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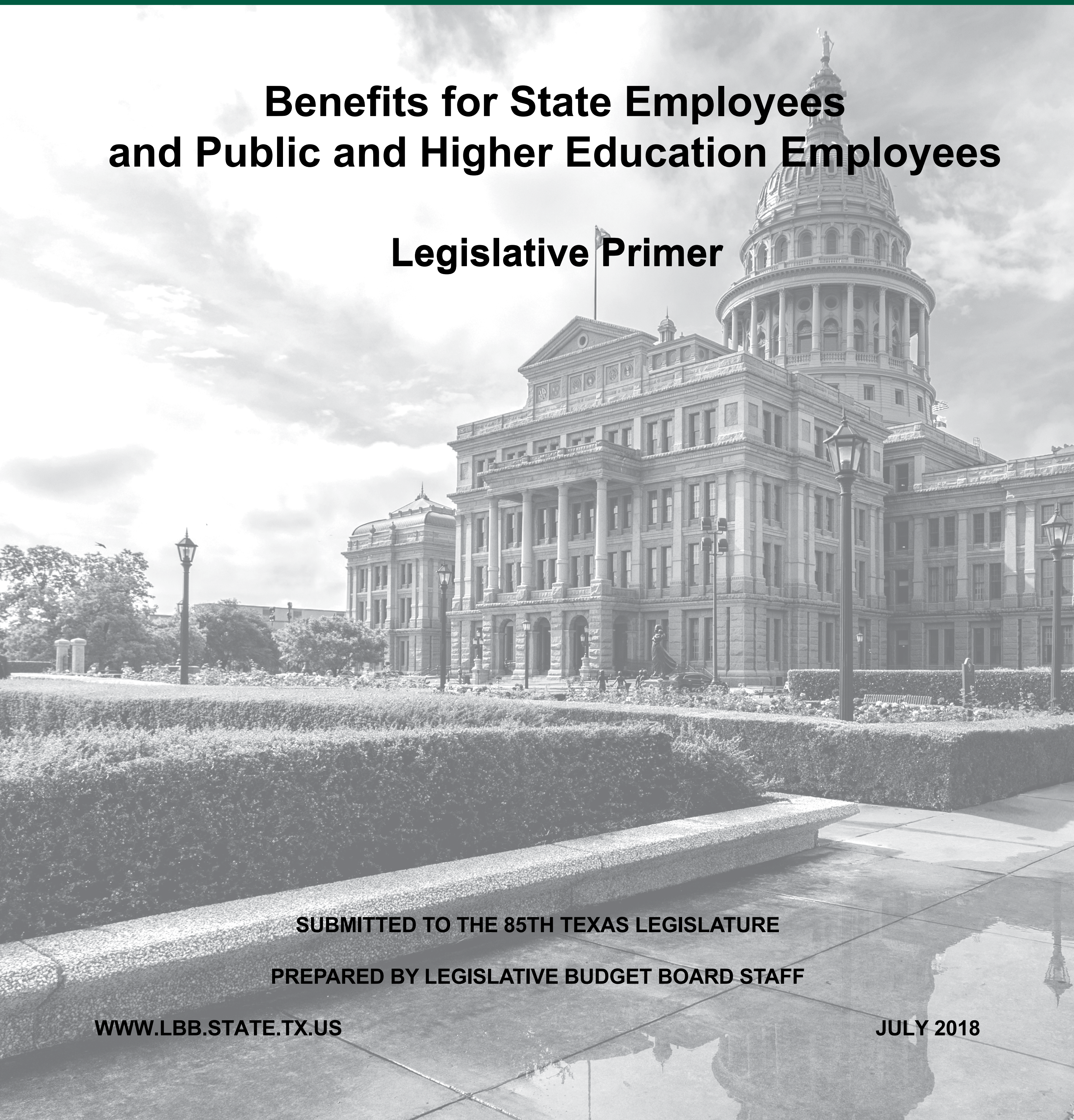

Benefits for State Employees and Public and Higher Education Employees

Legislative Primer

SUBMITTED TO THE 85TH TEXAS LEGISLATURE

PREPARED BY LEGISLATIVE BUDGET BOARD STAFF

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JULY 2018

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1. INTRODUCTION

Texas public employees are supported by a variety of state and local programs providing retirement and healthcare benefits. The Texas Constitution establishes two retirement systems to provide benefits to state employees and officers and to employees of public education, including higher education. The Employees Retirement System of Texas (ERS) and the Teacher Retirement System of Texas (TRS) were established by the Legislature more than seven decades ago. Each system is managed by a board of trustees that oversees administration of benefits delivery and management of trust fund assets. The four retirement systems at ERS together have 362,808 members and retirees and $27.6 billion in assets. TRS is one of the largest pension systems in the nation, with approximately 1.5 million members and retirees and $147.4 billion in assets. Retirement benefits paid by ERS for fiscal year 2017 total approximately $2.4 billion, and TRS paid $9.9 billion for fiscal year 2017 to retirees and their beneficiaries.

Actuarial soundness for each retirement system has been a topic of discussion during the last decade as investment performance has shown considerable volatility. Actuarial soundness is defined in statute as contributions sufficient to fund the normal cost and amortize the unfunded accrued liability across no more than 31 years. (See **Appendix C – Glossary** for definitions of related terms.) As of August 31, 2017, the five-year average investment return was 8.4 percent for ERS and 9.0 percent for TRS, and the 10-year average investment return was 5.7 percent for ERS and 5.8 percent for TRS. Both retirement systems previously had assumed 8.0 percent investment returns. Anticipating lower returns, ERS changed its return assumption effective fiscal year 2017 to 7.5 percent in August 2017, and TRS changed its return assumption effective fiscal year 2018 to 7.25 percent in July 2018. The actuarial valuations as of August 31, 2017, indicate that the funded ratios are 70.1 percent at ERS and 80.5 percent at TRS. **Figure 1** shows a comparison of the ERS and TRS retirement systems and additional retirement systems at ERS for law enforcement and judicial employees.

The Optional Retirement Program (ORP), an alternative to TRS participation for certain higher education employees, was established in 1967 to provide a more portable option for retirement accumulations for individuals who might experience interstate mobility during their careers. In addition, the Proportionate Retirement Program (PRP) enables prospective retirees to combine service among systems to meet eligibility requirements and receive proportionate annuities from two or more systems for which those retirees are eligible. PRP applies to nine public retirement systems in Texas, including ERS and TRS.

ERS and TRS also administer health benefit programs for active employees and retirees. The healthcare program at

FIGURE 1
COMPARISON OF EMPLOYEES RETIREMENT SYSTEM OF TEXAS (ERS) AND TEACHER RETIREMENT SYSTEM OF TEXAS (TRS) RETIREMENT SYSTEMS
AUGUST 31, 2017

CATEGORY	ERS	LECOS (MEMBERS OF ERS)	JRS II	JRS I (1)	TRS (2)
Members and Retirees	361,351	67,554	1,093	364	1,545,057
Market Value of Assets	$26.4 billion	$924.0 million	$420.9 million	N/A	$147.4 billion
Actuarial Funded Ratio	70.1%	66.0%	90.8%	N/A	80.5%
Unfunded Actuarial Accrued Liability	$11.3 billion	$475.9 million	$42.8 million	N/A	$35.5 billion
Funding Period	Infinite	Infinite	63 years	N/A	32.2 years
Benefits Paid for Fiscal Year 2017	$2.3 billion	$66.8 million	$23.0 million	$24.1 million	$9.9 billion

Notes:
(1) Judicial Retirement System Plan I (JRS I) is a pay-as-you-go plan, unlike ERS, the Law Enforcement and Custodial Officer Supplement Retirement Fund (LECOS), Judicial Retirement System Plan II (JRS II), and TRS, which are prefunded.
(2) TRS actuarial data do not reflect the 7.25 percent rate of return assumption, which is effective fiscal year 2018.
Source: 2017 Comprehensive Annual Financial Reports and Actuarial Valuations of Employees Retirement System of Texas and Teacher Retirement System of Texas.

ERS covered 554,948 participants, including dependents, and paid $3.5 billion in health benefit claims for fiscal year 2017. Two TRS programs for retirees and active members cover healthcare and paid a total of $3.5 billion for fiscal year 2017 for 760,744 total participants, including dependents. These amounts do not include the fully insured Medicare Advantage plans. Approximately 10.0 percent of eligible public school employers in Texas, who employ approximately 56.9 percent of Texas public school employees, do not participate in the TRS program for active employees and instead provide local options for healthcare benefits. Employees of higher education have access to health benefit programs provided by ERS, the University of Texas System, and the Texas A&M University System. (See related sections.) **Figure 2** shows a comparison of ERS and TRS healthcare benefits.

FIGURE 2
COMPARISON OF EMPLOYEES RETIREMENT SYSTEM OF TEXAS (ERS) AND TEACHER RETIREMENT SYSTEM OF TEXAS (TRS) HEALTH PLANS, FISCAL YEAR 2017

AS OF AUGUST 31, 2017	ERS GROUP BENEFITS PROGRAM	TRS-ACTIVECARE	TRS-CARE
Participants	554,948	492,317	268,427
Benefits Paid	$3.5 billion	$1.8 billion	$1.7 billion

NOTE: Healthcare benefits paid for fiscal year 2017 include medical and pharmacy claims and exclude Medicare Advantage Plans.
SOURCE: 2017 Comprehensive Annual Financial Reports of ERS and TRS.

Figure 3 shows which public entity is responsible for the administration of retirement and healthcare benefits for each category of eligible employees. **Chapter 2. ERS** outlines retirement eligibility, funding structure, benefit plans, and the actuarial condition of the four retirement systems that ERS oversees. **Chapter 2** also shows the basic components of the Group Benefits Program, including funding sources and benefit structure. **Chapter 3. TRS** discusses the important elements of the TRS retirement system and the two healthcare programs that TRS oversees, TRS-Care and TRS-ActiveCare. **Chapter 4. Optional Retirement Program**, **Chapter 5. Higher Education Employees Group Insurance**, and **Chapter 6. Social Security and Benefit Replacement Pay** discuss these respective programs. Appendices provide the most recent information available regarding state appropriations and contribution rates, and a glossary of terms for reference.

FIGURE 3
ADMINISTRATIVE RESPONSIBILITY FOR RETIREMENT AND HEALTHCARE BENEFITS AUGUST 31, 2017

RETIREMENT	ERS	TRS	ORP	SELF-ADMINISTRATION
State Employees	X			
Higher Education Employees		X	X	
Community College Employees		X	X	
Public School Employees		X		
HEALTHCARE	**ERS**	**TRS**	**ORP**	**SELF-ADMINISTRATION**
State Employees (Active Employees and Retirees)	X			
Higher Education Employees	X			UT, TAMU
Community College Employees	X			
Public School Employees				
Active Employees		X		Local ISDs
Retirees		X		

NOTE: ERS=Employees Retirement System of Texas; TRS=Teacher Retirement System of Texas; ORP= Optional Retirement Program; UT=the University of Texas System; TAMU=the Texas A&M University System; ISD=independent school district.
SOURCE: Legislative Budget Board.

2. EMPLOYEES RETIREMENT SYSTEM OF TEXAS

RETIREMENT

HISTORY

The Legislature established the Employees Retirement System of Texas (ERS) in 1947 based on a voter-approved constitutional amendment to provide retirement programs, disability, and death benefits for public employees and officers. The constitution requires ERS to provide benefits for officers and employees of the state, including state-compensated officers and employees of appellate courts and judicial districts. The ERS retirement plan is a traditional defined benefit plan, and it is a qualified pension trust, pursuant to the U.S. Internal Revenue Code, Section 401(a). The pension plan operates pursuant to the Texas Constitution, Article XVI, Section 67, and applicable federal and state governing statutes.

ERS responsibilities have expanded gradually. Legislation passed in 1954 transferred the administration of the Judicial Retirement System of Texas to ERS. In 1963, legislation expanded ERS membership to include elected state officials, including legislators. District attorneys were included in 1967. The Law Enforcement and Custodial Officer Supplement (LECOS) Retirement Fund was established in 1979 to provide an increased retirement benefit for certified peace officers and custodial officers. In 1985, the Judicial Retirement System Plan II (JRS II) was authorized to phase out the Judicial Retirement System Plan I (JRS I). JRS I was structured as a pay-as-you-go plan, which required the state to appropriate funds to pay the benefits owed to annuitants each year following their retirement. JRS II is a prefunded plan that enables the state and members to contribute during employees' working years, like ERS and LECOS. These contributions are invested to generate revenue for the long-term funding of retirement benefits, which enables the state to save money by utilizing investment returns to pay benefits.

In 1950, the U.S. Congress passed the Social Security Act, Section 218. Federal law authorized states to enter into voluntary agreements with the U.S. Social Security Administration (SSA) for coverage for their state and local governments. The Texas Legislature delegated responsibility to the Department of Public Welfare in 1951 for administration of the Texas Social Security Program. Administrative responsibilities were transferred to ERS in 1975. As the administrator, ERS has oversight for managing referendums, or elections, held by political subdivisions that provide for Social Security or Medicare Only coverage for employees of local governments. State employees participate in Social Security as a condition of employment. However, employees of many local governments in Texas still vary in participation, based on local elections. (See **Chapter 6. Social Security and Benefit Replacement Pay**.)

GOVERNANCE AND POLICY

The Employees Retirement System is governed by a board of six trustees who serve staggered, six-year terms. By statute, three trustees are active state employees who are elected by the members of the system. The remaining three trustees are appointed, one each by the Governor, the Speaker of the Texas House of Representatives, and the Chief Justice of the Supreme Court of Texas. As fiduciaries of the trust fund, ERS trustees are responsible for the prudent management of assets held in trust, seeking long-term investment returns that meet or exceed the established actuarial rate of return.

MEMBERSHIP

Figure 4 shows membership data for ERS, the LECOS Retirement Fund, JRS I, and JRS II as of the August 31, 2017, ERS Comprehensive Annual Financial Report (CAFR). Compared to the August 31, 2016, ERS CAFR, the number of active ERS members decreased by 4,761, or 3.3 percent. This decrease may be due partially to the Governor's hiring freeze on January 31, 2017. The number of noncontributing members increased by 3,319, or 3.0 percent, and the number of annuitants increased by 3,772, or 3.6 percent. For LECOS, the number of active members decreased by 860, or 2.2 percent. The number of noncontributing members increased by 1,897, or 12.5 percent, and the number of LECOS annuitants increased by 733, or 6.4 percent. For JRS I, the number of active members decreased by 1, or 10.0 percent; the number of annuitants decreased by 19, or 5.1 percent; and the plan no longer has any noncontributing members. For JRS II, the number of active members increased by 9, or 1.6 percent; the number of noncontributing members decreased by 8, or 4.8 percent; and the number of annuitants increased by 47, or 14.2 percent.

ERS has two classes of membership, the employee class and the elected class. The employee class includes employees and appointed officers of every state department, commission, board, agency, or institution except those participating in the Teacher Retirement System of Texas (TRS), the Optional Retirement Program, JRS I, and JRS II. Membership in the employee class is mandatory for all eligible employees and begins on the first day of employment. The elected class includes statewide elected officials that are not in JRS I and JRS II, members of the Legislature, and district attorneys and criminal district attorneys. Membership in the elected class is optional, and eligible participants apply to enroll with ERS.

Members of LECOS are also members of ERS. This plan covers employees who are licensed law enforcement officers or custodial officers of various state agencies including the following: Department of Public Safety, Texas Alcoholic Beverage Commission, Texas Parks and Wildlife Department, Juvenile Justice Department (Office of Inspector General), and the Texas Department of Criminal Justice, including the Board of Pardons and Paroles.

