

House Committee on Pensions

Update on ERS Programs

March 30, 2016

Porter Wilson

Executive Director



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



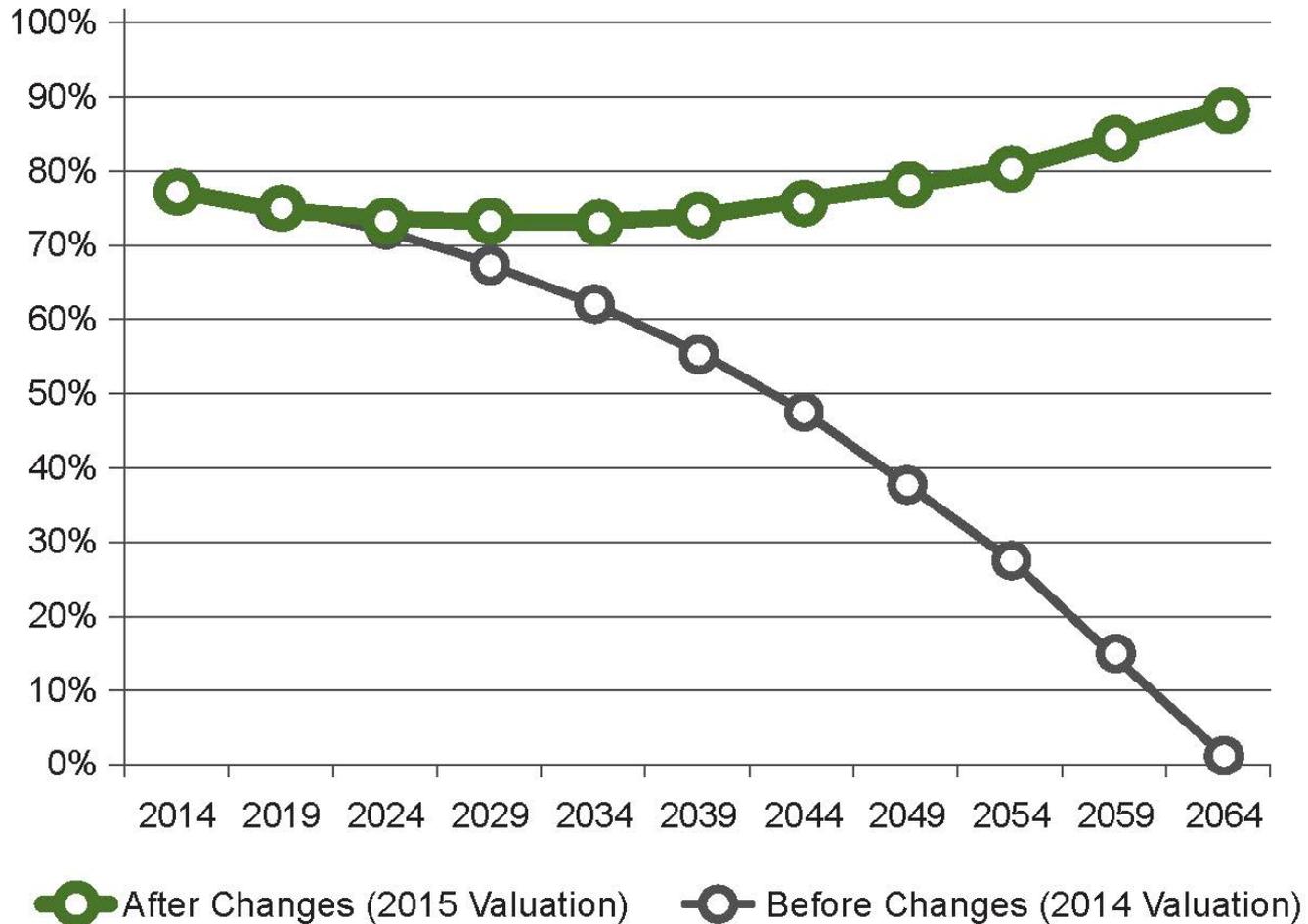
Retirement Update

ERS Retirement Trust Fund Projections

FY14 vs. FY15 Valuation

