

SENATE AMENDMENTS

2nd Printing

By: Flynn, Otto, Alonzo, Turner of Harris,
Bonnen of Brazoria, et al.

H.B. No. 9

A BILL TO BE ENTITLED

1 AN ACT
2 relating to member contributions to the Employees Retirement System
3 of Texas.

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

5 SECTION 1. Section 815.402(a), Government Code, is amended
6 to read as follows:

7 (a) Except as provided by Section 813.201, each payroll
8 period, each department or agency of the state shall cause to be
9 deducted from each member's compensation a contribution of:

10 (1) 9.5 [~~6.6 percent of the compensation if the member~~
11 ~~is not a member of the legislature, for service rendered after~~
12 ~~August 31, 2013, and before September 1, 2014,~~

13 [~~(2) 6.9 percent of the compensation if the member is~~
14 ~~not a member of the legislature, for service rendered after August~~
15 ~~31, 2014, and before September 1, 2015,~~

16 [~~(3) 7.2~~] percent of the compensation if the member is
17 not a member of the legislature, for service rendered after August
18 31, 2015, and before September 1, 2017 [~~2016~~];

19 (2) [~~(4) 7.5 percent of the compensation if the~~
20 ~~member is not a member of the legislature, for service rendered~~
21 ~~after August 31, 2016,~~

22 [~~(5)~~] for service by a member who is not a member of
23 the legislature rendered on or after September 1, 2017, the lesser
24 of:

1 (A) 9.5 [~~7.5~~] percent of the member's annual
2 compensation; or

3 (B) a percentage of the member's annual
4 compensation equal to 9.5 [~~7.5~~] percent reduced by one-tenth of one
5 percent for each one-tenth of one percent that the state
6 contribution rate for the fiscal year to which the service relates
7 is less than the state contribution rate established for the 2017
8 [~~2015~~] fiscal year; or

9 (3) 9.5 [~~(6) eight~~] percent of the compensation if the
10 member is a member of the legislature.

11 SECTION 2. This Act takes effect September 1, 2015.

ADOPTED

MAY 22 2015

Sally Law
Secretary of the Senate

FLOOR AMENDMENT NO. _____

BY: _____

Janet Huffman

Amend H.B. No. 9 (senate committee report) as follows:

(1) Add the following appropriately numbered SECTIONS:

SECTION _____. Sections 812.003(a), (d), and (e), Government Code, are amended to read as follows:

(a) Except as provided by Subsection [~~Subsections~~] (b) [~~and (d)~~], membership in the employee class of the retirement system includes all employees and appointed officers of every department, commission, board, agency, or institution of the state except:

(1) independent contractors and their employees performing work for the state; and

(2) persons disqualified from membership under Section 812.201.

(d) Membership in the employee class begins on the [~~91st day after the~~] first day a person is employed or holds office.

(e) A person who is reemployed or who again holds office after withdrawing contributions under Subchapter B for previous service credited in the employee class begins membership in the employee class on the [~~91st day after the~~] first day the person is reemployed or again holds office.

SECTION _____. Section 813.514, Government Code, is amended by amending Subsection (a) and adding Subsection (a-1) to read as follows:

(a) This section applies only to a member who became a member before September 1, 2015.

(a-1) A member may establish service credit under this section in the employee class only for service performed during a 90-day waiting period to become a member after beginning employment

or holding office.

SECTION _____. Section 812.003(f), Government Code, is repealed.

(2) Renumber the SECTIONS of the bill accordingly.

LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 84TH LEGISLATIVE REGULAR SESSION

May 25, 2015

TO: Honorable Joe Straus, Speaker of the House, House of Representatives

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB9 by Flynn (Relating to member contributions to the Employees Retirement System of Texas.), **As Passed 2nd House**

Estimated Two-year Net Impact to General Revenue Related Funds for HB9, As Passed 2nd House: a negative impact of (\$21,382,416) through the biennium ending August 31, 2017.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2016	(\$10,691,208)
2017	(\$10,691,208)
2018	(\$10,744,664)
2019	(\$10,798,387)
2020	(\$10,852,379)

All Funds, Five-Year Impact:

Fiscal Year	Probable Savings/(Cost) from General Revenue Fund 1	Probable Savings/(Cost) from GR Dedicated Accounts 994	Probable Savings/(Cost) from Federal Funds 555	Probable Savings/(Cost) from State Highway Fund 6
2016	(\$10,691,208)	(\$728,691)	(\$2,883,119)	(\$1,558,396)
2017	(\$10,691,208)	(\$728,691)	(\$2,883,119)	(\$1,558,396)
2018	(\$10,744,664)	(\$732,334)	(\$2,897,535)	(\$1,566,189)
2019	(\$10,798,387)	(\$735,996)	(\$2,912,022)	(\$1,574,019)
2020	(\$10,852,379)	(\$739,676)	(\$2,926,582)	(\$1,581,889)

