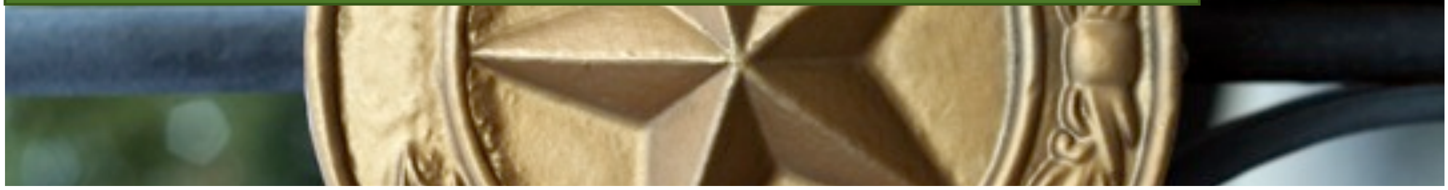
Texas Public Employees Association



Senate State Affairs Committee
Public Hearing, November 19, 2012

Introduction

The Texas Public Employees Association (TPEA) is pleased to have the opportunity to present testimony on the Interim Benefit Study Reports prepared by the Employees Retirement System of Texas (ERS) for both the pension and health care programs. We compliment ERS for both the comprehensive range of options presented for consideration and for the past extraordinary management of these two valuable employee benefit programs. We'd also like to thank the members of the Senate State Affairs Committee for devoting their time and attention to the very important issues that will be discussed in this hearing today.

On behalf of our 17,000 members, and for all Texas' current and retired state workers, TPEA cannot stress enough the importance these programs play in the maintaining a competent workforce that delivers on its critical missions for state government, as defined by the legislature, for all state agencies.

Administering an employees system that provides adequate compensation, cost-effective healthcare coverage, and reliable retirement benefits requires ERS to perform a delicate balancing act. Understanding the historical context in which the state's compensation and benefits structures were built is helpful in appreciating the importance and sensitivity of this equilibrium. TPEA recognizes that funds to support the state's workforce have been and continue to be limited. Each session, depending on the political realities at that time, state employees have been asked to make a choice: forgoing pay raises, underfunding the retirement program or decreasing healthcare benefits. The consequence is an aging workforce with a compensation system that is now not reflective of the private sector in terms of either salary or benefit.

Ask any employer to name the most valuable asset in their business, and the answer is always the same: employees. The same is true for the State of Texas. Attracting and retaining quality employees is vital for conducting state business efficiently and effectively. **We strongly urge this committee to carefully consider all the potential consequences before making any significant benefit change.**

Preserving the Model of Retirement & Healthcare Benefits Makes Business Sense

Preserving the Models: Preserving our State Workforce

Texas is clearly the most efficient government in the country, having grown at only 3% in a decade that has seen the state's population grow by 20.6%. Moreover, the total cost of salaries and benefits for general state government employees remains less than 3% of the state's budget.

Over the past decade...

Texas population growth: 20.6%

General state government employee* growth: 3%

** Excludes higher education employees*

Our productive workforce is largely attributable to the delicate balance of pay and benefits. Retaining this delicate balance is essential to maintaining an efficient and effective workforce. Earning roughly $40,000 annually, the average state employee counts on healthcare and retirement benefits for their families' security. With salaries averaging 17% less than salaries in Texas' private sector, employee benefits are an integral piece of a compensation package that attracts and retains quality state employees. State employees have done more with less in an environment that has not yielded an across-the-board percentage salary increase since the 2% increase in 2007. Our history of productivity and efficiency is the envy of other states.

TPEA believes that changing the Defined Benefits model will negatively affect the long-term viability of the pension fund. More than 13,000 active state employees are currently eligible to retire, about 9% of the state workforce. TPEA membership surveys indicate that changing the benefit model will trigger a rush to retirement and unnecessarily tax the system. Changing the Defined Benefits model also will downgrade the value of state employment and hurt Texas' ability to attract and retain the kind of employees we need to ensure public safety, register our vehicles, process our business taxes and maintain our highways.

