

Senate Finance Interim Hearing

Pension Funding Progress

March 30, 2016

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Executive Director



ERS supports state employees and retirees by offering competitive benefits at a reasonable cost.



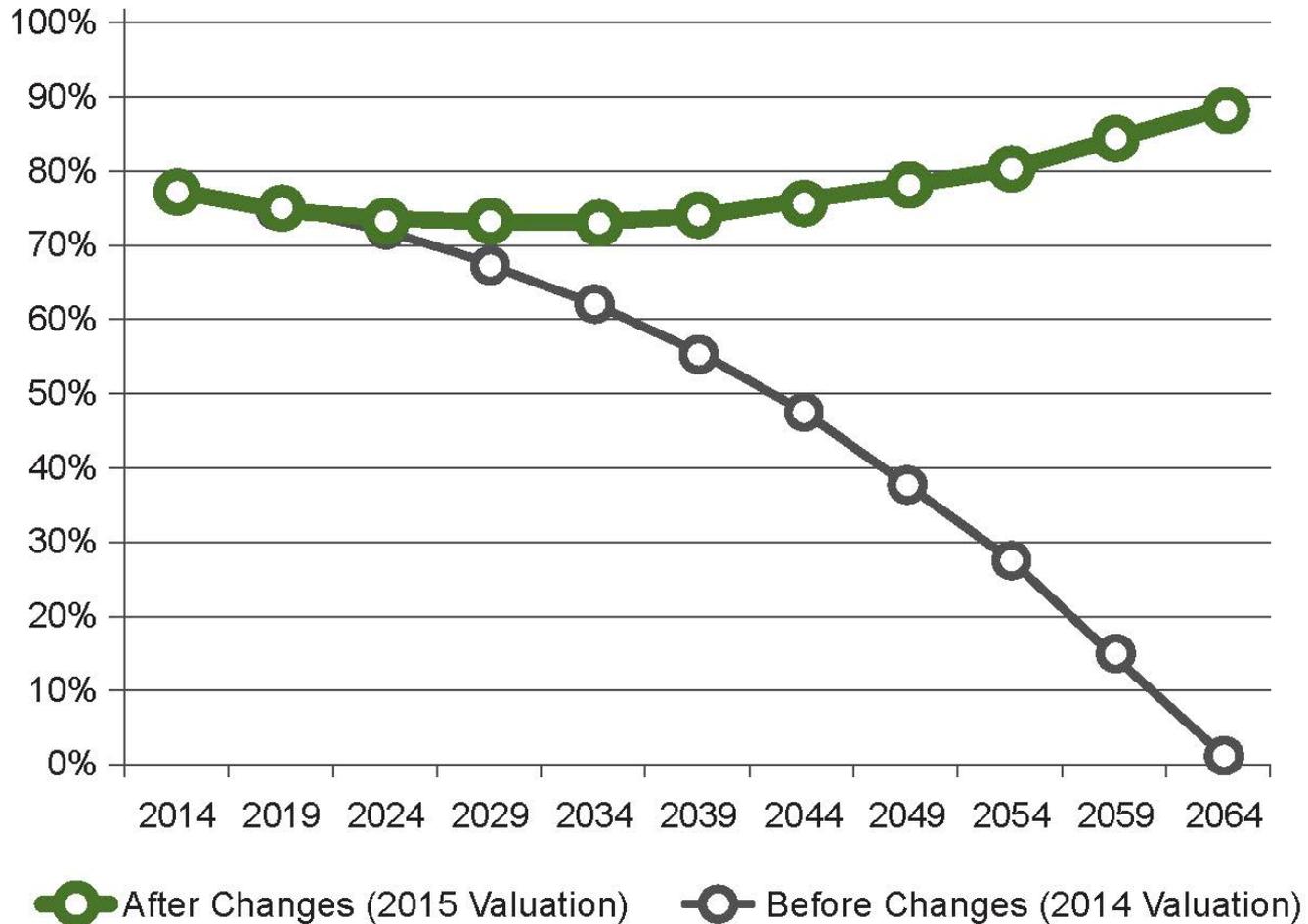
Retirement Update

ERS Retirement Trust Fund Projections

FY14 vs. FY15 Valuation

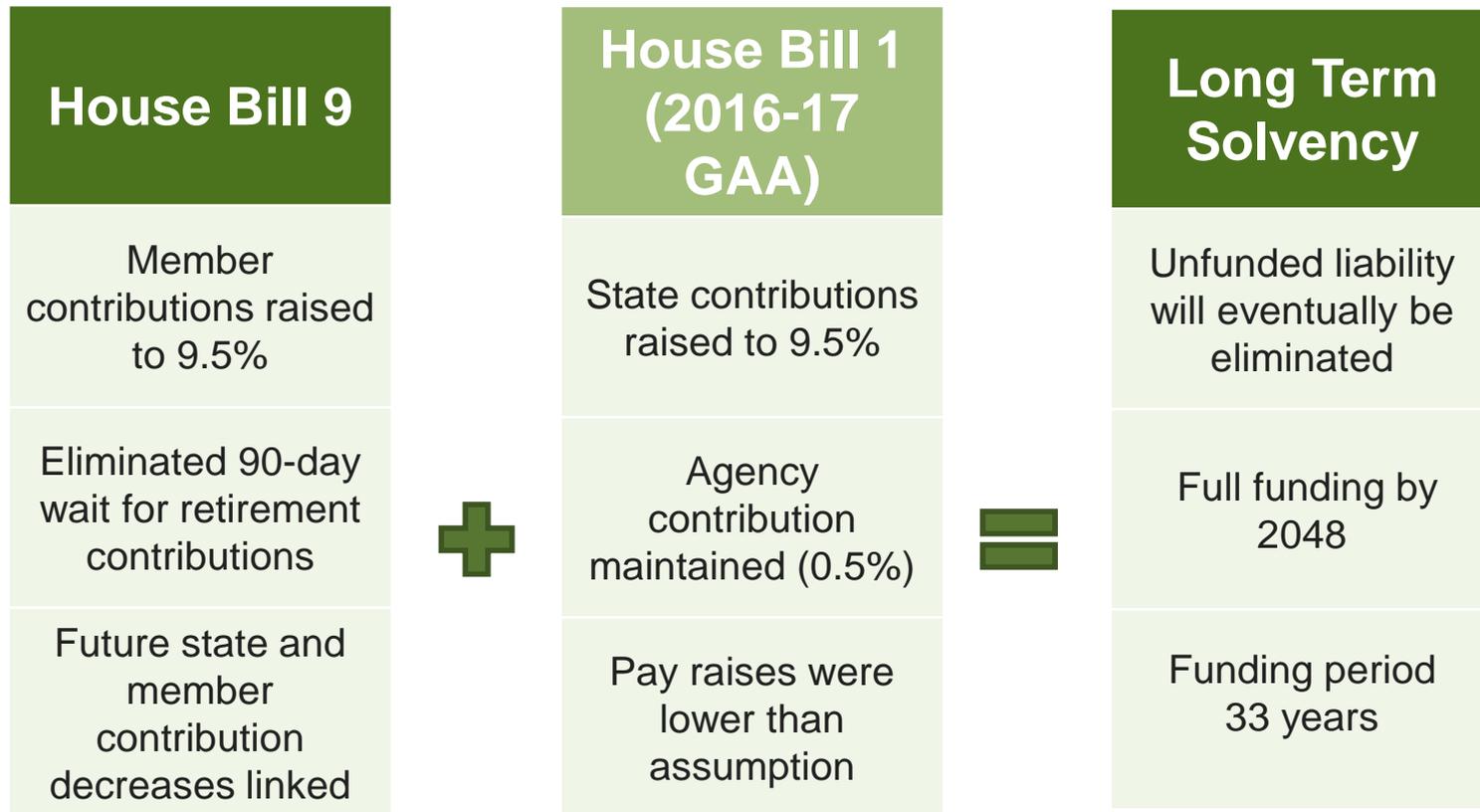


Funded Ratio Before and After Changes by the 84th Legislature



2015 Legislative Changes

A Sound Path for the ERS Pension Trust



Bottom line: Contribution increases and the elimination of the 90-day waiting period for retirement contributions primarily impact the funding projections and estimated funding periods. In the short term, these changes have minimal impact on current liability and funded ratio. The normal cost rate (base benefit cost) also slightly increased due to impact on member refunding behavior.

Contribution and Benefit Cost Rates



Key terms for cost rates:

- Normal Cost Rate – The base benefit cost for an employee
- Actuarially Sound Contribution (ASC) Rate – Rate needed to pay normal cost + pay off unfunded liabilities within 31 years; related to Texas Government Code 811.006.

Rates (% of payroll)	ERS	LECOSRF	JRS 2
As of August 31, 2015 – Current Valuation			
Normal Cost Rate	12.27%	1.77%	21.40%
ASC Rate	19.62%	3.01%	23.79%
Contribution Rates for FY16			
State	9.50%	0.5%	15.66%
Agency	0.50%	0.0%	0.0%
Member	9.50%	0.50%	7.16%
Dedicated Revenue (Court Cost)	0.0%	1.20%	0.0%
Total	19.50%	2.20%	22.82%
Contribution Sufficiency* (Total – ASC Rate)	(0.12%)	(0.81%)	(0.97%)

*A negative figure indicates the total contribution rate is less than the amount needed to meet the ASC rate.

