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# 2013 Legislative Wrap-Up

## Texas State Pensions

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As we explain in our recent report, A Different Breed: Stronger, Smarter, Good for Texas, Texas' state pensions—the Employee Retirement System (ERS) and the Teacher Retirement System (TRS)—have become national models for well-funded, strong, and sustainable pension systems by providing a modest benefit while controlling costs. Yet even ERS and TRS are not actuarially sound and some combination of strong market returns, increased state contributions, and increased employee contributions will be required to sustain the programs. Taking a step in that direction, the Legislature passed SB 1459 (ERS Omnibus Bill) and SB 1458 (TRS Omnibus Bill), which include contribution rate increases and benefit changes.

### KEY FINDINGS

- The actuarial soundness of ERS and TRS will improve due to benefit changes and increases in state and member contribution rates.
- TRS retirees will see a cost-of-living increase for the first time in more than 11 years.
- A more in-depth discussion on the state's pensions systems can be found here: A Different Breed: Stronger, Smarter, Good for Texas

## Increases In The Contribution Rate

The Legislature increased the state and employee contribution rates for both ERS and TRS. The state contribution rate for ERS holds steady at 6.5 percent of payroll for fiscal year 2014; however, an additional one percent increase is added from expended balances in 2013 for a total 2014 state contribution of 7.5 percent. The fiscal year 2015 state contribution rate is also set at 7.5 percent. This contribution rate increase brings the state into compliance, for the first time since 1990, with statute that requires the state contribution to be at least 7.4 percent of payroll.

SB 1459 will also require state agencies to contribute 0.05 percent of payroll to the ERS trust fund. The state makes a direct transfer to the ERS pension trust fund based on a set state contribution rate. The additional 0.05 percent of payroll collected directly from state agencies will go to the ERS trust fund for the purpose of administering ERS assets.

State employees will also see a gradual increase in their contributions over the next several years until it reaches 7.5 percent of payroll in fiscal year 2017 from 6.5 percent in 2013. The ERS employee contribution increase schedule is as follows:

- 6.6 percent in 2014
- 6.9 percent in 2015
- 7.2 percent in 2016
- 7.5 percent in 2017

The state contribution rate for TRS holds steady at 6.4 percent of payroll in 2014; however, an additional 0.40 percent increases is added from expended balances in 2013 for a total 2014 contribution rate of 6.8 percent. The state contribution rate for fiscal year 2015 is also set at 6.8 percent.

Starting in 2015, school districts that do not participate in social security will contribute 1.5 percent of payroll to the TRS pension trust fund. A Legislative Budget Board actuarial analysis estimates that 64 percent of total payroll would be subject to this additional contribution. The Legislature has appropriated $330 million as one-time aid in fiscal year 2015 to assist with this transition.

TRS members will also experience an incremental increase in the employee contribution rate starting in fiscal year 2015—this is the first increase to TRS employee contributions since at least 1989. The TRS employee contribution increase schedule is as follows:

- 6.7 percent in 2015
- 7.2 percent in 2016
- 7.7 percent in 2017

## Benefit Changes

Reducing benefits in turn decreases pension plan costs. However, reducing the already modest benefits provided by ERS and TRS erodes the value of the pension plan and its ability to attract and retain a quality public workforce.

The majority of benefit changes will only impact new employees, thereby protecting more tenured employees from unforeseen hardship or delayed retirement.

### Retirement Age

For ERS members who begin their employment on or after September 1, 2013, the early retirement age is increased to 62 from 60. A five percent annuity reduction is applied for every year of age below the minimum and the 25 percent reduction cap is eliminated.

For TRS members who being their employment on or after September 1, 2014, to retire a member must be at least age 65 and have five years of service credits OR be at least 62, have five years of service credit, and meet the “rule of 80” where the sum of age and years of service equals 80. Under current law, TRS members hired on or after September 1, 2007, have a minimum age of 60 to retire under the “rule of 80.”

Final Average Salary

Retirement income is based on final average salary and the number of years worked. For non-grandfathered ERS members, the number of months used to calculate the final average salary is increased to the highest 60 months (five years) of salary from the highest 36 months used for tier 1 employees and highest 48 months used for tier 2. Increasing the number of months used in the final average salary calculation brings more lowered paid months into the average which then results in a lower overall retirement income.

TRS currently uses the five highest annual salaries when determining the final average salary and this provision was not changed by SB 1458.

Cost of Living Adjustment (COLA)

ERS and TRS do not automatically adjust retirees’ income for increases in the cost of living. Texas law requires the pension systems to be actuarially sound, meaning that the unfunded liability can be paid down in 31 years or less under current assumptions and funding levels, before a COLA can be granted. Retired state employees and teachers have not seen a cost of living adjustment in their retirement annuity in over 11 years. When a retirement annuity is not adjusted for inflation the buying power of the retiree erodes over time.

SB 1459 added a one-time, three percent COLA provision (not to exceed $100 per month) for all ERS retirees who have been retired for 20 years or more on the condition that the system is actuarially sound. Currently, ERS is considered to be actuarially unsound because the system will never be able to fully pay off all its unfunded liabilities under current conditions—thus the funding period is infinite and this COLA is not expected to be granted anytime in the near future.

Texas teachers are hit particularly hard by the lack of an automatic COLA, because 90 percent are not eligible to participate in Social Security and thus rely heavily on their TRS pension for retirement income. SB 1458 creates a one-time, three percent COLA (not to exceed $100 per month) for all TRS retirees who have been retired since August 31, 1999, and is payable if the system is actuarially sound. It is anticipated that changes made to TRS, under SB 1458, will decrease the funding period to 28.9 years from infinite. This COLA is expected to be granted since the fund will be considered actuarially sound.

Interest on Employee Contributions

ERS and TRS members who leave covered employment before retirement eligibility are allowed to withdraw their employee contributions and the accumulated interest. This session the amount of interest earned on member contributions was reduced to two percent from five percent for both ERS and TRS. This change alone will make a small impact on the solvency of the fund overall, but will help to reduce the costs of administering the plan and bring interest earnings closer to what an individual would find in the open-market.

## Overall Health of the Pension Systems

The actuarial health of the ERS system is estimated to improve because of the contribution rate increases made in SB 1459. Due to cuts in benefits, the normal cost of the plan (the present cost of providing the future pension benefits that current active employees accrue year-to-year while employed) will decrease to 10.69 percent of payroll from the 12.27 percent estimated as of February 28, 2013. The actuarial sound contribution rate (the rate needed to cover the normal cost and amortize the unfunded liability within 31 years) will also decrease to 17.80 percent of payroll from 18.70 percent. The increased combined contribution rate of 15.5 percent (7.5 percent members/7.5 percent state/ 0.05 percent agencies) is enough to cover the normal cost of the plan, but not high enough to meet the actuarially sound rate and pay off the unfunded liabilities within 31 years, so the funding period remains infinite.

TRS will also see an overall increase in system health under changes made in SB 1458. The normal cost of the plan will decrease to 10.09 percent from 10.60 percent of payroll due to benefit cuts. Increases in both member and employee contribution rates will allow the system to pay off its unfunded liabilities in 28.9 years.

## Conclusion

Texas' state pensions provide much more than just a retirement income for state workers and teachers. As defined-benefit pension plans, our state pensions attract and retain a high-quality public workforce, strengthen the middle-class by supporting self-sufficiency for seniors, and they provide economic benefits for all Texans. The Legislature took positive steps towards fund stability this session by increasing their investment in the funds while making minimal changes to plan benefits.

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