Fiscal Year	Probable Savings/(Cost) from <i>Other Special State Funds</i> 998
2016	(\$138,586)
2017	(\$138,586)
2018	(\$139,279)
2019	(\$139,975)
2020	(\$140,675)

Fiscal Analysis

The bill would amend Government Code to increase the member contribution rate from 7.2 percent in fiscal year 2016 and 7.5 percent in fiscal year 2017 to 9.5 percent in both fiscal years and beyond. The member contribution rate would be reduced beyond fiscal year 2017 if the state contribution rate is less than 9.5 percent. The bill would also increase the contribution rate for members of the legislature from 8.0 to 9.5 percent in fiscal year 2016 and beyond. The bill would eliminate the 90-day membership waiting period, which would allow for retirement contributions by the state and members to the Employees Retirement System Retirement Program (ERS Retirement) to begin on the first day of employment.

Based on the projected August 31, 2015 actuarial valuation, the ERS actuary estimates the bill would decrease the unfunded actuarial accrued liability (UAAL) by \$49.3 million, from \$8,078.9 million to \$8,029.6 million; and that it would increase the funded ratio of assets to liabilities from 76.4 percent to 76.5 percent. The contribution rate needed to fund the normal cost and amortize the UAAL as a level percentage of payroll over 31 years would increase from 19.11 percent to 19.57 percent.

The change in the actuarially sound contribution rate is due to an increase in the projected normal cost from 11.58 percent to 12.26 percent, which was partially offset by a decrease to the rate required to amortize the unfunded liability over 31 years, from 7.53 percent to 7.31 percent. As the member contribution rate increases, the amount of contribution refunds expected to be paid to members upon termination would also increase. Significant increases in the member contribution rate could also result in an increased number of members electing to take a refund of their contributions when compared to historical experience. Since the normal cost rate is based on the present value of all benefits that ERS is expected to pay out to plan members after their employment ceases, the normal cost rate would increase as a result of the proposed increase in the member contribution rate. The total contribution rate of 17.50 percent under the bill is sufficient to cover the normal cost but is insufficient to pay down the existing UAAL.

The ERS actuary assumes that the changes in the bill would be accompanied by an increase in the State contribution rate to 10.0% of pay (9.5% from state contributions and 0.5% from agency contributions). The combination of these changes would be expected to reduce the funding period to 32 years, which would not meet the statutory definition of actuarial soundness of 31 years. Note that this analysis is isolated to the provisions of this legislation and changes to either the benefit plan or to state contributions would shift the analysis.

Government Code, Section 814.604 would provide for a cost-of-living adjustment be paid to certain ERS retirees once the actuarial valuation indicates that the amortization period for unfunded actuarial liabilities of the retirement system does not exceed 31 years, and would not exceed 31 years as a result of paying the adjustment. The ERS actuaries anticipate that the bill would allow for a cost-of-living adjustment in January 2019. At the time the COLA is granted, the

funding period for ERS would be expected to increase by one additional year.

The bill would take effect September 1, 2015.

Methodology

The cost included in the tables reflect the additional state contribution required to ERS Retirement, assuming a 10.0 percent total state contribution (9.5 percent from the state and 0.5 percent from agencies). Beginning membership in ERS Retirement on the first day of employment would require approximately \$16,000,000 in All Funds for fiscal year 2016 and fiscal year 2017. The additional All Funds cost to the state contribution would increase to \$16,080,001 in fiscal year 2018, \$16,160,300 in fiscal year 2019, and \$16,241,201 in fiscal year 2020, assuming 0.5 percent payroll growth in each year.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 327 Employees Retirement System

LBB Staff: UP, AG, EP, EMO

LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 84TH LEGISLATIVE REGULAR SESSION

April 29, 2015

TO: Honorable Joan Huffman, Chair, Senate Committee on State Affairs

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB9 by Flynn (Relating to member contributions to the Employees Retirement System of Texas.), **As Engrossed**

No significant fiscal implication to the State is anticipated.

The bill would amend Government Code to increase the member contribution rate from 7.2 percent in fiscal year 2016 and 7.5 percent in fiscal year 2017 to 9.5 percent in both fiscal years and beyond. The member contribution rate would be reduced beyond fiscal year 2017 if the state contribution rate is less than 9.5 percent. The bill would also increase the contribution rate for members of the legislature from 8.0 to 9.5 percent in fiscal year 2016 and beyond.

