

# Senate Bill 10-001

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## Constitutional and Legal Issues and Questions About Actuarial Necessity

Constitutional issues: pages 1, and 2. Why, according to the Attorney General and the courts, this legislation appears to violate the State Constitutional and the U.S. Constitution.

Colorado Revised Statutes: pages 2 and 3. Why this legislation appears to violate Colorado Revised Statutes.

Discrepancies between PERA Board presentation and actuarial necessity: pages 3, 4, 5 and 6. Questions about actuarial necessity and the justification for this legislation.

## Senate Bill 10-001

### Constitutional and Legal Issues and Questions About Actuarial Necessity

Senate Bill 10-001 seeks to substantially reduce the benefits of retirees covered by the Colorado Public Employees' Retirement Association or PERA. The reasons given for these changes are that there is an, "actuarial necessity", due to unfunded liabilities caused by the recent economic downturn and, consequent loss in value to PERA investments.

This bill is being rushed through the legislature with the idea that if it can be passed by March 1, retiree annual increases for 2010 can be eliminated. After that, annual increases would be lowered from the present 3.5% to either 2% or the CPI-W, whichever is lower. The immediate result would be no annual increase for current retirees in 2010 or 2011. After that the maximum increase would be 2% and, could easily be less some years.

The loss of a promised and planned for annual increase in benefits for two years and then the reduction from 3.5 to 2% or less, compounded over the life expectancy of a retiree could decimate the thoughtful retirement planning of thousands of current retirees.

Living expenses for those retirees will continue to rise. Recessions are, virtually always, followed by significant periods of inflation. Since the average age of a PERA retiree is 69, it is unlikely that most of them will be able to secure employment to make up the difference

In November of 2004, Colorado Treasurer, Mike Coffman, requested an opinion from Attorney General, Ken Salazar, concerning, "limits of the ability of the General Assembly to alter retirement benefits for public employees under the pension program administered by Public Employees' Retirement Association of Colorado ("PERA")."

*Question: What, if any, limitations exist upon the Legislature's ability to reduce the capacity of current employees to earn additional retirement benefits to assure the long term actuarial soundness of the plan?*

*Answer: The rate and amount of retirement benefits may qualify as a partially vested pension right protected by the contract clause of the constitution. An adverse change to partially vested pension right is lawful only if it is balanced by a corresponding change of a beneficial nature, a change that is actuarially necessary, or a change that strengthens or improves the pension plan. Once a PERA member fulfills all the statutory requirements for a pension benefit, retires and begins receiving a pension, the member's fully vested pension right cannot be reduced by the General Assembly. (emphasis authors)*

And: Rights that accrue under a pension plan can be contractual obligations protected under Colo. Const. Art. II, 11 and the U.S. Const. Art. 1, 10. *Knuckey v. Public Employees'* (see below).

Vested contractual rights are constitutionally protected from statutory impairment. *Kilbourn v. Fire and Police Pension Association*, 971 P.2d 284,287 (Colo. App. 1998).

And: PERA retirement benefits become a vested right when an employee has complied with the statutory conditions entitling the employee to the receipt of retirement benefits. See *Knuckey v. Public Employees' Retirement Association*, 851 P.2d 178, 180 (Colo. App. 1992)(citing *Police Pension & Relief Board of City and County of Denver v. Bills*, 148 Colo.383, 366 P.2d 581 (1961).

And: When a PERA member retires from active service and begins receiving a pension, the member's pension becomes a vested contractual obligation of the pension program that is not subject to unilateral change of any type by the General Assembly. *Police Pension & Relief Board of City and County of Denver v. Bills*, 148 Colo. 383, 366 P.2d 581 (1961) (citing *Police Pension & Relief Board of the City and County of Denver v. Mc Phail*, 139 Colo. 330, 338 P.2d 694, 700 (1959)

The opinion goes on to say, " that the general assembly can change the rate of employer and member contributions to PERA if indicated by actuarial experience." And, "employees contributing to PERA have some reasonable expectation that contribution rates to PERA may increase..."

The opinion, however, makes a clear distinction between a, "partially vested pension right", and a "fully vested pension right". The fully vested pension right cannot be reduced by the General Assembly.