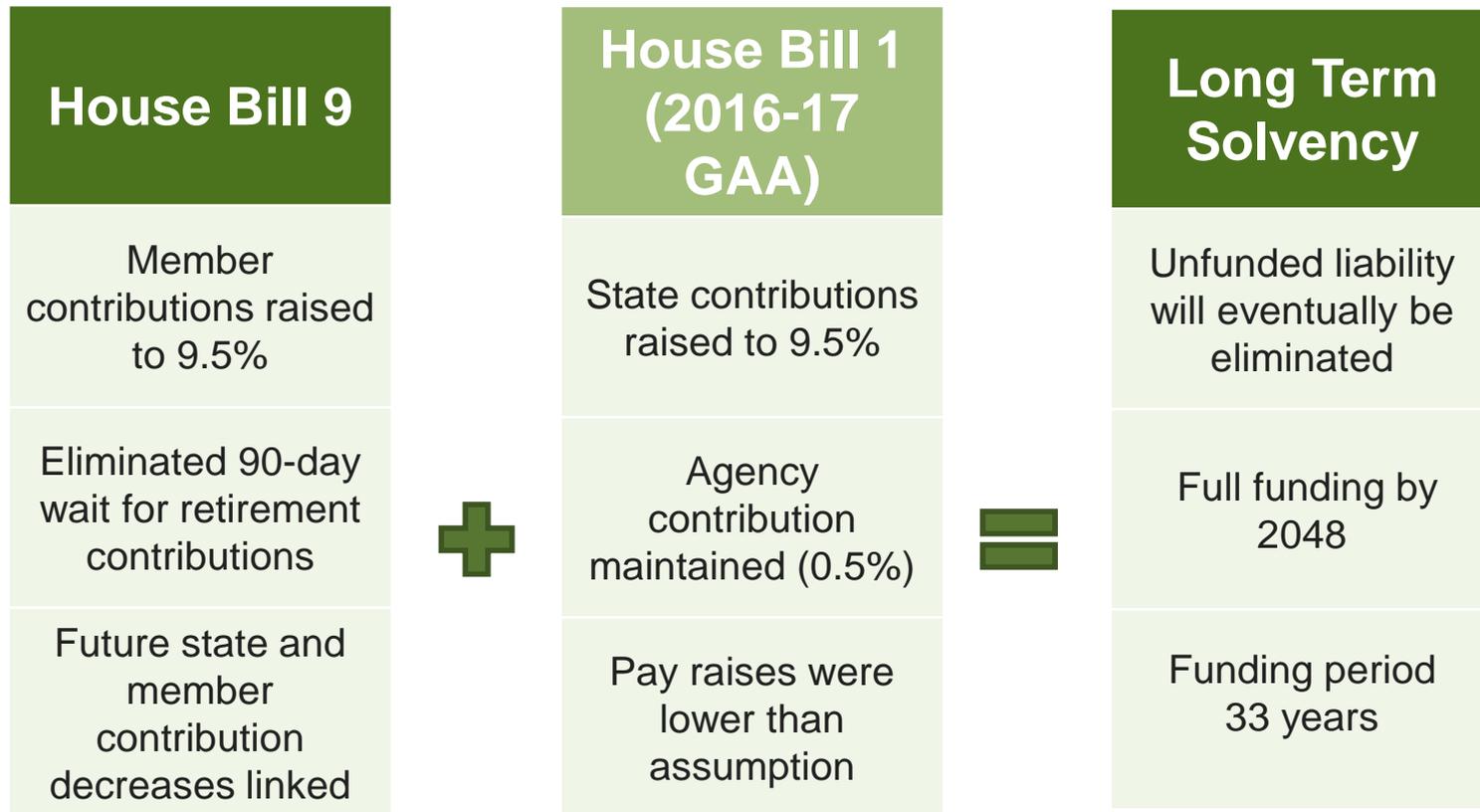


Funded Ratio Before and After Changes by the 84th Legislature



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 |

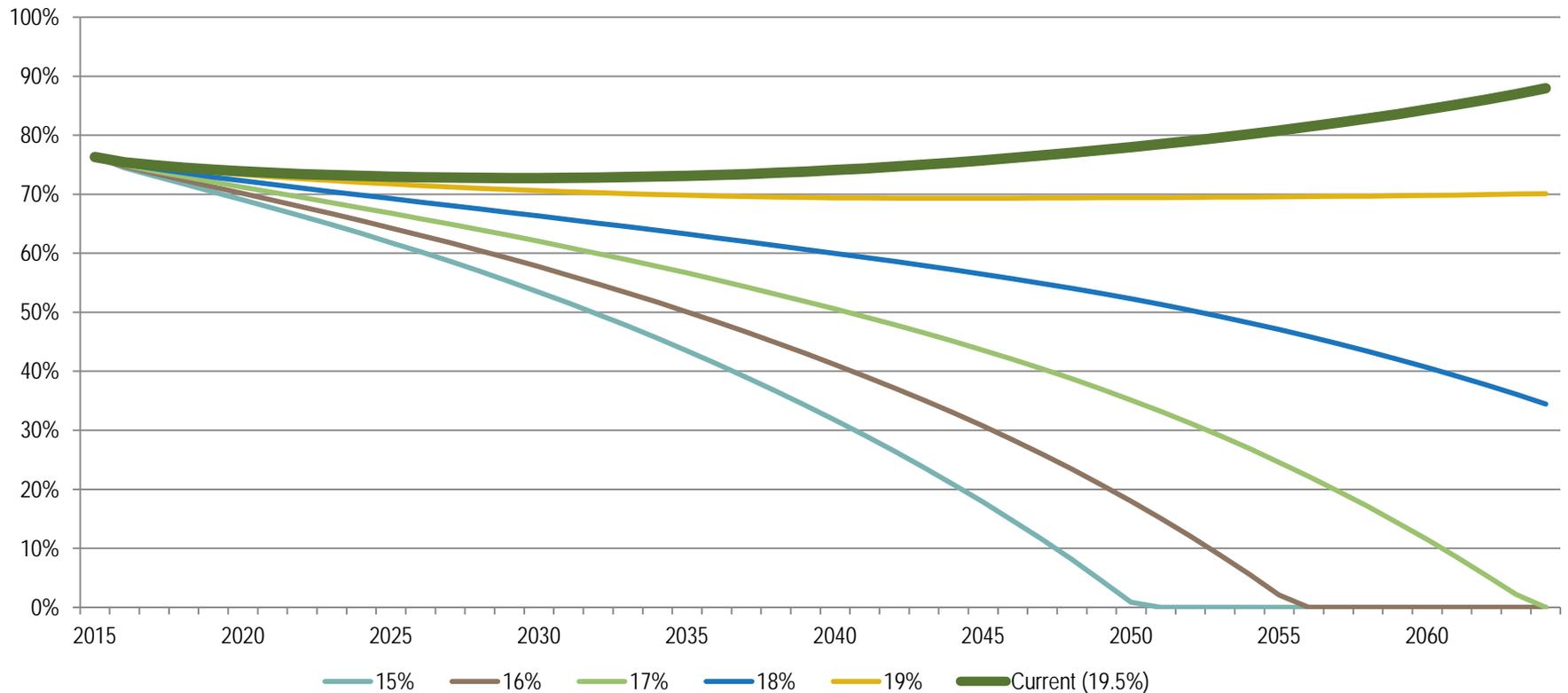
When a plan has unfunded liabilities, **funding period** (the number years to payoff unfunded liabilities) is the most important metric. It shows where a plan is headed. By contrast, funded ratio shows where a plan has been. A plan can have a high funded ratio but still be on a path to deplete, as seen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

