SUBJECT: Requiring payments to amortize ERS' liabilities, creating new benefit plan

COMMITTEE: Appropriations — favorable, without amendment

VOTE: 14 ayes — Bonnen, Ashby, C. Bell, Capriglione, Dean, Gates, Holland, Morrison, Schaefer, Stucky, E. Thompson, Toth, VanDeaver, Wilson

12 nays — M. González, Dominguez, Howard, A. Johnson, Jarvis Johnson, Julie Johnson, Minjarez, Rose, Sherman, Walle, Wu, Zwiener

1 absent — Raney

SENATE VOTE: On final passage, April 28 — 20-11 (Alvarado, Blanco, Eckhardt, Gutierrez, Johnson, Menéndez, Miles, Powell, West, Whitmire, Zaffirini)

WITNESSES: For — Luther Elmore, AFSCME Texas Retirees; Bill Hamilton, Retired State Employees Association; John Hryhorchuk, Texas 2036; Ann Bishop, Texas Public Employees Association; (*Registered, but did not testify*: Marshall Kenderdine and Maura Powers, AFSCME Texas Retirees; Ky Ash, Department of Public Safety Officers Association; David Sinclair, Game Warden Peace Officers Association; Ray Hymel, Texas Public Employees Association; Scott McCown)

Against — Jeff Ormsby, AFSCME; Tanisha Woods, AFSCME Texas Corrections; Rene Lara, Texas AFL-CIO; Joe Montemayor, Tyler Sheldon, and Sarah Swallow, Texas State Employees Union; and 16 individuals; (*Registered, but did not testify*: Jason Lopez, Austin Area AFL-CIO Labor Council; Harrison Hiner, Communications Workers of America; Sara Walling, Communications Workers of America District 6; James Smith, San Antonio Fire and Police Pension Fund; Phil Bunker, Teamsters JC 58; Dena Donaldson, Texas American Federation of Teachers; Laura Atlas Kravitz, Texas State Teachers Association; Brian Wheat, TSEU member; and 17 individuals)

On — Porter Wilson, Employees Retirement System of Texas; Joseph Newton, GRS Consulting; Anumeha Kumar, Pension Review Board; Rod

Bordelon, Texas Public Policy Foundation; (*Registered, but did not testify*: Steven Gassenberger, Reason Foundation)

DIGEST: SB 321 would specify the state contribution to the Employees Retirement System of Texas (ERS), require the state to amortize ERS' unfunded actuarial liabilities by a certain date, and create a new cash balance benefit retirement plan for certain future state employees.

State contribution to ERS. The bill would specify that the state contribution to ERS was an amount equal to 9.5 percent of the total compensation of all members for that fiscal year.

Legacy payment. In addition to the current state contribution required by law, each fiscal year the state would have to make an actuarially sound determined payment in the amount necessary to amortize ERS' unfunded actuarial liabilities by no later than the end of fiscal 2054.

Before each regular legislative session, ERS would have to provide the Legislative Budget Board (LBB) with the amount necessary to make the actuarially determined payment. The LBB director would include that payment in the general appropriations bill.

The bill's provisions relating to the legacy payment would expire September 1, 2055.

Cash balance benefit. The bill would create a new cash balance benefit retirement plan for ERS members and establishes the plan's structure.

Applicability. The cash balance benefit would apply only to a member of the employee or elected class of ERS membership who was hired or took office on or after September 1, 2022, and was not a member on the date the member was hired or took office.

Application. A member could apply for a cash balance annuity by filing an application for retirement with the ERS board of trustees. An application could not be made after the date the member wished to retire or more than 90 days before the member wished to retire.

Eligibility. A member who had service credit in the employee class of membership would be eligible to retire and receive a cash balance annuity if the member:

- was at least 65 years old and has five years of service credit in that class; or
- had at least five years of service credit in that class and the sum of the member's age and amount of service credit, including months of age and credit, equaled or exceeded the number 80.

A member who had service credit in the elected class of membership would be eligible to retire and receive a cash balance annuity if the member:

- was at least 60 years old and had eight years of service credit in that class; or
- was at least 50 years old and had 12 years of service credit in that class.

