

House Committee on Appropriations Subcommittee on Articles I, IV & V

Pension Funding Progress
April 20, 2016

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Executive Director



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



Retirement programs at a glance

Fiscal Year 2015



Three Defined Benefit Plans and One Supplemental Plan

	ERS	LECOSRF*	JRS 2	JRS 1
Contributing employees	142,409	38,526	563	10
Non-contributing employees	101,122	12,962	148	3
Retirees / beneficiaries	100,003	10,845	322	391
Total Annuity Payments: \$2.1 Billion for all plans				

Average ERS Plan Contributing Employee

- 43.6 years old
- 8.8 years of service
- Salary of \$44,990 per year
(or \$3,749 per month)
- Begin state service at 34.8 years old

Average ERS Plan Retiree

- 68.3 years old
- 22.2 years of service
- Annuity of \$19,402 per year
(or \$1,617 per month)
- Retired at 58.3 years old

*Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOSRF) members are included in ERS membership
All numbers as of August 31, 2015

Retirement Program Membership by Plan



Who participates in our plans?

ERS	LECOSRF*	JRS 2	JRS 1
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 positions covered explained in 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> 			

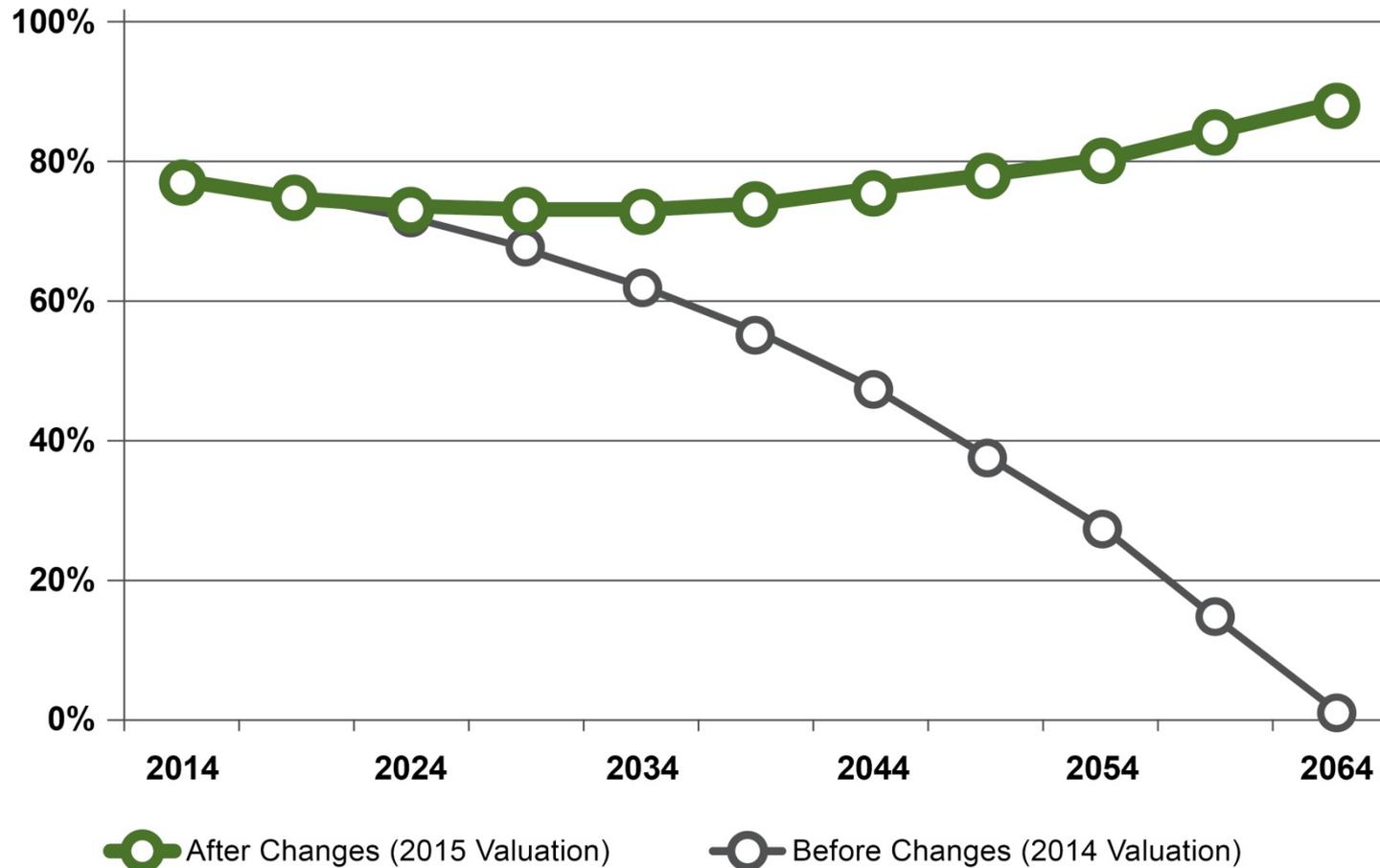
*Members of LECOSRF are also members of ERS. They receive about 80% of their annuities from the ERS trust and 20% from LECOSRF.