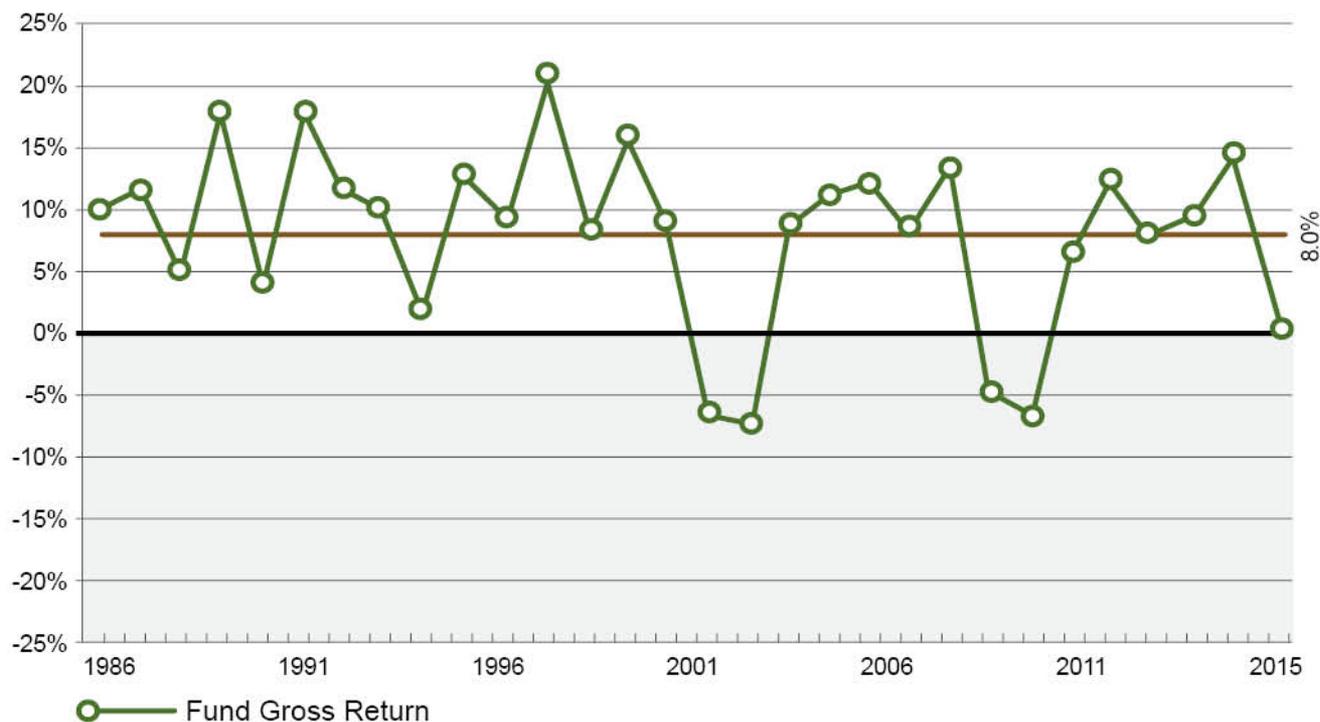
Investments Update

Investment Performance*

Long-term focus and recent returns

Trust Fund Investment Performance (Gross)

