SUBJECT: Raising member contributions to the Employees Retirement System

COMMITTEE: Pensions — favorable, without amendment

VOTE: 6 ayes — Flynn, Alonzo, Hernandez, Klick, Paul, J. Rodriguez

0 nays

1 absent — Stephenson

WITNESSES: For — Donald Zavodny, AFSCME Texas Corrections; Maura Powers, AFSCME Texas Retirees; David Sinclair, Game Warden Peace Officers Association; Elizabeth Blount, Retired State Employees Association; Gary Chandler, Texas Department of Public Safety Officers Association; Ray Hymel, Texas Public Employees Association; Harrison Hiner, Texas State Employees Union; (*Registered, but did not testify*: Cynthia Hayes, AFSCME Council 12; Marshall Kenderdine, AFSCME Texas Corrections; Bill Hamilton, Retired State Employees Association; Amy Chamberlain and Jenni Sellers, Texas Public Employees Association; Deborah Ingersoll, Texas State Troopers Association; Richard Lavine)

Against — None

On — Ann Bishop, Employees Retirement System of Texas; Robert May, Pension Review Board; (*Registered, but did not testify*: Ryan Falls, Employees Retirement System; Anu Anumeha and Daniel Moore, Pension Review Board)

BACKGROUND: Government Code, sec. 815.402(a) establishes the contribution rate for state employees to the Employees Retirement System of Texas (ERS), which administers the pension fund. The member contribution rates for the upcoming biennium are scheduled to be 7.2 percent in fiscal 2016 and 7.5 percent after August 31, 2016.

Under Texas Constitution, Art. 16, Sec. 67(b)(3), the state contribution may not be less than 6 percent nor more than 10 percent of the aggregate compensation paid to employees participating in the system. The state contribution to ERS is set biennially in the general appropriations act.

DIGEST: HB 9 would amend Government Code, sec. 815.402(a) to increase the member contribution rate to ERS. The rate would be set at 9.5 percent of a member's annual salary for those employees who are not members of the Legislature. The contribution rate would be effective for service after August 31, 2015, and before September 1, 2017.

After September 1, 2017, the 9.5 percent contribution rate would remain in effect, although it would be reduced by one-tenth of one percent for each one-tenth of one percent that the state contribution rate dropped below the rate established for fiscal 2017.

The bill would take effect September 1, 2015.

SUPPORTERS SAY: HB 9 would address one aspect of the state's chronically underfunded pension system by increasing state employee contribution rates. The pension fund had $7.8 billion in unfunded liabilities at the end of February, and the shortfall is projected to grow by $500 million annually. This problem could negatively impact retirees and the state's bond ratings in the future. Moody's Investors Service warned Texas in January to take care of its pension funds to avoid a future negative impact on the state's economy. HB 9 would be a step in the right direction and would send a message to Moody's and other bond rating agencies that the Legislature was committed to addressing the ERS shortfall.

The bill would increase employee contribution rates from the current 6.9 percent to 9.5 percent, but the increase would be offset by a 2.5 percent pay raise contained in the House-passed budget bill. Organizations representing state employees and retirees have expressed support for the bill because it addresses funding while not cutting benefits. More than two-thirds of the 17,000 state employees who responded to a recent survey said that to prevent benefit design changes, they would support increasing the employee contribution rate to ERS if the increase was coupled with a pay increase.

The House's budget bill also would increase the state's contribution to the pension fund to a combined 10 percent state (9.5 percent) and agency (0.5 percent) rate. This would demonstrate a joint commitment by the state and employees to shore up the retirement system. The bill also would continue a provision adopted by the 83rd Legislature in 2013 requiring employee contributions to be reduced if state contributions were reduced in a future biennium.

The future outlook for the pension system would improve under HB 9. An actuarial analysis projects the fund would go from an infinite amortization period to a 34-year amortization period. The 34-year period would be within the maximum 40-year amortization period recommended by the Texas Pension Review Board. According to the Legislative Budget Board (LBB), the bill – in conjunction with increased state contributions – likely would have a positive impact on ERS and the state under new governmental accounting reporting standards.