ERS Retirement Trust Fund Projections

FY14 vs. FY15 Valuation*



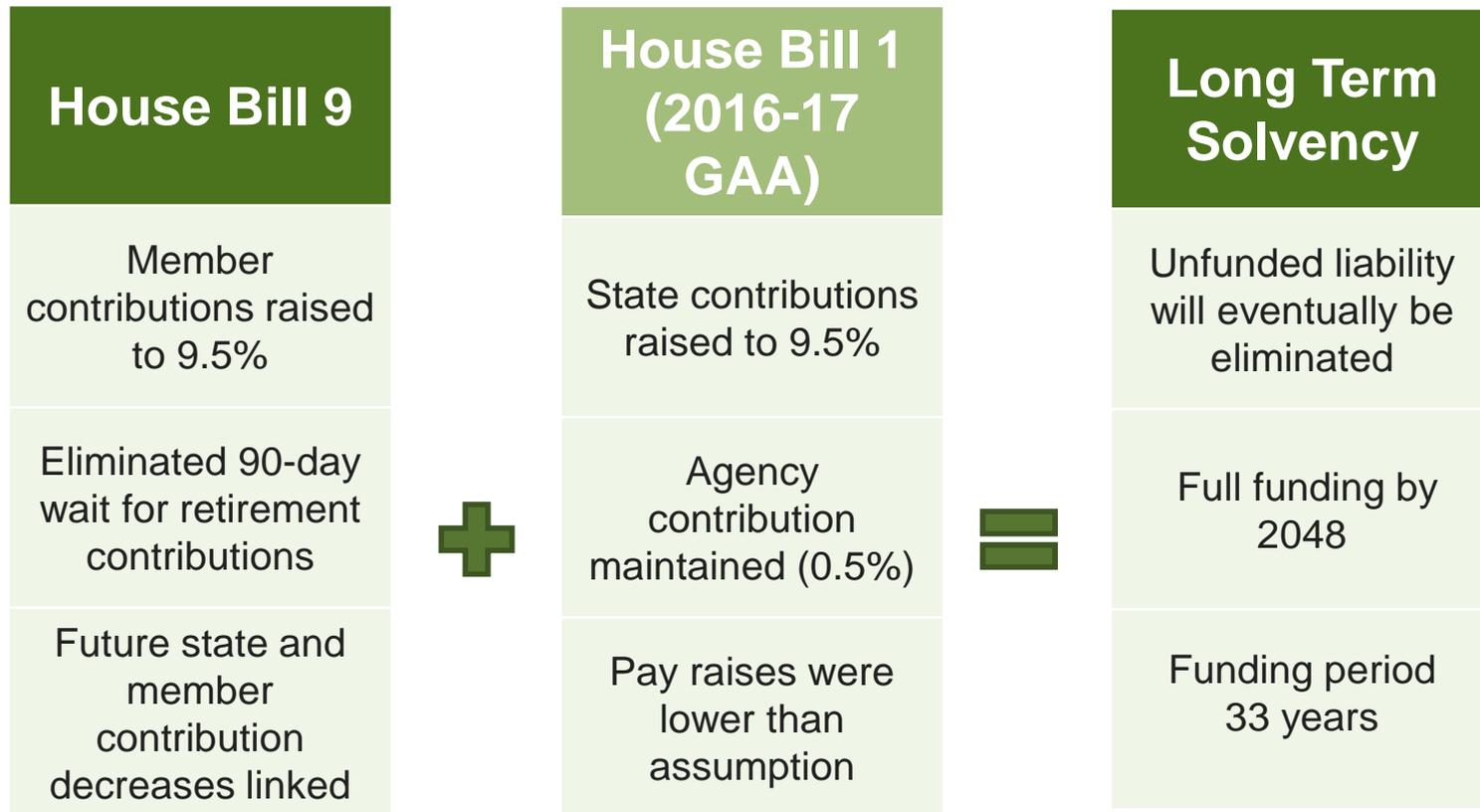
Funded Ratio Before and After Changes by the 84th Legislature