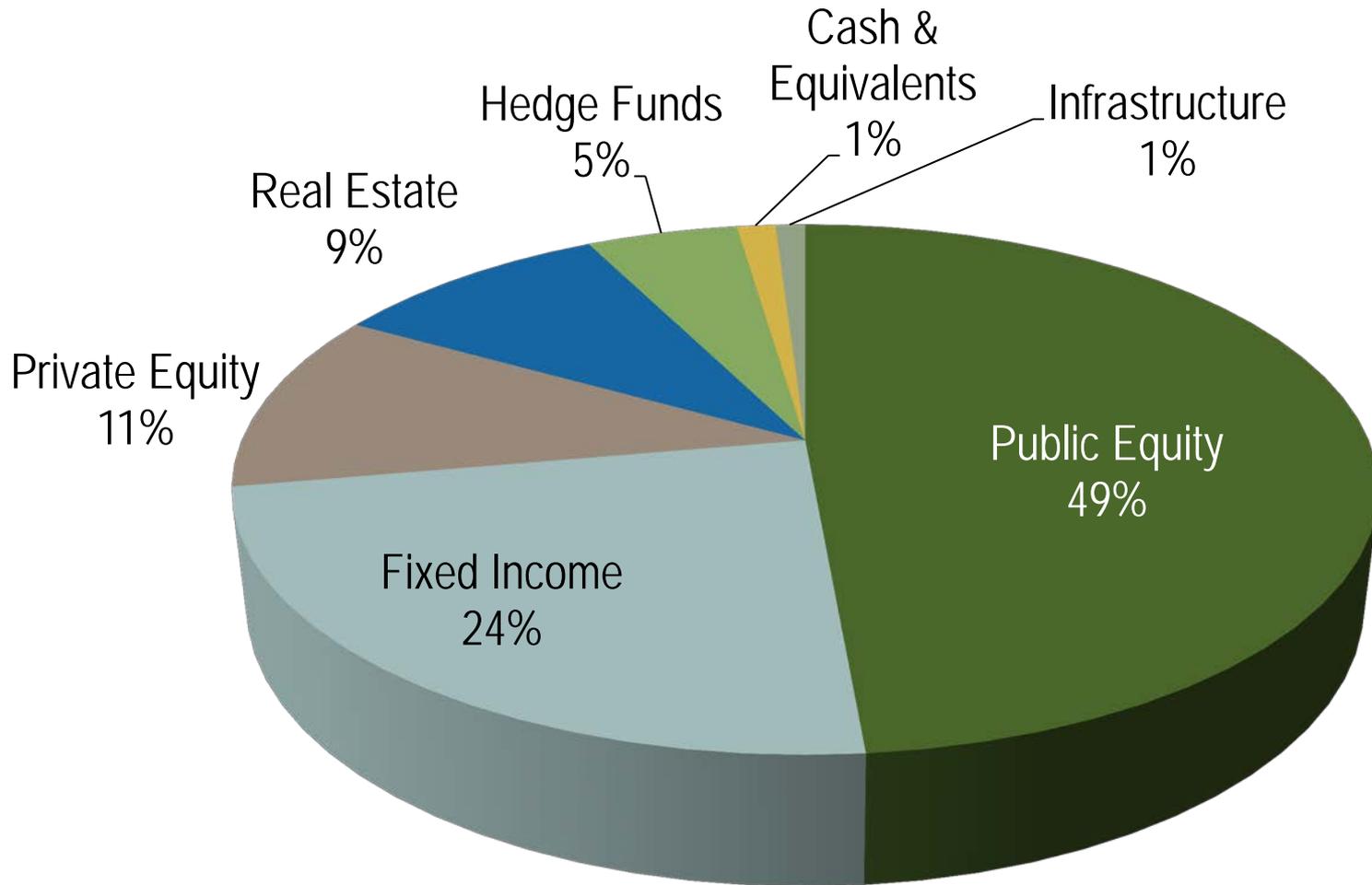
| 30-year | 25-year | 10-year | 5-year | 3-year | 1-year |
|---------|---------|---------|--------|--------|--------|
| 8.29% | 7.93% | 6.18% | 9.10% | 8.26% | 0.49% |



