HOUSE
RESEARCH
ORGANIZATION bill analysis 4/26/2021

(2nd reading)
HB 3397
Murphy

SUBJECT: Requiring actuarially established ERS contribution rates

COMMITTEE: Pensions, Investments and Financial Services — favorable, without amendment

VOTE: 9 ayes — Anchia, Parker, Capriglione, Muñoz, Perez, Rogers, Slawson, Stephenson, Vo

0 nays

WITNESSES: For — Keith Brainard, NASRA; Ann Bishop, Texas Public Employees Association; (*Registered, but did not testify*: David Sinclair, Game Warden Peace Officers Association; Hope Osborn, Texas 2036)

Against — Rod Bordelon, Texas Public Policy Foundation

On — Joe Hamill, AFSCME Texas Corrections and AFSCME Texas Retirees; Porter Wilson, Employees Retirement System of Texas; Anumeha Kumar, Pension Review Board; (*Registered, but did not testify*: Kenneth Herbold, Texas Pension Review Board)

BACKGROUND: The Employees Retirement System (ERS) is a retirement benefit provided to eligible state employees and elected officials and is funded by state contributions, employee contributions, and investment earnings. The current employee contribution rate is 9.5 percent and the current state contribution rate is 9.5 percent. Agency employers contribute 0.5 percent.

Government Code sec. 815.206 requires the ERS board of trustees to designate an actuary responsible for periodically making a valuation of the assets and liabilities of the retirement system's funds, among other responsibilities.

DIGEST: HB 3397 would require contribution rates for the Employees Retirement System (ERS) to be determined actuarially each year instead of being set in statute by the Legislature.

The bill would require the designated ERS actuary, for fiscal 2022 and for each subsequent fiscal year, to calculate an actuarially determined contribution rate and recommend the rate to the ERS board of trustees for review and adoption. The rate would be calculated by apportioning the actuarially determined contribution rate among members, the state, and the 0.5 percent statutory employer rate in a manner that resulted in the member contribution rate not exceeding 50 percent.

An actuarially determined contribution rate would be a percentage rate that reflected the sum of the normal cost of projected benefits for the fiscal year and an amount sufficient to amortize the retirement system's unfunded actuarial accrued liabilities in a period that did not exceed 30 years by one or more years.

The actuarially determined contribution rate would be based on:

- reasonable actuarial assumptions and methods;
- mortality, service, and other tables adopted by the board; and
- the ERS funding policy adopted by the board.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2021.

SUPPORTERS SAY:

HB 3397 would provide a sustainable path to fix long-standing structural problems with the Employees Retirement System (ERS) by requiring state contributions be actuarially determined to ensure the system can cover present and future promised retirement benefits. A strong retirement system is crucial for recruiting and retaining the state workforce, and the current system is slated to run out of money by 2061, which would leave the state unable to meet its pension promise to employees.

An actuarially determined rate would permanently address the $14.5 billion ERS unfunded liability shortfall. Failing to address the problem with ERS would make it more expensive for taxpayers to fix in the future. Without action, the unfunded liability is projected to grow by $1.5 billion by the 2023 legislative session. Funding a pension is similar to paying off a credit card or home mortgage in that paying less than the required payments will increase future costs. Addressing the issue now would send a positive message to investors and prevent a possible downgrade of the state's financial ratings.

The estimated $637.9 million cost of the bill, while expensive, is the least painful and most economical solution to reducing the ERS unfunded liability. Many states already require actuarially determined contributions to their pension funds, as do the retirement systems for Texas city and county employees.

The state would pay at least half of the actuarially determined rate to ensure the burden of strengthening the pension fund did not fall heavily on state employees, who already pay 9.5 percent of their salary into the fund. Employees should be expected to contribute to their own retirement but should not have to pay for the retirement of other state employees because the system is not structured to meet those obligations.

While some say the bill addresses only contributions to ERS, while ignoring the program's expenses for benefits, the Legislature has made changes that reduced benefits for newer employees and additional plan changes might be appropriate. Even if the state transitioned to a 401(k) type defined-contribution plan for newly hired employees, it still would have to address the unfunded liability of the current defined-benefit program.

While the bill would take away authority of the Legislature to set ERS contribution rates, an actuarially determined rate would be better situated to address financial market fluctuations and other circumstances that could affect the trust fund's assets.

While some also have raised concerns that increasing the state contribution rate would exceed the constitutionally permitted maximum of 10 percent under Texas Constitution Art. 16, sec. 67(b)(3), the constitution also provides that in an emergency determined by the governor, the Legislature may appropriate such additional sums as are actuarially determined to be required to fund benefits authorized by law.

CRITICS SAY:

HB 3397 would take the decision-making for contributions to ERS away from the Legislature and give it to the ERS actuary. This would give the actuary too much control over a significant state expense.

The bill addresses only the revenue side of the pension's unfunded liability without considering the expense of current retirement benefits. Lawmakers should take a broader approach to pension reform by limiting expenses to the program that could result from shifting from a defined-benefit system to a defined contribution model, similar to a 401(k).

NOTES:

According to the Legislative Budget Board, the bill would have a negative impact of about $637.9 million in general revenue related funds through fiscal 2023. The bill would make no appropriation but could provide the legal basis for an appropriation of funds, according to the fiscal note.

The LBB actuarial impact statement estimates HB 3397 would result in the retirement system having an amortization period of 31 years, based on an assumed employee contribution of 9.5 percent and an assumed employer contribution of 15.96 percent.