*Based on market value of assets (MVA)

2015 Legislative Changes

A Sound Path for the ERS Pension Trust



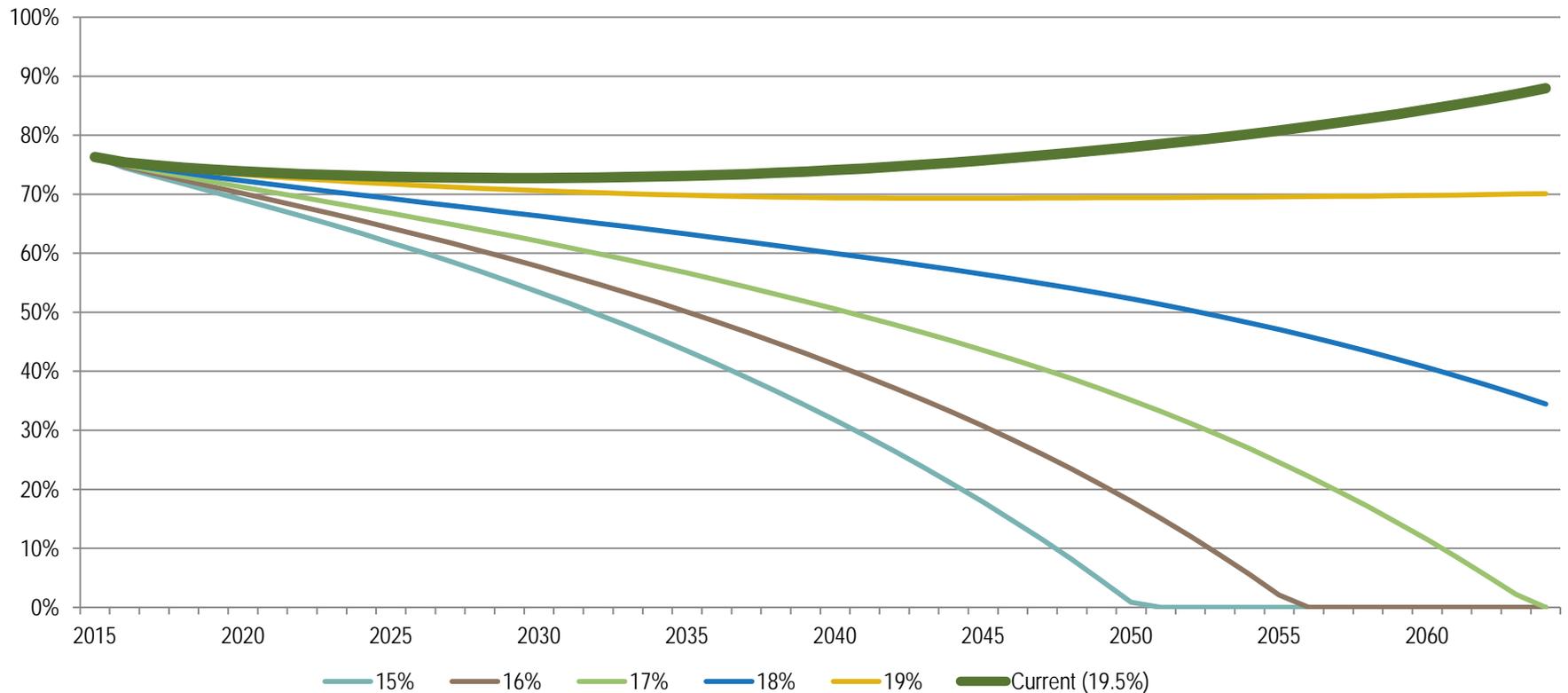
Bottom line: Contribution increases and the elimination of the 90-day waiting period for retirement contributions primarily impact the funding projections and estimated funding periods. In the short term, these changes have minimal impact on current liability and funded ratio. The normal cost rate (base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