Based on the projected August 31, 2015 actuarial valuation, the ERS actuary estimates the bill would decrease the unfunded actuarial accrued liability (UAAL) by \$49.3 million, from \$8,078.9 million to \$8,029.6 million; and that it would increase the funded ratio of assets to liabilities from 76.4 percent to 76.5 percent. The contribution rate needed to fund the normal cost and amortize the UAAL as a level percentage of payroll over 31 years would increase from 19.11 percent to 19.75 percent.

The change in the actuarially sound contribution rate is due to an increase in the projected normal cost from 11.58 percent to 12.26 percent, which was slightly offset by a decrease to the rate required to amortize the unfunded liability over 31 years, from 7.53 percent to 7.49 percent. As the member contribution rate increases, the amount of contribution refunds expected to be paid to members upon termination would also increase. Significant increases in the member contribution rate could also result in an increased number of members electing to take a refund of their contributions when compared to historical experience. Since the normal cost rate is based on the present value of all benefits that ERS is expected to pay out to plan members after their employment ceases, the normal cost rate would increase as a result of the proposed increase in the member contribution rate.

The total contribution rate of 17.50 percent under the bill is sufficient to cover the normal cost but is insufficient to pay down the existing UAAL. Therefore, the funding period would remain infinite. Note that this analysis is isolated to the provisions of this legislation and changes to either the benefit plan or to state contributions would shift the analysis.

The bill would take effect September 1, 2015.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 327 Employees Retirement System

LBB Staff: UP, AG, EP, EMo

LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 84TH LEGISLATIVE REGULAR SESSION

March 22, 2015

TO: Honorable Dan Flynn, Chair, House Committee on Pensions

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB9 by Flynn (Relating to member contributions to the Employees Retirement System of Texas.), **As Introduced**

No significant fiscal implication to the State is anticipated.

The bill would amend Government Code to increase the member contribution rate from 7.2 percent in fiscal year 2016 and 7.5 percent in fiscal year 2017 to 9.5 percent in both fiscal years and beyond. The member contribution rate would be reduced beyond fiscal year 2017 if the state contribution rate is less than 9.5 percent.

Based on the projected August 31, 2015 actuarial valuation, the ERS actuary estimates the bill would decrease the unfunded actuarial accrued liability (UAAL) by \$49.3 million, from \$8,078.9 million to \$8,029.6 million; and that it would increase the funded ratio of assets to liabilities from 76.4 percent to 76.5 percent. The contribution rate needed to fund the normal cost and amortize the UAAL as a level percentage of payroll over 31 years would increase from 19.11 percent to 19.75 percent.

The change in the actuarially sound contribution rate is due to an increase in the projected normal cost from 11.58 percent to 12.26 percent, which was slightly offset by a decrease to the rate required to amortize the unfunded liability over 31 years, from 7.53 percent to 7.49 percent. As the member contribution rate increases, the amount of contribution refunds expected to be paid to members upon termination would also increase. Significant increases in the member contribution rate could also result in an increased number of members electing to take a refund of their contributions when compared to historical experience. Since the normal cost rate is based on the present value of all benefits that ERS is expected to pay out to plan members after their employment ceases, the normal cost rate would increase as a result of the proposed increase in the member contribution rate.

The total contribution rate of 17.50 percent under the bill is sufficient to cover the normal cost but is insufficient to pay down the existing UAAL. Therefore, the funding period would remain infinite. Note that this analysis is isolated to the provisions of this legislation and changes to either the benefit plan or to state contributions would shift the analysis.

The bill would take effect September 1, 2015.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 327 Employees Retirement System

LBB Staff: UP, AG, EP, EMo

**LEGISLATIVE BUDGET BOARD
Austin, Texas**

ACTUARIAL IMPACT STATEMENT

84TH LEGISLATIVE REGULAR SESSION

May 25, 2015

TO: Honorable Joe Straus, Speaker of the House, House of Representatives

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB9 by Flynn (Relating to member contributions to the Employees Retirement System of Texas.), **As Passed 2nd House**

The increased contribution rate and the elimination of the 90-day waiting period for member participation under the bill would have a material positive impact on the actuarial soundness of the Employees Retirement System (ERS), changing its amortization period from infinite (never) to 32 years, based on the projected August 31, 2015 Actuarial Valuation.

Employees Retirement System of Texas

Projected for Fiscal Year 2016

	Current (Projected 08/31/2015 Valuation)	Proposed	Difference
State Contribution	7.5%	9.5%	2.0%
Employee Contribution	7.2%	9.5%	2.3%
State Agency Contribution	0.5%	0.5%	0.0%
Total Contribution*	15.2%	19.5%	4.3%
Normal Cost (% of payroll)**	11.6%	12.3%	0.7%
Unfunded Actuarial Accrued Liability (UAAL) (millions)**	\$8,078.9	\$8,029.6	(\$49.3)
Amortization Period (years)	Infinite (Never)	32	NA
Funded Ratio	76.40%	76.50%	0.10%
Projected Estimated Fund Exhaustion Date	Yes	No	NA

*The actuarial analysis assumes that the member (employee class and elected class, including members of the legislature) contribution rate increase to 9.5 percent proposed by the bill would be accompanied by an increase in the combined State and state agency contribution rate of 10.0 percent (9.5 percent State, 0.5 percent state agency) for fiscal year 2016 and beyond.

