COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 1247-01
Bill No.: HB 333
Subject: Highway Patrol; Retirement - State; Retirement Systems and Benefits - General; Transportation Dept.
Type: Original
Date: March 30, 2005

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2006	FY 2007	FY 2008
General Revenue	($54,700,000)	($54,700,000)	($54,700,000)
Total Estimated Net Effect on General Revenue Fund	**($54,700,000)**	**($54,700,000)**	**($54,700,000)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2006	FY 2007	FY 2008
Highway Fund	$0 - $55,273,697	$0 - $55,881,815	$0 - $55,917,269
Patrol Highway Fund	$0 - $208,990	$0 - $430,518	$0 - $443,434
Other Patrol Funds	$0 - 36,880	$0 - $75,974	$0 - $78,253
Total Estimated Net Effect on Other State Funds	**$0 - $55,519,567**	**$0 - $56,388,307**	**$0 - $56,438,956**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 13 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2006	FY 2007	FY 2008
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2006	FY 2007	FY 2008
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

The **Joint Committee on Public Employee Retirement** indicated the above referenced legislation would indicate that such legislation is a "substantial proposed change" in future plan benefits as defined in Section 105.655(5). Therefore, an actuarial cost statement as defined in Section 105.655 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 State and 3) the Joint Committee on Public Employee Retirement as public information for at least five (5) legislative days before final passage of the bill.

An actuarial cost statement for this legislation has not been performed, however preliminary actuarial impact to MOSERS has been identified should a merger of asset and liabilities occur. Consolidation of the systems would increase MOSERS assets on a market value basis by $1.3 billion with an increase in MOSERS' unfunded liabilities of $1.1 billion.

Officials from **MoDOT and Patrol Employees Retirement System (MPERS)** assume this proposal mandates the "consolidation" of MOSERS and MPERS. It is unclear whether or not

ASSUMPTION (continued)

this means that MPERS would cease to exist after the consolidation. Obviously, if the system is totally absorbed into MOSERS the potential for the elimination of jobs exists. The system currently employs 12 staff.

The fiscal impact of this proposal is contingent on the method of determining contribution rates for the combined plan following the merger. The proposal appears to vest final authority for that decision with the MOSERS Board. One method would be to separately experience-rate "Old MOSERS" and "Old MPERS', as separate groups within a "New MOSERS'. This would mean, essentially, combining the two systems for the purpose of investments and administration, but not for rate setting. Another would be to treat the combined group as a single rate group with a single contribution rate. These two approaches are as follows.

Separately Experience Rated

Under separate experience rating, the contribution rates for "Old MOSERS" and for "Old MPERS" will remain about the same as at present. Small differences might arise for technical reasons, but, basically, there would be almost no fiscal effect, and any cost shifting from the "Old MPERS" group to the "Old MOSERS" group would be minimized under this method. This approach would, however, represent a change indirection for MOSERS, since MOSERS has historically had a single contribution rate for all participating agencies. It would also single out one agency for different treatment from every other State agency. MPERS has not reviewed the statutes to determine whether or not separate experience rating complies with the statutes, nor have they made an attempt to determine whether or not that approach could have unintended spillover effects for MOSERS.

Single Rate Determination

A single rate determination is probably the most natural choice since that has been the historical method of operation of MOSERS. All agencies have contributed at the same rate for as long as we are aware. If a single rate is determined for all agencies under the combined plan, cost shifting will occur from the "Old MPERS" and the "Old MOSERS". The development of the single rate is illustrated below:

ASSUMPTION (continued)

		$ Millions
1)	Employer Contribution Rate for "Old MOSERS'	12.59%
2)	"Old MOSERS" Active Member Payroll	$1,737.5
3)	Employer Contribution Rate for "Old MPERS" (Combined)	32.43%
4)	"Old MPERS" Active Member Payroll	$ 328.2
5)	Present Estimated "Old MPERS" Contribution (3) & (4)	$ 106.4
6)	Combined Employer Rate ("New MOSERS") [(1) * (2) + (3) * (4)] / [(2) + (4)]:	15.4%
7)	MPERS' Agencies Single Rate Contribution (4) * (6)	$ 51.7
8)	Amount of Contribution Shifted from MPERS' Agencies to Other MOSERS Agencies (5) - (7)	$ 54.7

