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MEMORANDUM

February 10, 2006

TO: Barry Poulson and Christine Burt

FROM: Legislative Council Staff and Office of Legislative Legal Services

SUBJECT: Proposed initiative measure 2005-2006 #81, concerning the PERA Reform Initiative

Section 1-40-105 (1), Colorado Revised Statutes, requires the directors of the Colorado Legislative Council and the Office of Legislative Legal Services to "review and comment" on initiative petitions for proposed laws and amendments to the Colorado constitution. We hereby submit our comments to you regarding the appended proposed initiative.

The purpose of this statutory requirement of the Legislative Council and the Office of Legislative Legal Services is to provide comments intended to aid proponents in determining the language of their proposal and to avail the public of knowledge of the contents of the proposal. Our first objective is to be sure we understand your intent and your objective in proposing the amendment. We hope that the statements and questions contained in this memorandum will provide a basis for discussion and understanding of the proposal.

Purposes

The major purposes of the proposed amendment appear to be:

1. To specify that PERA shall not be subject to administrative direction by the state treasurer, and any department, commission, board, bureau, or agency of the state as determined by the state treasurer;
2. To abolish the existing PERA board of trustees on January 1, 2008, and terminate the terms of its members serving immediately prior to the date;

3. To create a new PERA board of trustees in the office of the state treasurer that shall consist of nine trustees, including the state auditor, the state treasurer, and seven trustees appointed to staggered terms by the governor who are professionally credentialed or have recognized competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis and who have limited terms of office;
4. To specify that:
 - a. Two trustees of the PERA board be members of the public, not hold state office, and not be members or beneficiaries of the association;
 - b. One trustee of the PERA board be employed as a finance officer for a political subdivision that is a member of the association;
 - c. Two trustees of the PERA board be members or retirees of the defined benefit plan managed by the board; and
 - d. Two trustees of the PERA board be members or retirees of the defined contribution plan managed by the board.
5. To specify certain requirements regarding the staggering of the terms of the PERA board of trustees appointed by the governor, the removal of trustees for cause, the filling of vacancies on the board, the existence of a quorum for the transaction of business, and the compensation and reimbursement of expenses for trustees;
6. To specify that the PERA board of trustees shall provide annual training to trustees on pension management and investment;
7. To require the PERA board of trustees to submit an initial report to the general assembly within one hundred twenty days of the start of the first term of the board with a preliminary assessment of PERA's financial status, including the defined benefit plan, and preliminary recommendations for improving PERA's financial stability;
8. To require the PERA board of trustees to contract with a private auditor to conduct an independent financial and performance audit at least once every two years for all transactions and accounts kept by or for PERA;
9. To require the PERA board of trustees to determine the appropriate investment objectives for the defined benefit plan and, after reviewing recommendations from two financial institutions, adopt investment policies for each of the funds entrusted to the board;
10. To reduce the maximum amortization period that is deemed actuarially sound for the defined benefit plan trust funds from forty to thirty years and to specify that an actuarial necessity shall exist when the defined benefit plan is not actuarially sound;
11. In the event of an actuarial necessity, to authorize the general assembly to modify the benefits