A member who had as least 20 years of service credit as a law enforcement or custodial officer would be eligible to retire regardless of age and receive a cash balance annuity in an amount computed and funded as provided by the bill. A member who was at least 55 years old and had at least 10 years of service credit as a law enforcement or custodial officer would be eligible to retire and receive a cash balance annuity provided that the member was only entitled to the enhanced benefit if the member had at least 20 years of service as a law enforcement or custodial officer.

Collection of member contributions. Each payroll period, each department or agency would have to deduct a contribution of 6 percent of the compensation of a member subject to the bill.

In addition, each department or agency that employed a law enforcement or custodial officer who was a member subject to the bill would have to deduct an additional 2 percent contribution from the member's compensation to be deposited in the law enforcement and custodial officer supplemental retirement fund.

Benefits for members. The state match for the cash balance benefit for service credited to:

- the employee class of membership would be an amount computed by multiplying the member's accumulated account balance by 150 percent;
- the employee class of membership of eligible law enforcement or custodial officers would be an amount computed by multiplying the member's accumulated account balance by 150 percent and, for the portion of the account balance based on the additional two percent contribution attributable to service as an eligible officer, 300 percent paid from the law enforcement and custodial officer supplemental retirement fund; and
- the elected class of membership would be an amount computed by multiplying the member's accumulated account balance by 150 percent.

ERS would have to compute a member's cash balance annuity by taking the sum of the member's accumulated account balance and the computed state match and annuitizing that amount over the life expectancy of the member as of the effective date of the member's retirement using mortality and other tables adopted by the board for that purpose.

A member of the elected class of membership that was a member of the Legislature would have the member's accumulated account balance computed as if the contributions to the account were based on the state base salary, excluding longevity pay payable under the Judicial Retirement of System of Texas, being paid a district judge as set by the General Appropriations Act in accordance with applicable law.

Death, disability benefits. A member subject to the bill, a retiree receiving a cash balance annuity, or the beneficiary of a member or retiree who qualified for a death or survivor benefit annuity or a disability retirement annuity under laws governing ERS benefits would be entitled to a cash balance annuity instead of the annuity provided under those laws. The ERS board of trustees could enter into contracts to provide additional death and disability benefits under the bill.

Annual interest adjustment. Each fiscal year, ERS would have to deposit an amount equal to 4 percent of a member's accumulated account balance deposited into the member's individual account in the employees saving account.

Gain sharing interest adjustment. Each fiscal year, ERS would have to compute the gain sharing interest rate applicable to the subsequent fiscal year by:

- determining the average return on the investment of the system's cash and securities during the preceding five fiscal years, expressed as a percentage rate;
- subtracting 4 percentage points from the above percentage rate; and
- multiplying the sum by 50 percent.

For a retiree receiving a cash balance annuity, in addition to the amount of the annual interest adjustment deposited, each fiscal year, the retirement system would have to:

- deposit into each member's individual account in the employees saving account an amount equal to the gain sharing interest rate for the fiscal year multiplied by the member's accumulated account balance; and
- recalculate the annuity of a retiree or annuitant under the bill by multiplying the annuity by an amount equal to the gain sharing interest rate.

The gain sharing interest rate applied could not be less than zero or more than 3 percent.

Conflict of law. To the extent of a conflict between the bill's provisions relating to the cash balance benefit, including a rule adopted by ERS under the bill's authority, and any other law, the bill would prevail.

Other provisions. A member of ERS subject to the cash balance benefit plan would be eligible to participate in the proportionate retirement program. A member eligible to receive cash balance benefits who had at least 10 years of eligible service credit would be able to participate as an annuitant in the group benefits program.

State law governing credit transfer between ERS and the Teacher Retirement System would not apply to an ERS member subject to the bill.

Under the bill, certain provisions of laws governing creditable service related to ERS and service retirement benefits would not apply to a cash balance group member. The bill would apply provisions related to certain deductions from annuity to members under the bill.

