COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4860-01
Bill No.: HB 1628
Subject: Highway Patrol; Retirement - State; Transportation Dept.
Type: Original
Date: March 1, 2006

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
General Revenue	$0	($19,090,000)	($19,960,000)
Total Estimated Net Effect on General Revenue Fund	**$0**	**($19,090,000)**	**($19,960,000)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
Highway Fund	$0	$19,200,000	$19,970,000
Total Estimated Net Effect on Other State Funds	**$0**	**$19,200,000**	**$19,970,000**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 10 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2007	FY 2008	FY 2009
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

The **Joint Committee on Public Retirement** indicates that this legislation does represent a "substantial proposed change" in future plan benefits as defined in Section 105.660(5). Therefore, an actuarial cost statement as defined in Section 105.665 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 legislative days before final passage of the bill.

An actuarial cost statement for this legislation has been filed with the Joint Committee on Public Employee Retirement.

Officials from the **Missouri Highway Patrol** assume the Highway and Patrol Retirement System will be responding for them.

Officials from the **Highway and Patrol Employees' Retirement System (MPERS)** assume this proposal mandates the "consolidation" of MOSERS and MPERS by December 31, 2006. Once

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the assets and liabilities transfer, the responsibility for administering the consolidation the potential for the elimination of job exists. The system currently employs 12 staff. The proposal makes no allowance of continuation of MPERS' staff.

Section 104.005.1 of the proposal would, if enacted, require the MOSERS Board of Trustees to assume control over all assets and liabilities and be vested with the powers and duties necessary to enable its trustees, employees and agents to administer the Missouri Department of Transportation and Highway Patrol Employees' Retirement system (MPERS) no later than December 31, 2006. This section further states that for purposes of this section "assets" will not include real and personal property located within MPERS that will remain the property of the Missouri Highway and Transportation Commission (MHTC) after the transfer to MOSERS.

Section 4104.005.2 states that upon transfer of authority the MOSERS Board of Trustees shall administer MPERS. This transfer of authority will not alter the statutory provisions applicable to MPERS' retirement, life insurance, medical and disability benefits.

Section 104.005.3 requires MOSERS to determine contribution rates (beginning at least ninety days before calendar year 2008) for MPERS" uniformed and non-uniformed plans which are to be the same as the rate for the MOSERS general employee plan.

104.005.4 requires the superintendent of the state highway patrol, and the director of MoDOT, to serve on the MOSERS board during the period beginning September 1, 2006 and ending on September 1, 2009. This section further authorizes MHTC to sell pension obligation bonds in an amount not to exceed $780,000,000. Proceeds from the sale of such bonds are to be deposited with and become assets of MOSERS; however, debt retirement of the bonds will be the sole responsibility of the MHTC with payoff duration not to exceed twenty years.

Section 104.040.6 allows non-uniformed members of MPERS to purchase non-federal full-time public employment. The calculation used to arrive at the cost to purchase this service is the same as the calculation used to determine the cost of purchasing military service. Currently members of MOSERS and the uniformed patrol members of MPERS can purchase this service at the military rate which is subsidized.

In performing the analysis, the Executive Directors of the Joint Committee on Public Employee (JCPER), MPERS and MOSERS determined that the estimated administrative savings resulting from the consolidation to be $553,954 annually. It was also estimated that first year transition costs, depending on the percentage of MPERS investment portfolio that would be liquidated, would range from $5 million to $12 million. Based on this research, the first year cost of

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consolidating MPERS investment portfolio would range from $4,446,046 ($5 million of transition costs less $553,954 savings) to $11,446,046 ($12 million less $553,954). Assuming a transition cost of $8,446,046 (middle of the range) it would take 15.24 years for the state to recover the costs of transitioning the assets.

The valuation prepared by Gabriel Roeder Smith & Company assumes that upon consolidation the combined single contribution rate for MOSERS/MPERS will be 13.79% resulting in a increase of 19.09 million in contributions from General Revenue in FY08. In FY09 an additional $19.96 million is required and in 2010 an additional $20.76 million from General Revenue would be required to fund this proposal.

