MAINTAIN THE PENSION SOLVENCY OF THE EMPLOYEES RETIREMENT SYSTEM AND THE TEACHER RETIREMENT SYSTEM

LBB RECOMMENDATIONS

1 Maintain solvency of ERS and TRS by implementing one of three options: (1) Fully funding both systems; (2) Maintaining the defined benefit plans while implementing benefit changes to make current funding levels sufficient to fully fund them; or (3) Creating a new hybrid plan structure.

2 Include a rider that requires ERS and TRS to perform a pension plan study that explores options for solvency.

Recommendation 1 may require statutory change, depending upon the option selected. The introduced 2012–13 General Appropriations Bill includes a rider implementing Recommendation 2.

The fiscal impact of the recommendations for the 2012–13 biennium would depend on the option selected. These recommendations would ensure the long-term solvency of the ERS and TRS pension plans while providing a secure benefit that the state can afford to fund.

Texas has two major public pension systems at the state level, the Employees Retirement System (ERS) for state employees and the Teacher Retirement System (TRS) for employees of public school districts and public institutions of higher education. Unlike other states, Texas' two major systems are not in a state of funding crisis, but both systems have long-term funding challenges that need to be addressed to maintain solvency. **Figure 1** shows the membership profile of ERS and TRS.

FIGURE 1
ERS AND TRS MEMBERSHIP PROFILE, AUGUST 2010

MEMBER INFORMATION	ERS	TRS
Active members	142,490	834,060
Average Annual Pay	$41,022	$43,916
Average Years of Service	9.2	9.7
Average Age	43.8	44.2
Retired members/Beneficiaries	79,311	296,491
Average Annual Benefit	$18,372	$21,354
Average Years of Service	22.5	24.6
Average Age of Current Retirees	67.7	70.2
Average Age at Retirement	58.4	59.8

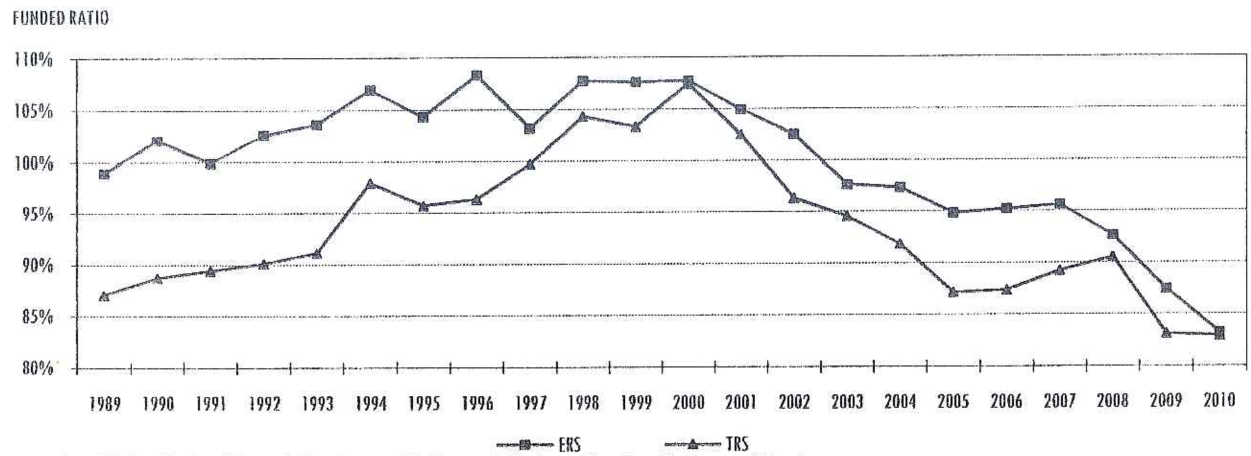
SOURCES: Legislative Budget Board; Employees Retirement System; Teacher Retirement System.

In August 2010, both ERS and TRS had a funded ratio, or ratio of assets to liabilities, greater than 80 percent, which experts generally consider an adequate level of funding for a sustainable pension system. Though the two systems meet this benchmark, each system has experienced a decline in funded ratio that began in 2001. As of August 2010, the funded ratio for ERS was 83.2 percent and for TRS it was 82.9 percent. Best practices for pension systems would be to maintain a funded ratio of 100 percent or greater to help systems weather downturns in the financial market.