- allowed to members of the defined benefit plan who are not eligible for service retirement or reduced service retirement;
12. To repeal the provision that allows members in the defined benefit plan to purchase service credit for service credit forfeited with a refund;
 13. To eliminate PERA's existing defined contribution plan and create a new defined contribution plan on January 1, 2008;
 14. To specify that all members of the existing defined contribution plan shall become members of the newly established defined contribution plan;
 15. To require employees hired on or after January 1, 2008 to become members of the new defined contribution plan;
 16. To allow eligible members of the defined benefit plan to elect to become members of the new defined contribution plan;
 17. To require each member of the new defined contribution plan to contribute eight percent of the member's salary, or any other amount determined by the PERA board of trustees, to his or her individual account;
 18. Beginning January 1, 2009, to increase the employee contribution by one-half of one percent of the employee's salary annually until the amount of the employee contribution is equal to the amount of the employer contribution;
 19. To authorize members in the defined contribution plan to make additional contributions to the member's individual account, and to specify the methods of transmitting and crediting contributions to a member's individual account;
 20. To require an employer of a member of the defined contribution plan to contribute eight percent, or any amount determined by the board, of the member's salary to the member's individual account;
 21. To require the difference between the current employer contribution rates and the eight percent matching rate paid by the employer into the new defined contribution plan be earmarked to pay off unfunded liabilities;
 22. To state that the defined contribution plan will be more efficient to administer than the existing defined benefit plan, and require the savings to be earmarked to repay unfunded liabilities without any increase in employer contribution rates or taxes;
 23. To reduce the employer contribution rate to the eight percent matching contribution into the defined contribution plan and cap employer contributions at that rate when the new pension plan has eliminated unfunded liabilities and is fully funded so as to meet the federal guidelines for state pension plans;

24. To limit annual additions to each member's individual account in the defined contribution plan to the amount permitted under federal law;
25. To allow a member of the defined contribution plan to elect to have all or part of an eligible direct rollover distribution paid directly into the member's individual account;
26. To provide that members in the defined contribution plan shall be fully vested in their own contributions, together with accumulated gains or losses;
27. To provide that members in the defined contribution plan shall be vested in a certain percentage of employer contributions to the plan together with accumulated gains or losses each year and shall be fully vested after five years in the association;
28. To allow each member of the defined contribution plan to exercise control of the investment of the member's account;
29. To require the PERA board of trustees to select at least five investment alternatives for members, to allow members to change investments regularly, to provide members with information describing investment alternatives, and to designate, subject to certain conditions, the companies from which investment products shall be purchased;
30. To specify that PERA and the employer shall not be responsible or liable for financial losses experienced by members of the defined contribution plan;
31. To specify that members of the defined contribution plan may participate in PERA's optional life insurance, long-term care insurance, voluntary investment program, and health care program;
32. To specify that the PERA board of trustees shall determine distribution options by which a member of the defined contribution plan may elect to receive the distribution of his or her individual account.
33. To require the PERA board of trustees to provide members with quarterly reports regarding the members' accounts and administrative fees charged to members;
34. To authorize members of PERA's defined benefit plan to make an irrevocable election to participate in the defined contribution plan in lieu of the defined benefit plan, subject to certain eligibility requirements;
35. To provide for the transfer to the defined contribution plan of the member's individual account and the matching employer contributions to which the member would be entitled at the time of the transfer;
36. To specify the requirements for the transfer, including a requirement that the PERA board of trustees inform the member of the effect of moving to the defined contribution plan; and

37. To make conforming amendments to certain statutory definitions and other provisions in accordance with the proposed statutory changes.

Comments and Questions

The form and substance of the proposed initiative raise the following comments and questions:

Technical questions:

1. To conform to standard drafting practices, would the proponents consider initial capitalizing the first letter of each sentence, as illustrated by the following example:

"(1) This subsection is repealed...."?
2. To conform to standard drafting practices, would the proponents consider indenting before each section heading and headnote, as illustrated by the following example:

"**SECTION 1. 24-51-102, Colorado Revised Statutes, is amended to read:**
24-51-102. Board of trustees - creation - termination - composition and election - repeal.
(1) There is hereby created...."?
3. To conform to standard drafting practices, would the proponents consider showing statutory language as stricken before inserting new language, as illustrated by the following example:

"(5) "Amortization period" means the number of years which that is required...."?
4. Under standard drafting practices, repealed language appears in strike type as follows: "The full term of office . . ." Would the proponents consider using this style?
5. To conform to standard drafting practices, would the proponents consider spelling out all numerical references in statutory language contained in the proposed initiative, as illustrated by the following example:

"Current employer contributions shall be eight percent..."?
6. In the interests of clarity, would the proponents consider specifying whether they intend to make the association subject to, or not subject to, administrative direction by the state treasurer in SECTION 2 of the proposed initiative?
7. In the interests of clarity, would the proponents consider specifying in proposed section 24-31-202 (1) (b), Colorado Revised Statutes, whether the effective date should be "JANUARY 1, 2008" or "JANUARY 13, 2008"?
8. Would the proponents consider adding punctuation to indicate the end of a sentence under

SECTION 8 of the proposed initiative between the words "association" and "Preference"?

