7**
**Highest Average Salary Period Under SB 18-200 After Base Year**

| As of 1/1/20 | All Divisions Except Judicial | Judicial |
|---|---|---|
| **Vested** | 3 periods of 12 months | 1 period of 12 months |
| **Not Vested** | 5 periods of 12 months | 3 periods of 12 months |

*Source: Section 24-51-101 (25) (a), C.R.S.*

## Automatic Adjustments to Contribution Rates and the COLA

Beginning July 1, 2019, with the first adjustment permitted on July 1, 2020, and each July 1 thereafter, PERA must annually determine whether an adjustment to the employer and member contribution rate and the COLA rate for retirees is required, based on certain conditions, as shown in Table 8. When an adjustment is made, it must be equally apportioned to employers, members, and retirees, and may not exceed the maximum yearly adjustment amount. Adjustments may occur only once in a calendar year, and are triggered when the blended total contribution amount is less than 98 percent or more than 110 percent of the blended total actuarially required contribution, using the following definitions:

- "Blended total contribution amount" is the weighted average of the total amounts paid by employers and members to PERA by all divisions, not to include the portions of employer contributions remitted to the health care trust fund and the COLA reserve.

- "Blended total required contribution" is the weighted average of the total reported actuarially determined contribution rates and member contribution rates for PERA's trusts.

- "Weighted average" means the most recent valuation of the proportion of unfunded actuarial accrued liability attributable to each division.

**Table 8**
**Automatic Contribution and COLA Rate Adjustments Under SB 18-200**

| | |
|---|---|
| ***When the blended total contribution amount is less than 98% of the blended total actuarially required contribution:*** | |
| COLA Rate | reduced up to 0.25%; not to be reduced to less than 0.5% total |
| Employer Contribution Rate | increased up to 0.5%; not to exceed statutory contribution rates plus 2% total |
| Member Contribution Rate | increased up to 0.5%; not to exceed statutory contribution rates plus 2% total |
| ***When the blended total contribution amount is greater than or equal to 110% of the blended total actuarially required contribution:*** | |
| COLA Rate | increased up to 0.25%; not to exceed 2% total |
| Employer Contribution Rate | reduced up to 0.5%; not to be less than statutory contribution rates |
| Member Contribution Rate | reduced up to 0.5%; not to be less than statutory contribution rates |

*Source: Section 24-51-413, C.R.S.*

## DC Supplement

Beginning January 1, 2021, the bill requires that employers in the state and local government divisions pay a "defined contribution supplement" whenever a new hire chooses the defined contribution option. The supplementary payment is the amount that would have otherwise gone to the defined benefit trusts to pay down the unfunded liability if a member had elected the defined benefit plan, plus investment earnings on that amount. The supplement must be paid by the employer for all new employees hired on or after January 1, 2019, who elect the defined contribution plan.

## Other Provisions

**Defined contribution plan expansion to higher education and local government.** Under current law, members in the state division (with the exception of higher education) hired after January 1, 2006, may elect to participate in PERA's defined contribution plan rather than its defined benefit plan. A defined contribution account receives the monthly employer contribution, while the amortization equalization disbursement (AED) and supplemental amortization equalization disbursement (SAED) payments are credited to pay down the unfunded liability of the defined benefit plan. Beginning January 1, 2020, anyone hired in higher education or the local government division may elect to participate in the defined contribution plan. An employee who elects the defined contribution plan will receive their full member contribution amount as increased under the bill, and the employer contribution amount under current law.

**Reclassification of corrections officers to state trooper benefit rate.** The bill expands the definition of state trooper to include state correctional officers and county sheriffs, undersheriffs, deputy sheriffs, noncertified deputy sheriffs, and detention officers hired by a local government division in the same benefit structure as state troopers for new employees hired after January 1, 2020. As a result, the employer contribution rate will increase 2.7 percent, from 10.15 percent to 12.85 percent, and the member contribution rate will increase 2.0 percent, from 8.0 percent to 10.0 percent for these reclassified members. These percentages do not include the additional employer and member contribution rate increase outlined in Tables 3 and 4.

**Pension Review Commission and Subcommittee.** The bill renames the existing Police Officers' and Firefighters' Pension Reform Commission, a standing legislative interim committee, as the Pension Review Commission. The composition of the commission is modified effective January 4, 2019, reducing the number of legislators from 15 to 10, with 5 from each house, and including minority leader appointments. In addition, the bill creates the Pension Review Subcommittee to study and develop legislation concerning PERA. The subcommittee consists of 14 legislative and non-legislative members appointed by legislative leadership, the Governor, and the State Treasurer. The subcommittee is required to make recommendations to PERA and the larger commission regarding several issues, including the requirement that the subcommittee commission an independent review of the economic and investment assumptions used to model the PERA financial situation every three years.

**Requirements of PERA's Board of Trustees.** The bill codifies the PERA board's current practice of performing an annual sensitivity analysis to determine whether actuarial assumptions are meeting targets. The board must report this information annually to the Governor, the Joint Budget Committee, the Legislative Audit Committee, and the House and Senate Finance Committees. The PERA board may also disclose investment information to the legislative members of the Pension Review Commission while the commission is in executive session.

**Requirements for local government employers that terminate PERA affiliation.** The bill clarifies provisions related to a local government that ceases participation in PERA. When a local government terminates its affiliation with PERA, the PERA board will determine the amount to be paid by the local government to fully fund its share of the unfunded liability of the defined benefit plan and of the health care trust fund. The board's determination may be appealed by the local government through an administrative review process. The local government's employees become inactive members of PERA effective on the termination date, and may elect to have their member contributions credited to an alternative pension plan or refunded. In the absence of such election, the member contributions remain with PERA.