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.

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.

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.

Accelerated Payoff of Unfunded Liabilities

*Impact of Lump Sums on the ERS Plan**



\$ Amount (in billions)	Current/ Baseline	\$1 Billion Lump Sum	\$4 Billion Lump Sum	\$8 Billion Lump Sum
Total Contributions Towards Unfunded Liability	\$29.1	\$20.7	\$11.6	\$9.5
Interest Savings	\$0	\$8.3	\$17.5	\$19.6
Full Funding Achieved by (Fiscal Year)	2048	2041	2028	2018

Source: Gabriel Roeder Smith (GRS), the independent consulting actuaries for ERS.

Background and assumptions related to the analysis:

- All of the member contribution is directed to paying for the normal cost (base benefit cost).
- The State and agency contributions will be allocated to both the remaining normal cost and eliminating the unfunded liability.
- For purposes of this comparison, it is assumed that the total contributions would drop to only contribute the normal cost once the plan is fully funded based on the actuarial value of assets.

These projections are based on the August 31, 2015 actuarial valuation of the ERS plan.

**Based on actuarial value of assets (AVA) and assuming payment on 9/1/17*

Historical Benefit Enhancements

Annuity Adjustments & Supplements



From 1980-2002, there were multiple benefit enhancements granted by the Legislature

Supplemental Payments (13 th Checks)	Cost of Living Adjustments (COLAs)	Benefit Multiplier Increases
6 supplemental checks from FY 1994 to 2001	12 COLAs paid from FY 1980 to 2002	6 multiplier increases from FY 1987 to 2002 (gradually increased from 1.5% to 2.3%)
Cost paid by Trust: \$201 million	Actuarial Cost paid by Trust for COLAs and multiplier changes: Approximately \$3.8 billion*	

** Additional benefit enhancements (such as service credit purchases and using unpaid leave to qualify for retirement) are included in these amounts. The legislative bills creating these changes often included several changes in a single bill.*

Statutory Cost-of-Living Adjustment (COLAs)



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

Current statute for 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.