**The increase in the normal cost rate and the slight decrease in the unfunded actuarial accrued liability (UAAL) are based on the assumption that a greater proportion of employee class members would terminate and elect to get a refund of their accumulated employee contributions instead of a deferred pension. The actuarial analysis shows that the bill would increase the normal cost rate due to the increase in future refunds of employee contributions. Also, the elimination of the 90-day waiting period for member participation lowers the plan's amortization period by providing a larger contribution base for amortizing the UAAL for both State and member contributions.

ACTUARIAL EFFECTS

The ERS total contribution rate for fiscal year 2016 is 15.2 percent. Based on the February 28, 2015 update of the August 31, 2014 valuation, the UAAL will never be amortized (infinite amortization period) with a 15.2 percent contribution rate. Assuming the State contributes 9.5 percent for fiscal year 2016 and thereafter, the bill would increase the total contribution rate to 19.5 percent in fiscal year 2016 and beyond, and significantly decrease the amortization period for the retirement system, as of the projected August 31, 2015 valuation, to 32 years. The actuarial analysis states that an amortization period of 32 years is a significant improvement from the current infinite (never) amortization period. Further, an amortization period of 32 years indicates that ERS would be expected to meet the 31-year amortization limit set in its statute within one year.

The actuarial review also states that ERS is currently actuarially unsound. The increased contribution rate is projected to make ERS actuarially sound with a 32 year amortization period. Under the current PRB *Guidelines for Actuarial Soundness*, funding should be adequate to amortize the UAAL over a period which should not exceed 40 years, with 15-25 years being a more preferable target. The PRB projects that the total contribution rate of 19.5 percent would make ERS's amortization period meet the PRB *Guidelines*.

SYNOPSIS OF PROVISIONS

The bill would amend section 815.402(a) of the Government Code to increase the employee contribution rate for ERS members who are not legislators from 7.2 percent to 9.5 percent and for legislators from 8.0 percent to 9.5 percent of the member's compensation for service after August 31, 2015. The contribution rate increase applies to both the employee class and the elected class, including members of the legislature. Additionally, for service rendered on or after September 1, 2017, the employee contribution rate for ERS members who are not legislators of 9.5 percent would be reduced by one-tenth of a percent for each corresponding one-tenth of a percent reduction in the State contribution. The bill also eliminates the 90-day member participation waiting period set forth in Section 812.003. This bill would become effective September 1, 2015.

Although not part of the bill, the actuarial analysis was prepared based on the understanding that the State and agency contribution would be increased to 10.0 percent (9.5 percent from the State, and 0.5 percent from state agency appropriations), also for service after August 31, 2015.

FINDINGS AND CONCLUSIONS

The bill would slightly improve the funded ratio of the system from 76.4 percent to 76.5 percent. Additionally, the actuarial analysis discusses the cost-of-living adjustment (COLA) under Texas Government Code Section 814.604. This COLA is required to be made to certain retiree benefits when ERS's amortization period is less than 31 years. At that time, the increase in liability associated with the COLA will increase the plan's amortization period by approximately one year.

The actuarial review states that any proposed increase in pay for ERS active members coinciding with the increase in member contribution rate could slightly increase ERS's amortization period. The actuarial review also notes that the bill increases the plan funding security for all ERS members.

GASB EFFECTS

Although not discussed in the actuarial analysis, the passage of the bill (together with an increase in the State plus agency contribution rate to 10.0 percent) is likely to have a positive impact on ERS and the State under the new Governmental Accounting Standards Board (GASB) reporting standards (GASB 67 & 68). The increase in the total contribution rate to 19.5 percent may have the

effect of reducing the 8/31/2015 ERS Net Pension Liability (NPL) from its \$14.5 billion (as of 8/31/14) level. The PRB believes that for GASB purposes, the State will be able to project future State, member and agency funding at the contribution rates put into effect for fiscal year 2016. The likely result, if the total contribution rate is increased to 19.5 percent, is that no fund exhaustion date or blended discount rate (lower than the assumed rate of return) will be used. In that case, the ERS NPL will be lower than the \$14.5 billion (as of 8/31/2014) level and will be equal to the Entry Age Normal unfunded actuarial accrued liability on a market value of assets basis.