Implementation. ERS would be required to implement a provision of the bill only if the Legislature appropriated money specifically for that purpose. If money was not appropriated, ERS could, but would not be required to, implement the bill using other available appropriations.

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:

SB 321 would improve the solvency of the Employees Retirement System (ERS) retirement program by requiring the state to make annual amortization payments to ERS to pay down the existing unfunded liability and establishing a new cash balance benefit retirement plan for certain future state employees. The bill would propose a long-term solution, not just a temporary fix.

A 2020 actuarial valuation of ERS reported that, at current contribution rates, the pension plan will not have enough money to pay all current and promised benefits, and the main ERS fund has a depletion date of 2061. To be considered actuarially sound under state law, the pension fund requires total contributions sufficient to fund the normal cost of the plan and to pay off the unfunded liability — the difference between the market value of the assets and the present value of future payment obligations — in no more than 31 years. The valuation assessed the unfunded actuarial accrued liability at about $14.7 billion.

Each biennium that ERS does not receive actuarially sound contributions, it will continue to accrue liabilities, with the current unfunded liability expected to grow by about $1 billion per biennium. Failing to address the problem now would make it more expensive for taxpayers to fix in the future and could impact the state’s financial status and credit rating and benefit reductions to current employees could be required.

SB 321 would support a strong retirement system, which is crucial for recruiting and retaining the state workforce, by committing ERS to a path that would meet long-term obligations to retirees and put the retirement fund back on track to full funding. Under the bill, the state would make annual payments to amortize the unfunded liability and eliminate the fund's depletion date, addressing existing pension liabilities and stabilizing retirement benefits for state employees and retirees. These payments would not be indefinite, and once the unfunded liability was paid off, the payments would cease.

The bill also would stabilize the plan and benefits for future state employees by establishing a new tier within the existing ERS fund for new regular state employees and law enforcement and custodial officers starting on or after September 1, 2022. A cash benefit plan is not a defined contribution plan. Instead, it mirrors a defined benefit plan but shares investment risk between the employer and employee. The plan and its shared-risk strategy would minimize future unfunded liabilities. These types of plans are considered to be fiscally responsible and a prudent method to establish a stable retirement plan and are popular in both the public and private sectors.

Under the new plan, employee paychecks would be larger as only 6 percent would be removed for the ERS trust fund, compared to the 9.5 percent for current employees. This increase in take-home pay would allow new employees to increase their retirement benefits by using the additional earnings to contribute more to their retirement account. The plan also would guarantee participating employees a lifetime annuity.

CRITICS SAY:

SB 321 could adversely affect the future of the state workforce by hindering Texas' ability to recruit and retain employees for public service. The state workforce already has a high turnover rate, and some agencies are challenged by chronic understaffing. Public employees often make far less in salaries than comparable positions in the private sector, and the promise of a secure retirement under a defined benefit plan is an effective recruiting and retention tool. Converting to a cash balance plan, which is similar to a defined contribution plan, could undermine the ability of state agencies to recruit and retain qualified staff.

The current defined benefit plan has continued to function as intended and there is no need to convert it to a cash balance plan, which is a less secure retirement that would leave retirees exposed to more risk and a less reliable annuity. Any movement away from the current plan could be the first step in an erosion of public employee pensions.

The Legislature should focus its efforts on fulfilling the promise to current state employees by only addressing the current unfunded liability. Fulfilling this obligation should not be contingent on any benefit restructuring.

NOTES:

According to the Legislative Budget Board, the bill would have a negative impact on several funds through fiscal 2023, including costs of:

- $678.3 million to general revenue funds;
- $52 million to general revenue dedicated funds;
- $171.4 million to federal funds;
- $14.3 million to other special state funds; and
- $104 million to the State Highway Fund.

The Senate Finance Committee substituted version of HB 2 by Bonnen (Nelson), the supplemental budget for fiscal 2020-21, would appropriate, contingent on the enactment of SB 321, to the Employees Retirement System (ERS) the amounts above for the purpose of amortizing the retirement program's unfunded actuarial liabilities by the end of fiscal 2054.