Officials from the **Missouri State Employees' Retirement System** assumes this proposal would, if enacted, require the MOSERS Board of Trustees to assume control over all assets and liabilities and be vested with the powers and duties necessary to enable its trustees, employees and agents to administer the Missouri Department of Transportation and Highway Patrol Employees' Retirement System (MPERS) no later than December 31, 2006. This transfer of authority would not alter the statutory provisions applicable to MPERS' retirement, life insurance, medical, and disability benefits.

The proposal would require MOSERS to determine contribution rates for MPERS' uniformed and non-uniformed plans to be the same as the rate that would be in effect for the general employee plan presently administered by MOSERS. The proposal also would allow the superintendent of the state highway patrol, and the director of MoDOT, to serve on the board during the period beginning September 1, 2006 and ending on September 1, 2009. The proposal would further authorize MoDOT to sell pension obligation bonds in an amount not exceed $780,000. Proceeds from the sale of such bonds would be deposited with and become assets of MOSERS; however, debt retirement of the bonds would be the sole responsibility of the Highway and Transportation Commission, with payoff duration not to exceed twenty years.

Cost savings related to consolidation of staffing and oversight services should be realized in the event of a merger. 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 consolidation of asset safekeeping with one custody bank. In addition, certain other oversight expenses related to portfolio management tools, research services, travel

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expenditures, and other miscellaneous oversight expenses could be consolidated and thus reduced; however, these expenses are minimal when compared to external management fees.

Cost savings related to economies of scale should also 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.

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 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 2.7% annually. Based on the size of MPERS' current portfolio, if this 2.7% gap continued in the future, a minimum of approximately $39 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 $34 million. This example assumes that the 2.7 % 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 nine temporary workers could prepare approximately 1.5 million documents during a 12-month period. Lastly, more time would be required if MOSERS is unable to

ASSUMPTION (continued)

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 $282,000 (which includes fees associated with licensing and storage as well as $20,500 for a new scanner).

The transfer of authority from MPERS to MOSERS would only apply to the administration of the retirement plan; other entities (either MoDOT or the MPERS board) would continue to administer its life insurance, medical, and disability programs.

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 from the **Department of Transportation (MoDOT)** assume that MPERS will continue but will be under MOSERS administrative control. Total administrative expenses of $1,916,592 and investment expenses of $3,286,414 were reported on the audited financial statements for MPERS for fiscal year 2005. They assumed $0 to $1,916,592 per year cost savings for administrative expenses, since it is unclear whether MPERS employees and consultants will be retained to administer the provisions of either plan. They are assuming that investment expenses will be approximately the same under either plan. Because the consolidation is required to go into effect no later than December 31, 2006, they assumed 6 months of impact for FY07. 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 Road Fund. Of the MSHP's 30% of the cost savings would be credited to the Highway Fund and 15% to other funds.

They are also assuming that MoDOT's ability to keep its separate medical and life insurance plans will not be affected. If these plans are affected and MoDOT employees are required to join Missouri Consolidated Health Care Plan and be covered under another life insurance plan, there will be a fiscal impact to MoDOT. For the medical plan, MoDOT would contribute approximately $1,953,967 more per month ($23,447,604 annually), and MSHP would contribute approximately $609,690 per month more ($7,316,280 annually) than with their current plan. Employees and retirees would also see their health insurance premiums increase. MoDOT's cost for life insurance would increase approximately $53,445 per month ($641,340 annually), while MSHP's life insurance cost would increase by approximately $20,919 per month ($251,028 annually).

ASSUMPTION (continued)

If the intent of the proposal is to eliminate MPERS and create a single plan with combined contribution rates, the contribution rates for MPERS and MOSERS would change substantially. It is anticipated that the MPERS current contribution rate would decrease and the MOSERS contribution rate would increase. The MOSERS increase would probably be funded primarily from General Revenue, unless the pension obligation bonds (POBs) contemplated by the legislation are issued. Depending upon how the combined rate is calculated according to the MPERS actuarial study the fiscal impact in FY08 for MoDOT could range from a $61.4 million cost savings to a $19.2 million cost savings. In FY09, the fiscal impact to MoDOT could range from a $63.84 million cost savings to a $19.97 million cost savings. There would be no fiscal impact in FY07.