The JRS I plan is for judges, justices, and commissioners of the Supreme Court of Texas, the Court of Criminal Appeals, the Courts of Appeals, district courts, and members of certain commissions whose service began before September 1, 1985. Those whose service began on or after September 1, 1985, are members of JRS II.

Figure 5 shows ERS membership during the last decade including contributing members, noncontributing members, and annuitants.

FIGURE 4
EMPLOYEES RETIREMENT SYSTEM (ERS) OF TEXAS MEMBERSHIP BY PLAN
AUGUST 31, 2017

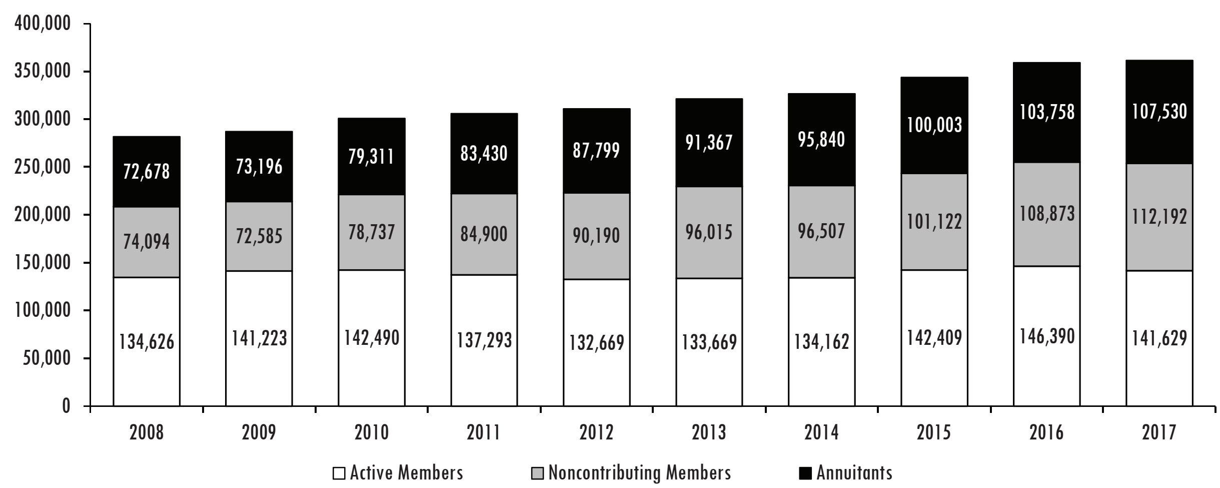
PLAN	ACTIVE MEMBERS	NONCONTRIBUTING MEMBERS (1)	RETIREES AND BENEFICIARIES (ANNUITANTS)
ERS	141,629	112,192	107,530
LECOS (2)	38,206	17,100	12,248
JRS-I (3)	9	0	355
JRS-II	557	158	378

NOTES:
(1) Noncontributing members are former employees who have not withdrawn their retirement funds.
(2) Members of Law Enforcement and Custodial Officer Supplement (LECOS) Retirement Fund are also members of ERS.
(3) JRS I=Judicial Retirement System Plan I; JRS II=Judicial Retirement System Plan II.
SOURCE: Employees Retirement System.

CONTRIBUTIONS

ERS retirement plans are funded by state contributions, member contributions, and investment earnings. The administrative costs to operate these programs are not appropriated out of state funds, but instead are funded by trust fund assets in each of the funds. The Legislature appropriates funds for the state contribution at the end of each article of the General Appropriations Act (GAA) for general state agencies as an estimated appropriation. The total appropriation for all state agencies is shown as an informational listing in the ERS appropriation bill pattern.

FIGURE 5
EMPLOYEES RETIREMENT SYSTEM MEMBERSHIP, FISCAL YEARS 2008 TO 2017



SOURCE: Employees Retirement System Comprehensive Annual Financial Report.

The Texas Constitution specifies a state contribution rate of 6.0 percent to 10.0 percent of total employee payroll. The percentage of payroll that the state contributes is determined by the Legislature and is identified by a rider in the ERS bill pattern in the GAA. For fiscal years 2018 and 2019, the state contribution rate via direct appropriations is 9.5 percent for ERS Retirement. In addition, state agencies contribute 0.5 percent of payroll, for a total employer contribution of 10.0 percent for fiscal years 2018 and 2019. Before changes made during the Eighty-fourth Legislature, 2015, the state's total contribution was 8.0 percent, and the member contribution was 6.9 percent.

For LECOS and JRS II, state contributions are 0.5 percent and 15.663 percent, respectively, for fiscal years 2018 and 2019. **Figure 6** shows state, member, and other contribution rates for all three retirement systems. (See **Appendix A – Appropriations** for actual appropriation amounts.)

FIGURE 6
EMPLOYEES RETIREMENT SYSTEM RETIREMENT PLANS CONTRIBUTION STRUCTURE
FISCAL YEARS 2018 AND 2019

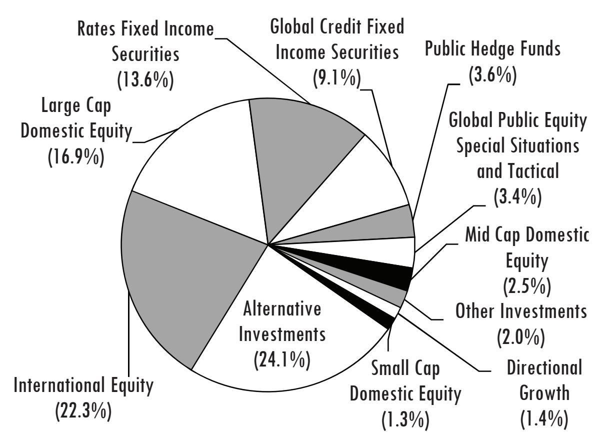
PLAN	STATE	MEMBER	OTHER	TOTAL
ERS	9.5%	9.5%	0.5% (2)	19.5%
LECOS	0.5%	0.5%	$18.8 million (3)	1.0% + $18.8 million
JRS II	15.663%	7.5% (4)	N/A	23.163%

NOTES:
(1) ERS=Employees Retirement System of Texas; LECOS=Law Enforcement and Custodial Officer Supplemental Retirement Program; JRS II=Judicial Retirement System Plan II.
(2) Agencies contribute 0.5% of payroll in addition to the state's 9.5% contribution.
(3) For fiscal year 2018, the court fee contribution is approximately 1.09% percent of payroll.
(4) The effective member contribution rate is 7.43% as some active members elect to cease contributions.
SOURCE: Legislative Budget Board.

INVESTMENT OF ASSETS

The ERS Board of Trustees oversees the investment of the system's trust fund assets. Initially, ERS was required to invest only in government securities. In 1958, investments were authorized in corporate securities, common stocks, preferred stocks, debentures, bonds, mortgages, and other financial instruments. Current investment strategies employ a diversified portfolio with a mix of active and passive management, and an array of management styles (**Figure 7**). Approximately 61.0 percent of assets are managed internally, and 39.0 percent are advised externally.

FIGURE 7
EMPLOYEES RETIREMENT SYSTEM TRUST FUND ASSET ALLOCATION
AUGUST 31, 2017

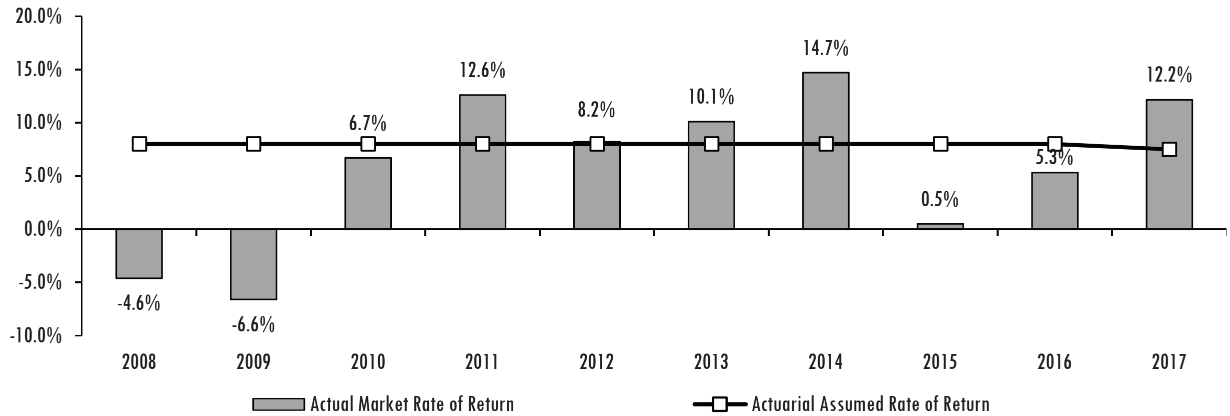


SOURCE: Employees Retirement System.

Investment policies of ERS are governed by the Texas Trust Code, the Texas Constitution, and other applicable federal and state statutes. Trained staff manage fund assets daily. To assist the staff and the board with investment recommendations and decisions, the board employs investment managers and has appointed an Investment Advisory Committee made up of Texas financial and business contributors. In addition, ERS retains several independent investment consultants to evaluate and analyze investment strategies and results.

The total portfolio was valued at $27.6 billion at the end of fiscal year 2017, and assets earned 12.2 percent for fiscal year 2017, gross before expenses, compared to 5.3 percent in fiscal year 2016. Annual rates of return for the three-year, five-year, and 10-year periods ending August 31, 2017, were 5.9 percent, 8.4 percent, and 5.7 percent, respectively. **Figure 8** shows the annual gross rate of return on investment for the retirement trust fund's assets since fiscal year 2008, and the assumed rate of return, which was 8.0 percent until 2017, when the board changed it to 7.5 percent. A commonly used actuarial technique called smoothing defers part of each year's performance, whether gains or losses. The ERS consulting actuary smooths investment performance when determining the actuarial value of assets in an effort to lessen the effect of marketplace volatility on the overall actuarial analysis from year to year.

FIGURE 8
EMPLOYEES RETIREMENT SYSTEM TRUST FUND ASSETS ANNUAL RATES OF RETURN ON INVESTMENT: ACTUAL COMPARED TO ASSUMED
FISCAL YEARS 2008 TO 2017



NOTE: The The five-year average annual return is 8.4 percent, and the 10-year average annual return is 5.7 percent.
SOURCE: Legislative Budget Board.

ACTUARIAL VALUATION

An actuarial valuation report is prepared at the close of each fiscal year by an outside consulting actuary. The valuation analyzes the plan's accrued liability compared to its assets. It considers all aspects of the pension plan including membership data, benefit structure, assets held in trust, actuarial assumptions, funding methodology, and contribution rates. Technical modeling yields data including the normal cost rate, unfunded actuarial accrued liability (UAAL), funded ratio, annual required contribution rate, and funding period. These data points serve in guiding daily management and higher-level policy decisions addressed by the Board of Trustees and the Legislature. (See **Appendix C – Glossary** for a definition of related terms.) In addition to the annual actuarial valuation, an actuarial update on the market value of assets only is conducted as of February 28 of each odd-numbered year, which provides the Legislature with updated information during the legislative session.

Investment assumptions and performance are major factors in determining the actuarial condition of a retirement system. The assumed rate of return is what ERS expects its investments to earn each year, on average. This assumption is used to assess the long-term health of the retirement trust and determine whether the system will be able to meet obligations. In August 2017, the Board of Trustees and the Investment Advisory Committee changed the assumed rate of return to 7.5 percent to provide a more realistic forecast of financial conditions. The board also chose to reset the actuarial smoothed value of assets equal to market value, a onetime change that recognized deferred losses, and prospectively changed its asset-smoothing method.

Actuarial soundness of the pension plan refers to the goal that total contributions are sufficient to fund the normal cost and to amortize the unfunded accrued liability during no more than 31 years. This standard is set in state law and reflects a common actuarial objective. The August 31, 2017, actuarial valuations for the ERS retirement plans can be found at www.ers.texas.gov. The annual valuations form the basis of the ERS requests for funding during each legislative session. (JRS I is funded on a pay-as-you-go basis, meaning the funds required for monthly annuity payments and refunds of member contributions are appropriated for each fiscal year in General Revenue Funds.)

According to the August 31, 2017, actuarial valuation, the market value of the ERS retirement fund is approximately \$26.4 billion, an increase of approximately \$1.9 billion, or 7.8 percent, from the previous fiscal year. The August 31, 2017, actuarial valuation for the ERS retirement program shows a funded ratio of 70.1 percent, 5.1 percentage points less than the funded ratio of the previous valuation as of August 31, 2016. (See **Appendix C – Glossary**.) This decrease in the funded ratio is due primarily to the reduced rate of return previously discussed. The total contribution rate of 19.5 percent of payroll for fiscal year 2017 is insufficient to amortize the unfunded accrued liability in a finite amount of time. Because this period is more than 31

FIGURE 9
EMPLOYEES RETIREMENT SYSTEM RETIREMENT ELIGIBILITY
AUGUST 31, 2017

EMPLOYEE CATEGORY		RETIREMENT ELIGIBILITY	ANNUITY REDUCTION
Plan 1	Hired before September 1, 2009	5 years of service and age 60 OR Rule of 80	None
Plan 2	Hired on or after September 1, 2009, and before September 1, 2013	10 years of service and age 65 OR Rule of 80	5.0% for each year retired before age 60 (25.0% maximum)
Plan 3	Hired on or after September 1, 2013	10 years of service and age 65 OR Rule of 80	5.0% for each year retired before age 62 (No maximum)

NOTE: The Rule of 80 is met when the sum of the retiree's age and years of service credit in the Employees Retirement System equals or exceeds 80.0 at the time of retirement.
SOURCE: Employees Retirement System.

years, the fund remains actuarially unsound. Furthermore, the assets are anticipated to be depleted in fiscal year 2084. To make the fund actuarially sound, the total required contribution rate as a level percentage of total payroll is 23.27 percent for fiscal year 2018. With a member contribution rate of 9.5 percent of payroll and an employer contribution of 0.5 percent of payroll, the fiscal year 2018 state contribution would have to be 13.27 percent to fund the liability within 31 years, which exceeds the maximum state contribution of 10.0 percent established by the Texas Constitution. Furthermore, the Texas Government Code, Section 811.006, precludes any supplemental payments, such as a thirteenth check to retirees at the end of a fiscal year or increases in annuity benefits, unless the fund is actuarially sound and would remain so after making any supplemental payments.

The August 31, 2017, actuarial valuation for the LECOS fund shows a funded ratio of 66.0 percent, 5.1 percentage points less than the funding ratio of the 2016 valuation. The total contribution rate of 1.0 percent of payroll, plus approximately $18.8 million in court fees, is not sufficient to amortize the unfunded accrued liability. Therefore, the funding period remains infinite. The total required contribution rate as a level percentage of total payroll is 3.67 percent for fiscal year 2017; for fiscal year 2018, the total contribution rate necessary to achieve actuarial soundness is 2.96 percent in addition to court fees. With a member contribution rate of 0.5 percent of payroll and court fees, the state contribution would have to be 2.46 percent to fund liabilities within 31 years. According to the August 31, 2017, actuarial valuation, the market value of the ERS LECOS fund is approximately $924.0 million, an increase of approximately $63.9 million from the previous fiscal year.