9. To conform to standard drafting practices, would the proponents consider centering a new part heading and separating it on two lines, as illustrated by the following example:

"PART 16
DEFINED CONTRIBUTION PLAN"?

10. In the interest of consistency, would the proponents consider using one term to refer to state employees in the proposed part 16? For example, all references would be to "employees"; "members"; or "participants".
11. In the interest of clarity, would the proponents consider specifying if they intended the proposed section 24-51-1603 (2), Colorado Revised Statutes, to read "employee contributions", or whether it should be consistent with the headnote that reads "Employer contributions"?
12. To avoid unnecessary language, would the proponents consider deleting the words "of time" if used after the word "period"? For example, the phrase "The thirty-day period of time may be" would read "The thirty-day period may be".
13. If section 24-51-402, C.R.S., is not being amended, would the proponents consider deleting SECTION 15 from the proposed initiative, or show any changes in capped and stricken language to indicate how it is amended?
14. To conform to standard drafting practices, would the proponents consider deleting the unnecessary subsection number in the effective date clause contained in SECTION 17 of the proposed initiative, as illustrated by the following example:

"SECTION 17. **Effective date.** Sections 2, 5, and 13...."?

Substantive questions:

1. The proposed initiative gives the state treasurer direct oversight of PERA and requires that all administrative functions be transferred to the state treasurer. If the treasurer has a fiduciary duty to protect the both the assets of PERA and the assets of the state, would the treasurer have a conflict of interest when the financial interests of the state and the association are at odds? Would it be a conflict for the state treasurer to have oversight of the board and to serve as a board member at the same time? Would the proponents consider clarifying the funding source for the oversight and administration of PERA by the state treasurer? Will funding be provided from employer and employee contributions or from appropriations by the general assembly?
2. Could the proponents clarify whether the existing defined contribution plan established in

section 24-52-201, Colorado Revised Statutes, will no longer be able to accept new employees after the proposed new defined contribution plan is created by the proposed initiative? Does the proposed initiative have any other effect on this plan?

3. The proposed initiative requires the PERA board of trustees to contract with a private auditor every two years to conduct an independent financial and performance audit. Section 24-51-204 (6), Colorado Revised Statutes, currently requires the state auditor to conduct such audits. What is the purpose of this provision? Would there be any difference in the substance of the audits? How would the audits be staggered? Would this new provision affect in any other way the authority or ability of PERA, the state auditor, or the legislative audit committee of the general assembly to conduct audits?
4. Proposed sections 24-51-1602 and 24-51-1603, Colorado Revised Statutes, require PERA employers and employees to contribute eight percent, "or any other amount determined by the board," of the employee's salary into the employee's account. Does the PERA board of trustees have unlimited discretion to modify this amount from zero percent to one hundred percent of the employee's salary? Have the proponents considered including standards to govern the board's decision, including placing upper and lower limits on the contribution rates?
5. The general assembly currently has authority to set employer and employee contribution rates. Since any contribution rate changes could cause a fiscal impact for the state and local government, would the proponents consider having the General Assembly involved in setting the contribution rates? Is it the proponents' intent to remove the function of determining member and employer contributions from the General Assembly?
6. Proposed section 24-51-211.5, Colorado Revised Statutes, allows the general assembly to modify the benefits to members of the defined benefit plan who are not eligible for a full or reduced service retirement benefit. Does this mean that these members could potentially have their benefits eliminated? Are there any limitations on how the general assembly could modify the benefits? Would the proponents consider including standards to guide the board's decision?
7. Existing PERA members may view any change in their benefits allowed by proposed section 24-51-211.5, Colorado Revised Statutes, as a violation of their contractual rights. Have the proponents considered this issue and the likelihood that litigation may result from any changes to existing PERA members' benefits?
8. Proposed section 24-51-1602 (1) (b), Colorado Revised Statutes, requires the employee contribution rate to increase by one-half of one percentage point annually until the contribution rate equals the employer contribution rate beginning January 1, 2009, which raises the following questions:
 - a. Can the proponents clarify whether the proposed section 24-51-1602, Colorado Revised Statutes, is referring to the employer contribution to the new defined contribution plan or the employer contribution to the existing defined benefit plan?