The rate combination scenarios contemplated in these ranges include: an immediate consolidation with MOSERS picking up the difference in rates ($61.4 million cost savings in FY08 and $63.84 million cost savings in FY09), the rate differences between the two plans being phased in over a 30 year period with MOSERS picking up the difference ($0 fiscal impact FY08 and $9.96 million cost savings in FY09), and an immediate consolidation of rates with a lump sum contribution from issuing pension obligation bonds (POBs) ($19.2 million cost savings in FY08 and $19.97 million cost savings in FY09). However, any cost savings from contribution rate reductions under the last scenario would be offset by the cost of debt service on the POSs (see below). These figures are based upon a study prepared by the Retirement system's actuary dated February 15, 2006.

The proposal authorizes, but does not mandate, the issuance of POBs up to a maximum of $780 million. Therefore, MoDOT assumes a zero fiscal impact for these provisions. However, if POBs are issued, the debt service on the bonds will be approximately $63 million per year for the next 20 years. The debt service costs would be paid from current revenues and would reduce amounts available for road and bridge construction. The additional debt will hinder MoDOT's ability to : (1) match future federal funds and 92) issue the remaining bonds from Amendment 3 to deliver the Smoother, Safer, Soon Construction program.

The proposal also allows non-uniformed members of MPERS to purchase up to 4 years creditable service for non-federal public employment in this state at the rate charged for military service buyback. MoDOT concurs with MPERS estimate of $70,000 to $100,000 of additional cost annually associated with this provision.

FISCAL IMPACT - State Government	FY 2007 (10 Mo.)	FY 2008	FY 2009
GENERAL REVENUE			
Transfer Out - MOSERS Contribution	$0	($19,090,000)	($19,960,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE	**$0**	**($19,090,000)**	**($19,960,000)**
OTHER STATE FUNDS			
Transfer in - Highway Fund			
MPERS Contribution - Uniformed	$0	$9,120,000	$9,490,000
MPERS Contribution - Non-Uniformed	$0	$10,080,000	$10,480,000
ESTIMATED NET EFFECT ON OTHER STATE FUNDS	**$0**	**$19,200,000**	**$19,970,000**

FISCAL IMPACT - Local Government	FY 2007 (10 Mo.)	FY 2008	FY 2009
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

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 retirements system. We have no way of knowing if any of these entities would be considered a small business. If consolidation of MPERS into MOSERS means that these contracts are no longer needed ant these contracts involve small businesses, then this proposal would have an economic impact on small business.

DESCRIPTION

This bill authorizes the board of trustees of the Missouri State Employees' Retirement System (MOSERS) to assume control over all assets, liabilities, and duties of the Missouri Department

DESCRIPTION (continued)

of Transportation and Highway Patrol Employees' Retirement System (MPERS) no later than December 31, 2006. Upon the effective date of this transfer, the MOSERS board of trustees will administer MPERS.

At least 90 days prior to January 1, 2008, the MOSERS board will determine the contribution rates for members of the system.

Between September 1, 2006, and September 1, 2009, the Superintendent of the State Highway Patrol and the Director of the Department of Transportation will be members of the board of trustees of MOSERS.

The Highways and Transportation Commission will be authorized to sell up to $780 million of pension obligation bonds with the proceeds going to MOSERS. Debt retirement of these bonds will be the sole responsibility of the commission.

The bill also allows any actively employed member of the system to purchase any prior creditable service as long as it is completed prior to retirement or termination of employment. If a member who purchased service dies prior to retirement, the surviving spouse can receive a refund of the amount contributed for the purchase if he or she is not eligible for survivor benefits.

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

Mickey Wilson

VL:LR:OD (12/02)

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