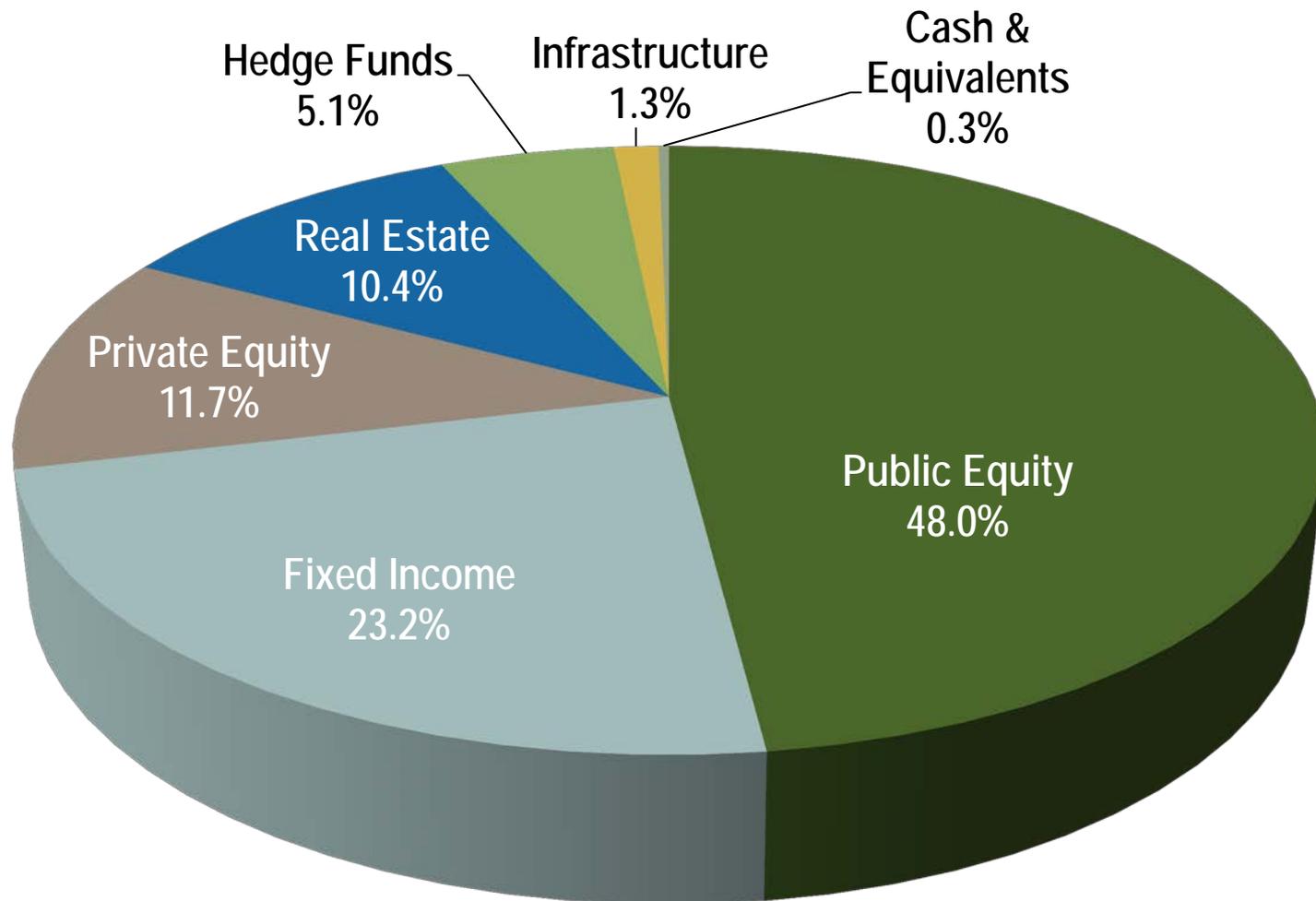
Actuarial Metrics	
Actuarial Accrued Liability	\$59.1 million
Unfunded Liability	\$59.1 million
ASC Rate	0.05%
Normal Cost Rate	No change
Annuitants Receiving COLA*	
Number	16,700
Percent affected	16.7%
Cost to ERS Trust	
Annual Annuity Payroll	\$9.5 million