**As of August 31, 2015*

Allocating Assets Across Investment Classes

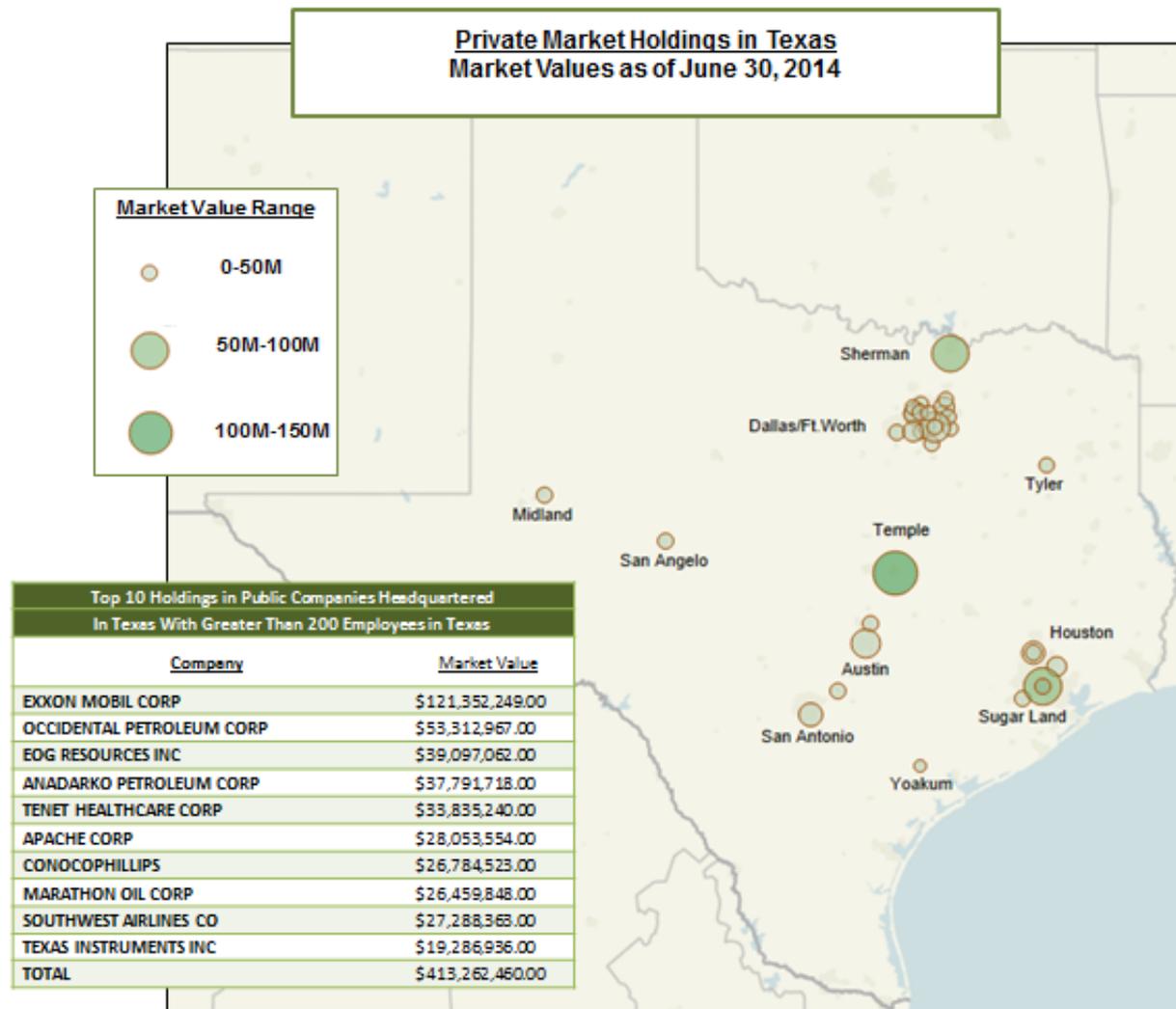
Total Fund Amount: \$25.2 Billion *



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

Investing in Texas

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



Group Benefits Program (GBP) Update

New HealthSelect Program – Now Available

Virtual Visits



Virtual diagnostic consultations with a physician for \$10 copay

- See and speak to doctor from mobile device or computer
- Access through “myuhc.com” or “health4me” phone app
- Make appointments online; no primary-care referral needed
- Connect to Texas doctors with “Doctors on Demand”
- Good for non-emergency medical care:
 - Cough/cold, migraine, sore throat, stomach ache, or injury assessment