The following table illustrates the potential dollar contributions before and after the merger based on the combined employer rate calculated:

	MPERS					
	Civilian Patrol	MoDOT	Uniformed Patrol	Total	MOSERS	Total
Before merger	$10.4	$ 75.6	$ 20.4	$106.4	$218.7	$325.1
After merger	$ 5.4	$ 39.0	$ 7.3	$ 51.7	$273.4	$325.1
Increase/(Decrease)$	$(5.0)	$(36.6)	$(13.1)	$(54.7)	$54.7	$ 0.0
% of Payroll	(14.75)%	(14.75)%	(28.53)%	(16.69)%	3.15%	0.0%

While these results are approximate, we believe they provide a reasonable indication of how a single rate system would work.

The calculations are based on the June 30, 2004 individual valuations for MPERS and MOSERS. A combined valuation may produce different results if MOSERS' actuarial methods and assumptions were applied to MPERS members, but the principles would be the same if the combined system were treated as a single rate group; there would be a cost shift from MPERS employers to MOSERS employers.

Regardless of how the contribution rate for "New MOSERS" is determined, the total funding level for "New MOSERS" would be expected to become 76.6%, which can be compared with the 84.6% funding level for "Old MOSERS" and 53.4% for "Old MPERS". This is based on a total unfunded actuarial accrued liability of $2.273 billion for "New MOSERS' ($1.161 billion for "Old MPERS plus $1.112 billion for "Old MOSERS) and a total actuarial value of assets of $7.450 billion for "New MOSERS" ($1.332 billion for "Old MPERS" plus $6.118 billion for

ASSUMPTION (continued)

"Old MOSERS")

Officials with the **Missouri State Employees Retirement Plan (MOSERS)** assume the proposed legislation described in Fiscal Note No. 1247-01N (HB 333) would, if enacted, require the boards of trustees of the Missouri State Employees' Retirement System (MOSERS) and the MoDOT and Patrol Employees' Retirement System (MPERS) to take all action necessary to effect the consolidation of MPERS into MOSERS, no later than September 1, 2008. Under the proposal, the MOSERS Board of Trustees would assume control over all assets and liabilities and be vested with the duties and powers specified in Chapter 104 that relate to the administration of MPERS upon execution of a written agreement entered into by the two boards of trustees. Such agreement would be required to be completed no later than December 31, 2005, and upon the effective date of such agreement, the MPERS Board of Trustees would no longer exist. The proposal provides for the superintendent of the state highway patrol and the director of the department of transportation to become temporary members of the MOSERS' board during the period from September 1, 2005, through September 1, 2008 to ensure a smooth transition.

The proposal is broadly written and allows the boards of both systems to develop a transition agreement that would address specific issues associated with a merger. Since that information is not yet known at this time, for purposes of this fiscal note, MOSERS will provide a general overview of the fiscal effects of such a consolidation on MOSERS' operation only. More specific detail regarding the effects of a consolidation can be found in the Joint Committee on Public Employee Retirement's Final Report on Issues Related to the Consolidation of Retirement Systems for State Employees (December 2004).

In the event this proposal is enacted, it is likely that MOSERS would administer the MPERS Uniformed and Non-Uniformed plans separately (as is the case with the Administrative Law Judges and Legal Advisors' Plan and the Judicial Plan). Under such an arrangement, the contribution rates for the Uniformed and Non-Uniformed plans would not change materially as a result of the consolidation and would primarily be funded by the State Highways and Transportation Department, with contributions being paid to MOSERS in lieu of being paid to MPERS.

If the state desired to merge the contribution rates for the Uniformed and Non-Uniformed Plans into the general employee plan administered by MOSERS, an actuarial study would be required to evaluate the various options available. Such an exercise would require the participation of at least the governor's office, the commissioner of administration, the director of transportation, the legislature, and the MOSERS' board to ensure that any such contribution rate is acceptable to all parties and attainable within current budgetary restrictions.

ASSUMPTION (continued)

To explain further, if the recently certified contribution rates (FY06) were merged today, it would have the immediate effect of increasing MOSERS' contribution rate from 12.59% to 15.74% of payroll. In addition, such a merger would lower MOSERS' present funded status from 84.6% to 76.6% due to the effect of absorbing MPERS' unfunded liability which is considerably higher as a percent of their accrued liability than is the case for MOSERS.

