

Section 1

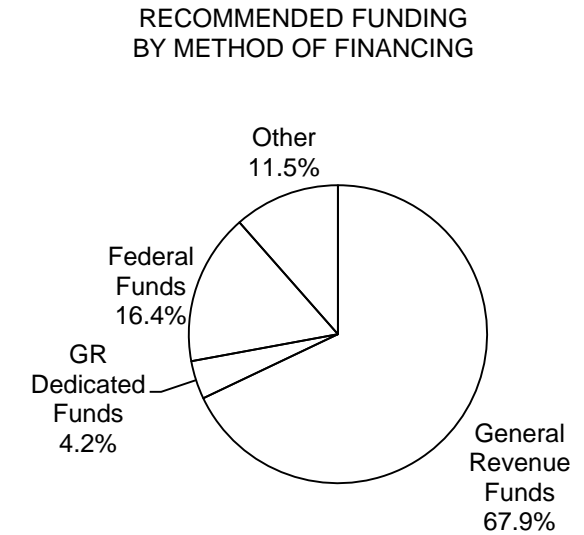
**Employee Retirement System
Summary of Recommendations - House**

Page: I-38
Ann Bishop, Executive Director

Emily Morganti, LBB Analyst

Method of Financing	2014-15 Base	2016-17 Recommended	Biennial Change	% Change
General Revenue Funds	\$2,551,062,322	\$3,181,749,078	\$630,686,756	24.7%
GR Dedicated Funds	\$170,337,183	\$195,049,124	\$24,711,941	14.5%
<i>Total GR-Related Funds</i>	<i>\$2,721,399,505</i>	<i>\$3,376,798,202</i>	<i>\$655,398,697</i>	<i>24.1%</i>
Federal Funds	\$687,743,747	\$768,746,444	\$81,002,697	11.8%
Other	\$665,095,825	\$538,170,901	(\$126,924,924)	(19.1%)
All Funds	\$4,074,239,077	\$4,683,715,547	\$609,476,470	15.0%

	FY 2015 Budgeted	FY 2017 Recommended	Biennial Change	% Change
FTEs	349.0	360.0	11.0	3.2%

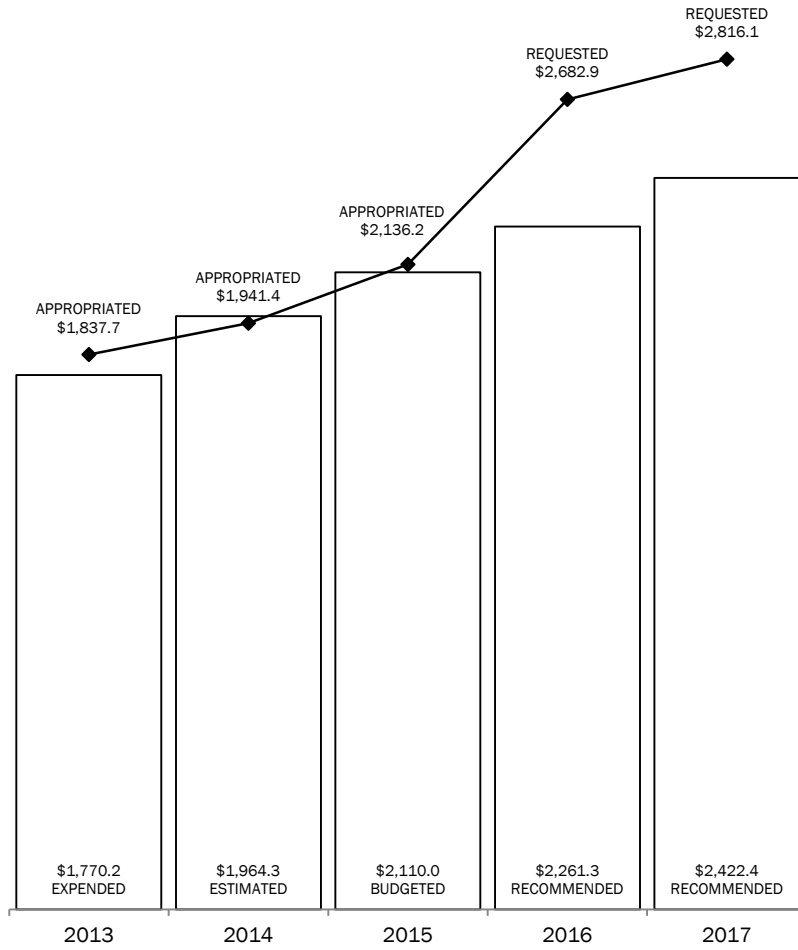


The bill pattern for this agency (2016-17 Recommended) represents an estimated 10.3% of the agency's estimated total available funds for the 2016-17 biennium.