METHODOLOGY AND STANDARDS

The analysis assumes no further changes are made to ERS and cautions that the combined economic impact of several proposals can exceed the effect of each proposal considered individually. The ERS analysis relies on the participant data, financial information, benefit structure and actuarial assumptions and methods used in the ERS actuarial valuation for August 31, 2014 and mid-year valuation as of February 28, 2015. According to the PRB actuary, the actuarial assumptions, methods and procedures used in the analysis appear to be reasonable. All actuarial projections have a degree of uncertainty because they are based on the probability of occurrence of future contingent events. Accordingly, actual results will be different from the results contained in the analysis to the extent actual future experience varies from the experience implied by the assumptions.

SOURCES

Actuarial Analysis by Mr. R. Ryan Falls, FSA, EA, MAAA and Mr. Joseph P. Newton, FSA, EA, MAAA; Senior Consulting Actuaries, Gabriel Roeder Smith & Company, May 23, 2015.
Actuarial Review by Robert M. May, FSA, EA, MAAA, Board Actuary; and Mr. Daniel P. Moore, FSA, EA, MAAA, Staff Actuary, Pension Review Board, May 23, 2015.

GLOSSARY

Actuarial Accrued Liability (AAL) - The portion of the PVFB that is attributed to past service.

Actuarial Value of Assets (AVA) - The smoothed value of system's assets.

Amortization Payments - The yearly payments made to reduce the Unfunded Actuarial Accrued Liability (UAAL).

Amortization Period - The number of years required to pay off the unfunded actuarial accrued liability. The State Pension Review Board recommends that funding should be adequate to amortize the UAAL over a period which should not exceed 40 years, with 15-25 years being a more preferable target.

Actuarial Cost Method - A method used by actuaries to divide the Present Value of Future Benefits (PVFB) into the Actuarial Accrued Liability (AAL), the Present Value of Future Normal Costs (PVFNC), and the Normal Cost (NC)

Funded Ratio (FR) - The ratio of the actuarial assets to the actuarial accrued liabilities.

GASB 68 and related terminology - A statement of the Governmental Accounting Standards Board (GASB) concerning accounting for pensions by governmental employers effective for FYE 6/30/2015 and later:

Net Pension Liability (NPL): The liability of employers and non-employer contributing entities for pension benefits shown on the entity's balance sheet for FYE 6/30/2015 and later. The NPL equals the TPL minus the market value of plan assets. (If plan assets exceed the TPL, there is a Net Pension Asset.)

Total Pension Liability (TPL): The portion of the actuarial present value of projected benefit payments attributed to past periods of employee service under the Entry Age Normal valuation method.

Discount Rate: A single rate used to discount and calculate the TPL which is equivalent to discounting future payments reflected in the TPL at the long-term expected rate of return until

plan assets are projected to be exhausted, and discounting at the municipal bond rate for subsequent payments reflected in the TPL.

Market Value of Assets (MVA) - The fair market value of the system's assets.

Normal Cost (NC) - The portion of the PVFB that is attributed to the current year of service. ERS uses the Ultimate Entry Age Normal Cost Method for funding.

Present Value of Future Benefits (PVFB) - The present value of all benefits expected to be paid from the plan to current plan participants.

Present Value of Future Normal Costs (PVFNC) - The portion of the PVFB that will be attributed to future years of service.

Unfunded Actuarial Accrued Liability (UAAL) - The Actuarial Accrued Liability (AAL) less the Actuarial Value of Assets (AVA).

Source Agencies: 338 Pension Review Board

LBB Staff: UP, EP, EMO, KFa

**LEGISLATIVE BUDGET BOARD
Austin, Texas**

ACTUARIAL IMPACT STATEMENT

84TH LEGISLATIVE REGULAR SESSION

April 29, 2015

TO: Honorable Joan Huffman, Chair, Senate Committee on State Affairs

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB9 by Flynn (Relating to member contributions to the Employees Retirement System of Texas.), **As Engrossed**

The increased contribution rate under the bill would have a material positive impact on the actuarial soundness of ERS, changing its amortization period from infinite (never) to 34 years, based on the mid-year valuation as of February 28, 2015.

**Employees' Retirement System of Texas
Projected for Fiscal Year 2016 and Beyond**

	Current (Projected 08/31/2015 Valuation)	Proposed	Difference
State Contribution	7.50%	9.50%	2.00%
Employee Contribution	7.20%	9.50%	2.30%
State Agency Contribution	0.50%	0.50%	0.00%
Total Contribution*	15.20%	19.50%	4.30%
Normal Cost (% of payroll)**	11.58%	12.26%	0.68%
Unfunded Actuarial Accrued Liability (millions)**	\$8,078.90	\$8,029.60	(\$49.30)
Amortization Period (years)	Infinite (Never)	34	NA
Funded Ratio	76.40%	76.50%	0.10%
Projected Estimated Fund Exhaustion Date	Yes	No	NA

*The actuarial analysis assumes that the member (employee class and elected class, including members of the legislature) contribution rate increase to 9.50 percent proposed by the bill would be accompanied by an increase in the combined State and state agency contribution rate of 10.00 percent (9.50 percent State, 0.50 percent state agency) for fiscal year 2016 and beyond.