Pension Plan Annual Check-up

The Purpose of an Actuarial Valuation



- Prepared as of August 31, 2015 using member data, financial data, benefit and contribution provisions, actuarial assumptions and methods as of that date
- Purpose:
 - Measure the actuarial liabilities and funding levels
 - Determine adequacy of current statutory contributions
 - Provide other information for reporting
 - GASB 67/68, Consolidated Annual Financial Report
 - Explain changes in actuarial condition of the plans
 - Track changes over time
 - Analyze future outlook

Summary of Actuarial Valuation Results

Comparing 2015 to 2014



Valuation Metrics	ERS	LECOSRF	JRS 2
As of August 31, 2015 – Current Valuation			
Actuarial Accrued Liability	\$33.9 B	\$1.3 B	\$404 M
Actuarial Value of Assets	\$25.9 B	\$909 M	\$373 M
Unfunded Liability	\$8.0 B	\$353 M	\$31 M
Funded Ratio	76.3%	72.0%	92.2%
Funding Period	33	Infinite	Infinite
As of August 31, 2014 – Prior Valuation			
Actuarial Accrued Liability	\$32.9 B	\$1.2 B	\$386 M
Actuarial Value of Assets	\$25.4 B	\$884 M	\$348 M
Unfunded Liability	\$7.5 B	\$323 M	\$38 M
Funded Ratio	77.2%	73.2%	90.2%
Funding Period	Infinite	Infinite	Infinite

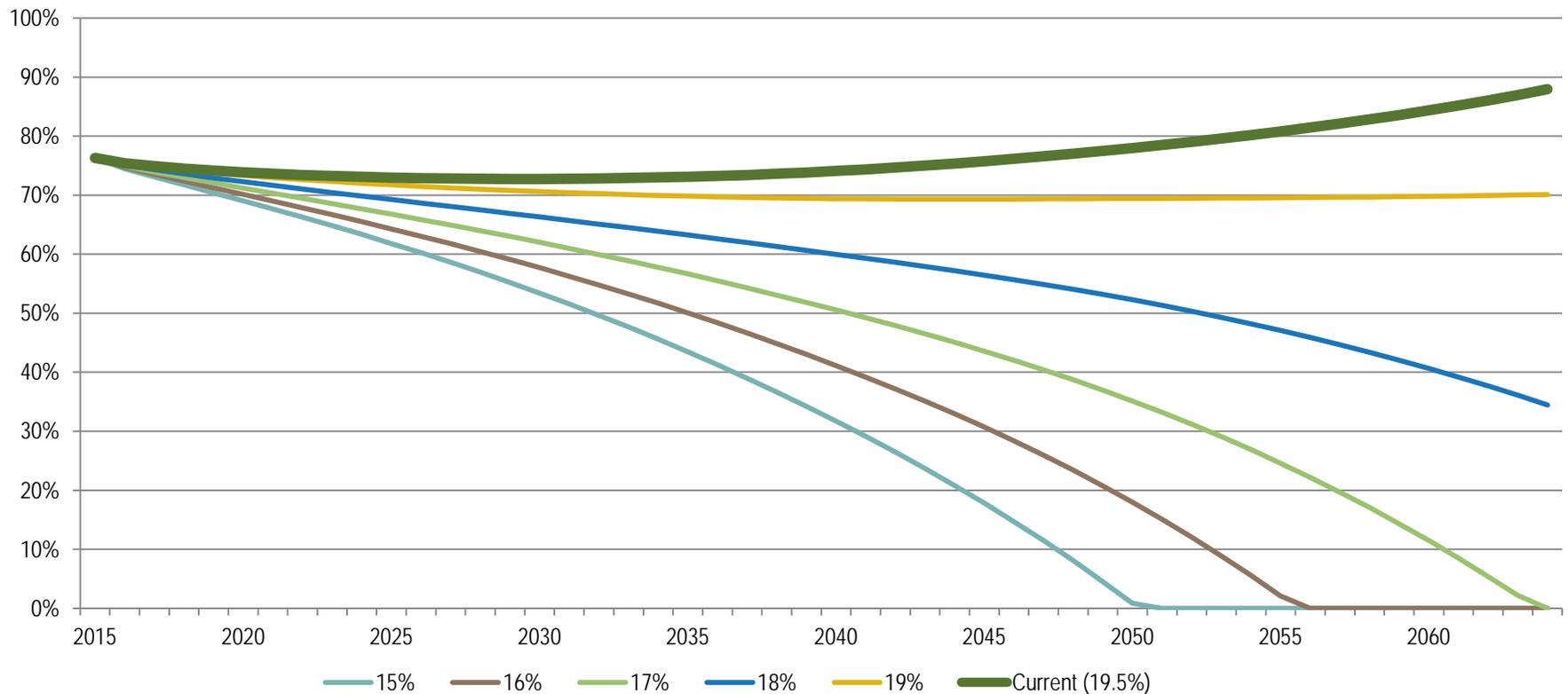
When a plan has unfunded liabilities, **funding period** (the number years to payoff unfunded liabilities) is the most important metric. It shows where a plan is headed. By contrast, funded ratio shows where a plan has been. A plan can have a high funded ratio but still be on a path to deplete, as seen with JRS 2.