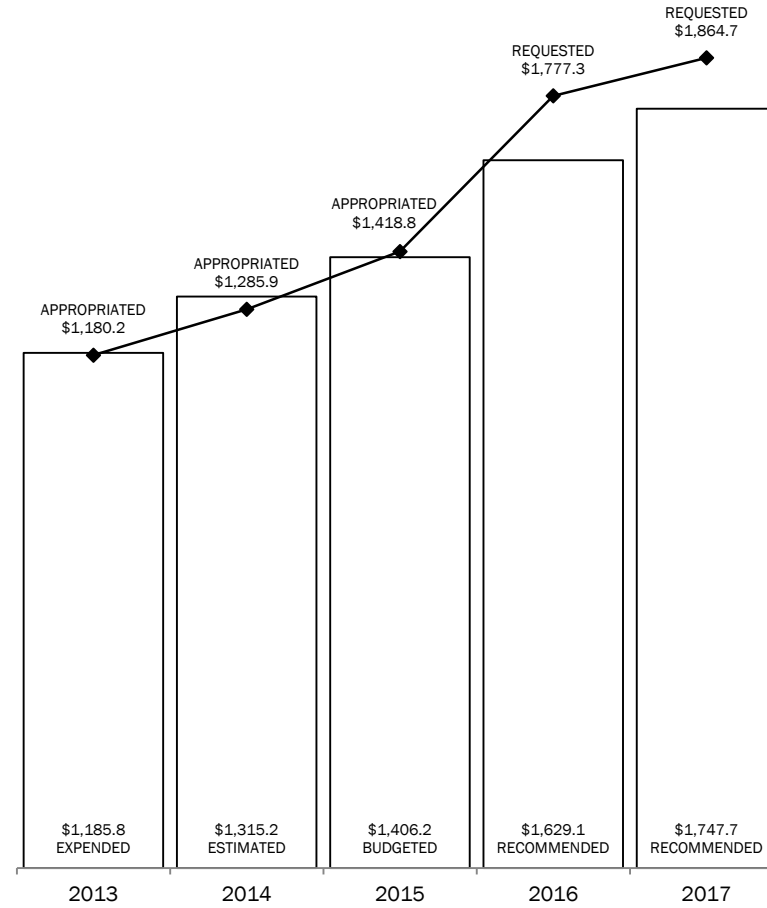
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Employees Retirement System
 2016-2017 BIENNIUM
 IN MILLIONS