The August 31, 2017, actuarial valuation for the JRS II fund shows a funded ratio of the actuarial value of assets to the actuarial accrued liability of 90.8 percent, 2.1 percentage points less than the funding ratio as of the previous valuation. The total contribution rate of 23.163 percent of payroll is sufficient to amortize the unfunded accrued liability in 63 years; however, the fund remains actuarially unsound because the funding period is more than 31 years. The total required contribution rate as a level percentage of payroll to achieve actuarial soundness for fiscal year 2018 is 24.00 percent. Considering that the member contribution rate is effectively 7.43 percent of payroll, the state contribution would have to be 16.57 percent to achieve soundness. According to the August 31, 2017, actuarial valuation, the market value of the ERS JRS II fund is approximately $420.9 million, an increase of $39.7 million from the previous fiscal year.

RETIREMENT ELIGIBILITY

Members of ERS become eligible to receive their retirement benefits, or vested, when they have five or 10 years of creditable service, depending upon the dates they began their state employment. Service credit refers to the length of time worked in which all required contributions have been made, and it also may include purchased active duty military time, months of unused sick and annual leave, and other eligible service. The purchase of additional service credit is available to enable certain qualified individuals to retire earlier and to increase the amounts of their annuity payments. **Figure 9** shows eligibility requirements for employee categories, based on when the employee was hired.

The LECOS retirement plan and the two judicial plans, JRS I and JRS II, have provisions that authorize early service retirement with decreased benefits. The amount of the decrease is calculated based on the member's age at the time of retirement.

Additional information related to retirement plan eligibility requirements can be found at www.ers.texas.gov.

Figure 10 shows the annuitant profile for fiscal years 2016 and 2017.

Figure 11 shows annual ERS retirement totals since 2008 and the percentage change each year.

RETIREMENT BENEFITS

The ERS retirement system is a qualified, defined benefit plan pursuant to the U.S. Internal Revenue Code, Section 401(a). A defined benefit plan uses employer and employee contributions during the employee's working years to prefund the employee's pension benefits primarily through long-term investment earnings. During fiscal year 2017, ERS paid pension benefit payments totaling $2.4 billion. For the general employee plan, the standard annuity pays 2.3 percent (referred to as the multiplier) of the employee's final average salary for each year of service credit. The final average salary is based on the greatest salary for 36 months for employees hired before September 1, 2009, or who had an account balance with ERS on August 31, 2009. For employees hired on or after September 1, 2009, the final average salary is based on the greatest salary for 48 months. For employees hired on or after September 1, 2013, the final average is based on the greatest salary for 60 months.

FIGURE 10
EMPLOYEES RETIREMENT SYSTEM ANNUITANT PROFILE
FISCAL YEARS 2016 AND 2017

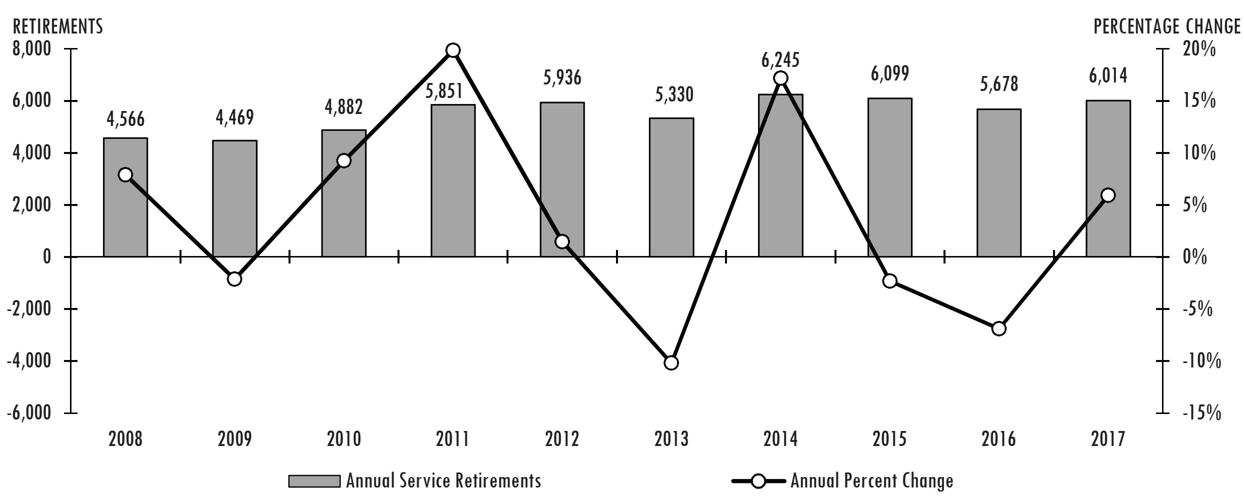
ANNUITANT PROFILE	2016	2017
Service and Disability Retirements	5,668	5,966
Average Age at Retirement	58.3	58.3
Average Years of Service	22.2	22.1
Ratio of Current Members to Retirees	1.41 to 1	1.32 to 1

SOURCE: Employees Retirement System.

Example calculation:
($3,000 average monthly salary)
X (20 years of service credit)
X (2.3 percent multiplier)
=$1,380 monthly standard annuity.

All of the retirement programs that ERS administers have optional benefits to provide a continuing annuity for a participant's designated surviving beneficiary. If the member chooses one of the available survivor benefit options, his or her monthly annuity is decreased depending on the option chosen. If the beneficiary dies before the retired member, the annuity paid to the member is increased to the standard annuity.

FIGURE 11
EMPLOYEES RETIREMENT SYSTEM ANNUAL RETIREMENTS AND ANNUAL PERCENTAGE CHANGE
FISCAL YEARS 2008 TO 2017



NOTE: Includes retirements for Employees Retirement System (ERS) and Judicial Retirement System Plan II. Law Enforcement and Custodial Officer Supplement retirements are included in ERS retirements.
SOURCE: Employees Retirement System.

Members have five alternatives for annuity payments in lieu of a standard annuity. The retiree may select one of three joint and survivor options, or one of two guaranteed-period annuities that provide a lifetime benefit to the retiree, with a guaranteed benefit of either 60 months or 120 months payable to the beneficiary if the retiree dies before the period ends. The alternative payments may be decreased by actuarial factors, based on the ages of the member and beneficiary.

Service percentage for members of the LECOS retirement program is calculated based on 2.8 percent for each year of service. The base service retirement annuity for members of the judicial retirement programs is 50.0 percent of the state salary for a judge of a court of the same classification as the court on which the judge last served. Monthly retirement annuities are adjusted automatically each time judicial salaries change.

ERS and LECOS retirees also may choose a partial lump-sum option at retirement. This option provides a lump-sum payment equal to up to 36 months of the standard annuity, with a permanent actuarial decrease of the monthly annuity. This option is not available to members who accept a disability retirement or an early age retirement, or those who retire through the Proportionate Retirement Program.

The formula for calculating benefits is the same for all elected class groups, regardless of when they began serving; however, eligibility and benefits differ from those of state employees. The primary difference is the calculation of the final average salary. For the elected class, this calculation is based on the salary of a district judge, currently set at $140,000 annually. The monthly standard annuity for a retiring elected class member may not exceed 100.0 percent of the state salary of a district judge.

DISABILITY RETIREMENT BENEFITS

Two types of disability retirement benefits are available to members of ERS: occupational and nonoccupational. ERS defines an occupational disability as "a sudden and unexpected injury or disease that results solely from a specific act or occurrence determinable by a definite time and place and solely from an extremely dangerous risk of severe physical or mental trauma or disease that is not common to the public at large and that is peculiar to and inherent in a dangerous duty that arises from the nature and in the course of a person's state employment." An example would be if a state trooper is shot in the line of duty and the injury results in a permanent and disabling condition. If all requirements are met, a benefit may be paid with at least one month of membership service credit.

A nonoccupational disability does not have to be related to the work being performed; this type of benefit is available only to employees with 10 years of membership service credit. An example of a qualifying nonoccupational disability retirement is if an employee is diagnosed with a terminal illness and is unable to continue working. Members must meet the conditions for one of these types of disability and must be certified by the ERS Medical Board to receive the retirement annuity and insurance benefits.

PROPORTIONATE RETIREMENT

State law also provides the Proportionate Retirement Program, which enables members to combine service credit from two or more retirement systems within the program to meet retirement eligibility. Annuity calculations are unaffected and continue to reflect only the amount of service credit in each system. A member of any of the retirement systems that take part in the Proportionate Retirement Program may purchase withdrawn ERS service without being reemployed by the state, and may purchase canceled service from any of the retirement systems participating in the program. Participating retirement systems include:

- ERS;
- TRS;
- JRS I and JRS II;
- Texas Municipal Retirement System;
- Texas County and District Retirement System;
- City of Austin Employees Retirement System;
- El Paso City Employees' Pension Fund;
- El Paso Firemen and Policemen's Pension Fund; and
- City of Austin Police Retirement System.

DEATH BENEFITS

In addition to the survivor benefits previously mentioned, ERS pays a $5,000 lump-sum death benefit to designated beneficiaries of retirees. ERS also provides basic life insurance coverage for active employees and retirees ($5,000 and $2,500, respectively), and members have the option to purchase additional life insurance. (See the section regarding Optional Coverage.) In addition, the state provides a $500,000 lump-sum payment to survivors and financial assistance for certain surviving children of a law enforcement officer, firefighter, or other eligible state or local public safety employee who is killed in the line of duty.

SIGNIFICANT LEGISLATION

Three bills passed by the Eighty-fifth Legislature, Regular Session, 2017, contain provisions particularly affecting ERS retirement and death benefits:

House Bill 1526 – Death benefits and Community Supervision and Corrections Departments group insurance. The legislation provides public safety death benefits to survivors of peace officers employed by private institutions of higher education or private junior colleges who are killed in the line of duty.

Senate Bill 301 – Employees Retirement System Sunset Review. The legislation implements several recommendations of the Sunset review process and sets the agency's next Sunset review for 2029. The legislation changes the timing of actuarial experience studies from every five years to every four years and requires additional approvals and reporting regarding alternative investments.

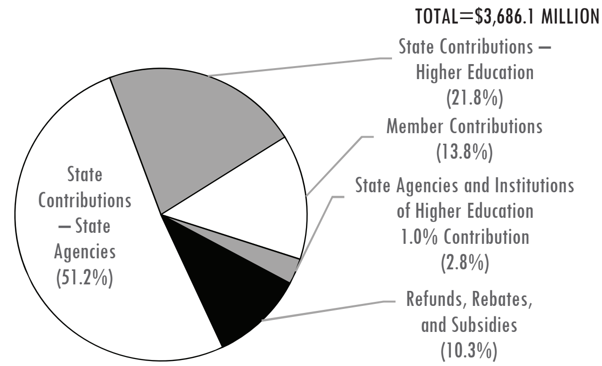
Senate Bill 500 – Retirement benefits for elected state officials. The legislation prevents certain state and local elected officials from receiving a pension if they are convicted of a felony related to the performance of their official duties.

GROUP BENEFITS PROGRAM

HISTORY

In 1975, the Legislature established the Texas Employees Uniform Group Insurance Program to provide health insurance and other optional coverage for employees, retirees, and their eligible dependents beginning September 1, 1976. The program started as an indemnity health plan defined and administered by the Texas Insurance Code, Chapter 1551, the Texas Employees Group Benefits Act. Health maintenance organizations (HMO) at that time provided health services to participants who chose to use them. The program now is called the Group Benefits Program (GBP), and it offers health insurance coverage to state employees and most institutions of higher education, except the University of Texas and Texas A&M University systems, which administer their own programs. (The Texas Municipal Retirement System, the Texas County and District Retirement System, local Community Supervision and Corrections Departments (CSCD), and other nonstate entities also participate in the GBP. This publication discusses the program only as it relates to state agency and higher education participants.)

FIGURE 12
EMPLOYEES RETIREMENT SYSTEM GROUP BENEFITS PROGRAM FUNDING SOURCES, FISCAL YEAR 2017



SOURCES: Legislative Budget Board; Employees Retirement System.

STATE FUNDING AND APPROPRIATIONS

Group Benefits Program premiums are funded by a combination of sources: state contributions, member contributions, employer contributions, local funds from participating entities, and investment earnings. The GBP is not prefunded like the retirement plans; it is funded on a pay-as-you-go basis. **Figure 12** shows the revenue allocation of the program's five major funding sources for fiscal year 2017. Funding from all sources is deposited into the Employees Life, Accident, Health Insurance and Benefits Trust Account, also known as the GBP Trust Fund or Contingency Reserve Fund, from which all claims are paid. The fund had a balance of $797.7 million at the end of fiscal year 2017; this balance is affected by revenues, expenditures, plan experience, rebates, subsidies, and related contract agreements. In addition to the amounts shown in **Figure 12**, GBP members also paid $491.4 million in fiscal year 2017 in cost sharing for copayments, coinsurance, and deductibles.

The state pays 100.0 percent of the premium for full-time employees and 50.0 percent of dependent coverage; members pay the other 50.0 percent of the dependent coverage. For part-time employees and graduate teaching assistants, the state and the participants each contribute 50.0 percent. For those participants' dependents, the state contributes 25.0 percent.

In addition to the state contribution, the GAA requires all general state agencies and institutions of higher education that participate in the GBP to contribute 1.0 percent of base payroll for group health insurance. The Eighty-fifth Legislature, GAA, 2018–19 Biennium, also instructs ERS to continue assessing a monthly $30 tobacco user premium differential to GBP participants who use tobacco. ERS began covering prescription drugs for tobacco cessation in 2012.

The Legislature appropriates funds for the state contribution at the end of each article of the GAA for general state agencies as an estimated appropriation. The total appropriation for all state agencies is shown as an informational listing in the ERS appropriation bill pattern. Higher education institutions receive separate sum-certain appropriations for insurance and must supplement any shortages with local funds. (See **Chapter 5. Higher Education Employees Group Insurance** and **Appendix A – Appropriations** for actual appropriation amounts.)

ELIGIBILITY AND MEMBERSHIP

All state employees and their dependents are eligible for the GBP. Retirees must have at least 10 years of ERS service credit, which may include up to five years of military service credit, but may not include any other special or equivalent service credit purchased. Additionally, the participant must meet one of the following requirements:

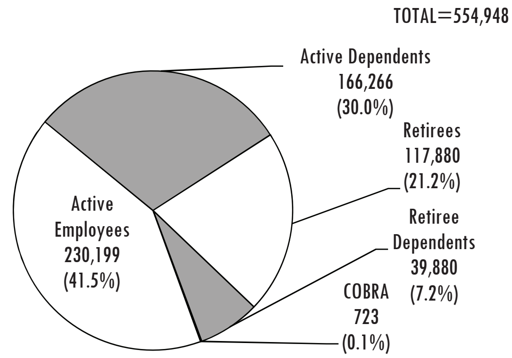
- the sum of the retiree's age and years of service credit in ERS must equal or exceed 80.0 at the time of retirement, regardless of whether the retiree had a decrease in the retirement annuity for early age (years of service credit can include all purchased service); or
- the retiree must be age 65 or older.

Disability retirees are eligible for the GBP regardless of the number of years of service credit.

Pursuant to Senate Bill 1459, Eighty-third Legislature, Regular Session, 2013, ERS implemented tiered insurance for retirees, which applied to all employees who had less than five years of service as of September 1, 2014. Employees who retire with more than 15 years but less than 20 years of service will receive 75.0 percent of the full state contribution for insurance. Employees who retire with more than 10 years but less than 15 years of service will receive 50.0 percent of the full state contribution for insurance upon retirement.

Figure 13 shows participation in the ERS Group Benefits Program.