ERS Is Now on a Sound Path

Contributions Must Be Maintained



ERS Retirement Trust Fund Projections
Funded Ratio at Various Contribution Rates, FY15 to FY64



The plan is leveraged on annual, ongoing contributions. Unless the state makes a large lump-sum deposit to pay down unfunded liabilities more quickly, it is crucial to maintain the current contribution rates until fully funded.

Pension Funding Summary



Key Takeaways

- Contribution rate increases and plan changes from the 2015 legislative session put the ERS Trust Fund on the path to solvency
 - However, there is very little margin for adverse plan experience or decreases in contributions
 - Current contributions are less than the actuarially sound contribution (ASC) rate
- For LECOSRF and JRS 2, current statutory rates are not sufficient to sustain the systems
 - Without an increase of contributions over the current schedule, or a reduction of benefits, the funded status will continue to decline
- 30-year gross return of 8.29% (as of FY15)
 - Actuarial assumption is 8.0%
 - 1-year gross return of 0.49% during FY15
 - Unrecognized losses of \$1.9 billion will need to be recognized in future years if not offset by future market returns in excess of 8.0%.



Increase Revenue

- Higher annual ongoing contributions
- Dedicated revenue sources
- Lump-sum cash deposit



Decrease costs

- More benefit changes
- Apply changes to current employees

Buying Future Budget Flexibility

Lump-Sum Deposit Would Get the Plans to 100% Funded Sooner



As of August 31, 2015

ERS Plan has an unfunded liability of \$8.0 billion – if paid off, the plan would be 100% funded.

\$1.0 billion lump-sum payment to the **ERS Plan** reduces the ASC* rate by 0.92%.
0.92% of payroll is equal to about \$61 million** annually.

LECOSRF Plan has an unfunded liability of \$354 million – if paid off, the plan would be 100% funded.

\$300 million lump-sum payment to the **LECOSRF Plan** reduces the ASC* rate by 1.0%.
1.0% of payroll is equal to about \$18 million** annually.

JRS 2 Plan has an unfunded liability of \$32 million – if paid off, the plan would be 100% funded.

\$14 million lump-sum payment to the **JRS 2 Plan** reduces the ASC* rate by 1.0%.
1.0% of payroll is equal to about \$122,000** annually.

**ASC = Actuarially sound contribution, based on paying off unfunded liabilities with a 31-year period.*

***These estimates are based on the 8/31/15 valuation and the FY16 payroll. These amounts may differ from any requests in the ERS 2018-19 LAR, which will be prepared during Summer 2016.*

Appendix: Retirement

Retirement Program Membership by Plan



Who participates in our plans?

ERS	LECOSRF*	JRS2	JRS1
Regular Class State Employees	Law Enforcement Officers <ul style="list-style-type: none"> • <i>DPS Troopers</i> • <i>TPWD Game Wardens and Park Police</i> • <i>TABC Agents</i> 	Judges, justices and commissioners serving on the Supreme Court, appellate courts, district court or for specified commissions	Judges, justices and commissioners serving on the Supreme Court, appellate courts, district court or for specified commissions
Law Enforcement and Custodial Officers <i>(specific position covered explained LECOSRF column)</i>	Custodial Officers (TDCJ) <ul style="list-style-type: none"> • <i>Correctional officers</i> • <i>Other positions with routine offender contact</i> • <i>Parole officers</i> 	Began eligible service September 1, 1985 or later	Began eligible service August 31, 1985 or earlier
Elected Officials <ul style="list-style-type: none"> • <i>Legislature</i> • <i>Statewide (Governor, Lt. Gov., Comptroller, etc.)</i> • <i>District Attorneys</i> 			

*Members of LECOSRF are also members of ERS. They receive about 80% of their annuities from the ERS trust and 20% from LECOSRF.