Due to state constitutional requirements, Texas has made annual payments to ERS and TRS. Foregoing annual contributions due to lean budget years or boom investment returns is one reason several other state pension systems are experiencing major solvency issues. Though the state has not missed annual contributions to ERS and TRS, there have been multiple years when the systems have not received enough state and member contributions to cover normal costs, which are the costs of pension plan benefits and expenses for each year. There were also multiple years when the systems did not receive enough contributions to meet the actuarially sound contribution rate based on statutory requirements intended to provide a level of funding that meets both normal costs and reduces a portion of unfunded liabilities.

Figure 2 shows the historical end of fiscal year funded ratio of the two plans.

FIGURE 2
FUNDED RATIO TREND FOR ERS AND TRS, FISCAL YEARS 1989 TO 2010



SOURCES: Legislative Budget Board; Employees Retirement System; Teacher Retirement System.

Defined benefit retirement plans such as ERS and TRS are dependent upon investment earnings and full funding by employer and employee contributions. If either of these factors underperform, these plans incur unfunded liabilities. ERS and TRS pension plans incur more liabilities than are funded by annual contributions. As of August 2010, the unfunded liability was $4.8 billion for ERS and $22.9 billion for TRS, the highest the unfunded liabilities have ever been.

The full text of this report can be found in the *Government Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 97.

REDUCE THE STATE CONTRIBUTION FOR EMPLOYEE HEALTH INSURANCE TO PRESERVE BENEFITS

LBB RECOMMENDATION

1 Amend Rider 6 in ERS's bill pattern to reduce the state contribution for group insurance by up to 10 percent and require ERS to develop a waiver process for employees with a household income less than 200 percent of the federal poverty level.

The introduced 2012–13 General Appropriations Bill does not include any adjustments as a result of this recommendation.

This recommendation would result in a revenue gain of $298.1 million in All Funds reducing ERS's need for $187.8 million in General Revenue Funds and General Revenue–Dedicated Funds for the 2012–13 biennium, and preserve benefits currently provided to state employees.

The Employees Retirement System (ERS) group insurance program healthcare expenses in fiscal year 2010 were $2.3 billion in All Funds. ERS modified the health benefit plan member cost sharing for fiscal year 2011 to address a $140 million gap between appropriations and expenses. The agency anticipates healthcare costs to increase 9 percent in each fiscal year of the 2012–13 biennium and requested an additional $575.6 million in All Funds to cover cost increases.

There are two options for the state to contain cost, reduce the cost or use of healthcare services or increase the members' share of costs. Without changes to employee and dependent premiums or increased funding, ERS would be required to significantly modify benefits by: paying doctors and hospitals less; encouraging plan members to use fewer services; increasing copayments and coinsurance; establishing a medical deductible; reducing the types of services covered; or reducing the size of the healthcare provider network to achieve discounts.

In calendar year 2009, Texas was one of five states that offered a state employee health plan that paid 100 percent of all active state employees' health insurance premiums and did not require members to pay a deductible. ERS is the only Texas state employee health plan that does not require active employees to pay a premium or medical deductible. In fiscal year 2009, the average full-time, classified state employee's base salary was $38,461 and the state paid an average of $18,423 for each employee's benefits (i.e. health, retirement, leave). The recommendation would increase the employee's monthly premium cost by between $41 (employee only) and $120 (employee and family) depending on the type of coverage they select.

The full text of this report can be found in the *Governmental Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 117.

FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2012 TO 2016

FISCAL YEAR	PROBABLE SAVINGS/ (COST) TO GENERAL REVENUE FUNDS	PROBABLE GAIN/ (LOSS) TO GENERAL REVENUE–DEDICATED FUNDS	PROBABLE SAVINGS/ (COST) IN FEDERAL FUNDS	PROBABLE SAVINGS/ (COST) IN OTHER FUNDS
2012	$84,972,653	$8,944,490	$29,814,966	$25,342,721
2013	$84,972,653	$8,944,490	$29,814,966	$25,342,721
2014	$84,972,653	$8,944,490	$29,814,966	$25,342,721
2015	$84,972,653	$8,944,490	$29,814,966	$25,342,721
2016	$84,972,653	$8,944,490	$29,814,966	$25,342,721

Source: Legislative Budget Board.

IMPLEMENT A TOBACCO USER SURCHARGE ON EMPLOYEES RETIREMENT SYSTEM HEALTH PREMIUMS

LBB RECOMMENDATIONS

1 Amend statute to require ERS to offer a more comprehensive tobacco cessation program that includes prescription drug coverage.

2 Amend statute to require ERS to apply a monthly premium surcharge for all tobacco users covered under the state health plan.

3 Include a contingency rider setting the monthly surcharge at $30 per tobacco user.

4 Amend statute to permit the University of Texas System, the Texas A&M University System, and the Teacher Retirement System to apply a tobacco user premium surcharge within their health plans.