**The increase in the normal cost rate and the slight decrease in the unfunded actuarial accrued liability (UAAL) are based on the assumption that a greater proportion of employee class members would terminate and elect to get a refund of their accumulated employee contributions instead of a deferred pension. The actuarial analysis projects that the bill would increase the normal cost rate due to the increase in future refunds of employee contributions.

ACTUARIAL EFFECTS

The Employees Retirement System (ERS) total contribution rate for fiscal year 2016 is 15.20 percent. Based on the February 28, 2015 update of the August 31, 2014 valuation, the UAAL will

never be amortized (infinite amortization period) with a 15.20 percent contribution rate. As of the projected August 31, 2015 valuation results, the total contribution rate necessary for ERS to fund the normal cost and achieve a 31-year amortization period is 19.11 percent of payroll. Assuming the State contributes 9.50 percent for fiscal year 2016 and thereafter, the bill would increase the total contribution rate to 19.50 percent in fiscal year 2016 and beyond, and significantly improve the amortization period for the retirement system, as of the February 28, 2015 valuation, to 34 years. The actuarial analysis states that an amortization period of 34 years is a significant improvement from the current infinite (never) amortization period. Further, an amortization period of 34 years indicates that ERS would be expected to meet the 31-year amortization limit set in its statute within three years.

The actuarial review also states that ERS is currently actuarially unsound. The increased contribution rate would make ERS actuarially sound with a 34 year amortization period. Under the current Pension Review Board (PRB) *Guidelines for Actuarial Soundness*, funding should be adequate to amortize the UAAL over a period which should not exceed 40 years, with 15-25 years being a more preferable target. The PRB projects that the total contribution rate of 19.50 percent would make ERS's amortization period meet the PRB Guidelines.

SYNOPSIS OF PROVISIONS

The bill would amend Government Code to increase the employee contribution rate for ERS members who are not legislators from 7.2 percent to 9.5 percent and for legislators from 8.0 percent to 9.5 percent of the member's compensation for service after August 31, 2015. The contribution rate increase applies to both the employee class and the elected class, including members of the legislature. Additionally, for service rendered on or after September 1, 2017, the employee contribution rate of 9.5 percent for ERS members who are not legislators would be reduced by one-tenth of a percent for each corresponding one-tenth of a percent reduction in the State contribution. This bill would become effective September 1, 2015.

Although not part of the bill, the actuarial analysis was prepared based on the understanding that the State and agency contribution would be increased to 10.0 percent (9.5 percent from the State, and 0.5 percent from state agency appropriations), also for service after August 31, 2015.

FINDINGS AND CONCLUSIONS

According to the actuarial analysis, the bill would increase, by 0.68 percent of payroll, the total normal cost rate of ERS from 11.58 percent to 12.26 percent. This increase in the normal cost rate would cause the actuarially sound contribution rate to increase from 19.11 percent to 19.75 percent of payroll. The proposal would slightly improve the funded ratio of the system from 76.40 percent to 76.50 percent.

Additionally, the actuarial analysis discusses the cost-of-living adjustment (COLA) under Texas Government Code Section 814.604. This COLA is required to be made to certain retiree benefits when ERS's amortization period is less than 31 years. At that time, the increase in liability associated with the COLA will increase the plan's amortization period by approximately one year.

The actuarial review states that any proposed increase in pay for ERS active members coinciding with the increase in member contribution rate could slightly increase ERS's amortization period. The actuarial review also notes that the bill increases the plan funding security for all ERS members.

GASB EFFECTS

Although not discussed in the actuarial analysis, the passage of the bill (together with an increase in the State plus agency contribution rate to 10 percent) would have a positive impact on ERS and

the State under the new Governmental Accounting Standards Board (GASB) reporting standards (GASB 67 & 68). The increase in the total contribution rate to 19.50 percent may have the effect of reducing the 8/31/2015 ERS Net Pension Liability (NPL) from its \$14.5 billion (as of 8/31/14) level. The PRB believes that for GASB purposes, the State will be able to project future State, member and agency funding at the contribution rates put into effect for fiscal year 2016. The likely result, if the total contribution rate is increased to 19.50 percent, is that no fund exhaustion date or blended discount rate (lower than the assumed rate of return) will be used. In that case, the ERS NPL will be lower than the \$14.5 billion (as of 8/31/2014) level and will be equal to the Entry Age Normal unfunded actuarial accrued liability on a market value of assets basis.