Summary of Demographic Results by Plan

As of August 31, 2015



Valuation Metrics	ERS	LECOSRF*	JRS 2
Active Members			
Active Contributing Members	142,409	38,526	563
Average Age (8/31/15)	43.6	41.7	56.9
Average Entry Age	34.8	33.3	47.6
Average Years of Service	8.8	8.4	9.3
Average Annual Salary	\$44,990	\$41,957	\$142,721
Annuitants			
Retirees and beneficiaries	100,003	10,845	322
Average annual annuity	\$19,402	\$5,291	\$63,599
Average Years of Service**	22.2	23.8	15.2
Average Age (8/31/15)**	68.3	61.9	68.4
Average Age at Retirement**	58.3	53.9	62.7

**Members of LECOSRF are also members of ERS. They receive about 80% of their annuities from the ERS trust and 20% from LECOSRF.*

***Annuitant demographics are based on service retirements.*

Future Pension Policy Considerations

2017-18 Pension Experience Study



The study may affect funding status if assumptions change. Assumptions reviewed include:

Demographic	Economic	Other
Mortality	Inflation	Administrative expenses
Retirement	Real rate of return	Account refund/withdrawal upon termination
Termination	Salary increases	Payment option elections
Disability	Payroll growth	
Service credit		

In addition, an experience study provides an opportunity to review any current methodologies, such as the actuarial cost method and the asset smoothing method.

Future Pension Policy Considerations

Cost-of-Living Adjustments (COLAs)



Ad-hoc, retroactive benefit enhancements create an unfunded liability for the ERS Plan Trust.

Existing mandatory COLA

Government Code 814.604 includes a mandatory COLA equal to the lesser of 3% or \$100 per month for those retirees who have been retired 20 years or more at the time the COLA is triggered.

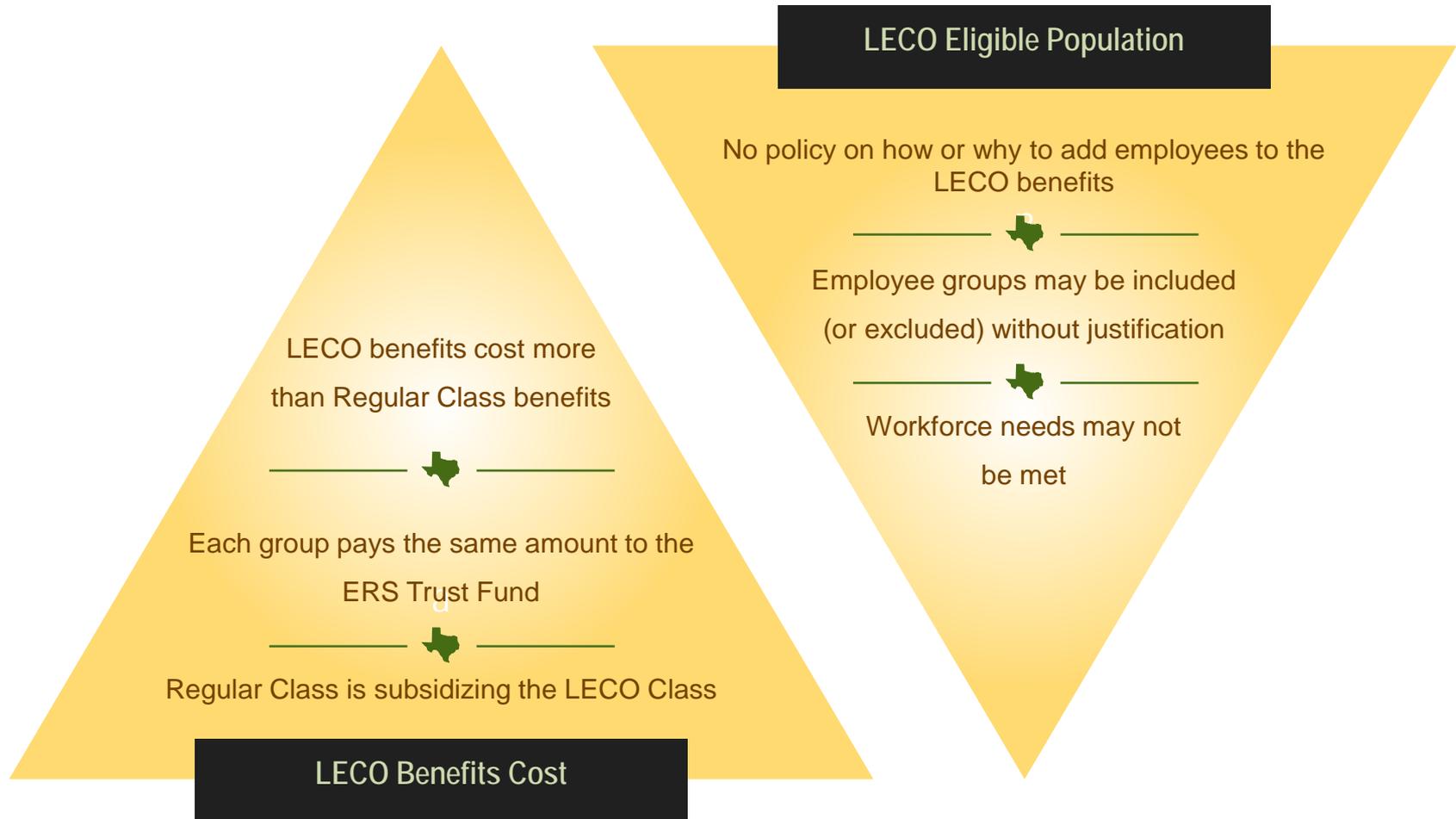
- Can only be paid when the plan is actuarially sound and if it will remain sound after COLA is granted.
- It is not expected to be paid within the next four years.
- Estimated impacts are based on the 8/31/15 valuation and assume a hypothetical trigger date of December 2016; shown for illustrative purposes only.