- b. It appears that the employee contribution specified in section 24-51-1602, Colorado Revised Statutes, and the employer contribution specified in proposed section 24-51-1603, Colorado Revised Statutes, are both eight percent. How can the employee contribution increase until the rates are equal if they are already the same? Does this provision only apply if the PERA board of trustees increases the employer contribution to a rate that is higher than the employee contribution?
 - c. Would the PERA board of trustees be able to offset or override the required increases using its authority in proposed section 24-51-1602 (1) (a), Colorado Revised Statutes, to determine the amount of member contributions?
9. The proposed initiative indicates that the new defined contribution plan will be more efficient to administer than the existing defined benefit plan and that savings will be earmarked to repay the defined benefit plan's unfunded liability. Do the proponents have evidence to place this claim in state statute? How is the amount of the savings calculated? Would the proponents consider tempering this statement to state that "if the administration of the defined contribution plan creates savings, any savings will be earmarked to repay the defined benefit plan's unfunded liability"?
10. The proposed initiative requires all employees subject to PERA hired on or after January 1, 2008, as well as any existing or eligible defined contribution members, to become members of a new defined contribution plan (section 24-51-1601, Colorado Revised Statutes). Have the proponents conducted or received an actuarial analysis or other research regarding how this will impact the existing defined benefit plan, retirees of the existing defined benefit plan, or the state budget?
11. What is the proponents' intent in using the phrase "earmarked to repay unfunded liabilities" in proposed section 24-51-1603 (3), Colorado Revised Statutes? Are the moneys to be transferred to the trust funds of the defined benefit plan? If so, how and when would the transfers be made?
12. What are the federal guidelines for state pension plans that must be met in accordance with proposed section 24-51-1603 (3), Colorado Revised Statutes? Would the proponents consider specifying the guidelines in the text of the proposed measure?
13. Proposed section 24-51-1603 (3), Colorado Revised Statutes, provides that when the new pension plan has eliminated unfunded liabilities and is fully funded, employer contribution rates shall then be reduced to eight percent matching contribution into the defined contribution plan and be capped at this rate. Does "new pension plan" refer to the new defined contribution plan or the defined benefit plan? Are rates only reduced for the defined contribution plan? Is the PERA board of trustees thereafter prohibited from adjusting the rate? What happens if the defined contribution plan becomes underfunded again in the future? Have the proponents conducted or received an actuarial analysis on how long it would take to pay down the unfunded liability using this method?
14. A defined benefit plan, in theory, provides a predictable future source of income, but

employees who leave the plan after only a few years of employment may sacrifice some or all of the contributions made on their behalf by employers. In contrast, a defined contribution plan may provide a less predictable amount in the future; however, it is considered portable, allowing the employee to take both the employee and employer contributions when he or she leaves employment. The proposed initiative does not allow an employee to take all of the employer contributions until the employee has been with PERA for five years. What is the proponents' intent in including this requirement? What happens to the amount of forfeited employer contributions?

15. The proponents may be aware that the general assembly is currently considering legislation that affects PERA. If the general assembly passes a bill and the proposed initiative is approved by voters, how would any resulting conflicts be resolved?
16. Assuming it is the proponents intent to make conforming amendments similar to HB 06-1083, SECTIONS 14, 15, and 16 of the proposed initiative appear to be missing some repealed language. Would the proponents consider appropriate modifications to each of these sections?