TOTAL= \$4,683.7 MILLION

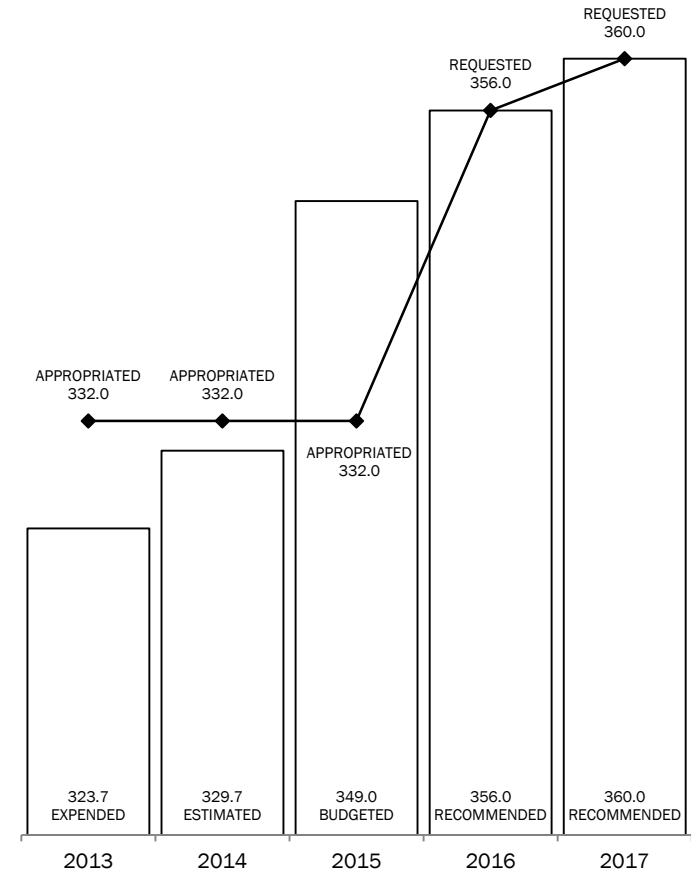
ALL FUNDS



**GENERAL REVENUE AND
 GENERAL REVENUE-DEDICATED FUNDS**



FULL-TIME-EQUIVALENT POSITIONS



Section 2

**Employee Retirement System
Summary of Recommendations - House, By Method of Finance -- ALL FUNDS**

Strategy/Goal	2014-15 Base	2016-17 Recommended	Biennial Change	% Change	Comments
RETIREMENT CONTRIBUTIONS A.1.1	\$895,969,680	\$916,804,297	\$20,834,617	2.3%	Recommendations reflect an All Funds increase of \$20.8 million over the 2014-15 spending levels for continuation of the 2014-15 state contribution level of 7.5 percent of payroll in each fiscal year of the 2016-17 biennium based on the following assumptions (see Selected Fiscal and Policy Issue #2): <ul style="list-style-type: none"> • Biennialization of the fiscal year 2015 statewide salary increase; • 0.5 percent annual payroll growth assumption in each fiscal year of the 2016-17 biennium; and • Significant changes in the number of FTEs and/or funding of FTEs at certain state agencies.
LECOS A.1.2	\$15,545,350	\$16,156,048	\$610,698	3.9%	Recommendations reflect an increase of \$0.6 million related to the biennialization of the fiscal year 2015 Schedule C and statewide salary increases for certain Law Enforcement and Custodial Officer Supplemental (LECOS) retirement fund employees. Recommendations continue the 2014-15 state contribution level of 0.5 percent of payroll in each fiscal year of the 2016-17 biennium to the LECOS retirement fund. (See Selected Fiscal and Policy Issue #3.)
JRS-II A.1.3	\$24,323,446	\$24,323,446	\$0	0.0%	Recommendations continue the 2014-15 state contribution level of 15.663 percent of payroll in each fiscal year of the 2016-17 biennium to the Judicial Retirement System - Plan II (JRS-II). (See Selected Fiscal and Policy Issue #4.)
JRS-I A.1.4	\$54,837,896	\$53,060,844	(\$1,777,052)	(3.2%)	Recommendations reflect a decrease of \$1.8 million related to the natural attrition of annuitants in the Judicial Retirement System - Plan 1, which is operated on a pay-as-you-go basis. JRS-1 participants are those retired judges who joined the bench prior to 1985.
PUBLIC SAFETY BENEFITS A.1.5	\$13,636,279	\$10,943,702	(\$2,692,577)	(19.7%)	Recommendations reflect a decrease of \$2.7 million from 2014-15 expenditure levels related to additional one-time benefit payments to the survivors of public law enforcement or fire-fighting personnel for the West, Texas plant explosion that will not continue into the 2016-17 biennium.

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**Employee Retirement System
Summary of Recommendations - House, By Method of Finance -- ALL FUNDS**

Strategy/Goal	2014-15 Base	2016-17 Recommended	Biennial Change	% Change	Comments
RETIREE DEATH BENEFITS A.1.6	\$19,540,000	\$19,540,000	\$0	0.0%	Recommendations maintain 2014-15 spending levels for lump sum death benefit payments to the survivors or estate of a person retired under any ERS-administered program.
Total, Goal A, EMPLOYEES RETIREMENT SYSTEM	\$1,023,852,651	\$1,040,828,337	\$16,975,686	1.7%	
GROUP INSURANCE B.1.1	\$3,050,386,426	\$3,642,887,210	\$592,500,784	19.4%	Recommendations reflect an All Funds increase of \$592.5 million over 2014-15 spending levels for a state contribution rate increase of 7.19 percent in fiscal year 2016 and 7.17 percent in fiscal year 2017. The contribution rate increase for each fiscal year of the biennium is primarily based on: <ul style="list-style-type: none"> • Actual and projected expenditures for fiscal year 2014; • Funding a 6.9 percent benefit cost trend; • Spending down approximately \$231.0 million of the ERS-projected insurance fund balance over the 2016-17 biennium; • Continuation of the 1.0 percent contribution of payroll by state agencies and institutions of higher education including biennialization of the fiscal year 2015 statewide salary increase; • 5.0 percent annual growth in retirees, resulting in approximately 1.5 percent growth in overall total population per fiscal year; and • Significant changes in the number and/or funding of FTEs at certain state agencies. (See Selected Fiscal and Policy Issue #1.)
Total, Goal B, EMPLOYEES RETIREMENT SYSTEM	\$3,050,386,426	\$3,642,887,210	\$592,500,784	19.4%	
Grand Total, All Strategies	\$4,074,239,077	\$4,683,715,547	\$609,476,470	15.0%	