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

Asset Allocation Across Investment Classes



Total Fund Amount: \$24.8 billion *



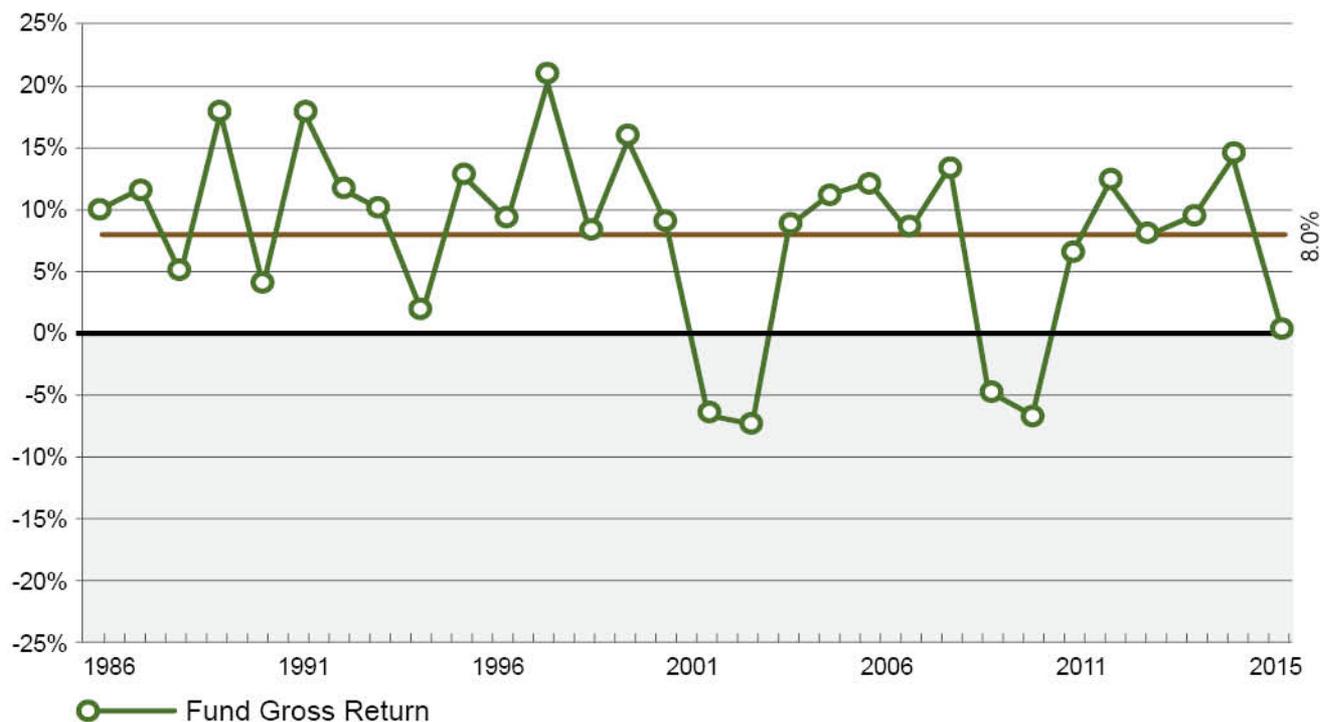
*Fund amount and asset allocation are as of March 31, 2016.