FIGURE 13
EMPLOYEES RETIREMENT SYSTEM GROUP BENEFITS PROGRAM PARTICIPATION
AUGUST 31, 2017



NOTE: COBRA=The U.S. Consolidated Omnibus Budget Reconciliation Act provides elective continuation of health coverage.
SOURCE: Employees Retirement System.

PROGRAM STRUCTURE

Health and other insurance benefits are subject to change based on available state funding. The ERS board designs and contracts for the insurance options offered in the GBP based upon anticipated contributions, experience, and other factors such as cost-savings measures. The GBP offers two types of health insurance plans: HealthSelect and HMOs. Both types provide comprehensive health and prescription drug benefits, but the benefits work differently. HealthSelect is available in all Texas counties; HMOs provide services to specific counties, and employees can enroll in an HMO if they live or work in a county served by one of the HMOs in the program.

HealthSelect is a self-funded plan that was introduced in 1992. HealthSelect is administered by Blue Cross and Blue Shield of Texas, and the pharmacy benefit manager is Optum Rx. Participating HMOs for plan year 2018 are Community First Health Plans (San Antonio), Scott & White Health Plan (Central Texas area), and KelseyCare powered by Community Health Choice (Houston area).

In fiscal year 2017, the GBP paid 6.1 million medical claims and expended $3.5 billion in payments to hospitals, pharmacies, and other healthcare providers.

House Bill 966, Eighty-fourth Legislature, Regular Session, 2015, directed ERS to establish a voluntary, consumer-directed health plan, which would include a high-deductible health plan and a health savings account, as an option for GBP participants. The legislation also requires the state to contribute the difference, if any, between the full state contribution to HealthSelect and coverage cost of the high-deductible plan, to a health savings account. At the end of fiscal year 2017, 614 members and 491 dependents were enrolled in Consumer Directed HealthSelect.

OPTIONAL COVERAGE

In addition to health insurance and the accompanying prescription drug program, the following optional coverage programs are offered: dental, vision insurance, term life insurance, voluntary accidental death and dismemberment, long-term and short-term disability, and long-term care. The Legislature introduced a flexible spending account, now known as a healthcare reimbursement account (TexFlex), for state employees in 1988. TexFlex provides employees with the opportunity to fund accounts for themselves and their dependents with payroll deductions that reduce federal income and Social Security taxes. State employees may contribute $15 to $217 per month, or $180 to $2,600 per year. TexFlex reimburses medical, dental, and vision expenses such as copayments, deductibles, coinsurance, and other costs that exceed the health plan benefit. The program operates on participant fees.

ERS has three dental plans available to employees and retirees: the Dental HMO, the State of Texas Dental Choice PPO Plan, and the Dental Discount plan. The Dental HMO works like a typical HMO, and members and their eligible dependents must receive their dental care within the Dental HMO service area. The Dental Choice PPO Plan enables members to visit any dentist, and they and their eligible dependents can enroll regardless of where they live. The Dental Discount Services plan provides discounts instead of dental insurance for specific dental services from participating dentists.

The vision insurance plan, called State of Texas Vision, is available to employees, retirees, and eligible dependents. Copayments are set for standard vision-related services such as eye examinations and lenses that are provided in the network. Maximum reimbursement amounts are set for services provided outside of the network.

Basic term life insurance coverage is included with GBP health coverage. An employee receives a $5,000 policy, and a retiree receives a $2,500 policy. Employees also may enroll in group term life insurance coverage worth one time or two times their annual salaries without proof of good health. With evidence of insurability, employees may enroll in life insurance coverage worth three times or four times their annual salaries. Retirees may continue the coverage they had as employees or enroll in a $10,000 policy.

Dependent term life insurance coverage provides coverage for each enrolled family member and requires a monthly premium. An employee's dependent is eligible for a $5,000 policy, and a retiree's dependent is eligible for a $2,500 policy.

Voluntary accidental death and dismemberment (AD&D) coverage provides benefits in the event of an accident or certain accidental injuries. This coverage is in addition to AD&D benefits provided with basic and optional term life for active employees, and it requires a monthly premium.

Short-term disability and long-term disability insurance are available in the GBP. The short-term disability benefit provides a portion of an employee's monthly salary if illness or injury keeps him or her from working. To be eligible for benefits, a physician must certify the employee as totally disabled. Benefits are paid for up to five months. The long-term disability benefit works the same way except that the length of time the employee receives benefit payments depends on the employee's age at the onset of the disability.

Long-term care insurance is offered only to currently enrolled state employees, retirees, and certain family members. It provides certain benefits not covered by the medical plan, such as nursing home care and day activity and health services. The insurance has been closed to new enrollees since January 1, 2012.

Effective January 1, 2013, Medicare-eligible retirees are enrolled automatically in the HealthSelect Medicare Advantage plan, administered by Humana, but they may opt out. Medicare Advantage is a preferred provider organization plan, which provides the same level of coverage at a lower cost to the state and retirees. As of August 31, 2017, approximately 72,800 participants were enrolled in the plan.

SIGNIFICANT LEGISLATION

Two bills passed by the Eighty-fifth Legislature, Regular Session, 2017, contain provisions that particularly affect ERS group insurance and the Group Benefits Program:

House Bill 1526 – Death benefits and Community Supervision and Corrections Departments group insurance. The legislation makes the state, instead of the Department of Criminal Justice, Community Justice Assistance Division, responsible for paying insurance contributions for employees of Community Supervision and Correction Departments.

Senate Bill 301 – Employees Retirement System Sunset Review. The legislation implements several recommendations of the Sunset review process and sets the agency's next Sunset review for 2029. The legislation requires a new process enabling members to participate directly in Group Benefits Program benefit determinations and expands annual reporting on the GBP.

3. TEACHER RETIREMENT SYSTEM

RETIREMENT

HISTORY

The Teacher Retirement System of Texas (TRS) was established by an amendment to the state constitution in 1936 and by acts of the Texas Legislature in 1937 to provide a statewide teacher retirement system to public and higher education employees. TRS administers a traditional, defined benefit retirement plan that provides service and disability retirement, death benefits, and survivor benefits to eligible Texas public and higher education employees and their beneficiaries. The pension plan operates pursuant to the Texas Constitution, Article XVI, Section 67, and applicable federal and state governing statutes, and it is a qualified pension trust pursuant to the U.S. Internal Revenue Code, Section 401(a).

The agency has two core responsibilities: (1) to deliver retirement benefits, group insurance, and death, survivor, and disability benefits to employees of public schools, colleges, and universities as authorized by the Texas Legislature; and (2) to manage the trust funds that finance member benefits.

GOVERNANCE AND POLICY

The TRS Board of Trustees administers retirement and related benefits for employees of public, state-supported, educational institutions in Texas. Statute grants the board significant independence in the operation and management of retirement fund investments. The board is composed of nine trustees who are appointed by the Governor, with the approval of the Texas Senate, and who serve staggered, six-year terms. Three trustees are direct appointments by the Governor and are individuals who have demonstrated financial expertise, have broad investment experience, and are not active or retired members of the system. Two trustees are appointed by the Governor from a list of candidates offered by the State Board of Education. These trustees also must possess demonstrated financial experience and broad investment expertise. The remaining four trustee appointments are selected from lists of three or fewer candidates who receive the most votes in elections among active and retired public and higher education employees. As fiduciaries of the trust fund, the trustees are responsible for the prudent management of assets held in the trust, seeking long-term investment returns that meet or exceed the established actuarially assumed rate of return.

MEMBERSHIP

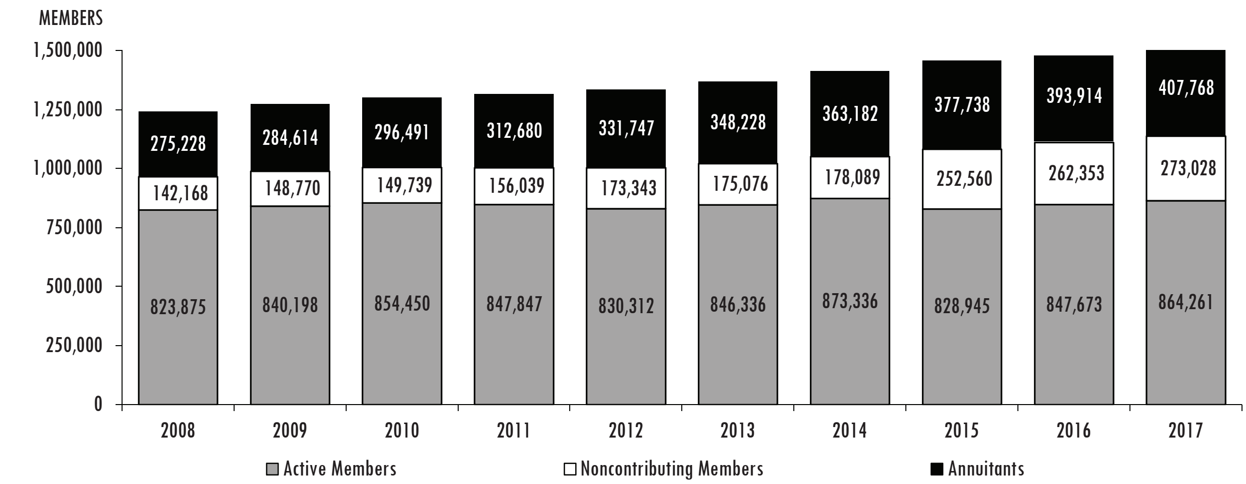
Membership in TRS is a condition of employment for all employees of public, state-supported educational institutions who work at least 20.0 hours or more per week and at least 4.5 months during one school year. Public education employees in membership-eligible positions are required to participate in TRS and are enrolled automatically in TRS on the first day of employment. Unless excluded from membership by law, participation in TRS cannot be waived by public education employees. Certain eligible employees of institutions of higher education are offered a onetime, irrevocable option to elect the Optional Retirement Program (ORP) as an alternative to the Teacher Retirement System. (See **Chapter 4. Optional Retirement Program**.)

As of August 31, 2017, TRS had approximately 1.5 million members, including 864,261 active members, 407,768 retired annuitants, and 273,028 inactive vested and nonvested members. Public school employees constitute approximately 78.0 percent of the TRS-covered payroll; higher education and state agency employees make up the remaining 22.0 percent. **Figure 14** shows TRS membership, active and retired, since fiscal year 2008.

CONTRIBUTIONS

The TRS pension plan is a cost-sharing plan funded by member, state, and employer contributions to the trust fund and by investment earnings of pension trust fund assets. Contributions by all sources for fiscal year 2017 are shown in **Figure 15**. Statute sets the active member contribution rate at 7.7 percent of total employee compensation. This rate became effective during fiscal year 2017, following increases phased in by Senate Bill 1458, Eighty-third Legislature, Regular Session, 2013. Statute also requires school districts and charter schools that do not contribute to Social Security for TRS-eligible employees to contribute 1.5 percent of either the statutory minimum salary or an employee's total salary, dependent upon whether or not each employee's position is subject to the state statutory minimum salary schedule.

FIGURE 14
TEACHER RETIREMENT SYSTEM MEMBERSHIP, FISCAL YEARS 2008 TO 2017



SOURCE: Teacher Retirement System.

FIGURE 15
TEACHER RETIREMENT SYSTEM ACTUAL CONTRIBUTIONS, FISCAL YEAR 2017

(IN MILLIONS)	6.8% STATE CONTRIBUTION		1.5% LOCAL CONTRIBUTION	7.7% EMPLOYEE CONTRIBUTION	
CATEGORY	STATE APPROPRIATIONS	EMPLOYERS (1)	CERTAIN PUBLIC EDUCATION EMPLOYERS (2)	ACTIVE MEMBERS	TOTAL CONTRIBUTIONS
Public Education	$1,647.1	$593.6	$408.7	$2,537.2	$5,186.5
Percentage of Total	25.3%	9.1%	6.3%	39.0%	79.8%
Higher Education	$214.3	$398.3	N/A	$700.9	$1,313.5
Percentage of Total	3.3%	6.1%	N/A	10.8%	20.2%
Total	**$1,861.4**	**$991.9**	**$408.7**	**$3,238.1**	**$6,500.1**

NOTES:
(1) Employer portion of the 6.8% state contribution includes amounts associated with school district salary paid greater than the state's statutory minimum salary schedule for educators, contributions for new members in the first 90 days of membership, and contributions for public and higher education employees paid from federal funding and private grants for salary amounts paid from those sources.
(2) Public education employers not participating in Social Security pay 1.5% of member payroll as an additional contribution.
(3) Higher education state appropriations include funding from the Pension Trust Fund for TRS employee retirement.
Figure totals may not sum due to rounding.
SOURCES: Legislative Budget Board; Teacher Retirement System.

The Texas Constitution, Article XVI, Section 67, establishes that the state contribution rate must range from 6.0 percent to 10.0 percent of total TRS-related payroll, except in an emergency declared by the Governor. The General Appropriations Act (GAA) sets the state contribution rate for each biennium within that range. For the 2018–19 biennium, the state contribution is 6.8 percent of total employee compensation. **Figure 16** shows contribution rates for the last three biennia.

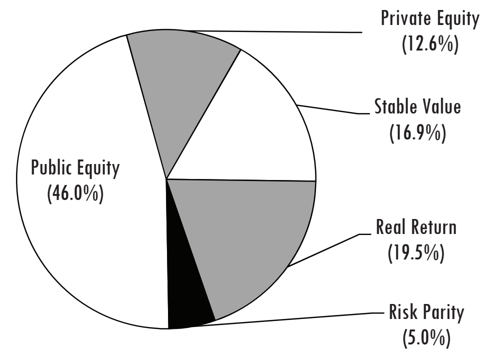
Statute further limits state retirement contributions to TRS for public community and junior colleges to 50.0 percent of the creditable compensation of members whose duties are instructional or administrative. An additional limit to state retirement contributions applies for each community and junior college based on the growth of each college's staff size in proportion to changes in student enrollment. Additionally, statute links the state contribution rate to the member and district contribution rates, establishing that any decrease of the state contribution rate to less than 6.8 percent will result in equal and corresponding decreases of the member and district contribution rates to less than 7.7 percent and 1.5 percent, respectively.

FIGURE 16
TEACHER RETIREMENT SYSTEM RETIREMENT CONTRIBUTION RATES
FISCAL YEARS 2014 TO 2019

YEAR	STATE CONTRIBUTION	LOCAL CONTRIBUTION (1)	EMPLOYEE CONTRIBUTION
2014	6.8%	0.0%	6.4%
2015	6.8%	1.5%	6.7%
2016	6.8%	1.5%	7.2%
2017	6.8%	1.5%	7.7%
2018	6.8%	1.5%	7.7%
2019	6.8%	1.5%	7.7%

NOTE: Local contribution includes only public education employers not participating in Social Security.
SOURCE: Teacher Retirement System.

FIGURE 17
TEACHER RETIREMENT SYSTEM ASSET ALLOCATION
AUGUST 2017



SOURCE: Teacher Retirement System.

An additional rule known as proportionality limits the share of the 6.8 percent state contribution that may be funded by General Revenue Funds for most TRS members. (See **Appendix C – Glossary**.) For TRS retirement, this rule applies to funds appropriated in the GAA and certain federal and local funds held by employers outside the state Treasury. Employers transfer these funds directly to TRS without appropriation. This rule applies to all TRS members except for community college employees, whose benefits may be paid from any source of funds regardless of whether the salaries are paid from appropriated funds.