METHODOLOGY AND STANDARDS

The analysis assumes no further changes are made to ERS and cautions that the combined economic impact of several proposals can exceed the effect of each proposal considered individually. The ERS analysis relies on the participant data, financial information, benefit structure and actuarial assumptions and methods used in the ERS actuarial valuation for August 31, 2014 and mid-year valuation as of February 28, 2015. According to the PRB actuary, the actuarial assumptions, methods and procedures used in the analysis appears to be reasonable. All actuarial projections have a degree of uncertainty because they are based on the probability of occurrence of future contingent events. Accordingly, actual results will be different from the results contained in the analysis to the extent actual future experience varies from the experience implied by the assumptions.

SOURCES

Actuarial Analysis by Mr. R. Ryan Falls, FSA, EA, MAAA and Mr. Joseph P. Newton, FSA, EA, MAAA; Senior Consulting Actuaries, Gabriel Roeder Smith & Company, April 21, 2015.
Actuarial Review by Robert M. May, FSA, EA, MAAA, Board Actuary; and Mr. Daniel P. Moore, FSA, EA, MAAA, Staff Actuary, Pension Review Board, April 28, 2015.

GLOSSARY

Actuarial Accrued Liability (AAL) - The portion of the PVFB that is attributed to past service.

Actuarial Value of Assets (AVA) - The smoothed value of system's assets.

Amortization Payments - The yearly payments made to reduce the Unfunded Actuarial Accrued Liability (UAAL).

Amortization Period - The number of years required to pay off the unfunded actuarial accrued liability. The State Pension Review Board recommends that funding should be adequate to amortize the UAAL over a period which should not exceed 40 years, with 15-25 years being a more preferable target.

Actuarial Cost Method - A method used by actuaries to divide the Present Value of Future Benefits (PVFB) into the Actuarial Accrued Liability (AAL), the Present Value of Future Normal Costs (PVFNC), and the Normal Cost (NC)

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Total Pension Liability (TPL): The portion of the actuarial present value of projected benefit payments attributed to past periods of employee service under the Entry Age Normal valuation method.

Discount Rate: A single rate used to discount and calculate the TPL which is equivalent to

discounting future payments reflected in the TPL at the long-term expected rate of return until plan assets are projected to be exhausted, and discounting at the municipal bond rate for subsequent payments reflected in the TPL.

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Unfunded Actuarial Accrued Liability (UAAL) - The Actuarial Accrued Liability (AAL) less the Actuarial Value of Assets (AVA).

Source Agencies: 338 Pension Review Board

LBB Staff: UP, EP, EMo, KFa

**LEGISLATIVE BUDGET BOARD
Austin, Texas**

ACTUARIAL IMPACT STATEMENT

84TH LEGISLATIVE REGULAR SESSION

March 22, 2015

TO: Honorable Dan Flynn, Chair, House Committee on Pensions

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: HB9 by Flynn (Relating to member contributions to the Employees Retirement System of Texas.), **As Introduced**

**Employees Retirement System of Texas
Projected for Fiscal Year 2016 and Beyond**

	Current (Projected 08/31/2015 Valuation)	Proposed	Difference
State Contribution	7.50%	9.50%	2.00%
Employee Contribution	7.20%	9.50%	2.30%
State Agency Contribution	<u>0.50%</u>	<u>0.50%</u>	<u>0.00%</u>
Total Contribution*	15.20%	19.50%	4.30%
Normal Cost (% of payroll)**	11.58%	12.26%	0.68%
Unfunded Actuarial Accrued Liability (millions)**	\$8,078.90	\$8,029.60	(\$49.30)
Amortization Period (years)	Infinite (Never)	34	NA
Funded Ratio	76.40%	76.50%	0.10%
Projected Estimated Fund Exhaustion Date	Yes	No	NA

*The actuarial analysis assumes that the employee contribution rate increase to 9.50% proposed by the bill would be accompanied by an increase in the combined State and state agency contribution rate of 10.00% (9.50% State, 0.50% state agency) for fiscal year 2016 and beyond.

**The increase in the normal cost rate and the slight decrease in the unfunded actuarial accrued liability (UAAL) are based on the assumption that a greater proportion of employee class members would terminate and elect to get a refund of their accumulated employee contributions instead of a deferred pension. The actuarial analysis projects that the bill would increase the normal cost rate due to the increase in future refunds of employee contributions.