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**Employee Retirement System
Summary of Recommendations - House, By Method of Finance -- GENERAL REVENUE FUNDS**

Strategy/Goal	2014-15 Base	2016-17 Recommended	Biennial Change	% Change	Comments
RETIREMENT CONTRIBUTIONS A.1.1	\$553,338,257	\$600,390,924	\$47,052,667	8.5%	Recommendations reflect an increase of \$52.1 million in General Revenue primarily related to the MOF swap from State Highway Fund 6 for certain agencies that previously expended Fund 6 for employee benefits. Recommendations also reflect a decrease of approximately \$5.0 million over the 2014-15 spending levels for continuation of the 2014-15 state contribution level of 7.5 percent of payroll in each fiscal year of the 2016-17 biennium based on the following assumptions (see Selected and Fiscal Policy Issues #2): <ul style="list-style-type: none"> • Biennialization of the fiscal year 2015 statewide salary increase; • 0.5 percent annual payroll growth in each fiscal year of the 2016-17 biennium biennium; and • Significant changes in the number of FTEs and/or funding of FTEs at certain state agencies.
LECOS A.1.2	\$13,570,453	\$15,847,890	\$2,277,437	16.8%	Recommendations reflect an increase of \$1.9 million in General Revenue related to the MOF swap from State Highway Fund 6. Recommendations also reflect an increase of \$0.4 million related to the biennialization of the fiscal year 2015 Schedule C and statewide salary increases. Recommendations continue the 2014-15 state contribution level of 0.5 percent of payroll in each fiscal year of the 2016-17 biennium to the LECOS retirement fund (see Selected and Fiscal Policy Issues #3).
JRS-II A.1.3	\$15,063,510	\$15,063,510	\$0	0.0%	Recommendations continue the 2014-15 state contribution level of 15.663 percent of payroll in each fiscal year of the 2016-17 biennium to the Judicial Retirement System - Plan II (JRS-II).
JRS-I A.1.4	\$54,837,896	\$53,060,844	(\$1,777,052)	(3.2%)	Recommendations reflect a decrease of \$1.8 million related to the natural attrition of annuitants in the Judicial Retirement System - Plan 1, which is operated on a pay-as-you-go basis. JRS-1 participants are those retired judges who joined the bench prior to 1985.

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**Employee Retirement System
Summary of Recommendations - House, By Method of Finance -- GENERAL REVENUE FUNDS**

Strategy/Goal	2014-15 Base	2016-17 Recommended	Biennial Change	% Change	Comments
PUBLIC SAFETY BENEFITS A.1.5	\$9,939,955	\$7,551,054	(\$2,388,901)	(24.0%)	Recommendations reflect a decrease of \$2.4 million from 2014-15 expenditure levels related to additional one-time benefit payments to the survivors of public law enforcement or fire-fighting personnel for the West, Texas plant explosion that will not continue into the 2016-17 biennium.
RETIREE DEATH BENEFITS A.1.6	\$19,540,000	\$19,540,000	\$0	0.0%	
Total, Goal A, EMPLOYEES RETIREMENT SYSTEM	\$666,290,071	\$711,454,222	\$45,164,151	6.8%	
GROUP INSURANCE B.1.1	\$1,884,772,251	\$2,470,294,856	\$585,522,605	31.1%	Recommendations reflect an increase of \$181.3 million in General Revenue related to a MOF swap from State Highway Fund 6 for certain agencies that previously expended Fund 6 for employee benefits. This increase is combined with an increase of \$404.2 million related to spending levels for a state contribution rate increase of 7.19 percent in fiscal year 2016 and 7.17 percent in fiscal year 2017. The contribution rate increase for each fiscal year of the biennium is primarily based on: <ul style="list-style-type: none"> • Actual and projected expenditures for fiscal year 2014; • Funding a 6.9 percent benefit cost trend; • Spending down approximately \$231.0 million of the ERS-projected insurance fund balance over the 2016-17 biennium; and • Continuation of the 1.0 percent contribution of payroll by state agencies and institutions of higher education including biennialization of the fiscal year 2015 statewide salary increase; • 5.0 percent annual growth in retirees, resulting in approximately 1.5 percent growth in overall total population per fiscal year; and • Significant changes in the number and/or funding of FTEs at certain state agencies. (See Selected Fiscal and Policy Issue #1.).
Total, Goal B, EMPLOYEES RETIREMENT SYSTEM	\$1,884,772,251	\$2,470,294,856	\$585,522,605	31.1%	
Grand Total, All Strategies	\$2,551,062,322	\$3,181,749,078	\$630,686,756	24.7%	