INVESTMENT OF ASSETS

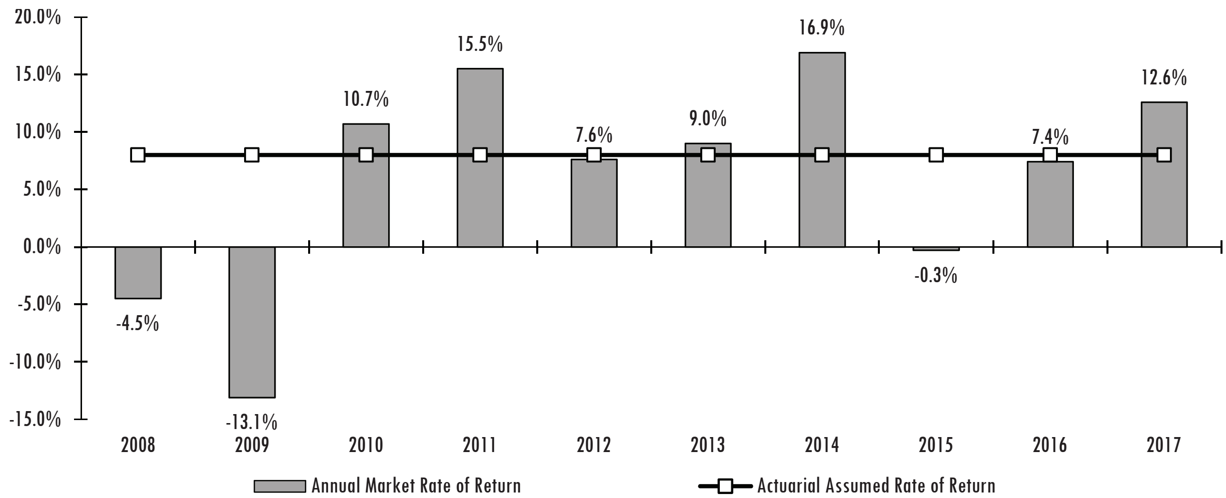
The TRS Board of Trustees oversees the investment of the system's trust fund assets. Professional investment staff manage fund assets. To assist the staff and the board with investment recommendations and decisions, the board employs independent investment consultants to evaluate and analyze investment strategies and outcomes.

TRS investment risks are diversified throughout market sectors and securities. The investment strategy is intended to improve long-term investment results while decreasing downside market risk. At the end of fiscal year 2017, global equity investments (public and private equity) made up approximately 58.6 percent of the system's investments. Other investments included 16.9 percent allocated to a stable value portfolio (fixed, short-term, and hedge funds), 19.5 percent allocated to real return investments (bonds, commodities, natural resources and infrastructure, real estate, and other real assets), and 5.0 percent to risk parity. **Figure 17** shows TRS asset allocation as of August 31, 2017.

The Eighty-second Legislature, Regular Session, 2011, passed legislation to broaden authority on investment products such as futures contracts, options, swaps, and other investment tools. The legislation continued board authority to delegate up to 30.0 percent of the portfolio to external investment managers and raised the threshold limiting investments in hedge funds from 5.0 percent to 10.0 percent of the portfolio. Both provisions were set to expire September 1, 2019, unless reauthorized by the Legislature. The Eighty-fifth Legislature, Regular Session, 2017, continued the first provision related to board authority to delegate to external investment managers by removing the provision's expiration date. TRS has expanded the role of alternative investments in its overall strategy to improve effective diversification, risk management, and long-term performance.

The actual return on investment for fiscal year 2017 was 12.6 percent. The three-year, five-year, and 10-year average annual returns as of August 31, 2017, were 6.4 percent, 9.0 percent, and 5.8 percent, respectively. **Figure 18** shows the annual rate of return on investment for the retirement trust fund's assets since fiscal year 2008. However, the system's actuary uses a five-year smoothing of investment performance when conducting the actuarial valuation. The actuary recognizes 20.0 percent of the annual gains or losses for the year of performance; the remainder is smoothed at 20.0 percent per year during the next four years. As of the August 31, 2017, actuarial valuation, the fund has $1.1 billion in deferred gains to recognize in future valuations, compared to $4.8 billion in deferred losses as of the August 31, 2016, valuation.

FIGURE 18
TEACHER RETIREMENT SYSTEM TRUST FUND ASSETS ANNUAL RATES OF RETURN ON INVESTMENT: ACTUAL COMPARED TO ASSUMED
FISCAL YEARS 2008 TO 2017



NOTE: The five-year average annual return is 9.0 percent and the 10-year average annual return is 5.8 percent.
SOURCE: Teacher Retirement System.

ACTUARIAL VALUATION

An outside consulting actuary conducts an actuarial valuation annually based on data as of August 31, the last day of the system's fiscal year. Valuations determine the adequacy of the total contribution rate for addressing system solvency by comparing the value of the pension trust fund's assets against its liabilities. Actuarial valuations account for current and projected assets and liabilities. Valuations also consider various other factors, including demographic trends and longevity, projected retirement system membership and salaries, and trends in members' retirement behavior. The TRS retirement trust fund is considered actuarially sound if its funding and investment income are sufficient to cover its normal cost (see **Appendix C – Glossary**) and pay off any unfunded liabilities within 31 years. The TRS actuarial valuation report can be found at www.trs.texas.gov.

In addition to the annual actuarial valuation, an actuarial update on the market value of assets only is conducted as of February 28 of each odd-numbered year, which provides the Legislature with updated information during the legislative session.

As of the August 31, 2017, actuarial valuation, the market value of the TRS pension trust fund is $147.4 billion, compared to $134.0 billion at the close of fiscal year 2016, a 10.0 percent increase. Applying an actuarial smoothing method, the trust fund's actuarial value of assets is $146.3 billion. The system's unfunded actuarially accrued liability based on the actuarial value of assets is $35.5 billion, an increase of $0.02 billion compared to the previous fiscal year. The fund has a funded ratio of 80.5 percent. Based on membership, benefit obligations, and other actuarial assumptions, the funding period is 32.2 years. (See **Appendix C – Glossary** for definitions of related terms.)

Investment assumptions and performance are major factors in determining the actuarial condition of a retirement system. The assumed rate of return is what TRS expects its investments to earn each year, on average. This assumption is used to assess the long-term health of the retirement trust and determine whether the system will be able to meet obligations. The actuarial valuation as of August 31, 2017, includes an investment return assumption of 8.0 percent. In July 2018, the Board of Trustees decreased the return assumption to 7.25 percent to provide a more reasonable forecast of current and future financial conditions. This lower return assumption is expected to increase the funding period and the projected contributions needed to pay off the actuarially accrued liability.

Historically, the steady growth of the TRS active member population has improved the TRS Pension Trust

FIGURE 19
TEACHER RETIREMENT SYSTEM (TRS) RETIREMENT ELIGIBILITY
FISCAL YEAR 2018

EMPLOYEE CATEGORY EFFECTIVE SEPTEMBER 1, 2014		NORMAL-AGE RETIREMENT ELIGIBILITY	EARLY-AGE RETIREMENT ANNUITY REDUCTION (3)
Tier 1	Current TRS membership began before September 1, 2007, had at least 5.0 years of service credit as of August 31, 2014, and met grandfather criteria (1)	Age 65 with 5.0 years of service credit or Rule of 80 (2) with 5.0 years of service credit	Younger than age 65, 2.0% for each year that the combined age and years of service is less than the Rule of 80 (2)
Tier 2	Current TRS membership began before September 1, 2007, had at least 5.0 years of service credit as of August 31, 2014, and not grandfathered (1)	Age 65 with 5.0 years of service credit or Rule of 80 (2) with 5.0 years of service credit	Younger than age 65, 2.0% for each year that the combined age and years of service is less than the Rule of 80 (2)
Tier 3	Current membership began on or after September 1, 2007, and before September 1, 2014, had at least 5.0 years of service credit as of August 31, 2014, and not grandfathered (1)	Age 65 with 5.0 years of service credit or age 60 with Rule of 80 (2) and 5.0 years of service credit	5.0% for each year that the member's age is younger than 60
Tier 4	Current membership began on or after September 1, 2007, and before September 1, 2014, had at least 5.0 years of service credit as of August 31, 2014, and grandfathered (1)	Age 65 with 5.0 years of service credit or age 60 with Rule of 80 (2) and 5.0 years of service credit	5.0% for each year that the member's age is younger than 60, with certain exceptions
Tier 5	Not grandfathered (1) and: (a) Current membership began on or after September 1, 2014, or (b) Less than 5.0 years of service credit as of August 31, 2014	Age 65 with 5.0 years of service credit or age 62 with Rule of 80 (2) and 5.0 years of service credit	5.0% for each year that the member's age is younger than 62
Tier 6	Grandfathered (1) and: (a) Current membership began on or after September 1, 2014, or (b) Less than 5.0 years of service credit as of August 31, 2014	Age 65 with 5.0 years of service credit or age 62 with Rule of 80 (2) and 5.0 years of service credit	5.0% for each year age that the member's age is younger than 62, with certain exceptions

NOTES:
(1) Grandfather criteria include that a member must have at least one of these requirements on or before August 31, 2005: (a) at least age 50; or (b) age and years of service equal at least 70.0; or (c) have at least 25.0 years of service credit.
(2) The Rule of 80 is met when the retiree's age and years of service credit in TRS equals or exceeds 80.0 at the time of retirement.
(3) The early-age retirement annuity reduction excludes decreases for the partial lump-sum option. The member must meet additional eligibility criteria based on age, tier, and years of service to qualify for early-age retirement. See www.trs.texas.gov for more information.
SOURCE: Teacher Retirement System.

Fund's actuarial position. Member population growth is driven by the increase of student enrollment in public schools and institutions of higher education, which is related to general population growth in Texas. As the number of educational staff increases, the payroll on which employee and state retirement contributions are calculated increases. Liabilities also increase, but at a slower rate than contributions. As of August 31, 2017, annual public education payroll growth during the previous five-year, 10-year, and 20-year periods averaged 3.8 percent, 3.3 percent, and 4.6 percent, respectively. Higher education payroll covered by All Funds has grown at an average annual rate of 5.8 percent during five-year and 10-year periods, and at an average annual rate of 7.0 percent during the last 20 years.

RETIREMENT ELIGIBILITY

Changes to the retirement plan have resulted in six membership categories, or tiers, each with its own retirement eligibility requirements. Members' tiers are determined by the dates they entered TRS membership; grandfather criteria; the amount of service credit established as of August 31, 2014; and whether TRS membership ever has been terminated by a refund payment (**Figure 19**). Terminated membership results in future membership being considered as first employment, even if previously withdrawn service is paid and reinstated. Starting with the 2012–13 school year, all TRS members receive service credit based on a standardized school year that begins September 1 and ends August 31.

RETIREMENT BENEFITS

Benefit calculations are determined by statute and are based on an employee's salary, age, and years of creditable service. Calculations of normal-age service retirement annuity are based on the standard annuity, which provides the retiree a maximum amount of benefit each month, compared to optional service retirements for survivor benefits, and ends upon the retiree's death. The annual standard annuity equals 2.3 percent times the average of the five greatest annual creditable salaries multiplied by years of creditable service. For members who meet the grandfather criteria, the three greatest annual salaries are used.

Members have five options for annuity payments in lieu of a standard annuity. Optional annuities decrease the monthly annuity payable during the retiree's life but provide for a beneficiary to receive a monthly benefit after the retiree's death, either for life or for a guaranteed period. The retiree may select one of three joint and survivor optional forms of payment that provide for lifetime payments to a beneficiary after the retiree's death. These options decrease the standard annuity based on age-related actuarial reduction factors. The two remaining optional forms of annuity are guaranteed-period annuities, guaranteeing a benefit to the beneficiary during the first 60 or 120 months after the retirement date if the retiree's death occurs during that period. If the beneficiary dies before the retired member, the retiree's annuity is increased to the standard annuity.

FIGURE 20
TEACHER RETIREMENT SYSTEM ANNUITANT PROFILE
FISCAL YEARS 2016 AND 2017

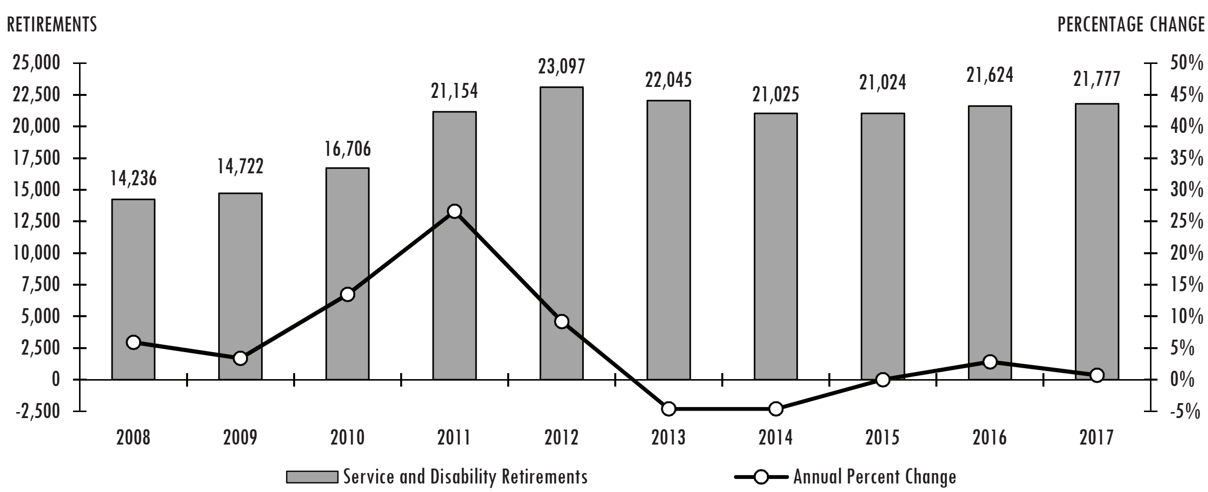
ANNUITANT PROFILE, ALL RETIREES	2016	2017
Service and Disability Retirements	21,624	21,777
Average Age at Retirement	60.1	60.2
Average Years of Service	24.3	24.3
Ratio of Current Members to Retirees	2.8 to 1	2.8 to 1

SOURCE: Teacher Retirement System.

A retiree also may choose a partial lump-sum option at retirement equal to up to 36 months of the standard monthly annuity, resulting in a permanent actuarial decrease of the monthly annuity. This option is not available to members who accept a disability retirement, an early-age retirement, or who retire through the Proportionate Retirement Program. A summary of the TRS retirement benefits can be found at www.trs.texas.gov.

During fiscal year 2017, TRS paid pension benefits totaling $9.8 billion. According to TRS, 20,986 members retired during fiscal year 2017. The average age of members retiring during fiscal year 2017 is 61.9, an increase from the average of age 61.8 during fiscal year 2016. **Figure 20** shows the

FIGURE 21
TEACHER RETIREMENT SYSTEM ANNUAL SERVICE AND DISABILITY RETIREMENTS AND ANNUAL PERCENTAGE CHANGE
FISCAL YEARS 2008 TO 2017



SOURCE: Teacher Retirement System.

annuitant profile for all retirees during fiscal years 2016 and 2017.

Figure 21 shows annual TRS service and disability retirements since 2008. Although the percentage increase in the number of retirements fluctuates from year to year, the data show a general increasing trend in retirement rates until fiscal year 2011 and then a flattening or decrease in the trend in subsequent years.

DISABILITY RETIREMENT BENEFITS

A member, regardless of age or years of service credit, may receive a disability retirement from further performance of duty if the member is disabled mentally or physically, and if the member's disability is probably permanent, as certified by the TRS Medical Board.

A member who qualifies for disability retirement and has at least 10.0 years of service credit may receive a monthly annuity that is not decreased due to early age. Similarly to standard retirement options, the member may select a standard annuity or one of five optional annuities. If the member selects an optional annuity plan, the member's monthly annuity will be decreased using disability retirement actuarial factors to include the additional liability for payment to the member's beneficiary.