Colorado Constitution:

Article 2, Section 11. *Ex post facto laws*. No ex post facto law, nor law impairing the obligation of contracts, or retrospective in its operation, or making any irrevocable grant of special privileges, franchises or immunities, shall be passed by the general assembly.

Colorado Revised Statutes, Title 24-51-1002. Annual percentages to be used. (pertaining to PERA)

*For the benefit of recipients whose benefits are based on the account of a member who was a member, inactive member, or retiree on December 31, 2006, the cumulative increase applied to benefits paid shall be recalculated annually as of March 1 and shall be the total percent derived by multiplying three and one-half percent compounded annually, times the number of years such benefit has been effective after March 1, 2000.*

The U.S. Supreme Court has stated that, "In general, a statute is itself treated as a contract when language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State." *United States Trust Co.*, 431 U.S. at 17, n. 14. Benefit guidelines were changed for persons hired after 2006 including an annual increase of 3% or the CPI-W whichever is lower.

The PERA board reduced the actuarial period from 40 years to 30 years. They reduced the estimated rate of return on investments from 8.5% to 8%. They based their projections on the four year period that included the greatest economic downturn in that past 70 years. These things combined could give the impression of actuarial necessity.

PERA's return on investments has averaged 9% over 25 years and averaged 10.8% before the recent economic downturn. PERA has not released the percentage of funding at the end of 2009. PERA was 70% funded at the end of 2008.

In 2002, PERA Executive Director, Meredith Williams was asked, because of a downturn in the stock market, if retirement benefits were safe. He replied, "First, the 'loss' is due to a decline in the stock market. PERA still owns the same stocks that it did before the decline and this 'loss' is a result of the value of the stock decreasing. It is not 'lost' since we haven't sold the stocks, and because PERA is a long term investor, we can ride out the bad times the market experiences. When the market recovers, the value of these stocks will also increase, offsetting this 'loss'." (See PERA Retiree Report, October, 2002)

Mr. Williams was quoted in the same report as saying, "Most pension funds are considered sound at 80 percent funding levels."

Jim Prentice, a PERA retiree has done considerable and well documented research on the present legislative proposal and the reasons behind it. He says on his Blog site, ([coloradoperaanalysis.blogspot.com](http://coloradoperaanalysis.blogspot.com)), "The markets recovered substantially in 2009. Jennifer Paquette, PERA's Chief Investment Officer, reported at the Board of Trustees meeting on November 20, 2009, that PERA's investments were up about 20% for the year and investments in emerging markets were up a whopping 75% for the year."

Meredith Williams said, in 2002, that, "Most pension funds are considered sound at 80% funding levels." He said at the Senate Finance Committee hearing, in January, that PERA needed to be funded at 100%. When the PERA representatives were asked by a member of the committee why, in view of the fact that PERA had only been funded at 100% for about seven of the past 30 years, it was necessary now. The answer was, "It just makes things easier."

The proposed legislation does include provisions for raising the employee and employer, (AED and SAED), contributions. Those increases do not begin until 2013 and 2014. The reduction in retiree benefits would be effective immediately.

Again, according to Jim Prentice, "PERA's Comprehensive Annual Financial Report for the Fiscal Year Ended December 31, 2008, (available at [www.copera.org](http://www.copera.org)), in a table at the bottom of page 28, lists the amount of time until full funding of each division is achieved under the provisions of the existing law. But, the following statement is made at the top of page 29. 'The amortization periods with AED and SAED do not include the full effect of the 2006 legislation. The legislation includes plan changes that will lower the normal cost for future new hires and will allow more of the employer's contribution to be used to amortize past service costs earned'."

Prentice goes on to point out, "The table was created by Cavanaugh Macdonald Consulting, LLC, which is the Pension and Health Care Program Actuary for PERA. Although, full funding of all divisions is not achieved within 30 years as PERA would like, the table directly contradicts the information package presented by PERA in support of its proposed legislation. It is also important to recognize that an amortization period longer than 30 years does not constitute insolvency."

And, "The discrepancy between PERA's information package and the table prepared by PERA's own actuary must be reconciled. We need to know what assumptions were used for PERA's graphs. Did PERA prepare its graphs when the market was at its lowest in March of 2009? PERA should be willing to allow independent verification of the data or at least have it prepared by the actuary firm rather than in-house, and all effects from existing law should be built into the calculations to get an accurate picture. Does the projection program take into account the fact that the group of employees and retirees with the 3.5% annual increase is a closed group with membership declining as deaths occur?"