New HealthSelect Program – Now Available

Real Appeal Diabetes Prevention Program



- **Online, virtual program focused on weight loss**
 - Free personalized clinical plan and tool kit
 - Up to 52-weeks of online coaching sessions and unlimited use of web-based interactive tools
- **Pay-for-performance** – The plan is only billed if participants attend weekly sessions and lose weight
- **NO COST** for qualified HealthSelect participants

real appeal

12% of
HealthSelect adult
population is diabetic

27% of
HealthSelect spending
is on diabetes

Group Benefits Program Contracts

Upcoming RFPs and Contracts



| Program Name | Description | Target Effective Date |
|--|--|-----------------------|
| New Vision Care Benefit | The Group Vision Care Plan will offer benefits for routine eye care services (i.e. eye exams, contact lenses, corrective vision glasses) | 9/1/2016 |
| New Episode-Based Bundled Payments | Episode-based bundling is a new form of payment for health care services. It allows for a single discounted price that encompasses all aspects of the episode of care (i.e. diagnostic tests, pre-operative visits, surgeon fees, facility costs, etc.). | 11/1/2016 |
| HealthSelect Pharmacy Benefits Manager (PBM) | The PBM administers the HealthSelect Prescription Drug Program and the Employer Group Waiver Plan (EGWP + Wrap) | 1/1/2017 |
| HealthSelect Third Party Administrator (TPA) | The TPA administers health care benefits and/or services for the HealthSelect program. This includes claims processing, network management and utilization review. The TPA will manage both the HealthSelect plan and the CDHP. | 9/1/2017 |

Consumer-Directed Health Plan Update

Implementing a Consumer-Directed Health Plan (CDHP)



- HB 966 (84R) directs ERS to offer an optional consumer-directed health plan that combines a high-deductible health plan (HDHP) with a health savings account (HSA)
- HealthSelect CDHP will be available as a health plan choice beginning 9/1/2016
- Legislation has two important provisions:
 - ERS must implement as **revenue neutral** as possible
 - ERS may not divide the risk pool of traditional health plan and new CDHP
- UnitedHealthcare will administer the HDHP and the HSA

HDHPs and Health Savings Accounts (HSAs)

2016 IRS Requirements



| Minimum Deductible (in-network)* | Out-of-Pocket Expense Maximum (in-network)* | HSA Contribution Maximums** |
|----------------------------------|---|--|
| \$1,300 Single coverage | \$6,550 Single coverage | \$3,350 Single coverage |
| \$2,600 Family coverage | \$13,100 Family coverage | \$6,750 Family coverage |
| | Includes deductible | Additional \$1,000 catch-up permitted for individuals age 55-64 |

**Out-of-network deductibles and expense maximums are typically double the amount of network benefits.*

***Contributions must stop once an individual is enrolled in any type of Medicare coverage.*

High-Deductible Health Plan

Plan Design - Beginning September 1, 2016



| In-Network Deductible Individual / Family | Estimated Monthly Employer Deposit to HSA Individual / Family* | % Reduction in Dependent Contribution Compared to HealthSelect | Example of Impact on Dependent Spouse Contribution H/S in FY17 = \$353.34 |
|---|--|--|---|
| \$2,100 / \$4,200 | \$45 / \$90 | -10% | \$318.00 |

- Plan will operate as a network PPO – no need for primary care referrals to specialists
- In-network deductible is \$2,100 / \$4,200
- Out-of-network deductible is \$4,200 / \$8,400
- In-network out-of-pocket maximum is \$6,550 / \$13,100
- Out-of-network out-of-pocket maximum is \$13,100 / \$26,200
- Preventive services are covered at 100% not subject to the deductible

*Estimated based on expected FY17 rates following May 2016 board adoption.

Appendix

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.