Recommendations 1, 2, and 4 require statutory change. The introduced 2012–13 General Appropriations Bill includes a contingency rider implementing Recommendation 3.

These recommendations would result in a net savings of $24.5 million in General Revenue Funds and General Revenue–Dedicated Funds for the 2012–13 biennium, and provide incentives for employees and their covered dependents to quit using tobacco, resulting in improved health.

Health insurance is a valuable benefit state employees receive as part of their compensation package. To maintain this benefit and contain costs, the state continues to look for opportunities for appropriate employee cost sharing. In recent years, private and public employers have increasingly used financial incentives to promote wellness and motivate employees to change unhealthy behaviors. Tobacco use, which is a contributing factor to many diseases, is one area where employers are applying premium surcharges, higher deductibles, and other increased costs to encourage employees to change behavior. Implementing a comprehensive tobacco cessation program with prescription drug coverage and a monthly tobacco user surcharge within the Employees Retirement System (ERS) health plan would result in a net cost savings and encourage state employees, retirees, and their dependents to stop using tobacco.

In 2010, the Centers for Disease Control and Prevention reported that an estimated 18.5 percent of Texans smoke. Applying this rate to the ERS health plan, an estimated 77,409 adults enrolled in the health plan smoke. A patchwork of tobacco cessation programs is available to state employees. Most employees can access telephone coaching or an online tool, though these programs could be more comprehensive. There are two tobacco cessation program pilots underway for state employees. Through December 2011 employees can receive eight weeks of free nicotine replacement therapy via the quitline. Employees of the health and human services agencies also have prescription drug coverage as part of a pilot tobacco cessation program through the fall of 2011.

In September 2010, nine states had financial incentives for tobacco cessation, seven of which were a monthly premium surcharge for tobacco users and one of which has a wellness surcharge that includes tobacco use. The average monthly surcharge among those states is $36 per tobacco user, with a range of $20 to $80.

The full text of this report can be found in the *Government Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 121.

FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2012 TO 2016

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS	PROBABLE SAVINGS/(COST) IN FEDERAL FUNDS	PROBABLE SAVINGS/(COST) IN OTHER FUNDS
2012	$8,872,134	$933,909	$3,113,029	$2,646,075
2013	$3,308,201	$1,400,863	$4,669,544	$3,969,112
2014	$13,308,201	$1,400,863	$4,669,544	$3,969,112
2015	$13,308,201	$1,400,863	$4,669,544	$3,969,112
2016	$13,308,201	$1,400,863	$4,669,544	$3,969,112

SOURCE: Legislative Budget Board.

IMPLEMENT A TIERED COINSURANCE PLAN FOR STATE EMPLOYEES

LBB RECOMMENDATIONS

1 Include a rider requiring ERS to implement a tiered coinsurance plan for medical expenditures to reduce plan costs and increase participants' cost sharing.

2 Include a rider requiring ERS to implement a tiered coinsurance plan for pharmaceutical expenditures.

3 Include a rider requiring ERS to change the Medicare coordination of benefits so Medicare eligible retirees pay coinsurance for most medical procedures, as do other retirees and active employees.

The introduced 2012–13 General Appropriations Bill includes a rider implementing Recommendation 1. Recommendations 2 and 3 require riders.

These recommendations would save $59.7 million in General Revenue Funds and General Revenue–Dedicated Funds for the 2012–13 biennium, and increase cost sharing among plan participants thereby improving the plan's cost effectiveness.

Employees currently pay 20 percent coinsurance on medical procedures up to $10,000. Under tiered coinsurance additional tiers of coinsurance would be added at lower rates; 5 percent on expenditures between $10,001 and $50,000 and 2 percent on expenditures up to $100,000. This requires cost sharing on high cost medical procedures while not overburdening employees. A small reduction in utilization for affected procedures would save much more than the direct savings of the plan change, so the plan saves more without passing all the costs on to employees. Tiered coinsurance for high cost prescription drugs would work similarly, but only apply to high cost specialty prescription drugs.

Due to the way the Employees Retirement System (ERS) coordinates benefits with Medicare, Medicare eligible retirees and dependents have no share in almost all medical costs after their deductible is met. ERS should change this coordination of benefits so these retirees participate in the costs of their care, as do active employees and other retirees. This proposal could also have a significant additional impact on plan costs due to utilization reductions.

The full text of this report can be found in the *Government Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 127.