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**Employee Retirement System
Summary of Recommendations - House, By Method of Finance -- 6 - State Highway Fund**

Strategy/Goal	2014-15 Base	2016-17 Recommended	Biennial Change	% Change	Comments
RETIREMENT CONTRIBUTIONS A.1.1	\$138,533,909	\$89,296,535	(\$49,237,374)	(35.5%)	Recommendations reflect a decrease of \$52.8 million related to a MOF swap from State Highway Fund 6 to General Revenue or Other Funds for certain agencies that previously expended Fund 6 for employee benefits. This decrease is offset by an increase of \$3.6 million over the 2014-15 spending levels for continuation of the 2014-15 state contribution level of 7.5 percent of payroll in each fiscal year of the 2016-17 biennium based on the following assumptions: <ul style="list-style-type: none"> • Biennialization of the fiscal year 2015 statewide salary increase; and • 0.5 percent annual payroll growth in each fiscal year of the 2016-17 biennium.
LECOS A.1.2	\$1,689,393	\$0	(\$1,689,393)	(100.0%)	Recommendations reflect a decrease of \$1.7 million related to an MOF swap from State Highway Fund 6 to General Revenue for certain agencies that previously expended Fund 6 for employee benefits.
JRS-II A.1.3	\$0	\$0	\$0	0.0%	
JRS-I A.1.4	\$0	\$0	\$0	0.0%	
PUBLIC SAFETY BENEFITS A.1.5	\$0	\$0	\$0	0.0%	
RETIREE DEATH BENEFITS A.1.6	\$0	\$0	\$0	0.0%	
Total, Goal A, EMPLOYEES RETIREMENT SYSTEM	\$140,223,302	\$89,296,535	(\$50,926,767)	(36.3%)	
GROUP INSURANCE B.1.1	\$494,805,352	\$414,030,990	(\$80,774,362)	(16.3%)	Recommendations reflect a decrease of \$182.8 million related to a MOF swap from State Highway Fund 6 to General Revenue or Other Funds for certain agencies that previously expended Fund 6 for employee benefits. This decrease is offset by an increase of \$102.0 million related to 2014-15 spending levels for a state contribution rate increase of 7.19 percent in fiscal year 2016 and 7.17 percent in fiscal year 2017.
Total, Goal B, EMPLOYEES RETIREMENT SYSTEM	\$494,805,352	\$414,030,990	(\$80,774,362)	(16.3%)	
Grand Total, All Strategies	\$635,028,654	\$503,327,525	(\$131,701,129)	(20.7%)	

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**Employees Retirement System
Selected Fiscal and Policy Issues - House**

1. **ERS Group Benefits Program (GBP).** Recommendations reflect an increase of \$585.5 million in General Revenue and \$592.5 million in All Funds above 2014-15, primarily for a state contribution increase of 7.19 percent in fiscal year 2016 and 7.17 percent in fiscal year 2017.

	State Contribution Increase (Cost Trend)	Agency Contribution	Contingency Reserve Fund Balance (Increase)/Decrease	Benefit Cost Trend (Actual and Projected)
2014	7.36% (7.0%)	1.0%	(\$36.3 million)	9.5%
2015	7.33% (7.0%)	1.0%	\$30.7 million	8.5%
Rec 2016	7.19% (6.9%)	1.0%	Recommendations assume expenditure of \$231.0 million (leaving \$100.0 million balance at end of FY 2017)	8.5%
Rec 2017	7.17% (6.9%)	1.0%		8.5%
ERS requested a 6.9 percent state contribution increase each fiscal year of the 2016-17 biennium, which funds an 8.5 percent benefit cost trend when combined with use of \$231.0 million of the contingency reserve fund. The agency's request assumes no growth in retirees or FTEs in either fiscal year of the 2016-17 biennium, which differs from assumptions included in recommendations.				
Recommendations reflect 5.0 percent annual growth in retirees, resulting in approximately 1.5 percent growth in overall total population per fiscal year. Recommendations also account for projected changes in the number and/or funding of FTEs at state agencies. Article IX, Section 17.04, Payroll Contribution for Group Health Insurance in House Bill 1, Eighty-fourth Legislature, Regular Session, 2015, Introduced, continues the state agencies contribution of 1.0 percent of payroll for the ERS GBP.				