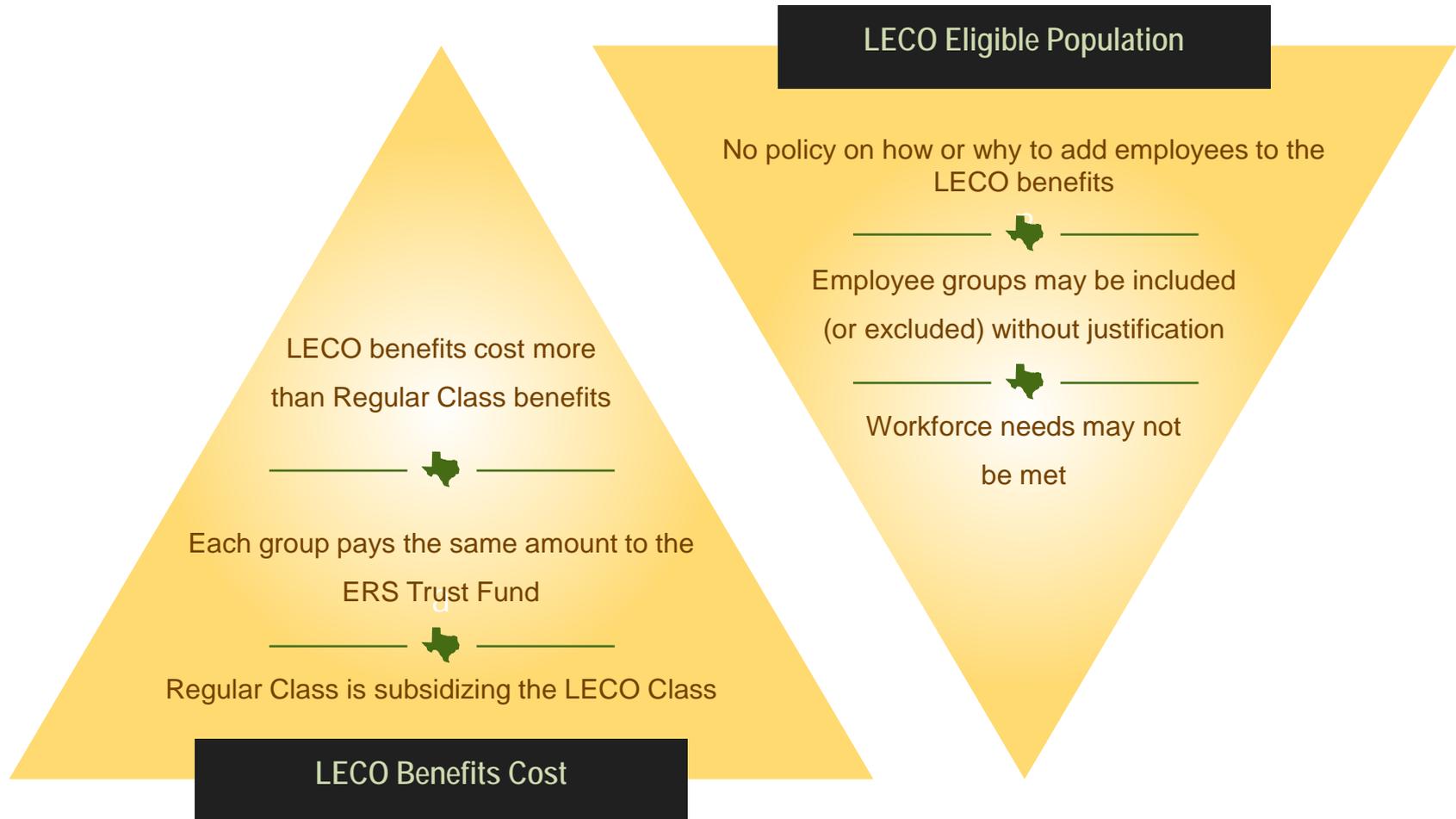
- Can only be paid when the plan is actuarially sound and if it will remain sound after COLA is granted.
- It is not expected to be paid within the next four years.
- Estimated impacts are based on the 8/31/15 valuation and assume a hypothetical trigger date of December 2016; shown for illustrative purposes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