FIVE–YEAR FISCAL IMPACT, FISCAL YEARS 2012 TO 2016

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE FUNDS	PROBABLE SAVINGS/(COST) IN GENERAL REVENUE–DEDICATED FUNDS	PROBABLE SAVINGS/(COST) IN FEDERAL FUNDS	PROBABLE SAVINGS/(COST) IN OTHER FUNDS
2012	$26,470,720	$2,105,833	$7,124,772	$7,893,570
2013	$28,850,560	$2,295,157	$7,765,322	$8,603,239
2014	$32,099,029	$2,553,583	$8,639,669	$9,571,932
2015	$35,761,856	$2,844,973	$9,625,544	$10,664,188
2016	$39,895,711	$3,173,835	$10,738,199	$11,896,903

Source: Legislative Budget Board.

ESTABLISH PILL-SPLITTING PROGRAMS TO REDUCE OUT-OF-POCKET EXPENSES FOR STATE EMPLOYEES

LBB RECOMMENDATIONS

1 Amend statute to require that the Employees Retirement System, Teacher Retirement System, UT System and Texas A&M System each establish a voluntary pill-splitting program with a copay reduction as a participation incentive.

2 Amend statute to require that the Texas Board of Pharmacy establish an advisory committee to develop a list of medications that are appropriate for splitting and education materials for participants.

These recommendations require statutory action. The introduced 2012–13 General Appropriations Bill does not include any adjustments as a result of these recommendations.

These recommendations would save $710,190 in General Revenue Funds for the 2012–13 biennium. A 50 percent copay reduction participation incentive would result in more than $1 million in out-of-pocket savings for state employees.

Pill splitting is a strategy for containing prescription drug costs. It allows users of a qualified medication to buy half as many pills at twice the dose and split them in half to achieve the prescribed dose. This strategy is safe and effective with medications that split easily, meet pricing criteria, and have a low risk of toxicity. These characteristics limit any pill-splitting program to a short, discrete medication formulary.

Prescription drug spending for the Texas employee health plans exceeded $1.5 billion in All Funds for the 2007–08 biennium. Out-of-pocket costs for state employees were over $1.1 billion. Creating an optional pill-splitting program in the state employee health plans has the potential to save approximately $710,190 in General Revenue Funds for the 2012–13 biennium. A 50 percent copay reduction participation incentive would result in over $1 million in out-of-pocket savings for state employees.

The full text of this report can be found in the *Government Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 133.

FIVE-YEAR FISCAL IMPACT, FISCAL YEARS, 2012 TO 2016

FISCAL YEAR	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE FUNDS	PROBABLE SAVINGS/ (COST) IN GENERAL REVENUE–DEDICATED FUNDS	PROBABLE SAVINGS/(COST) IN FEDERAL FUNDS	PROBABLE SAVINGS/(COST) IN OTHER FUNDS	PROBABLE SAVINGS/(COST) IN LOCAL FUNDS	PROBABLE COMBINED SAVINGS/(COST) IN ALL FUNDS
2012	$226,249	$10,481	$35,984	$28,473	$116,564	$417,750
2013	$452,498	$20,962	$71,968	$56,946	$233,128	$835,501
2014	$452,498	$20,962	$71,968	$56,946	$233,128	$835,501
2015	$452,498	$20,962	$71,968	$56,946	$233,128	$835,501
2016	$452,498	$20,962	$71,968	$56,946	$233,128	$835,501

Source: Legislative Budget Board.

REQUIRE STATE RETIREES TO PAY A GREATER SHARE OF THEIR HEALTH INSURANCE COST TO PRESERVE BENEFITS

LBB RECOMMENDATIONS

1 Amend Rider 6 in ERS's bill pattern to require retirees to pay a portion of their health insurance premium based on years of service.

2 Amend Rider 6 in ERS's bill pattern to reduce the state contribution for retirees' dependents from 50 percent to 40 percent of the premium.

The introduced 2012–13 General Appropriations Bill does not include any adjustments as a result of these recommendations.

These recommendations would result in a revenue gain of $95.5 million in All Funds reducing ERS's need for $60.1 million in General Revenue Funds and General Revenue–Dedicated Funds for the 2012–13 biennium and would preserve benefits currently provided to state retirees.

The cost of providing retiree health benefits continues to increase as both the cost of the program and the number of retirees increases. Monthly health insurance premiums for the Employees Retirement System (ERS) health insurance increased from $216 to $411 a month from fiscal years 2000 to 2011—a net increase of $195 a month, or 90.7 percent. From fiscal years 2000 to 2010, the number of ERS retirees increased from 47,310 to approximately 78,619. Texas does not require ERS health plan members to pay a monthly premium and the state pays 50 percent of a retirees' dependent's premium.