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%



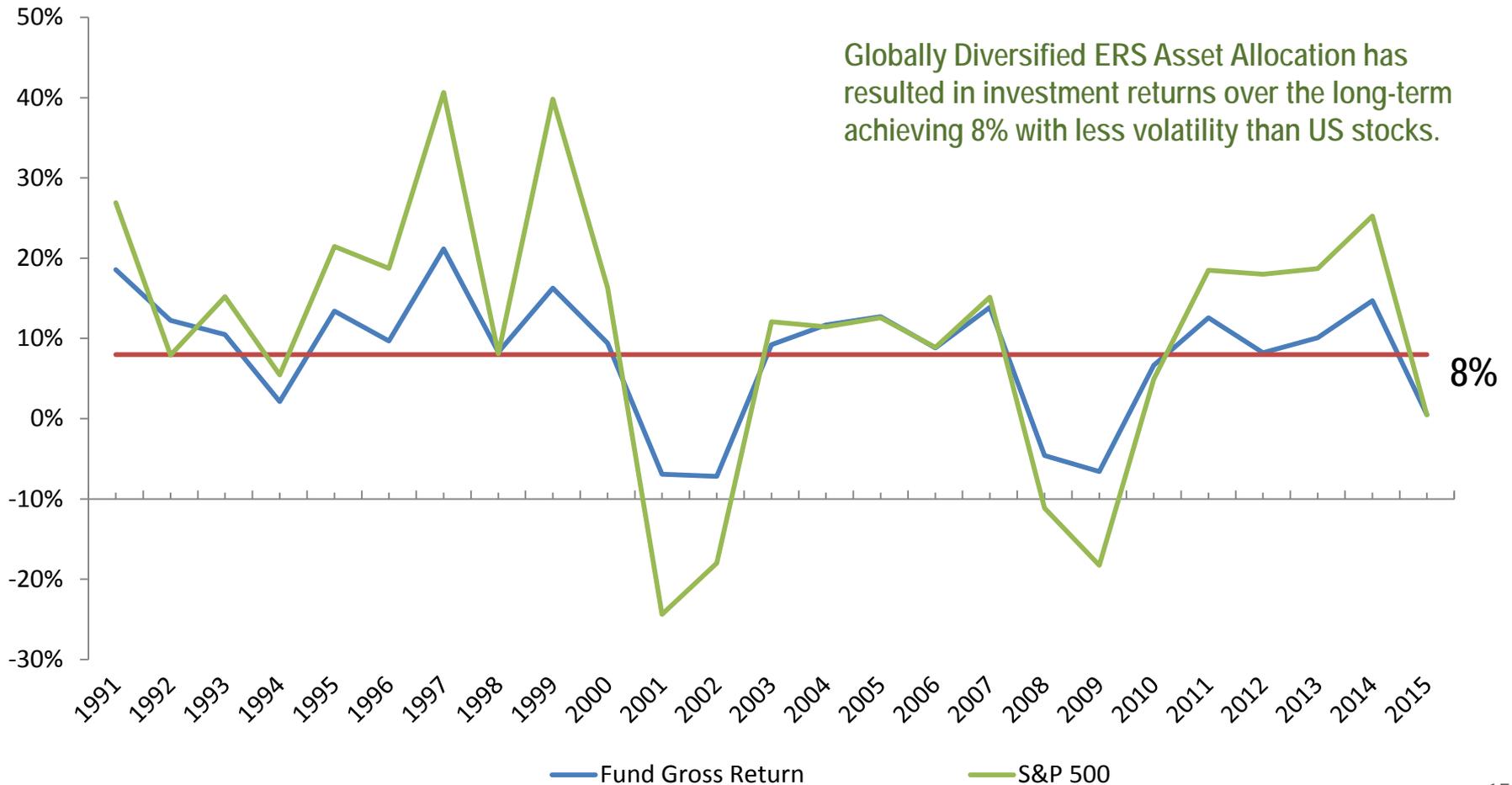
**As of August 31, 2015*

ERS Gross Investment Return

Compared to US Stock Market (S&P 500 Index)



25 Year Gross Investment Return



2016 Global Market Risks / Risk Mitigators



ERS Risk Mitigators

ERS Mitigates Market Risks with Asset Class and Geographic Diversification



Dedicated Team to Analyze Risk & Evaluate Investment Opportunities

Geopolitical Risks



China, Collapse in Commodity Prices,
Global Central Bank Policies



Tightening of Global Markets resulting from US Dollar
Strength, Pending Fed Rate Increase and Inflation
Concerns

2016 Global Market Risks

Appendix

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

Law Enforcement and Custodial Officer (LECO) Benefits



LECO Benefit Cost

LECO benefits cost more than Regular Class benefits

Each group pays the same amount to the ERS Trust Fund

Regular Class is subsidizing the LECO Class

LECO Eligible Population

No policy on how or why to add employees to the LECO benefits

Employee groups may be included (or excluded) without justification

Workforce needs may not be met

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*