2. **ERS Retirement Program.** Recommendations reflect an increase of \$47.1 million in General Revenue and \$20.8 million in All Funds over 2014-15 base levels. The following summarizes the rates for recommended and requested amounts, as well as constitutional and statutory requirements.

	State Contribution	Agency Contribution	Member Contribution	Total	2014 Actuarial Valuation
2014	7.5%*	0.5%	6.6%	14.6%	Actuarially Sound Contribution (ASC) Rate: 18.76% ERS Projected ASC from 2016-17 LAR: 19.79% (Normal Cost: 11.58%) Infinite amortization period. Constitutional/Statutory State Contribution Rates for ERS Retirement: • 6.0 percent – Constitutional minimum state contribution rate • 7.4 percent – Statutorily required state contribution rate, Government Code, Sec. 815.403 • 10.0 percent – Constitutional maximum state contribution rate
2015	7.5%	0.5%	6.9%	14.9%	
Req 2016	11.94%	0.5%	7.2%	19.64%	
Req 2017	11.94%	0.5%	7.5%	19.94%	
Rec 2016	7.5%	0.5%	7.2%	15.2%	
Rec 2017	7.5%	0.5%	7.5%	15.5%	

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Recommendations provide for 2.06 percent payroll growth in fiscal year 2015 to maintain salary increases related to the general state employee pay raise, 0.5 percent payroll growth in each fiscal year of the 2016-17 biennium, and projected FTE changes at certain state agencies. These include FTE additions at the Office of the Attorney General, Comptroller of Public Accounts, State Preservation Board, Department of Family and Protective Services, Department of State Health Services, Texas Military Department, and the Department of Public Safety. These FTE increases are partially offset by an FTE reduction at the Texas Workforce Commission. Art. IX, Sec. 17.08, Additional Payroll Contribution for Retirement Contributions in House Bill 1, Introduced, continues the state agencies contribution of 0.5 percent of payroll for ERS Retirement.

ERS requested approximately \$538.4 million in All Funds (\$352.6 million in General Revenue) for the biennium to provide the projected actuarially sound state contribution rate of 11.94 percent in each fiscal year of the 2016-17 biennium. If funded, this contribution request would exceed the maximum state contribution of 10 percent, pursuant to the Texas Constitution, Art. XVI, Sec. 67(b)(3). This request is not included in recommendations.

As of the August 31, 2014 Actuarial Valuation of the ERS retirement fund, the unfunded actuarial accrued liability is \$7.5 billion, an increase of \$0.3 billion over the \$7.2 billion unfunded liability from the fiscal year 2013 valuation. The plan's funded ratio is 77.2 percent, which is 0.2 percent lower than the 77.4 percent funded ratio for fiscal year 2013.

*Note: Fiscal year 2014 state contribution rate of 7.5 percent is comprised of a base contribution of 6.5 percent and an increase of 1.0 percent from retirement and group insurance unexpended and unobligated balances remaining as of August 31, 2013.

3. **Law Enforcement and Custodial Officers Supplemental (LECOS).** Recommendations reflect an increase of \$2.3 million in General Revenue and \$0.6 million in All Funds.

	State	Court Fees	Member	Total	2014 Actuarial Valuation
2014	0.5%	1.2%	0.5%	2.2%	FY 2014 Actuarially Sound Contribution Rate: 2.96% ERS Projected ASC from 2016-17 LAR: 3.16% (Normal Cost: 1.8%) Infinite amortization period.
2015	0.5%	1.2%	0.5%	2.2%	
Req 2016	1.46%	1.2%	0.5%	3.16%	
Req 2017	1.46%	1.2%	0.5%	3.16%	
Rec 2016	0.5%	1.2%	0.5%	2.2%	
Rec 2017	0.5%	1.2%	0.5%	2.2%	

Recommendations provide for approximately 5.05 percent payroll growth in fiscal year 2015 to maintain salary increases related to the Schedule C pay raise. Recommendations also provide for FTE increases at the Department of Public Safety. The LECOS fund receives a portion of court fees that the ERS actuary estimates to be equal to 1.2 percent of payroll. This contribution is expected to continue into the 2016-17 biennium.