In fiscal year 2009, retirees' healthcare claims were approximately $402.8 million but they are not the most expensive group. According to ERS, the group with the highest claims is dependent spouses. In fiscal year 2009, the average annual claim cost for retirees' dependent spouses' age 50 to 64 was approximately $6,400, and 26 percent of ERS health plan participants report that their dependent has access to other health coverage but enrolled in the ERS health plan instead.

The Governmental Accounting Standards Board's rules require public employers to identify and report the cost of the liability of retiree health benefits and either continue to "pay-as-you-go" or begin to prefund the costs (as they prefund costs associated with pension plans). In 2007, the Texas Legislature authorized government retiree health plans to continue to pay-as-you-go and required them to fully disclose to members that employers' are not obligated to provide insurance beyond the two year appropriation cycle.

In calendar year 2008, at least 10 states varied retiree premium contributions based on years of service. Texas can reduce its expense for retiree health benefits by reducing the state contribution for retirees' dependents and requiring retirees to contribute toward their health insurance premium based on years of service. Requiring persons who work for the state for 10 years to pay a 20 percent premium ($82 a month), and reducing premiums as service increases until those with 30 years or more pay nothing, would reward retiree who have given the longest service to the state with the greatest benefit.

The full text of this report can be found in the *Government Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 137.

FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2012 TO 2016

FISCAL YEAR	PROBABLE SAVINGS/(COST) TO GENERAL REVENUE FUNDS	PROBABLE GAIN/(LOSS) TO GENERAL REVENUE–DEDICATED FUNDS	PROBABLE SAVINGS/(COST) IN FEDERAL FUNDS	PROBABLE SAVINGS/(COST) IN OTHER FUNDS
2012	26,808,686	2,821,967	9,406,556	7,995,573
2013	27,607,229	2,906,024	9,686,747	8,233,735
2014	28,441,707	2,993,864	9,979,546	8,482,614
2015	29,313,737	3,085,656	10,285,522	8,742,693
2016	30,225,007	3,181,580	10,605,266	9,014,476

Source: Legislative Budget Board.

PROVIDE COMMUTER CHOICE INCENTIVES FOR STATE EMPLOYEES

LBB RECOMMENDATIONS

1 Amend statute to require, rather than authorize, ERS to establish a statewide Qualified Transportation Benefit Program for state employees.

2 Amend statute to require state agencies to designate an employee transportation coordinator.

3 ERS and other state agencies should attempt to negotiate employee discount options with apartments within walking and biking distance of state office buildings.

Recommendations 1 and 2 require statutory change. The introduced 2012–13 General Appropriations Bill does not include any adjustments as a result of these recommendations.

These recommendations would save $82,590 in All Funds for the 2012–13 biennium and provide state employees a tax incentive to use alternative commuting options.

Commuter benefits are an environmentally responsible way Texas could help state employees while encouraging transportation options that reduce congestion and pollution from motor vehicles. The Transit Benefit Program established by the federal government allows employers to subsidize employees' cost of commuting to work by mass transit and allows employees to use pre-tax dollars to pay for mass transit passes. The federal government also offers a bicycle commuting reimbursement, which allows employers to reimburse employees for certain costs associated with bicycling to work and exclude these reimbursements from gross wages so they are nontaxable. Incentives can be offered to encourage employees to live near their workplace so that walking and bicycling are commuting options.

The Employee Retirement System (ERS) is statutorily authorized to offer a Qualified Transit Benefit Program but has currently chosen not to offer this benefit. As a result, state employees using alternative commuting options are unable to take advantage of federal tax incentives, the state misses out on savings realized from a reduction in payroll taxes, and the state does not incentivize state employees to consider alternative commuting options that reduce congestion and pollution. Additionally, a 2010 survey of almost 37,000 employees across all state agencies conducted by Legislative Budget Board staff found that forty-three percent of state employees would consider joining a carpool if the state were to assist with finding a matching ride. Implementing the recommendations in this report would provide an employee benefit that also reduces vehicle emissions, traffic congestion, and the state's share of payroll taxes.

The full text of this report can be found in the *Government Effectiveness and Efficiency* report (Legislative Budget Board, January 2011), page 143.

FIVE-YEAR FISCAL IMPACT, FISCAL YEARS 2012 TO 2016

FISCAL YEAR	PROBABLE SAVINGS/(COST) IN ALL FUNDS
2012	$41,295
2013	$41,295
2014	$41,295
2015	$41,295
2016	$41,295

SOURCE: Legislative Budget Board.