Contribution Rate Comparison
FY06

Contribution Rate for	MPERS FY06 Non-Uniformed	MPERS FY06 Uniformed	MOSERS FY06 Gen. Emp. Plan	MOSERS Comb. Rate
Normal Cost	11.79%	13.55%	8.07%	8.70%
UAAL	17.64	29.66	3.78	6.25
Expenses	0.50	0.50	0.33	0.36
Disability	0.56*	0.56*	0.41	0.43
Total Rate	30.49%	44.27%	12.59%	15.74%

*Actual charge by the insurance company is 0.60% of payroll. The difference of 04% of payroll is funded from a portion of the assets that were formerly held as a reserve for the Long-Term Disability Plan.

Contributions for benefits for all state employees (including MoDOT and the Highway Patrol) are paid from the funds established for employee benefits. In the case of MoDOT and Highway Patrol employees, the vast majority of such contributions come from the State Highways and Transportation Department Fund.

As illustrated in the tables that follow, if MPERS' and MOSERS' rates were combined, the costs associated with MoDOT and Highway Patrol employees (primarily paid by the State Highways and Transportation Department Fund) would decrease by approximately $41.6 million in annual contributions for non-uniformed members and approximately $13.1 million less in annual contributions for uniformed members. In contrast, the benefit contributions paid for all other state employees would increase $54.7 million (approximately 40% of which would be paid from the state's general revenue fund).

ASSUMPTION (continued)

MPERS
DOLLAR CONTRIBUTIONS
Effect of Unadjusted Combined Rate Structure
NON-UNIFORMED
($Amount in Millions)

Valuation Payroll	MPERS FY06 Contribution Rate	MPERS Combined Contribution Rate	Increase/ (Decrease) in % of Payroll	Increase/ (Decrease) in Contribution $
$282	30.49%	15.74%	(14.75%)	($41.6)

The unadjusted contribution dollars shown are not affected in the aggregate, i.e., the first year decreases of $41.6 million and $13.1 million from the State Highways and Transportation Department Fund would be balanced by an increase of $54.7 million from MOSERS' funding sources.

MPERS
DOLLAR CONTRIBUTIONS
Effect of Unadjusted Combined Rate Structure
UNIFORMED
($Amount in Millions)

Valuation Payroll	MPERS FY06 Contribution Rate	MPERS Combined Contribution Rate	Increase/ (Decrease) in % of Payroll	Increase/ (Decrease) in Contribution $
$46	44.27%	15.74%	(28.53%)	($13.1)

ASSUMPTION (continued)

MOSERS
DOLLAR CONTRIBUTIONS
Effect of Unadjusted Combined Rate Structure
GENERAL EMPLOYEES
($Amount in Millions)

Valuation Payroll	MPERS FY06 Contribution Rate	MPERS Combined Contribution Rate	Increase/ (Decrease) in % of Payroll	Increase/ (Decrease) in Contribution $
$1,737	12.59%	15.74%	3.15%	$54.7

The three previous tables are intended to demonstrate the shifting of contributions by source among the groups if the contribution rate is combined or pooled. This is not the only alternative for determining the contribution rate(s). The $54.7 million dollar contribution shift to other funding sources would have an immediate impact on the state's budget planning. This could be mitigated by applying an actuarial approach that would allow for gradual changes toward a combined contribution rate (a measured increase in contributions from general revenue and a measured decrease in contributions from the State Highways and Transportation Department Fund) that would eventually result in a single rate being achieved at a future specified date. As stated previously, such an approach would require the participation of the appropriate parties to ensure that any such approach is fiscally responsible and attainable within current budgetary restrictions.

Cost savings related to economies of scale should be realized in the event of a merger. Combining the MOSERS' assets and the MPERS' assets would likely result in increased management fee negotiating power and thus lower cost structures, especially as it relates to the more traditional areas of investments (such as stocks and bonds). In the investment management industry, fees are based on assets under management and as assets grow, incremental dollars are managed at lower rates.

