LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 78TH LEGISLATIVE REGULAR SESSION

May 29, 2003

TO: Honorable Tom Craddick, Speaker of the House, House of Representatives

FROM: John Keel, Director, Legislative Budget Board

IN RE: **HJR54** by King (Proposing a constitutional amendment providing that certain benefits in certain public retirement systems may not be reduced or impaired.), **As Passed 2nd House**

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.

Local Government Impact

The proposed constitutional amendment would apply to public retirement systems other than statewide systems. Under the resolution, accrued benefits could not be reduced or impaired for retirees and active members eligible to retire prior to any proposed change in benefits. If fund balances were insufficient to pay benefits, costs would be the responsibility of the political subdivision which is the plan sponsor. 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. The proposed constitutional amendment would not allow increased contributions from active members to assist in making up any shortfall.

Due to their size, major municipal plans would have the majority of any fiscal implications, and 12 of the largest are used for examples in this analysis. Similar fiscal implications are anticipated to occur for other plans and their sponsors, except the city of San Antonio which is generally exempted. Some plans have provisions 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. Other plan sponsors, including El Paso and Dallas, have agreements with their plans to increase member contributions when actuarially required contribution increases arise; these agreements would be negated by the 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 greatly reduce the ability of cities to reduce this obligation through plan design changes. We estimate that for some plans, 80 percent of the liability (AAL) would be directly protected by the amendment, for others somewhat less than 70 percent of the AAL would be directly protected. The protected liability includes liability for retirees, active members eligible to retire, and for our calculation, liability for those eligible to retire in the next two years, since for these plans any reductions would be unlikely take effect prior to the end of the next legislative session. Plans which have generous early retirement eligibility, especially fire and police plans, would be more greatly affected; some allow early retirement at age 45 with 5 years of service. If such a plan reduced benefits for all non-protected members by a fairly significant amount, say 25 percent, under the scenarios below they would only reduce their unfunded liabilities and additional costs by an eighth. Other plans would be able to have a somewhat greater impact on their unfunded liabilities by reducing benefits for non-protected members. The best funded plans would be able to have a somewhat greater impact on unfunded liabilities with benefit changes, while the least well funded plans would have less ability to have an impact on unfunded liabilities with benefit changes.

Being unable to impair benefits would mean recent plan design changes such as automatic post retirement benefit increases greater than inflation can't be changed for protected members. Also, increased eligibility requirements for Deferred Retirement Option Plans (DROPs) could never be added for those eligible to retire, even those only eligible for early retirement. 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.

Plans analyzed include municipal employees, firefighters, and police. 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.

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

LBB Staff: JK, WP, JB, JO, RR, WM