Actuarial Metrics	
Actuarial Accrued Liability	\$59.1 million
Unfunded Liability	\$59.1 million
ASC Rate	0.05%
Normal Cost Rate	No change
Annuitants Receiving COLA*	
Number	16,700
Percent affected	16.7%
Cost to ERS Trust	
Annual Annuity Payroll	\$9.5 million

**Out of 100,003 annuitants as of 8/31/15.*

Future Pension Policy Considerations

Law Enforcement and Custodial Officer (LECO) Benefits



Cost of Benefits by Employee Type

Regular Class Compared to Law Enforcement/Custodial Officers (LECO)



LECO employees receive a more expensive retirement benefit than Regular Class employees.

- LECO employees retire at an earlier age.
- The combined ERS and LECOSRF benefits makes the LECO benefit 25% more valuable than what Regular Class employees receive.
- The base LECO benefit cost (normal cost) is 2.42% higher than the Regular Class benefit.
- When paying off the unfunded liability is considered, the Actuarially Sound Contribution (ASC) rate is 4.77% higher.
- Future contribution rates could be structured to fully address the cost differential to prevent Regular Class employees from subsidizing LECO employees.

Valuation Metrics as of 8/31/15	Regular Class	LECO
Actuarial Accrued Liability	\$26.7 B	\$8.4 B
Actuarial Value of Assets	\$21.0 B	\$5.7 B
Unfunded Liability	\$5.7 B	\$2.7 B
Funded Ratio	78.7%	68.1%
Funding Period	29	76
Normal Cost Rate	12.10%	14.52%
ASC Rate	19.16%	23.93%
Contribution Rates for FY16		
State	9.50%	11.20%
Agency	0.50%	0.50%
Member	<u>9.50%</u>	<u>10.00%</u>
Total	19.50%	21.70%
Contribution Sufficiency*	0.34%	(2.23%)

*The positive figure for the Regular Class indicates the member class total contribution is higher than needed based on the 31-year ASC rate standard set by Government Code 811.006. The negative figure for the LECO class indicates the total contribution rate is less than the amount needed to meet the ASC rate.

Demographic Results by Population

As of August 31, 2015



Valuation Metrics	Regular Class	LECO
Active Members		
Active Contributing Members	103,883	38,526
Average Age (8/31/15)	44.3	41.7
Average Entry Age	35.4	33.3
Average Years of Service	8.9	8.4
Average Annual Salary	\$46,115	\$41,957
Annuitants		
Retirees and beneficiaries	83,028	16,975
Average annual annuity	\$19,292	\$23,320
Average Years of Service**	22.5	21.5
Average Age (8/31/15)**	69.3	63.7
Average Age at Retirement**	59.0	55.4

**Annuitants with at least 10 years of Certified Peace Officer (CPO) service are identified as LECO annuitants. These headcounts are shown for illustration purposes and do not directly relate to the methods used to allocate individual liabilities to the two resulting plans.*

***Annuitant demographics are based on service retirements.*

Comparison of Funding and GASB Methodologies for the ERS Plan



GASB addresses accounting and reporting requirements, not funding calculations

Metric	Funding*	GASB
Asset Value	\$25.9 billion	\$24.0 billion
Total Liability	\$33.9 billion	\$37.3 billion
Unfunded Liability	\$8.0 billion	\$13.3 billion

**This standard is used to determine contribution rates and legislative appropriations requests. This approach creates more stable contribution rates and is based on a smoothed asset value.*

