LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 78TH LEGISLATIVE REGULAR SESSION

May 14, 2003

TO: Honorable Bill Ratliff, Chair, Senate Committee on State Affairs

FROM: John Keel, Director, Legislative Budget Board

IN RE: **HJR54** by King (Proposing a constitutional amendment providing that benefits in certain public retirement systems may not be reduced or impaired.), **As Engrossed**

No significant fiscal implication to the State is anticipated, other than the cost of publication.

The cost to the state for publication of the resolution is $85,275.

Long term costs for paying for benefit payments to members of the Statewide Emergency Services Personnel Retirement Fund would likely increase. If this plan is actuarially unsound, the state is statutorily required to contribute one third of the local contributions to the plan, currently estimated to be $606,000 annually. Under the proposed constitutional amendment, if this amount was ever insufficient to pay the costs of benefits, the state would be constitionally bound to make up for any shortfalls. It is estimated that the system is actuarially unsound; however, it is not anticipated that any required benefit payments would commence for quite some time. If the state contributes one third of local contributions, the present value of future benefit payments is currently estimated to be not significant, but that could change if experience does not meet plan assumptions.

Local Government Impact

The proposed constitutional amendment would apply to public retirement systems other than statewide systems, and the Statewide Emergency Services Personnel Retirement Fund. Under the resolution, vested accrued benefits could not be reduced or impaired. If fund balances were insufficient to pay benefits, costs would be the joint responsibility of the political subdivision which is the plan sponsor, and the active members of the plan. If a political subdivision has an election in May 2004 and the majority votes to opt out of this requirement, their retirement system would not have this protection and they would have no fiscal implication from the constitutional amendment.

Unless investment returns are well above plan assumptions of 8 or 8.5 percent for the next few years, losses will be realized and for plans to remain actuarially sound, overall contributions may have to be significantly increased, or benefits reduced in some way.

Due to their size, major municipal plans would have the majority of any fiscal implications, and 13 of the largest are used for examples in this analysis. Similar fiscal implications are anticipated to occur for other plans and their sponsors. Some plans have provisions which which reduce benefits if fund balances are insufficient to pay benefits; sponsors for these plans would have a direct fiscal impact from the constitutional amendment.

Pension plan costs come from either the "normal costs" which are paid by the plan sponsor for the benefit accruals in a given fiscal year, or from paying off unfunded liabilities. A plan’s obligation for prior benefit accruals is the actuarial accrued liability (AAL). The AAL minus the value of assets is the unfunded liability of the system, though the AAL is the full obligation of a plan sponsor. The resolution would remove the ability of cities to reduce this obligation for vested benefits through plan design changes. Vested benefits represent roughly 95 percent of the AAL for all but one of the reviewed systems. Being unable to impair income benefits would mean recent plan design changes such as lower retirement eligibility, Deferred Retirement Option Plans (DROPs), and automatic post retirement benefit increases greater than inflation can't be changed for vested employees. Allowable changes for them would be reducing or ending all future benefit accruals, though these would not reduce current obligations.

For reviewed plans, we estimate (market-value) liabilities as of December 31, 2002 using the latest available actuarial valuation and market fund values as of December 31, 2002 (in some cases these are estimated.) In addition to projecting the impact of meeting plan assumptions of 8 or 8.5 percent over the next five years, we project the impact of earning 4.5 percent investment return over the next five years as a likely "test" scenario. Projected returns are below historic averages due to low inflation, historically low interest rates for Treasury bills and other fixed income, and reduced expectations for the stock market in the short term. If these lower returns come to pass, plans may need to revisit economic assumption changes made in the 1990s, which would increase liabilities and costs. A combination of a six percent return and a modest economic assumption change is anticipated to have effects similar to the test scenario. Due to deferred recognition of asset losses, we assume for the five-year period no increases in contribution rates for unfunded liabilities. We assume contribution increases made by cities due to payroll growth are partially offset by similar levels of benefit payments, liabilities grow at investment rate assumptions, and other experience is as expected.

Contribution increases shown are only those attributable to unfunded liabilities and current normal cost shortfalls, and are based on paying off the unfunded liability as a level dollar amount over 30 years. While public plans often use a different methodology which places greater payments in the future, this method is required of private pensions and has the same present value. Plan sponsors that immediately increase contributions to make their systems actuarially sound would face smaller future increases in contributions.

The proposal states any obligation is the joint responsibility of the plan sponsor and the active members; to the extent plan members pay increased contributions this would lower the impact on plan sponsors. For all but two of the plans, current unfunded liabilities per active member range from $100,000 to $240,000; they range from $140,000 to $360,000 in 2007 under the plan assumptions and from $190,000 to $550,000 under the test scenario.

Plans analyzed include municipal employees, firefighters, and police. For San Antonio, only the combined firefighter and police plan is included. Liabilities and costs are aggregated by municipality to show the fiscal impact of maintaining current plan designs.

Austin retirement systems have unfunded liabilities of $650 million, which under the plan assumptions and test scenarios grow to $950 million and $1.3 billion, respectively. Contributions are $45 million now; realizing 2002 losses requires a $45 million increase; the plan assumption and test scenarios require increases of $70 million and $90 million, respectively.

Dallas retirement systems have unfunded liabilities of $1.9 billion, which under the plan assumptions and test scenarios grow to $2.9 billion and $3.7 billion, respectively. Current contributions are $110 million; realizing 2002 losses requires a $150 million increase; the plan assumption and test scenarios require increases of $240 million and $310 million, respectively.

El Paso retirement systems have unfunded liabilities of $440 million, which under the plan assumptions and test scenarios grow to $650 million and $820 million, respectively. Contributions are $20 million now; realizing 2002 losses requires a $35 million increase; the plan assumption and test scenarios require increases of $50 million and $65 million, respectively.

Fort Worth retirement systems have unfunded liabilities of $500 million, which under the plan assumptions and test scenarios grow to $750 million and $1.0 billion respectively. Contributions are $25 million now; realizing 2002 losses requires a $35 million increase; the plan assumption and test scenarios require increases of $55 million and $80 million, respectively.

Houston retirement systems have unfunded liabilities of $2.4 billion, which under the plan assumptions and test scenarios grow to $3.7 billion and $4.9 billion, respectively. Contributions are $100 million now; realizing 2002 losses requires a $230 million increase; the plan assumption and test scenarios require increases of $350 million and $450 million, respectively.

San Antonio retirement systems have unfunded liabilities of $500 million, which under the plan assumptions and test scenarios grow to $700 million and $950 million, respectively. Contributions are $45 million now; realizing 2002 losses requires a $25 million increase; the plan assumption and test scenarios require increases of $40 million and $60 million, respectively.

Source Agencies: 325 Fire Fighters' Pension Commissioner, 338 Pension Review Board, 304 Comptroller of Public Accounts, 327 Employees Retirement System

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