Cost savings related to consolidation of staffing and oversight services should be realized in the event of a merger. In the area of staffing, MOSERS might possibly retain the current investment staff position from MPERS, thus there would be no expense elimination in this area. However, there would be considerable savings in other oversight expenses incurred by each system. For example, given that each system retains the same consultant and actuary, it is estimated that approximately $250,000 in cost savings could be realized through consolidation of the plans for these two services alone. An additional amount of savings could be realized through

ASSUMPTION (continued)

consolidation of asset safekeeping with one custody bank. In addition, certain other oversight expenses related to portfolio management tools, research services, travel expenditures, and other miscellaneous oversight expenses could be consolidated and thus reduced, however, these expenses are minimal when compared to external management fees.

Transactions costs would be incurred as MPERS' portfolio positions were merged into the MOSERS portfolio. It is difficult to predict actual transactions costs, however, estimates are in the neighborhood of $5.0 million. While this amount seems large in absolute dollars, it should be pointed out that if cumulative performance on the MPERS' assets improves by a modest 1/3rd of one percent in the future, these costs would be negated. To explain, over the last ten years MOSERS' investment portfolio has outperformed MPERS by 2.8% annually. Based on the size of MPERS' current portfolio, if this 2.8% gap continued in the future, a minimum of approximately $42 million per year in additional investment income would be realized by the MPERS' assets receiving the MOSERS' return. Investment income in year one would be reduced by the $5.0 million in transactions costs, thus net additional investment income would be $37 million. This example assumes that the 2.8% annual difference realized in the last ten years continues in the future; however, there is no guarantee that actual results will approximate historical results.

MOSERS' member database contains all of the information needed to calculate benefits, such as demographic data, detailed service records, and pay history. The service data contains all periods of service and is coded to identify, in detail, how that service was earned and how it is to be used in calculating benefits. In the event of a full consolidation, all information in MPERS' paper files (approximately 1.5 million documents) would need to be entered into MOSERS' system. All MPERS' files would require preparation (sorting by document type, assigning of bar codes, placement in date order, and removal of staples and paperclips) for scanning. After scanning was complete, MOSERS' staff would need to verify the number of documents scanned compared to the number of documents in MPERS' master files. MOSERS could convert the data from SAMII demographics to the MOSERS' demographics files for active members. The MPERS' benefit files appear to contain the information necessary to build new benefit recipient files. MOSERS' staff would copy the MPERS' data to its database and run edits to insure integrity. It is estimated that six temporary workers could prepare approximately 1.5 million documents during a six-month period. An additional three-month period would likely be required to actually scan and verify member records. Lastly, more time would be required if MOSERS is unable to electronically transfer all of the data needed to populate the database maintained on MOSERS IBM I series primary computer system. It is estimated that this work could be performed for approximately $125,000. Additionally, there is a possibility that one position from MPERS may need to be retained to maintain the extra data entry created by a consolidation.

ASSUMPTION (continued)

The basic retirement plan design of MPERS is very similar to the state employee plan that is in effect for general employees. MOSERS' programs could be modified to accommodate any differences and, with time and testing, be altered to provide benefit estimates as soon as data is entered and verified. This would enable MPERS' members to access MOSERS' web site for benefit estimates and individualized information, and also allow estimates to immediately be provided from MOSERS' benefits department. MOSERS would also be able to process MPERS' new retirees automatically giving them estimates of all options on their election forms. If a full consolidation occurred, MOSERS may require the permanent staffing assistance of one to two MPERS' benefit specialist positions in order to ensure an appropriate level of service to MPERS' members. In addition, MOSERS could administer the life insurance and disability programs. At present, the Standard Insurance Company serves as the third party administrator for MOSERS' basic and optional life insurance plans, and the long-term disability plan for state employees. The similarities and differences in these plans are detailed in the Final Report on Issues Related to the Consolidation of Retirement Systems for State Employees (December 2004).

In summary, it is estimated that initially a merger between the two plans would result in savings realized from non-duplication of administrative and investment services. Over the longer term, it is believed that a greater return on investments could be achieved due to certain economies of scale and the investment expertise already in place at MOSERS.