***Table based on actuarial valuation as of August 31, 2015*

Appendix: Investments

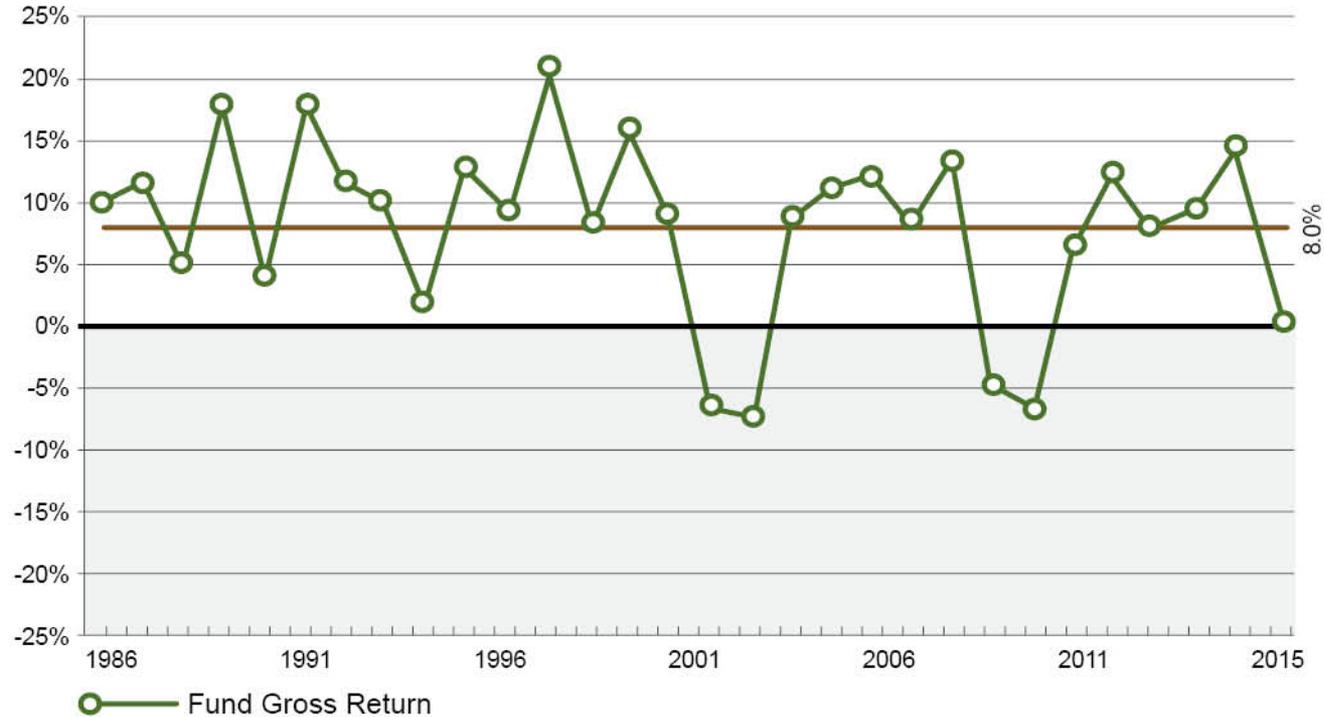
Investment Performance*

Long-term focus and recent returns



Trust Fund Investment Performance (Gross)