A member who qualifies for disability retirement but has less than 10.0 years of service credit may receive a monthly disability benefit of $150 that is paid for the lesser of the following factors: (1) the number of months the member has been covered by TRS; (2) the duration of the member's disability; or (3) the duration of the member's life. Disability retirees must file an annual compensation statement with TRS, and they may forfeit their disability annuity or be required to pay an increased amount for TRS-Care coverage if earned compensation exceeds the limits set by the TRS Board of Trustees. The requirement does not apply to members who applied for disability before September 1, 2007, or whose effective date of disability retirement is before September 1, 2007.

PROPORTIONATE RETIREMENT

Participants who have active membership credit in more than one Texas public retirement system, as described previously (see the section on Proportionate Retirement in **Chapter 2. Employees Retirement System**), may be eligible to combine all of their service credit to satisfy TRS eligibility requirements to retire.

DEATH BENEFITS FOR ACTIVE EMPLOYEES

The primary beneficiary of an active member may choose one of five options in the event of the member's death. The benefits are available if the member dies during a school year in which the member has performed TRS-covered service, or if the member dies while performing qualified military services as defined by applicable federal law. The benefits are also available when a member's absence from service is due to a sickness or accident, or other work absences described by law. Benefit options with certain restrictions include the following: (1) a lump-sum payment; (2) 60 monthly payments equal to the member's standard annuity without a decrease for early age; (3) lifetime payments; (4) an amount equal to a return on the member's contributions with accumulated interest; and (5) survivor benefits of a $2,500 lump-sum payment plus a monthly benefit.

DEATH BENEFITS FOR RETIREES

The designated beneficiary of a service or disability retiree may receive a lump-sum death and survivor benefit payment of $10,000. This payment is in addition to any joint and survivor or guaranteed-period annuity that may be payable through an optional plan chosen by the retiree at retirement, unless the retiree has exhausted all monthly payments before death. In lieu of the $10,000 death and survivor benefit, survivors may select alternative payment options, which include a lump-sum payment of $2,500 and an applicable monthly survivor benefit payment.

SIGNIFICANT LEGISLATION

The Eighty-fifth Legislature, Regular Session, 2017, passed the following legislation that affects TRS retirement:

Senate Bill 1663 – TRS Administration of Systems and Programs. The legislation amends and clarifies various statutes governing TRS administration, including changes related to contributions, benefits, late fees, eligibility, reporting, and creditable service. The legislation also grants additional authority for investment decisions of the board, and establishes a Sunset review for TRS in 2025.

Senate Bill 1664 – TRS Administration of Systems and Programs. The legislation amends and clarifies the governing statutes of TRS, including provisions related to U.S. Internal Revenue Service Code compliance, statutory corrections, and certain benefit changes. The legislation also provides TRS members additional time to purchase sick and personal leave credit at retirement, and clarifies the statutory provision that board certifications of the state contribution to the Optional Retirement Program refer to the Higher Education Coordinating Board rather than the Teacher Retirement System Board.

Senate Bill 1665 – Investment Authority of TRS. The legislation clarifies and extends authorization for the use of derivatives and external managers in the investment of Pension Trust Fund assets, and repeals the Sunset dates on these authorities.

HEALTH BENEFIT PLANS

RETIREE HEALTH BENEFITS (TRS-CARE)

HISTORY

In 1985, the Legislature established the Texas Public School Retired Employees Group Benefits program, or TRS-Care, and designated TRS as the administering agency. TRS-Care offers health insurance coverage to eligible public education retirees and their dependents through two plans: the Standard Plan, a self-insured plan for non-Medicare-eligible members, and TRS-Care Medicare Advantage, a fully insured plan for Medicare-eligible members.

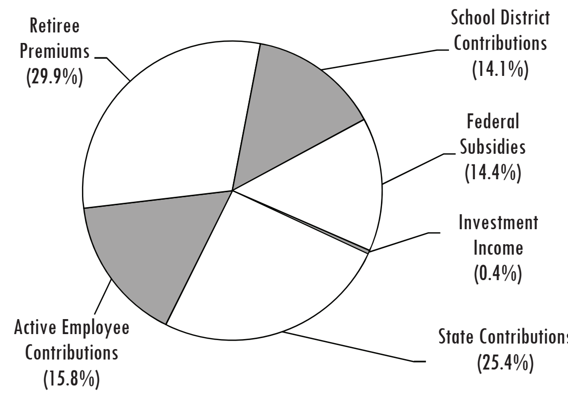
FUNDING

The TRS-Care program is funded by participant premiums, federal subsidies earned from Retiree Drug Subsidy payments and Medicare Part D subsidy payments, investment income, and regular payroll contributions from the state, active employees, and school districts. TRS-Care is not prefunded like the retirement plan; it is funded on a pay-as-you go basis. Payroll contributions to TRS-Care are fixed percentages of school district employee salaries set by statute and the GAA, including 1.25 percent from the state, 0.75 percent from school districts, and 0.65 percent from active employees. Additionally, the Legislature periodically has appropriated onetime funding to the program, including a $394.6 million supplemental appropriation in fiscal year 2018.

Figure 22 shows the program's major funding sources for fiscal year 2017. TRS deposits funding from all sources into the TRS-Care Trust Fund, from which it pays claims for the Standard Plan, premiums for the Medicare Advantage Plan, and program administrative costs.

FIGURE 22
TRS-CARE FUNDING SOURCES, FISCAL YEAR 2017

(IN MILLIONS) TOTAL=$1,352.6



NOTE: State Contributions include the statutory state contribution equal to 1.25% of eligible active employee salaries and $15.6 million in additional General Revenue Funds appropriated by rider during fiscal year 2017. Per statute, the 1.25% statutory state contribution also includes $24.3 million in federal and other local funding sources during fiscal year 2017. These funds are transferred directly from public education employers to TRS without appropriation.
SOURCE: Teacher Retirement System.

TRS-CARE REFORM

House Bill 3976, Eighty-fifth Legislature, Regular Session, 2017, implemented significant reforms to ensure the solvency of the TRS-Care Trust Fund. In January 2017, TRS-Care faced a funding shortfall projected to reach from $1.1 billion to $1.4 billion by the end of the 2018–19 biennium, and more than $3.0 billion by the end of fiscal year 2021, growing geometrically thereafter as rising healthcare costs continued to outpace revenues by ever-increasing margins.

Two separate but related elements of the program's structure caused this shortfall, or unfunded liability. The first element is that funding provided to the TRS-Care program by regular contributions from the state, school districts, and active employees is based on public education salaries, which grow at a modest rate. Program costs are linked to much higher rates of healthcare and prescription drug inflation, causing a large and growing disjuncture between the program's revenues and costs. The second element is that, at the same time that healthcare costs were outpacing payroll contributions, for several biennia the GAA expressed legislative intent that TRS should not increase retiree premiums, and statute directed TRS to provide a basic health plan at no cost to the retiree, resulting in insufficient revenue from monthly premium contributions paid by TRS-Care participants. These provisions, intended to keep retiree healthcare affordable while a long-term solution was found, had the consequence of decreasing the program's capacity to generate revenue and offset costs, and, therefore, caused the funding shortfall to grow.

TRS-Care expenditures began to outpace revenue during fiscal year 2012. TRS projected that the fund would run out of money by fiscal year 2016 and, thereafter, would accrue a large, unfunded liability without legislative action. As a result of this projected shortfall for fiscal year 2016, the Eighty-fourth Legislature, 2015, provided a onetime supplemental appropriation of $768.1 million for fiscal year 2015 to maintain the fund's solvency through the 2016–17 biennium.

By January 2017, the TRS-Care Fund was projected to become insolvent by August 31, 2017, and to incur a large shortfall by the end of the 2018–19 biennium. House Bill 3976, Eighty-fifth Legislature, Regular Session, 2017, enacted funding changes and structural reforms sufficient to keep the TRS-Care program solvent. The legislation eliminated the statutory requirement that TRS provide a basic plan at no cost. Simultaneously, the Legislature removed the rider from the General Appropriations Act expressing legislative intent that TRS should not increase retiree premiums. The legislation also directed TRS to establish and collect payments for the share of total costs allocated to participants. These changes emphasized TRS's responsibility as the fiduciary of the program to set premium rates and plan structure as needed to maintain the fund's solvency, thereby eliminating TRS-Care's statutory unfunded liability.

Alongside these reforms, the Eighty-fifth Legislature, Regular and First Called Sessions, 2017, increased funding to the TRS-Care program to reduce financial effects on participants. State funding of TRS-Care increased from $580.9 million for the 2016–17 biennium to $1.2 billion for the 2018–19 billion, and school district contributions to TRS-Care increased by $133.9 million. These funding increases were achieved through a variety of mechanisms, including onetime appropriations, increases of state and district contribution rates in statute and the GAA, and transfers of funds from another agency.

For plan year 2018, TRS implemented the legislative changes by altering plan options, premiums, and benefit design. These changes included decreasing the number of plan options to one Standard Plan, required for all non-Medicare eligible members, and one Medicare Advantage Plan, required for all members with Medicare Parts A and B. Previously, plan choices included three Standard Plan options, available to all members, and two Medicare Advantage Plan options, available to members with Medicare Parts A and B. The impact of these changes varies greatly by family size, prior TRS-Care plan, and Medicare status. For retirees with covered spouses and other dependents, new plan options generally provide decreased benefits and increased premiums compared to previous plans.

FIGURE 23
TRS-CARE PARTICIPATION AS OF AUGUST 31, 2017

CATEGORY	PARTICIPANTS
Retirees	204,987
Surviving Spouses and Surviving Children	6,797
Dependents	56,643
Total Participants	**268,427**

SOURCE: Teacher Retirement System

TRS expects high healthcare inflation to continue during future biennia, presenting a continuing funding challenge for TRS-Care. As of April 4, 2018, TRS projects that the program will require an additional $400.0 million to $600.0 million for the 2020–21 biennium based on the current plan structure. This amount may come from additional legislative appropriations, premium increases for members, or decreases to plan benefits.

ELIGIBILITY

Health benefits are provided for public school retirees who are not eligible to participate in the state higher education or state employee plans. (See the section on Premiums and Coverage.)

To be eligible for TRS-Care, retirees must have at least 10.0 years of TRS service credit, which may include up to 5.0 years of military service credit, but may not include any other special or equivalent service credit purchased. Additionally, the member must meet one of these requirements:

- the sum of the retiree's age and years of service credit in TRS equals or exceeds 80.0 at the time of retirement, regardless of whether the retiree had a decrease in the retirement annuity for early age (years of service credit can include all purchased service); or
- the retiree has 30.0 or more years of service credit in TRS at the time of retirement (years of service credit can include all purchased service).

Disability retirees are eligible initially for TRS-Care at any age. TRS-Care coverage for disability retirees who have less than 10.0 years of TRS service credit ends when the disability retirement benefit ends.

Figure 23 shows total participation in TRS-Care.

PREMIUMS AND COVERAGE

Effective for plan year 2018 (January 1, 2018, to December 31, 2018), TRS began offering new plans and premium rates to replace the previous plan options. TRS-Care offers a Medicare Advantage plan and a Medicare prescription drug plan to participants eligible to enroll in Medicare, and the Standard Plan, including medical and pharmacy benefits, for participants not eligible to enroll in Medicare. TRS is permitted but not required to provide another health benefit plan to Medicare-eligible members.

Although each member's enrollment in the Standard Plan or Medicare Advantage is based on their Medicare eligibility, premium rates are determined by the Medicare eligibility of the retiree or surviving spouse and the family size. For plan year 2018, retiree-only coverage in the Standard Plan and Medicare Advantage Plan cost $200 and $135 per month, respectively. Retirees in both plans pay additional premiums for dependent coverage. Additionally, actions by the Eighty-fifth Legislature, Regular Session, 2017, granted exemptions from premium contributions until the 2022 plan year for non-Medicare disability retirees who meet certain criteria.

TRS-Care plans offer comprehensive healthcare through statewide and nationwide networks of hospitals, physicians, and other healthcare providers and pharmacies. Aetna Life Insurance Company administers TRS-Care Standard Plan medical benefits, and Humana fully insures and administers the Medicare Advantage plan. CVS Caremark administers pharmacy benefits for Medicare and non-Medicare participants.

The Standard Plan covers participants who use in-network providers at 80.0 percent of eligible expenses after they pay an individual or family deductible each plan year. Certain preventive-care services, such as vaccinations and well checks, are covered at 100.0 percent of eligible expenses before meeting the deductible. After members spend a maximum out-of-pocket amount for each individual or for all family members on the Standard Plan, the plan covers all additional costs at 100.0 percent for the remainder of the plan year. Services provided outside of the network are reimbursed at a lower rate and carry higher deductibles and maximum out-of-pocket costs.

Medicare Advantage covers participants at 95.0 percent of eligible expenses after they pay an individual deductible each plan year for combined in-network and out-of-network costs. The Medicare Advantage plan also covers certain preventive-care services at 100.0 percent of eligible expenses and fully covers costs after each member meets the annual out-of-pocket maximum. Additionally, in the Medicare Part D Prescription Drug Plan, participants pay copayments of a minimum of $5 for a one-month supply of generic medications, with reduced copayments for 90-day supplies of certain brand drugs.

A summary of the retiree health insurance plans can be found at www.trs.texas.gov.

FIGURE 24
TRS-ACTIVECARE PARTICIPATION AS OF AUGUST 31, 2017

CATEGORY	PARTICIPANTS
Participating Entities	1,093
Employees	305,234
Dependents	187,083
Total Participants	**492,317**

SOURCE: Teacher Retirement System

ACTIVE EMPLOYEES HEALTH BENEFITS (TRS-ACTIVECARE)

HISTORY

TRS-ActiveCare, established by the Seventy-seventh Legislature, 2001, is a self-funded, statewide, group health insurance program for public education employees and their eligible dependents. Members include employees of school districts, open-enrollment charter schools, regional education service centers, and other educational districts whose employees are members of TRS.

FUNDING

At the time the legislation establishing TRS-ActiveCare was passed, the state provided an increase in the Foundation School Program school finance formulas to ensure additional state aid equivalent to at least $75 per employee per month to help fund district costs. The state has no statutory obligation to appropriate additional funding to the program beyond this contribution. In addition, districts are required to contribute a minimum of $150 per employee per month, for a total of $225 toward the cost of coverage. Employees are responsible for any remaining premium costs. Premiums are paid into a separate trust fund from which health claims are paid.

ELIGIBILITY

To be eligible for TRS-ActiveCare, an individual must be employed by a participating district or entity and either be an active contributing TRS member or be employed 10.0 or more regularly scheduled hours each week. As shown in **Figure 24**, as of August 31, 2017, 492,317 employees and dependents from 1,093 entities have elected to participate. Although this represents almost 90.0 percent of the 1,215 districts or entities eligible to participate in TRS-ActiveCare, the number of employees covered by TRS-ActiveCare is approximately 43.1 percent of public education employees. Many local school districts, particularly larger employers, provide local programs for employee healthcare benefits.

COVERAGE

As of September 1, 2017, Aetna administers TRS-ActiveCare medical benefits, and CVS Caremark manages the prescription drug benefits. TRS-ActiveCare offers a choice of two preferred provider organization (PPO) plans statewide, ActiveCare-1HD and ActiveCare-2. Effective September 1, 2014, TRS-ActiveCare also offers ActiveCare Select, an exclusive provider organization (EPO) plan. This plan provides in-network benefits similar to ActiveCare-2 at lower premiums but offers no out-of-network coverage. Additionally, employees in certain areas also have the option of choosing HMO coverage.