ERS requested approximately \$31.0 million in All Funds (\$30.4 million in General Revenue) for the biennium to provide the projected actuarially sound state contribution rate of 1.46 percent in each fiscal year of the 2016-17 biennium. This request is not included in recommendations. As of the August 31, 2014 Actuarial Valuation for the LECOS fund, the unfunded actuarial accrued liability is approximately \$323.2 million, a decrease of \$30.9 million over the

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\$354.1 million unfunded liability from the fiscal year 2013 valuation. The plan's funded ratio is 73.2 percent, which is 2.8 percent higher than the 70.4 percent funded ratio for fiscal year 2013.

4. **Judicial Retirement System – Plan II (JRS II)** (appointed/hired after August 31, 1985). Recommendations equal 2014-15 spending levels.

	State	Member	Total	2014 Actuarial Valuation
2014	15.663%	6.6%	22.263%	Actuarially Sound Contribution Rate: 23.86% ERS Projected ASC from 2016-17 LAR: 24.29% (Normal Cost: 21.03%) Infinite amortization period.
2015	15.663%	6.9%	22.563%	
Req 2016	16.94%	7.2%	24.14%	
Req 2017	16.94%	7.5%	24.44%	
Rec 2016	15.663%	7.2%	22.863%	
Rec 2017	15.663%	7.5%	23.163%	
ERS requested approximately \$2.0 million in All Funds (\$1.2 million in General Revenue) for the biennium to provide the projected actuarially sound state contribution rate of 16.94 percent in each year of the 2016-17 biennium. This request is not included in recommendations. As of the August 31, 2014 Actuarial Valuation for the JRS-II fund, the unfunded actuarial accrued liability is approximately \$37.9 million, an decrease of \$3.1 million from the \$41.0 million unfunded liability from the fiscal year 2013 valuation. The plan's funded ratio is 90.2 percent, which is 1.6 percent higher than the 88.6 percent funded ratio for fiscal year 2013.				

5. **Payroll Contributions for ERS Group Health Insurance and Retirement.** Recommendations continue the 1.0 percent contribution from state agencies and institutions of higher education to ERS for the 2016-17 biennium in Article IX, Sec. 17.04, Payroll Contribution for Group Health Insurance of House Bill 1, Introduced. Article IX, Sec. 17.05, Payroll Contribution for Group Health Insurance in the 2014-15 General Appropriations Act (GAA) directs all agencies and institutions of higher education to contribute 1.0 percent of total base wages and salaries to the ERS Insurance Fund to offset benefit costs within the GBP. Based on the assumption of 0.5 percent payroll growth for state agencies and 4.0 percent payroll growth for institutions of higher education, ERS is estimated to receive approximately \$119.5 million in All Funds from state agencies and \$74.5 million in All Funds from institutions of higher education during the 2016-17 biennium. During fiscal year 2014, ERS received approximately \$58.1 million in All Funds from state agencies and approximately \$35.1 million from institutions of higher education.

Recommendations continue the 0.5 percent contribution from state agencies to ERS for the 2016-17 biennium in Article IX, Sec. 17.08, Additional Payroll Contribution for ERS Retirement of House Bill 1, Introduced. This provision was added to the 2014-15 GAA to direct state agencies to contribute an additional 0.5 percent of total base wages and salaries to the ERS retirement fund. Based on assumptions to maintain the fiscal year 2015 pay raise and 0.5 percent payroll growth in each year of the 2016-17 biennium, ERS is estimated to receive approximately \$58.8 million in All Funds during the 2016-17 biennium. During fiscal year 2014, ERS received approximately \$28.6 million in All Funds.

