HOUSE
RESEARCH
ORGANIZATION bill analysis | 5/2/95 | HB 1899
S. Turner

SUBJECT: City of Houston police pension deferred retirement plan

COMMITTEE: Pensions and Investments — favorable, with amendment

VOTE: 5 ayes — Telford, Johnson, Averitt, Haggerty, Rangel

0 nays

4 absent — Berlanga, McCall, Willis, Wilson

WITNESSES: For — Craig S. Goralski, Houston Police Officers Pensions System

Against — None

BACKGROUND: The City of Houston Police Officers' Pension System has almost 5,000 active members. The system has two plans, Plan 1 and Plan 3. Both plans permit members to retire with 20 years service at 45 percent of their last year base salary, with increases of 2 percent a year up to 80 percent of base salary. At 30 years, for instance, a member would receive 65 percent of base salary. Retired members of Plan 1 are entitled to an annual cost of living adjustment (COLA) of two-thirds of the Consumer Price Index (CPI) with a minimum of 2.5 percent and a maximum of 8 percent, upon retirement. Plan 3 members may not receive the COLA until they reach age 55. Most members of the system retire with about 25 years service.

DIGEST: HB 1899, as amended, would allow the Houston Police Officer's Pension Board to establish an optional deferred retirement option plan (DROP) for members with at least 20 years service. The decision to participate in the DROP plan would be irrevocable. Members who elected to participate in the DROP would no longer accrue service time towards their regular retirement plan, and pay increases could not be used towards computing their retirement benefits. However, retirement benefits would reflect any allowed cost-of-living adjustments.

Members would be entitled to receive a lump-sum DROP benefit when they terminated employment. The lump sum would be the total amount shown in their DROP account, a bookkeeping (notational) account that would include the retirement benefits members would have received if they had retired (45 percent of base salary), plus their continued contribution to the pension system (8.75 percent of base salary), and earned interest that is based on the aggregate rate of return on pension fund investments for the past five years.

Members who became disabled or died, or their beneficiaries, would be allowed to revoke the DROP election and to receive regular death or disability benefits.

As amended, the bill would authorize the board of trustees to take any necessary action if the system should have unanticipated actuarial costs, including closing participation in the DROP program, but it would be required to continue the program for those who elected the DROP program.

HB 1899 would take effect immediately if approved by a two-thirds vote of the membership of each house.

SUPPORTERS SAY:

The DROP retirement option would provide Houston police officers with a modified lump-sum retirement option and encourage them to stay on the force instead of taking other law enforcement jobs. The DROP retirement option would allow members to receive a large lump-sum payment (more than $100,000 in some cases) when they retire, plus their regular 20-year retirement benefits.

The cost of the program would be offset by the reduction in training and recruiting costs for new police officers and the considerable value of experienced officers. Although the actuarial analysis says the DROP program would cost $1.6 million (1 percent of payroll) the first year, the costs would continually decrease until they were 0.2 percent or about $300,000 in the sixth year and thereafter.

The DROP program would not be established until the pension system had an educational program in place for investing the lump sum payment. But if retired police officers want to use their payment to invest in an annuity or mutual fund, to start a business or for some other purpose, that would be their choice to make.

The City of Dallas has created a DROP program to encourage officers to stay on the force longer, and many other cities are considering this type program to keep experienced, qualified police working longer.

OPPONENTS SAY:

Although the intent of the DROP program is good — to provide police officers an incentive to stay on the force after 20 years — it would cost more money than the City of Houston is willing to pay and could prove to be a financial disaster for police officers who have little experience handling large sums of money.

The City of Houston cannot support the added cost of the DROP program. The city was led to believe that the cost of the program would be nominal; however, the revised actuarial analysis shows that the plan would require a prohibitive 1 percent increase in the city's contribution rate in the first year. If costs could be lowered, the city would be pleased to support the bill.

The bill would provide police officers with a large lump-sum payment when they retire along with regular retirement benefits based on 20 years service. Retired officers who made a bad investment with the lump-sum payment would lose a good chunk of their retirement and suffer throughout their retirement years.

The difference between receiving 45 percent of base salary after 20 years and 65 percent of base salary after 30 years could be considerable. The point of a pension plan is to provide a retirement wage, and this bill would undermine the responsibility of the pension system to do that. Most police officers have no investment experience, and the chances of making a bad investment are great. This bill could end up being a disservice to those it purports to help.

NOTES:

The committee amendment would authorize the board of trustees to take any action necessary if an unanticipated actuarial cost occurs and would eliminate the provision in the original bill that would require the pension system's actuary to certify to the board that continued enrollment in the DROP would likely result in an actuarial loss.