SIGNIFICANT LEGISLATION

The Eighty-fifth Legislature, Regular and First Called Sessions, 2017, passed the following legislation that affects the TRS healthcare programs:

House Bill 3976, Regular Session, 2017 – TRS-Care reform. The legislation makes significant changes to the health benefit plans available to retirees. (See the section on TRS-Care Reform.)

House Bill 21, First Called Session, 2017 – Transfer of funds from the Health and Human Services Commission (HHSC) to the TRS-Care program. The legislation transfers $212.0 million in General Revenue Funds appropriations for the 2018–19 biennium from HHSC to TRS to provide support to participants in the TRS-Care program. The legislation directs TRS to use the funds to decrease costs for participants by decreasing premiums and deductibles and enhancing coverage of prescription drugs during plan years 2018 and 2019. The legislation also directs TRS to decrease the premium rates and maximum out-of-pocket costs for an enrolled adult child with a mental disability or physical incapacity during those plan years. The legislation increases the net total additional funding to TRS-Care provided by the Eighty-fifth Legislature, Regular and First Called Sessions, 2017, to $695.9 million, which includes state and school district contributions.

4. OPTIONAL RETIREMENT PROGRAM

HISTORY

The Optional Retirement Program (ORP) is a defined contribution plan established in 1967 as an alternative to the defined benefit retirement plan provided by the Teacher Retirement System (TRS). The plan serves as a recruitment tool to draw higher education faculty, librarians, professionals, and administrators who require interstate mobility during their careers. ORP is funded by tax-deferred contributions made by the state and the employee.

GOVERNANCE AND POLICY

ORP is not administered by TRS or the Employees Retirement System, but instead is a separate retirement mechanism. The Texas Higher Education Coordinating Board oversees the program's rules; the Comptroller of Public Accounts and the institutions that participate are responsible for accounting; and each institution's governing board administers its respective ORP and selects qualified vendors of investment products for its employees.

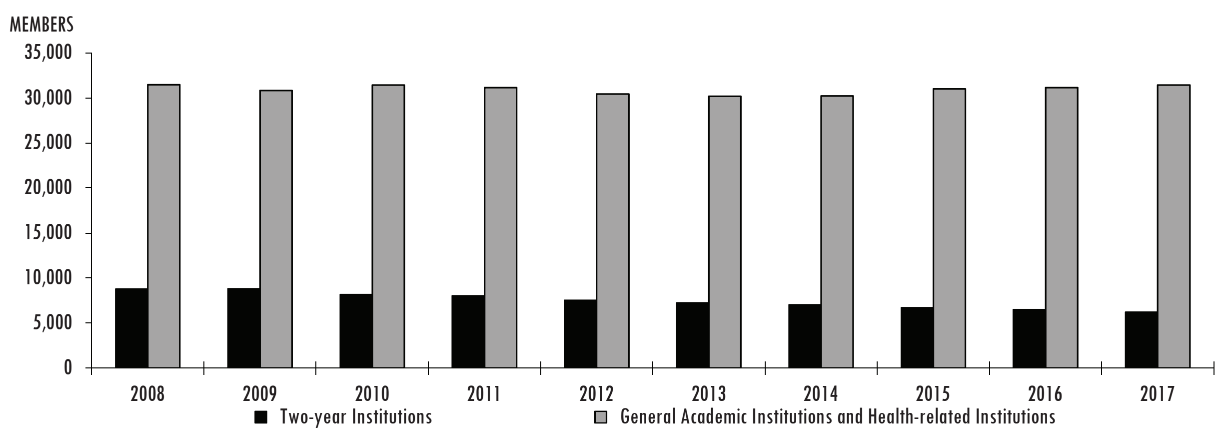
MEMBERSHIP

New public higher education employees who are employed in an ORP-eligible position have 90 days from the first date of eligibility to make a onetime, irrevocable choice between participation in ORP and TRS membership. **Figure 25** shows the last 10 years of ORP membership for two-year institutions compared to four-year general academic institutions and health-related institutions. Employees who elect ORP in lieu of TRS membership must continue to participate in ORP for the remainder of their careers in Texas public higher education. Participation in the program is limited to full-time faculty and certain administrators employed by Texas public institutions of higher education, including public community and technical colleges; the commissioners of education and higher education; and certain positions designated by law.

CONTRIBUTIONS

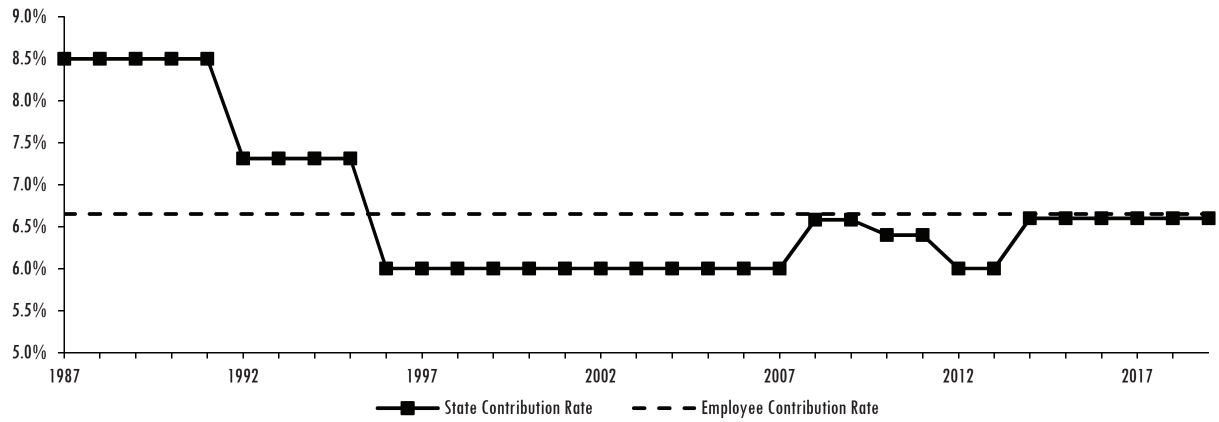
The Legislature establishes ORP member and state contribution rates each biennium. These rates may fluctuate. The ORP state contribution rate for the 2018–19 biennium is 6.6 percent, as established by the General Appropriations Act. Institutions of higher education may provide supplements to the state rate up to 8.5 percent of payroll. Member contribution amounts are based on a percentage of the employee's salary, set in statute at 6.65 percent. Members invest their accounts through the purchase of individual investment contracts. A rule known as proportionality limits the share of the state contribution that may be funded by General Revenue Funds. (See **Appendix C – Glossary**.) This

FIGURE 25
OPTIONAL RETIREMENT PROGRAM MEMBERSHIP FOR TWO-YEAR INSTITUTIONS COMPARED TO GENERAL ACADEMIC INSTITUTIONS AND HEALTH-RELATED INSTITUTIONS, FISCAL YEARS 2008 TO 2017



SOURCE: Higher Education Coordinating Board.

FIGURE 26
OPTIONAL RETIREMENT PROGRAM STATE AND EMPLOYEE CONTRIBUTION RATES, FISCAL YEARS 1987 TO 2019



SOURCE: Higher Education Coordinating Board.

rule is applicable to all ORP members except for community college employees, whose benefits may be paid from any source of funds regardless of whether the salaries are paid from appropriated funds.

Statute further limits state retirement contributions to ORP for public community and junior colleges to 50.0 percent of the creditable compensation of members whose duties are instructional or administrative. An additional limit to state retirement contributions applies for each community and junior college based on the growth of each college's staff size in proportion to changes in student enrollment.

Figure 26 shows the state and member contribution rates since 1987.

RETIREMENT PROGRAM

The retirement benefit provided in ORP is based on the accumulated contributions and rate of return earned during the employee's career. The ORP features one-year vesting and is a portable benefit that enables participants to maintain their retirement savings after separation from employment in Texas public higher education. Employees may withdraw contributions, including state contributions, after the one-year vesting period. ORP participants who terminate state employment before meeting the vesting requirement forfeit employer contributions made during that period of employment.

The ORP participant's benefit amount depends directly on the actual amounts contributed. Because the defined contribution plan enables participants to manage their own personal investment accounts, no state provisions are made for improvement of benefits after termination, such as a cost-of-living adjustment. Program participants purchase individual investment contracts pursuant to the U.S. Internal Revenue Code, Section 403(b), from insurance and investment companies. Vendor selection must be made from the employer's authorized list at the same time that ORP is elected. ORP participants assume full responsibility for monitoring their selected companies and investments and have at least two opportunities each year to change their selected companies. Contributions and interest earnings are not subject to federal income tax until the funds are withdrawn or paid as a retirement annuity. Funds in the ORP accounts are available at termination of participation, including the employee and employer contributions if the participant has at least one year of service. Termination of participation occurs upon retirement, death, or termination of employment in all Texas public institutions of higher education.

5. HIGHER EDUCATION EMPLOYEES GROUP INSURANCE

HISTORY, STRUCTURE, AND ENROLLMENT

In the early 1990s, higher education institutions were given the option of providing health insurance benefits to employees through the Employees Retirement System (ERS) Uniform Group Insurance Program, now called the Group Benefits Program. All institutions of higher education opted to join ERS, except those in The University of Texas (UT) and Texas A&M University (TAMU) systems, which opted to continue separate health insurance programs.

State contributions for health insurance premiums for higher education employees and retirees in the three systems are appropriated through Higher Education Employees Group Insurance (HEGI). **Figure 27** shows the number of state-funded higher education enrollees, excluding dependents, in each system for fiscal years 2004 to 2016.

FUNDING AND PROPORTIONALITY

Legislative appropriations for HEGI for the 2018–19 biennium total $1,412.2 million in General Revenue Funds, an increase of $34.3 million from the 2016–17 biennium. General Revenue Funds includes $5.3 million from the General Revenue Fund – Insurance Companies Maintenance Tax for the Texas A&M Forest Service. **Figure 28** shows HEGI appropriations by type of institution for the 2018–19 biennium.

The 2018–19 biennial appropriations for HEGI are calculated by multiplying the number of eligible enrollees by premium contribution rates and applying an annual growth rate to the total. HEGI premium contribution rates vary by insuring system and type of institution. The 2018–19 biennial premium contributions for general state employees covered by ERS are funded at 100.0 percent of the ERS premium rates, 74.3 percent of the ERS rate for the UT and TAMU systems, 74.7 percent of the ERS rate for other higher education institutions, and 50.0 percent of the ERS rate for employees of public community colleges.

Appropriations to institutions other than community colleges provide state contributions to health insurance premiums in a manner prescribed by proportional cost-sharing requirements. As such, institutions are required to cover all health benefit costs for employees whose salaries are paid from sources other than the General Revenue Fund.

HEGI premium rates increased by 4.57 percent for fiscal year 2018 from fiscal year 2017 rates and by 4.56 percent for fiscal year 2019 from fiscal year 2018 rates.

The number of employees at an institution enrolled in each health insurance program as of December 1, 2016 determines its 2018–19 biennial appropriation from the General Revenue Fund. State contributions are capped at the institution's sum-certain, line-item appropriation (see **Appendix C – Glossary**). The institution must pay for any additional costs using other appropriated or local funds. However, the General Appropriations Act (GAA) authorizes ERS, the UT System, and the TAMU System to transfer HEGI appropriations among institutions within their group insurance programs to address each institution's needs.

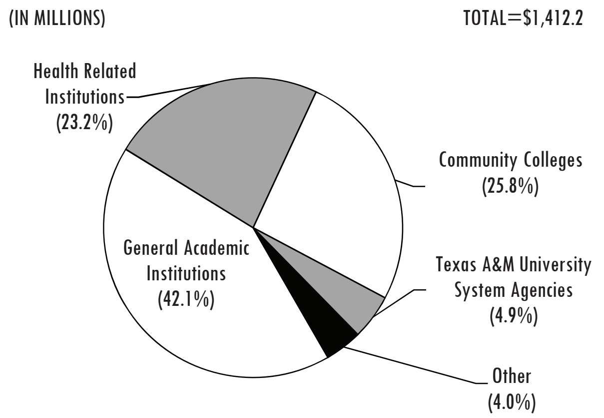
State contributions to group health insurance for community colleges cover costs associated with instructional or administrative employees whose salaries may be paid fully from funds appropriated in the GAA, regardless of whether such salaries actually are paid from appropriated funds. The

FIGURE 27
STATE-FUNDED HIGHER EDUCATION ENROLLEES IN HIGHER EDUCATION EMPLOYEES GROUP INSURANCE
FISCAL YEARS 2004 TO 2016, BIENNIALLY

SYSTEM	2004	2006	2008	2010	2012	2014	2016
Employees Retirement System	56,442	56,980	60,714	64,271	63,033	62,589	65,710
The University of Texas System	33,034	32,255	34,296	35,325	31,503	32,129	33,663
Texas A&M University System	16,296	15,532	16,064	16,980	15,219	16,354	17,184
Total	**105,772**	**104,767**	**111,074**	**116,576**	**109,755**	**111,072**	**116,557**

Source: Legislative Budget Board.

FIGURE 28
HIGHER EDUCATION EMPLOYEES GROUP INSURANCE APPROPRIATIONS BY TYPE OF INSTITUTION
2018–19 BIENNIUM



SOURCE: Legislative Budget Board.

FIGURE 29
COMMUNITY COLLEGE STEPPED EMPLOYEE HOLD HARMLESS LEVELS
2018–19 BIENNIUM

PERCENTAGE DECREASE IN CONTACT HOURS	HOLD HARMLESS EMPLOYEE LEVEL
2.0% to 5.0%	98.0% (2.0% decrease)
More than 5.0% to 10.0%	95.0% (5.0% decrease)
More than 10.0% to 15.0%	90.0% (10.0% decrease)
More than 15.0%	85.0% (15.0% decrease)

SOURCE: Legislative Budget Board.

number of employees eligible to receive HEGI contributions may not be adjusted in a proportion greater than the change in student enrollment. However, beginning in the 2016–17 biennium, an institution whose student enrollment has decreased may petition the Legislative Budget Board to maintain the number of eligible employees up to 98.0 percent of the previous biennium. The level of hold harmless for employee levels is based on the decrease in enrollment, represented by contact hours, at each institution; levels of this hold harmless amount are shown in **Figure 29**.

PLAN BENEFITS

The type of benefits and overall premium amounts covered are the same for higher education institutions as those for general state employees. The difference is that the state does not cover the full premium for employees at higher education institutions. For full-time employees at all higher education institutions, the state and the institution pay the full employee-only premium and half the difference between the employee-only premium and the premium for dependent coverage.

6. SOCIAL SECURITY AND BENEFIT REPLACEMENT PAY

HISTORY AND POLICY

The Comptroller of Public Accounts (CPA) is responsible for the payment of state and employee Social Security taxes to the federal government. The employer payroll tax contribution for the Social Security program is 6.2 percent, and the employer payroll tax for Medicare is 1.45 percent. The Social Security wage base, which is the amount of wages subject to the 6.2 percent tax, increased from $118,500 for each of fiscal years 2015 and 2016 to $127,200 for 2017 and $128,400 for 2018. Since 1993, Medicare-taxable earnings have no limit.

Also appropriated to the CPA within the Social Security benefits are Benefit Replacement Pay (BRP) contributions for certain state employees. Before fiscal year 1996, the state paid for a portion of employees' Social Security obligations. The Seventy-fourth Legislature, 1995, replaced that portion with BRP, a benefit supplement to ensure that employees' net pay was not reduced. Employees retain BRP as long as they do not have a break in service from the state for 30 days. Employees hired after August 31, 1995, are not eligible to receive the benefit supplement or the additional state-paid Social Security.