And, quoting Prentice again, "After CEA representatives left the PERA Board meeting on December 18, 2009, a Board member asked if updated charts were available from Cavanaugh Macdonald. The Chief Operating Officer replied that new ones are available and would be distributed to the Board members during Closed Executive Session."

I called PERA and asked what the funding levels were at the end of 2009. I was told those numbers would be released mid-year. It would appear, that the PERA board members know the funding level at the end of 2009. I would urge the members of this committee to ask the PERA representatives what that number is considering its relevance to the claim of actuarial necessity.

Senator Josh Penry, in a videotaped discussion with Representative Mike May, ([videocenter.denverpost.com](http://videocenter.denverpost.com)), said, "we can't, can't miss this window." And, ..." we have an opportunity to pass something that Republicans have long advocated, a significant increase in retirement age, which the PERA Board embraced, reigning in the cost of living increases..."

Penry went on to say, "I think it is important to pass something because if you lose actuarial necessity, as you know, it becomes extremely difficult to increase retirement age. You cannot change course and this year, when PERA's investment numbers come out, their investment returns ... numbers are going to be significant, like double, 15-16% investment return. So that could change the specter of actuarial necessity. We gotta' do it this year or else these other structural changes won't be possible."

Senator Penry goes on, "The courts have said if the fund itself is in peril, you can go back and change the contract which is why, if the market were to recover over two or three years, we didn't pass a bill this year, we didn't pass a bill next year, we couldn't make those changes."

Senator Penry's assertion about changing the contract is only partially true. The courts have consistently held that actuarial necessity allows some changes to a partially vested contract but not to a fully vested contract as this legislation proposes.

This raises the appearance that the PERA Board and members of the legislature are using the recent economic downturn to justify a significant overhaul of the PERA retirement structure. When, in fact, those numbers are, very possibly, no longer valid and that the, "actuarial necessity", used for justifying those changes may not exist.

Also, of note, the proposed legislation is being presented as a, "2+2+2 plan with the suggestion that, "everyone must share the pain". A 2% increase in employee contributions, a 2% increase in employer contributions and, a 2% cap on annual increases for retirees. The implication being that 2+2+2 would distribute the burden fairly among current employees, employers and retirees when, in fact, the way the 2+2+2 plan is structured, an extremely disproportionate share of the financial correction would fall upon the retirees. Estimates range from 60% to 90%. It appears it would be at least 70%.

This legislation would require that part of the total PERA membership falling under the 3.5% annual increase provision, a declining group, to sustain almost the entire economic burden of restoring the funding level for the entire system.

If PERA is, in fact, experiencing a situation of actuarial necessity, there are remedies the legislature can exercise, that are constitutional and legal. Many of these things, including changing the annual benefits increase for future hires were done in 2006.

What they cannot do is take away a vested, contractual obligation made to retirees. If the legislature were able to set the legal precedent of reducing vested retirees benefits then, any time they wished, they could lower the employer contribution, declare an actuarial necessity and further reduce the contractual benefits of retirees.

This is one of the reasons that the courts have held the fully vested retirement benefit sacrosanct under the contract clause of the State Constitution with the agreement of the U.S. Constitution. The courts and the Attorney General have recognized the contractual obligation incurred by the state in a fully vested retirement benefit and have taken into account the hardship the violation of this contract would impose upon the elderly, those who have devoted their working lives to public service.

A decent retirement plan is a means of assuring the State's ability to hire and retain good employees. If the state does not honor its commitments, how could anyone contemplating employment with the state have any confidence in the compensation package?

I cannot imagine, with all the questions raised, that this committee would consider moving this legislation forward without investigating these allegations.

Senate bill 10-001 should not be passed. If, in fact, a situation of actuarial necessity exists, this is not the solution. It not only appears to be unconstitutional and illegal, it would constitute a betrayal, a gross violation of the trust of retirees who have worked so many years for the State of Colorado, by the State of Colorado. It is up to this committee and to this legislature to insure that this betrayal not occur.

Respectfully submitted,

Jim Alexander,

PERA Retiree