ACTUARIAL EFFECTS

The ERS total contribution rate for FY 2016 is 15.20%. Based on the February 28, 2015 update of the August 31, 2014 valuation, the UAAL will never be amortized (infinite amortization period) with a 15.20% contribution rate. As of the projected August 31, 2015 valuation results, the total contribution rate necessary for ERS to fund the normal cost and achieve a 31-year amortization period is 19.11% of payroll. Assuming the State contributes 9.50% for fiscal year 2016 and thereafter, HB 9 would increase the total contribution rate to 19.50% in fiscal year 2016 and beyond, and significantly improve the amortization period for the retirement system, as of the February 28, 2015 valuation, to 34 years. The actuarial analysis states that an amortization period of 34 years is a significant improvement from the current infinite (never) amortization period. Further, an amortization period of 34 years indicates that ERS would be expected to meet the 31-year amortization limit set in its statute within three years.

The actuarial review notes that the increased contribution rate would have a material positive impact on the actuarial soundness of ERS, changing its amortization period from infinite (never) to 34 years, based on the February 28, 2015 Interim Valuation.

The actuarial review also states that ERS is currently actuarially unsound. The increased contribution rate is projected to make ERS actuarially sound with a 34 year amortization period. Under the current PRB Guidelines for Actuarial Soundness, funding should be adequate to amortize the UAAL over a period which should not exceed 40 years, with 15-25 years being a more preferable target. The PRB projects that the total contribution rate of 19.50% will make ERS's amortization period meet the PRB Guidelines.

SYNOPSIS OF PROVISIONS

HB 9 would amend section 815.402(a) of the Government Code to increase the member contribution rate from 7.2% to 9.5% for employee class members for service rendered after August 31, 2015. Additionally, for service rendered on or after September 1, 2017, the member contribution rate of 9.5% would be reduced by one-tenth of a percent for each corresponding one-tenth of a percent reduction in the State contribution. This bill would become effective September 1, 2015.

Although not part of HB 9, the actuarial analysis was prepared based on the understanding that the State and employer contribution would be increased to 10.0% (9.5% from the State, and 0.5% from state agency appropriations), also for service after August 31, 2015.

FINDINGS AND CONCLUSIONS

According to the actuarial analysis, HB 9 would increase, by 0.68% of payroll, the total normal cost rate of ERS from 11.58% to 12.26%. This increase in the normal cost rate would cause the statutory 31-year amortization total contribution rate to increase from 19.11% to 19.75% of payroll. The proposal would slightly improve the funded ratio of the system from 76.40% to 76.50%.

Additionally, the actuarial analysis discusses the cost-of-living adjustment (COLA) under Texas Government Code Section 814.604. This COLA is required to be made to certain retiree benefits when ERS's amortization period is less than 31 years. At that time, the increase in liability associated with the COLA will increase the plan's amortization period by approximately one year.

The actuarial review states that any proposed increase in pay for ERS active members coinciding with the increase in member contribution rate could slightly increase ERS's amortization period. The actuarial review also notes that the bill increases the plan funding security for all ERS members.

GASB EFFECTS

Although not discussed in the actuarial analysis, the passage of HB 9 (together with an increase in the State plus agency contribution rate to 10%) is likely to have a positive impact on ERS and the State under the new Governmental Accounting Standards Board (GASB) reporting standards (GASB 67 & 68). The increase in the total contribution rate to 19.50% may have the effect of reducing the 8/31/2015 ERS Net Pension Liability (NPL) from its \$14.5 billion (as of 8/31/14) level. The PRB believes that for GASB purposes, the State will be able to project future State, employee and agency funding at the contribution rates put into effect for FY 2016. The likely result, if the total contribution rate is increased to 19.50%, is that no fund exhaustion date or blended discount rate (lower than the assumed rate of return) will be used. In that case, the ERS NPL will be lower than the \$14.5 billion (as of 8/31/2014) level and will be equal to the Entry Age Normal unfunded actuarial accrued liability on a market value of assets basis.

METHODOLOGY AND STANDARDS

The analysis assumes no further changes are made to ERS and cautions that the combined economic impact of several proposals can exceed the effect of each proposal considered

individually. The ERS analysis relies on the participant data, financial information, benefit structure and actuarial assumptions and methods used in the ERS actuarial valuation for August 31, 2014 and mid-year valuation as of February 28, 2015. According to the PRB actuary, the actuarial assumptions, methods and procedures used in the analysis appear to be reasonable. All actuarial projections have a degree of uncertainty because they are based on the probability of occurrence of future contingent events. Accordingly, actual results will be different from the results contained in the analysis to the extent actual future experience varies from the experience implied by the assumptions.

SOURCES

Actuarial Analysis by Mr. R. Ryan Falls, FSA, EA, MAAA and Mr. Joseph P. Newton, FSA, EA, MAAA; Senior Consulting Actuaries, Gabriel Roeder Smith & Company, March 18, 2015.

Actuarial Review by Robert M. May, FSA, EA, MAAA, Board Actuary; and Mr. Daniel P. Moore, FSA, EA, MAAA, Staff Actuary, Pension Review Board, March 21, 2015.

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