STATE FUNDING

As with Employees Retirement System state contributions, the Legislature appropriates funds for the state contribution to Social Security at the end of each article of the General Appropriations Act as an estimated appropriation. The total appropriation is shown as an informational listing in the CPA appropriation bill pattern.

Increases in Social Security appropriations are related primarily to payroll growth and full-time-equivalent position changes at certain state agencies. Decreased appropriations for BRP contributions reflect the attrition of state employees hired before September 1, 1995. See **Appendix A – Appropriations** for actual appropriations amounts.

APPENDIX A – APPROPRIATIONS

State contributions to the retirement benefits for the Employees Retirement System of Texas (ERS), the Teacher Retirement System of Texas (TRS), and the Optional Retirement Program (ORP) are estimated appropriations. Each agency has the authority to increase the appropriation as needed within the parameters of the General Appropriations Act. Funded amounts are based on set contribution rates but vary due to the fluctuating number of employees and the actual amount of monthly payroll. TRS settles up with the state at the end of the fiscal year to balance retirement contribution levels based on actual payroll amounts. ERS and ORP receive varying amounts each month based on the contribution rates and active payroll.

State contributions to TRS-Care and the ERS Group Benefits Program for state employees and Community Supervision and Corrections Department employees also are estimated. ERS-funded amounts and expenditures vary based upon membership in the Group Benefits Program. TRS settles up with the state at the end of the year for TRS-Care to balance contribution levels based on actual payroll amounts. State contributions to Higher Education Employees Group Insurance are made as a sum-certain appropriation. TRS-ActiveCare receives no direct state appropriations; state contributions are appropriated through the Foundation School Program formula structure.

State contributions to Social Security are also an estimated appropriation. Expended amounts vary based upon the actual amount of payroll and the number of employees eligible for Benefit Replacement Pay.

Figure A–1 shows the appropriation history for each retirement and state-funded health insurance program and Social Security.

FIGURE A–1
EMPLOYEE BENEFITS APPROPRIATIONS, ALL FUNDS, FISCAL YEARS 2015 TO 2019

(IN MILLIONS)

RETIREMENT	2015	2016	PERCENTAGE CHANGE	2017	PERCENTAGE CHANGE	2018	PERCENTAGE CHANGE	2019	PERCENTAGE CHANGE
ERS	$458.6	$633.2	38.1%	$644.9	1.8%	$655.3	1.6%	$659.0	0.6%
LECOS	$7.5	$8.6	14.2%	$9.0	4.3%	$9.1	1.8%	$9.2	0.5%
JRS I	$26.5	$25.6	(3.4%)	$24.9	(3.0%)	$24.9	0.0%	$24.9	0.0%
JRS II	$12.4	$12.4	0.0%	$12.4	0.0%	$12.4	0.0%	$12.4	0.0%
TRS – Public Education	$1,547.4	$1,625.8	5.1%	$1,647.1	1.3%	$1,741.6	5.7%	$1,802.6	3.5%
TRS – Higher Education	$167.3	$190.8	14.0%	$214.3	12.3%	$211.7	(1.2%)	$218.1	3.0%
ORP	$148.0	$150.5	1.7%	$148.3	(1.5%)	$172.2	16.1%	$172.4	0.1%
Retirement Subtotal	**$2,367.8**	**$2,646.9**	**11.8%**	**$2,700.8**	**2.0%**	**$2,827.2**	**4.7%**	**$2,898.5**	**2.5%**
HEALTH INSURANCE	**2015**	**2016**	**PERCENTAGE CHANGE**	**2017**	**PERCENTAGE CHANGE**	**2018**	**PERCENTAGE CHANGE**	**2019**	**PERCENTAGE CHANGE**
ERS – Health – State Employees	$1,594.8	$1,728.6	8.4%	$1,902.8	10.1%	$1,964.7	3.3%	$2,022.2	2.9%
ERS – Health – CSCD (3)						$62.2		$67.3	8.2%
HEGI – ERS	$310.6	$327.9	5.6%	$351.4	7.2%	$352.5	0.3%	$368.6	4.6%
HEGI – UT System	$205.7	$221.8	7.8%	$237.7	7.2%	$221.8	(6.7%)	$231.9	4.6%
HEGI – TAMU System	$101.2	$115.4	14.0%	$123.7	7.2%	$116.1	(6.1%)	$121.4	4.6%
TRS-Care	$1,049.2	$297.1	(71.7%)	$319.4	7.5%	$795.7	149.1%	$413.9	(48.0%)
Insurance Subtotal	**$3,261.5**	**$2,690.8**	**(17.5%)**	**$2,935.0**	**9.1%**	**$3,513.0**	**19.7%**	**$3,225.3**	**(8.2%)**
SS/BRP	**2015**	**2016**	**PERCENTAGE CHANGE**	**2017**	**PERCENTAGE CHANGE**	**2018**	**PERCENTAGE CHANGE**	**2019**	**PERCENTAGE CHANGE**
Social Security	$795.4	$837.4	5.3%	$859.5	2.6%	$880.5	2.4%	$891.0	1.2%
Benefit Replacement Pay	$21.0	$18.3	(13.0%)	$16.3	(10.6%)	$15.0	(8.1%)	$12.9	(14.0%)
SS/BRP Subtotal	**$816.4**	**$855.6**	**4.8%**	**$875.9**	**2.4%**	**$895.5**	**2.2%**	**$903.9**	**0.9%**
Total Retirement, Insurance, and SS/BRP	**$6,445.8**	**$6,193.3**	**(3.9%)**	**$6,511.6**	**5.1%**	**$7,235.7**	**11.1%**	**$7,027.7**	**(2.9%)**

NOTES:
(1) Totals may not sum due to rounding.
(2) ERS=Employees Retirement System of Texas; LECOS=Law Enforcement and Custodial Officer Supplemental Retirement Program; JRS I= Judicial Retirement System Plan I; JRS II= Judicial Retirement System Plan II; TRS=Teacher Retirement System of Texas; ORP=Optional Retirement Program; CSCD=Community Supervision and Corrections Departments; HEGI=Higher Education Employees Group Insurance; UT=The University of Texas; TAMU=Texas A&M University; SS/BRP=Social Security and Benefit Replacement Pay.
(3) This appropriation was previously at the Texas Department of Criminal Justice.
SOURCE: Legislative Budget Board.

APPENDIX B – CONTRIBUTION RATES

FIGURE B–1
CONTRIBUTION RATES AND LEGAL AUTHORITY, 2018–19 BIENNIUM

	CONTRIBUTION RATE (BASED ON PERCENTAGE OF ACTIVE MEMBER PAYROLL, OR SET AMOUNT AS NOTED)			AUTHORITY		
SYSTEM	STATE/ EMPLOYER	ACTIVE EMPLOYEES	OTHER	CONSTITUTION (1)	STATUTE	GAA
Retirement						
ERS	9.50%	9.50%	Agency contribution, 0.5% of payroll	Article XVI, §67(b)(3)	The Texas Government Code: • State – §815.403(a)(1); • Employee – §815.402(a)(1) and (2); • Agency – §815.4035	page I-34, Rider 4; page IX-80, §17.06
LECOS	0.5%	0.5%	Court fees totaling $18.8 million, approximately 1.09% of payroll	N/A	The Texas Government Code: • State – §815.403(a)(3); • Employee – §815.402(h); • Court fees –§815.317(a-1)	page I-34, Rider 5
JRS I	Pay-as-you-go	9.5% (2)	N/A	Article XVI, §67(d)(1)	The Texas Government Code: • State – §835.102; • Employee –§835.101	N/A
JRS II	15.663%	7.5% (2)	N/A	Article XVI, §67(d)(1)	The Texas Government Code: • State – §840.103; • Employee – §840.102	page I-34, Rider 6
TRS	6.8% (3)	7.7%	School districts not contributing to Social Security, mandatory 1.5%	Article XVI, §67(b)(3)	The Texas Government Code: • State – §825.404(a); • Employee – §825.402; • District – §825.4035	page III-36, Rider 4
ORP	6.6% (3)	6.65%	Employer, optional addition up to 1.9% (4)	N/A	The Texas Government Code, §830.201	page III-39, Riders 2 and 3

FIGURE B–1 (CONTINUED)
CONTRIBUTION RATES AND LEGAL AUTHORITY, 2018–19 BIENNIUM

	CONTRIBUTION RATE (BASED ON PERCENTAGE OF ACTIVE MEMBER PAYROLL, OR SET AMOUNT AS NOTED)			AUTHORITY		
SYSTEM	STATE/ EMPLOYER	ACTIVE EMPLOYEES	OTHER	CONSTITUTION (1)	STATUTE	GAA
Health Insurance						
ERS – State Employees	Full premium rate for employees and retirees; 50.0% of dependent premium	50.0% of dependent premium	Agency contribution, 1.0% of payroll	N/A	The Texas Insurance Code, §1551.301	page I-34, Rider 7; page IX-79, §17.03
ERS – CSCD	Full premium rate for employees and retirees and 50.0% of dependent premium	50.0% of dependent premium	N/A	N/A	The Texas Insurance Code, §1551.114	N/A
HEGI – ERS (5)	Full premium rate for employees and retirees and 50.0% of dependent premium	50.0% of dependent premium	Institution contribution, 1.0% of payroll	N/A	The Texas Insurance Code: • Institutions – §1551.301; • Community Colleges – §1551.3111	page III-42, Rider 1; page IX-79, §17.03
HEGI – UT and TAMU System Institutions (6)	Full premium rate for employees and retirees and 50.0% of dependent premium	50.0% of dependent premium	N/A	N/A	The Texas Insurance Code, §1601.207	UT – page III-42, Rider 2; TAMU – page III-43, Rider 3
TRS-Care	1.25%	0.65%	Public education employers, 0.75%	N/A	The Texas Insurance Code: • State – §1575.202; • Employer – §1575.204; • Employee – §1575.203	page III-36, Riders 5 and 9
TRS-ActiveCare	$900 per employee per year, through the Foundation School Program formula structure	Costs not covered by state or employer	Public education employers, at least $1,800 per employee per year	N/A	The Texas Insurance Code: • State – §1579.251; • Employer – §1581.052; • Employee – §1579.253	N/A

FIGURE B–1 (CONTINUED)
CONTRIBUTION RATES AND LEGAL AUTHORITY, 2018–19 BIENNIUM

NOTES:
(1) The Texas constitution requires a state contribution from 6.0 percent to 10.0 percent for participants in the Employees Retirement System of Texas (ERS) and the Teacher Retirement System of Texas (TRS), and an employee contribution of at least 6.0 percent.
(2) After a set period, members of the Judicial Retirement System Plan I (JRS I) and the Judicial Retirement System Plan II (JRS II) may elect to cease contributing to the plans, which makes the effective member contribution rates less than those set in the General Appropriations Act (GAA).
(3) State contributions to TRS and Optional Retirement Program (ORP) retirement for public community and junior colleges are limited to 50.0 percent of the creditable compensation of members whose duties are instructional or administrative. Contributions are further limited based on the growth of each college's staff size in proportion to changes in student enrollment.
(4) State law requires a state contribution to ORP of 8.5 percent. The GAA sets the state rate at 6.6 percent, with an option for institutions or agencies to use local funds or other sources to supplement up to 1.9 percent.
(5) For the 2018–19 biennium, institutions of higher education, excluding institutions in the University of Texas (UT) and Texas A&M University (TAMU) systems and community colleges, receive state funding from 55.7 percent to 96.27 percent of ERS premium rates, depending on the institution. Community college districts receive state funding at 50.0 percent of ERS premium rates.
(6) For the 2018–19 biennium, UT System and TAMU System institutions receive state funding at 74.3 percent and 74.7 percent of ERS premium rates, respectively.
(7) LECOS=Law Enforcement and Custodial Officer Supplemental Retirement Program; CSCD=Community Supervision and Corrections Departments; HEGI=Higher Education Employees Group Insurance.

SOURCE: Legislative Budget Board.

APPENDIX C – GLOSSARY

Actuarial Accrued Liabilities—The portion, as determined by a particular actuarial cost method, of the actuarial present value of the plan benefits and expenses that is not accounted for by future normal costs.

Actuarial Soundness—A public retirement system is considered actuarially sound if an actuary determines that the fund has adequate contributions to pay ongoing normal costs and amortize the unfunded actuarial accrued liability (UAAL) during a reasonable period, called the funding period. Effective June 30, 2017, the Texas Pension Review Board guidelines recommend that the funding period should not exceed 30 years and preferably should be within 10 years to 25 years. The Government Finance Officers Association recommends that the funding period should not exceed 25 years, and ideally should range from 15 years to 20 years. Additional guidance exists for the Employees Retirement System (ERS) and Teacher Retirement System (TRS) in the Texas Government Code, which prohibits certain changes in the benefit plans and funding of each retirement system if the change would cause the period necessary to amortize unfunded actuarial liabilities to exceed 30 years by one or more years.

Annually Required Contribution—A calculated contribution for a defined benefit pension plan for the reporting period, most often determined based on the plan's funding policy. Typically, the calculated contribution has a normal cost payment and an amortization payment. Often referred to as the Actuarially Sound Contribution rate.

Defined Benefits—Retirement benefits that are defined by a formula applied to a specific member compensation and/or years of service. The amount of the benefit is not a function of contributions or actual earnings on those contributions.

Defined Contributions—A system providing pension benefits equal to the combined employer and employee contributions plus interest and minus administrative expenses.

Funding Period—The length of time required for contributions and other revenues, including investment earnings, to pay all normal costs and amortize any unfunded liabilities. If a contribution rate will never amortize the unfunded liability, the funding period is said to be never or infinite. Also referred to as Amortization Period.

Funded Ratio—The funded ratio of a pension plan refers to the proportion of assets to liabilities and is expressed as a percentage. It is calculated by dividing the actuarial value of assets by the actuarial accrued liabilities. The actuarial (also called smoothed) value of assets often is used for this calculation, although some plans may calculate a market-funded ratio using the market value of assets.

Normal Cost—The annual cost assigned, using the actuarial funding method, to service performed in the current plan year and subsequent plan years. It is expressed as a percentage of pay and is equal to the present value at hire of all possible benefits of the system, divided by the present value of anticipated future compensation to be received by the new member. The normal cost is separate from the contribution amount required to amortize the unfunded liability.

Proportionality—A funding rule, specified by General Appropriations Act (GAA), Article IX, Section 6.08, Benefits Paid Proportional by Method of Finance, that requires a member's benefit costs to be paid by the same methods of finance and in the same proportions as overall agency appropriations in the GAA, excluding any funds that may not be expended on salaries and wages.

Smoothing—The smoothed value of assets (also called the actuarial value of assets) phases in investment gains and losses during a period to reduce the effects of short-term marketplace volatility on the calculation of the UAAL. Smoothing serves to stabilize employer contribution rates. Contributions and funding periods are calculated using the smoothed asset values, not the market values of assets. The smoothed value may be subject to a corridor around the market value, such as plus or minus 20.0 percent of the market value of assets, to put a maximum limit on the amount of deferred gains and losses included in the actuarial value of assets.

Sum-certain Funding—A funding mechanism setting the state's contribution for Higher Education Employees Group Insurance at a certain, nonestimated appropriation. Institutions must pay for any incurred costs greater than these amounts.

Unfunded Actuarial Accrued Liability—The difference between the actuarial accrued liability and valuation of assets. The UAAL sometimes is referred to as unfunded accrued liability.