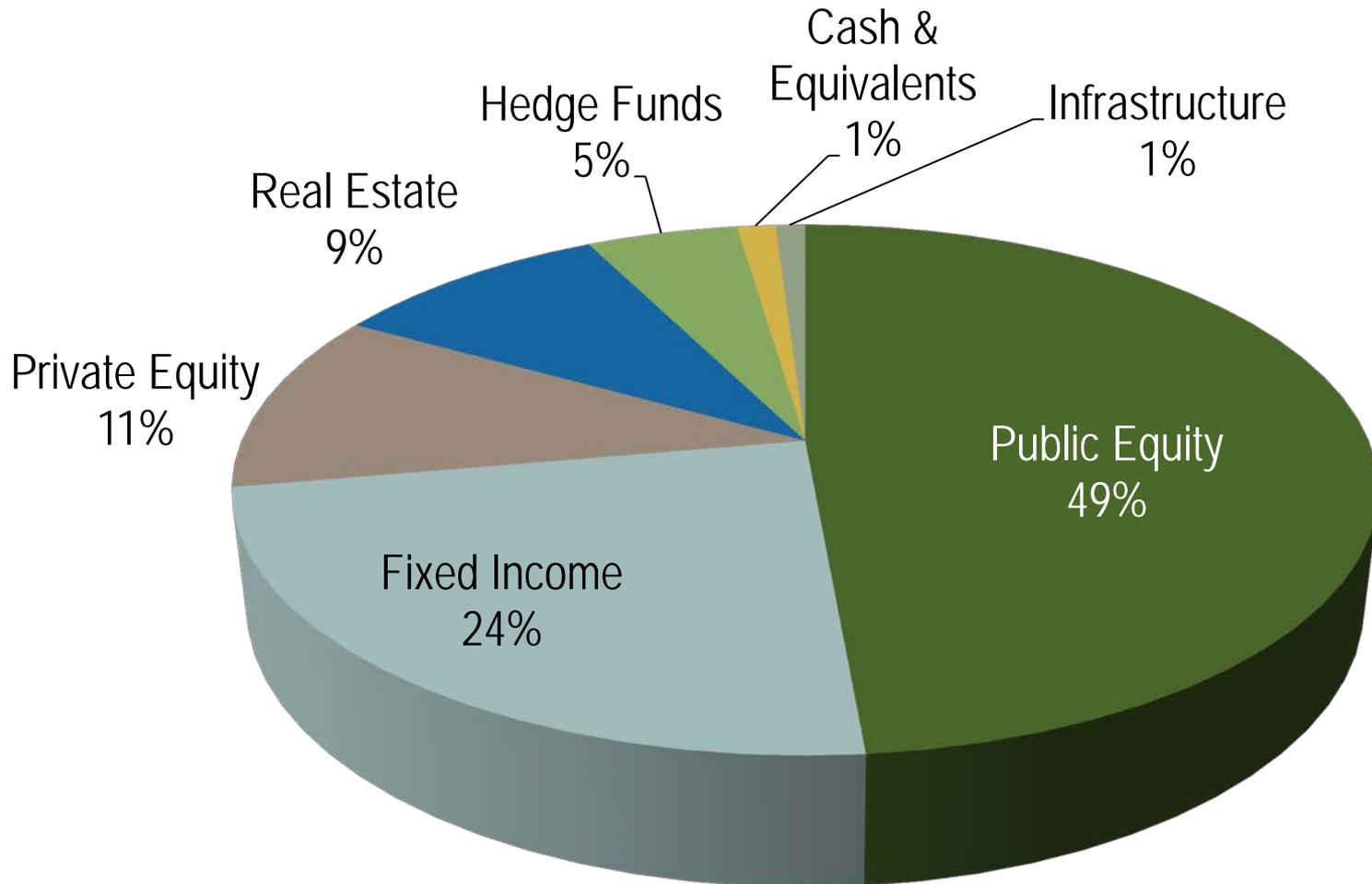
30-year	25-year	10-year	5-year	3-year	1-year
8.29%	7.93%	6.18%	9.10%	8.26%	0.49%



**As of August 31, 2015*

Allocating Assets Across Investment Classes

Total Fund Amount: \$25.2 Billion*



*Fund amount and asset allocation are as of August 31, 2015.

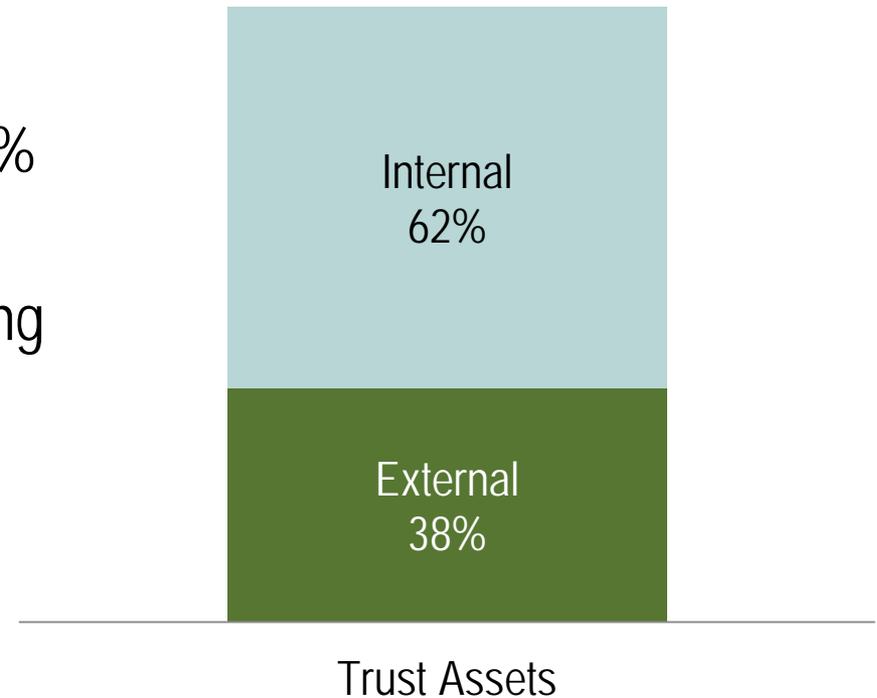
Internal and External Management

As of August 31, 2015



- The majority of the ERS trust is internally managed.
- Internal management costs are less than 0.10%.
- External management fees are 0.40% on average.
- ERS spent \$34.4 million in fees during FY15.
 - \$19.7 million internal
 - \$14.7 million external

How ERS Trust Assets are Managed



Investing in Texas

30% of ERS Trust investments are in Texas-based companies or companies with more than 200 Texas employees.