The bill also could pave the way for a future increase in retiree pay. Government Code, sec. 814.604 requires a cost-of-living adjustment be made to certain longtime retirees when ERS's amortization period is less than 31 years.

The state's retirement program is an essential tool in both recruitment and retention of the state's workforce. HB 9 would preserve ERS as a valuable part of state employees' compensation package. Those who argue for benefit cuts often fail to recognize that the state salaries generally are lower than those of comparable jobs in the private sector.

While some have suggested that a better approach would be making benefit changes that could impact newly hired employees, this could create a new set of problems. Recent changes in state law have created three tiers of retirement benefits, and continuing to add tiers could exacerbate an existing equity risk among the state workforce as employees contribute the same percentage of their salaries but receive different benefits. Further changes impacting current employees could create a rush to retirement, which could add to the pension system's woes.

OPPONENTS SAY:

HB 9 would not be the best option for addressing the unfunded liability in the state's pension fund. The ERS shortfall largely is a result of lawmakers failing to appropriate adequate funds for 19 of the past 20 years. Other options are available for lawmakers to make the pension fund solvent without raising employee contributions. For example, SJR 68 by Eltife would ask voter approval for a one-time $1.5 billion contribution from the rainy day fund to the ERS trust fund. That amount would pay down about 20 percent of the outstanding unfunded liability.

In its legislative appropriations request for 2016-17, ERS asked for about $350 million in general revenue above base funding to make the system sound. Some have expressed concern that such an appropriation could exceed the Texas Constitution's limit of state contributions to 10 percent of employee payroll. To avoid exceeding the limit, some proposals would appropriate part of the funding in a fiscal 2015 supplemental appropriations bill. Others have discussed counting pension liabilities as state debt and exempting reductions of state debt from the overall constitutional spending cap.

Increased state appropriations would be a more efficient funding method than increasing the employee contribution because employees can cash out their ERS contributions when they leave state employment. According to the fiscal note, significant increases in member contributions could result in more members electing to take a refund of their contributions than historically has happened.

Making the fund solvent should not come at the expense of a real pay raise for state employees, who have seen only modest increases in pay over the past seven years. Failure over the next biennium to provide a pay raise without requiring a corresponding increase in ERS contributions could lead to higher turnover of employees who do critical work serving Texans.

OTHER

The Legislature should not raise employee pay in the state budget to cover

OPPONENTS SAY:

the increased member contributions proposed in HB 9. Employees and the state both need to make financial sacrifices to stabilize ERS. In addition, benefit changes should be part of any proposal to shore up the pension fund. ERS administrators have provided several options for benefit changes that could make the plan sound, including some that would impact current employees. Even with benefit changes, state employees still would enjoy a defined benefit pension system at a time when many private sector employers have shifted to 401(k) or other defined contribution plans.

NOTES:

CSHB 1, as passed by the House, would appropriate $390.2 million in all funds for an across-the-board pay raise of 2.5 percent and related benefits for state employees who contribute to ERS, contingent on passage of HB 9 by Flynn or similar legislation. CSHB 1 also would raise the state's contribution to ERS from 7.5 percent to 9.5 percent for fiscal 2016-17.

The LBB's fiscal note indicates no significant fiscal implication to the state is anticipated from HB 9. The fiscal note estimates the bill would decrease the unfunded actuarial accrued liability by $49.3 million from $8.08 billion to $8.03 billion. The fiscal note indicated that the bill could result in more state government employees electing to receive a refund of their accumulated employee contributions, rather than a deferred pension, upon leaving state employment.

The actuarial impact statement prepared by the LBB assumes the 9.5 percent employee contribution rate would be accompanied by an increase in the combined state and state agency contribution rate to 10 percent for fiscal 2016 and beyond, resulting in a total combined contribution of 19.5 percent. The statement said this would significantly improve the amortization period for ERS from the current infinite period to 34 years. As a result, ERS would be expected to meet the 31-year amortization limit set in statute within three years.