Officials with the **Department of Transportation** assume for purposes of this analysis, that MPERS will continue to exist but will be under MOSERS administrative control. Total administrative expenses of $1,639,133 and investment expenses of $4,108,418 were reported on the audited financial statements for MPERS for fiscal year 2004. We assumed $0 to $1,639,133 per year cost savings for administrative expenses, since it is unclear whether MPERS employees and consultants will be retained to administer the provisions of the MPERS plan. We are assuming that investment expenses will be approximately the same under either plan. Because the consolidation agreement is not required to go into effect until January 1, 2006, only 6 months of impact are reported in FY06. The benefit of any cost savings would accrue 70% to MoDOT and 30% to the Missouri State Highway Patrol (MSHP). All of MoDOT's cost savings would be credited to the Highway Fund. Of the MSHP's 30% of the cost savings, 85% would be credited to the Highway Fund and 15% to other funds.

The contribution rates of MPERS and MOSERS should not change substantially under this scenario.

If the intent of the legislation is to eliminate MPERS and create a single plan with combined contribution rates, the contribution rates for MPERS and MOSERS would change substantially.

ASSUMPTION (continued)

It is anticipated that the MPERS current contribution rate of 32.43% would decrease and the MOSERS current contribution rate of 12.59% would increase. The MOSERS increase would probably be funded primarily from General Revenue.

In addition, the bill would impact the medical plan and life insurance for MoDOT and the Highway Patrol since section 104.270 RSMo bases participation in the medical plan/life insurance benefits on membership in MPERS. It is unclear whether the legislation intended to consolidate MoDOT's medical plan with the Missouri Consolidated Health Care Plan (MCHCP). Additional analysis will be necessary to accurately determine the fiscal impact of such a consolidation. However, a consolidation of MoDOT's medical and life insurance plans with MCHCP's plans is expected to have a negative fiscal impact to MoDOT in excess of $100,000.

Additionally, if the consolidation means that the MOSERS board shall determine and certify only one combined contribution rate for all current agencies in MOSERS plus those in MPERS, there will be a savings of $54.7 million in State Highway Funds.

FISCAL IMPACT - State Government	FY 2006 (10 Mo.)	FY 2007	FY 2008
GENERAL REVENUE			
Transfer Out - MOSERS Contribution	($54,700,000)	($54,700,000)	($54,700,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**($54,700,000)**	**($54,700,000)**	**($54,700,000)**
OTHER STATE FUNDS			
Transfer In - Highway Fund MPERS Contribution	$54,700,000	$54,700,000	$54,700,000
Cost Savings - Highway Fund Administrative Expenses	$0 - $573,697	$0 - $1,181,815	$0 - $1,217,269
Cost Savings - Patrol Highway Fund Administrative Expenses	$0 - $208,990	$0 - $430,518	$0 - $443,434

Cost Savings - Other Patrol Funds			
Administrative Expenses	$0 - $36,880	$0 - $75,974	$0 - $78,253
ESTIMATED NET EFFECT ON OTHER STATE FUNDS	**$0 - $55,519,567**	**$0 - $56,388,307**	**$0 - $56,438,956**

FISCAL IMPACT - Local Government	FY 2006 (10 Mo.)	FY 2007	FY 2008
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

The MoDOT and Patrol Employees Retirement System (MPERS) currently contracts with investment managers, investment consultants, an actuary, a business consultant, and numerous local businesses to provide services (building maintenance, cleaning, mailing services), to the retirement system. They have no way of knowing if any of these entities would be considered a small business. If the consolidation of MPERS into MOSERS means that these contracts are no longer needed and these contracts involve small businesses, then this consolidation would have an economic impact on small businesses.

DESCRIPTION

This bill requires consolidation of the Highways and Transportation Employees' and Highway Patrol Retirement System (HTEHPRS) into the Missouri State Employees' Retirement System (MOSERS) by September 1, 2008. The board of trustees of the two retirement systems will enter into a written agreement by December 31, 2005, describing the consolidation process. By January 1, 2006, or the date of the written agreement, the MOSERS board will assume the powers and duties regarding administration of the system from the HTEHPRS board.

During the period beginning September 1, 2005, and ending September 1, 2008, the Superintendent of the State Highway Patrol and the Director of the Department of Transportation will be members of the MOSERS board with the same duties and responsibilities as any other member.

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
MoDOT and Patrol Employees Retirement System
Department of Transportation
Missouri Highway Patrol
Missouri State Employees Retirement System

Mickey Wilson, CPA
Director
March 30, 2005