Health insurance benefits are the most valued benefit among a majority of Texas state employees and are regarded by state employers to be an extremely important factor in attracting and retaining the best talent. Though the healthcare plan is an essential element to employee compensation, ERS' analysis shows that overall, it is no more generous than the average private sector plan. Shifting costs to employees or cutting benefits further, however, could drive employees away.

Preserving the Model of Retirement & Healthcare Benefits Makes Business Sense

The ERS Pension and Healthcare Plans: An Exceptionally Good Value to the State and Employees

In contrast to some other states' pension funds' and many local pension funds, the ERS pension fund is in good health and remains a good value to Texas taxpayers:

- Today, the average retiree worked for Texas for 23 years and receives an annuity of about $18,000 each year.

- Historically 64% of the payments from the ERS pension fund are based off the investment returns, with 18% coming from the contributions of the state and 18% from the employees.

- Despite the investment market downturns in the last decade, the ERS Trust Fund has exceeded its investment return assumptions over the past 30 years with an overall return rate of more than 8.4%.

Unlike troubled public pensions in other states and at the local level, the ERS pension fund has had strong oversight and good stewardship by the Texas Legislature, which has enabled it to remain actuarially sound through prudent management.

Both the Legislature and ERS have taken a 30-year view in decision-making and have avoided bad practices that have undermined so many public pension plans such as:

- spiking
- contribution holidays
- Deferred Retirement Option Plans (DROPs)
- allowing unreasonably early retirements
- Cost of Living Adjustments (COLAs) for retirees.

The Legislature has prohibited most of these practices under statute.

Additionally, the Legislature recently has taken fiscally responsible steps to improve the health of the ERS pension fund by:

- increasing the state and employee contribution to a healthy 6.5% contribution by each.
- reducing the benefit for those retiring at younger ages.
- expanding the final average salary calculation from three years to four years.

It is this kind of management that lead the Pew Center on the States to count Texas among the 11 states whose pension funds are solid performers.

Preserving the Model of Retirement & Healthcare Benefits Makes Business Sense

Moving to a 401K plan will cost more and provide less value to employees, who would regard the change as a cut in benefits, and to the state, whose unfunded liability would not shrink. More importantly, Defined Benefit pension plans can deliver the same retirement income at nearly 40% lower cost than a defined contribution plan, such as a 401(k), according to a recent analysis by the City of New York.

Our current healthcare plan remains a good value to both the state and to state employees. There is no unfunded liability on our healthcare plan, due to the fact that our model is Pay-As-You-Go. With roughly 500,000 people covered, the risk is spread evenly across age groups and the HealthSelect benefit cost trend has averaged only 5.5% over the last decade. The previous two rounds of benefit cuts (2003 and 2010) did reduce cost trends, but at a cost of less employee and retiree participation in the health plan.

Incremental Investment will Bridge the Gap

Improving the health of the ERS pension fund requires minor adjustments now to make a major difference later. While the funded ratio of assets to liabilities is 82.6%, down slightly from the previous year, the combined reasons for the decline are that contribution rates were less than the actuarially sound rate and the downturns in the market.

The current $5.05 billion unfunded liability is a long-term challenge that would require a much smaller ($259 million) annual investment to fully fund the pension fund over the course of 31 years. Since that amount would exceed the constitutionally allowed maximum state contribution, we support ERS's exceptional item request in its LAR for an additional annual $130 million in General Revenue that would bring the state contribution from 6.5% to 10%, the constitutional cap, getting us very close to fully funding the pension fund and maintaining solvency over time.

In summary, we believe that the current structure of Defined Benefit and healthcare plans are what keeps state employees delivering on the missions for state government. Thank you for your service to the state and your attention to these critical issues.