LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 85TH LEGISLATIVE REGULAR SESSION

April 30, 2017

TO: Honorable Dan Flynn, Chair, House Committee on Pensions

FROM: Ursula Parks, Director, Legislative Budget Board

IN RE: **HB440** by Martinez, "Mando" (Relating to a cost-of-living increase applicable to benefits paid by the Teacher Retirement System of Texas.), **As Introduced**

No significant fiscal implication to the State is anticipated, as the payment of benefit enhancements is contingent on TRS being actuarially sound, and the bill does not require increased contributions to fund its implementation. However, if TRS became actuarially sound, the bill would trigger significant but indeterminate costs to the TRS Pension Trust Fund to provide enhanced benefits. The impact of the enhanced benefits would depend on investment performance, membership experience, payroll growth, and other factors that affect the future revenues and expenditures of the fund.

The bill would require the Teacher Retirement System of Texas (TRS) to provide for a cost-of-living adjustment (COLA) for service retirement benefits, disability retirement benefits, and death benefits, adjusted for inflation, under certain specified circumstances. The bill would require the TRS board to grant an annual cost-of-living adjustment equal to the percentage increase made by the United States Social Security Administration, which is currently indexed to an inflation assumption of 2.5 percent. The adjusted benefits would be payable on January 1, 2018, and on January 1st of each subsequent year thereafter. The bill would take effect on September 1, 2017.

The increase could be made only if the board finds the TRS retirement fund to be actuarially sound and if funds are available to increase benefits. If a full cost of living adjustment could not be made possible while maintaining actuarial soundness, the board would be directed to compute the largest possible adjustment for a partial COLA while still meeting the requirement of actuarial soundness. Since TRS currently has a funding period greater than 31 years and therefore does not meet the statutory definition of actuarial soundness, it is assumed that the benefit enhancements proposed by the bill would not be implemented in the 2018-19 biennium.

However, based on the February 28, 2017 actuarial valuation update, it is estimated that fully implementing the COLA proposed in the bill would increase the unfunded actuarial accrued liability by $46.4 billion, from $36.6 billion to $83.0 billion, reduce the funding ratio from 79.5 percent to 63.1 percent, and result in an infinite funding period. In effect, absent additional contributions to the fund, the bill would result in TRS remaining at a funding period of 31 years in perpetuity, since falling below 31 years would trigger a full or partial COLA, and rising above 31 years would automatically reduce or eliminate the COLA to an amount that would allow the system to meet the actuarial soundness requirement.

Due to the automatic trigger for cost-of-living adjustments, amortizing the unfunded liability would require aggregate contributions to the fund to exceed the maximum benefit enhancements provided for by the bill. To maintain a 30-year funding period, the state contribution rate would have to increase from the current 6.8 percent of employee payroll to the maximum rate of 10.0 percent allowed by the Texas Constitution, Article 16, Section 67, Subsection (b)(3), while the member contribution would have to rise from the current 7.7 percent of salary to 14.0 percent of salary, for a combined member and state contribution rate increase of 9.5 percent of aggregate payroll. Providing a contribution sufficient to amortize the unfunded liability would require a further increase of contributions in addition to those described above.

No significant fiscal implication to the State is anticipated because the bill requires the retirement system to be actuarially sound before a benefit enhancement can be provided, and TRS does not currently meet the statutory definition of actuarial soundness. However, because the bill would trigger automatic benefit enhancements upon becoming actuarially sound, the bill would result in significant but indeterminate costs to the Pension Trust Fund to pay enhanced benefits whenever the system attained actuarial soundness, thereby preventing the system from reducing its funding period to less than 31 years, unless revenues from new contribution increases exceeded the maximum COLA triggered by the bill. For this reason, paying down the unfunded liability would require significant increases of state and member contributions.

Local Government Impact

No significant fiscal implication to units of local government is anticipated.

Source Agencies: 323 Teacher Retirement System

LBB Staff: UP, AG, AM, TSI