6. **Senate Bill 1459, Eighty-third Legislature, Regular Session, 2013.** The Eighty-third Legislature, Regular Session, 2013, passed Senate Bill 1459, amending Government Code, Chapter 815 and Insurance Code, Chapter 1551 to make the following significant changes to ERS administered benefits:

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- Increase the member contribution rate to the Employees Retirement Program to 6.6 percent in fiscal year 2014, with 0.3 percent incremental increases in each fiscal year up to 7.5 percent in fiscal year 2017 and beyond.
- Change how retirement benefits are calculated for all members beginning employment after August 31, 2013. The retirement benefits of these employees will be based on the highest 60 months of salary instead of the highest 48 or 36 months of salary as for other employees. Additionally, the annuity for these employees will be reduced by 5.0 percent for each year the employee retires before age 62.
- Provide for an assessment of an employer contribution of 0.5 percent of total base payroll as determined in the GAA for all general state agencies to increase the total state retirement contribution to ERS. Accordingly, Article IX, Section 17.13 of the 2014-15 GAA requires this contribution, which is estimated to be \$55.0 million in All Funds for the 2014-15 biennium, and is recommended to continue into the 2016-17 biennium (see Item #5 above).
- Implement tiered insurance for retirees, which applies to all employees with less than five years of service as of September 1, 2014. Employees who retire with more than 15 but less than 20 years of service will receive 75 percent of the full state contribution for insurance and employees who retire with more than 10 but less than 15 years of service will receive 50 percent of the full state contribution for insurance upon retirement.

ERS estimated that benefit changes to the retirement fund would have a moderate positive impact on the plan, decreasing the normal cost and unfunded liability. However, the agency does not anticipate realizing the impact of tiered insurance for retirees for a number of years.

Senate Bill 1459 also required ERS to conduct studies on the following:

- Account for any assets and liabilities attributed to members of the LECOS fund separately from the ERS main plan, in order to determine the actuarial impact of separating law enforcement and custodial officer (LECO) members and retirees into a single fund. In a report released January 15, 2015, ERS identified two options to achieve the separate accounting of LECO employees. **Option 1** would combine the ERS and LECOS trusts into a single trust and different contribution rates would be set for the different populations. Option 1 would require statutory changes to allowing for combining of the trusts. **Option 2** would require separating the LECO employee related assets and liabilities from the ERS trust and adding them into the LECOS trust. Option 2 would require statutory changes and a plan determination letter from the Internal Revenue Service certifying that the plans are in good standing.
- Examine the feasibility of adding custodial officers employed at the Texas Juvenile Justice Department to the class of employees eligible to participate in the LECOS fund. ERS also chose to examine the impact of adding law enforcement officers at the Office of Attorney General in the study due to similar interest. ERS determined that adding these populations to the LECOS retirement fund plans would increase the cost to the LECOS fund and the ERS main fund, which are currently both actuarially unsound. Government Code, Sec. 811.006(b) prohibits benefit enhancements when a fund is not actuarially sound.

7. **State Auditor's Report on the HealthSelect Contract at the Employees Retirement System.** In November 2014, the State Auditor's Office (SAO) released an audit report entitled, *The HealthSelect Contract at the Employees Retirement System*. The audit reviewed the process ERS followed to plan, procure, and contract for the HealthSelect third-party administrator, which was awarded to UnitedHealthcare Service, Inc (United) in February 2012. The HealthSelect contract with United is valid through the end of fiscal year 2016, with the option for ERS to extend the contract for an additional two years. If ERS does not choose to extend the contract, the agency would need to reprocure a HealthSelect third-party administrator with the RFP process likely beginning in the summer of 2015.

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The audit highlighted deficiencies related to the planning and procurement of the HealthSelect contract, including compliance issues with state and ERS criteria for contracts. The audit also looked at post-award management of the HealthSelect contract and determined that until July 2014, ERS did not have a process to reconcile daily reimbursement payments to health care claims. The audit provided the following recommendations to address identified weaknesses.

- Ensure that key staff involved in procurement meet state training and certification requirements;
- Enhance planning documentation for procurements to clearly define what ERS intended the selected contractor to accomplish;
- Ensure RFPs comply with state statutes and previously implemented system policies;
- Develop established scoring tools and guidelines for consistent use of scoring tools;
- Document process to address additional factors and information included in evaluation of proposals and subsequent negotiation;
- Improve contract formation and amendment process to comply with state statutes; and
- Improve timeliness and effectiveness of contract monitoring.

ERS generally agreed with most recommendations and indicated the agency will continue to improve planning, documentation and management of the HealthSelect contract procurement process. Recommendations include a new rider to require the agency to comply with SAO recommendations. The rider also requires ERS to submit several reports to the LBB and the SAO to certify that the agency's HealthSelect contract planning, procurement, formation, and oversight complies with statutory and contract management guidelines outlined by the SAO audit. ERS requested several changes to the rider to clarify timelines and allow the agency to contract on terms that differ from the Contract Management Guide, provided that the contract terms are stricter and more favorable to the state (see Section 6 - Items Not Included in Recommendations).

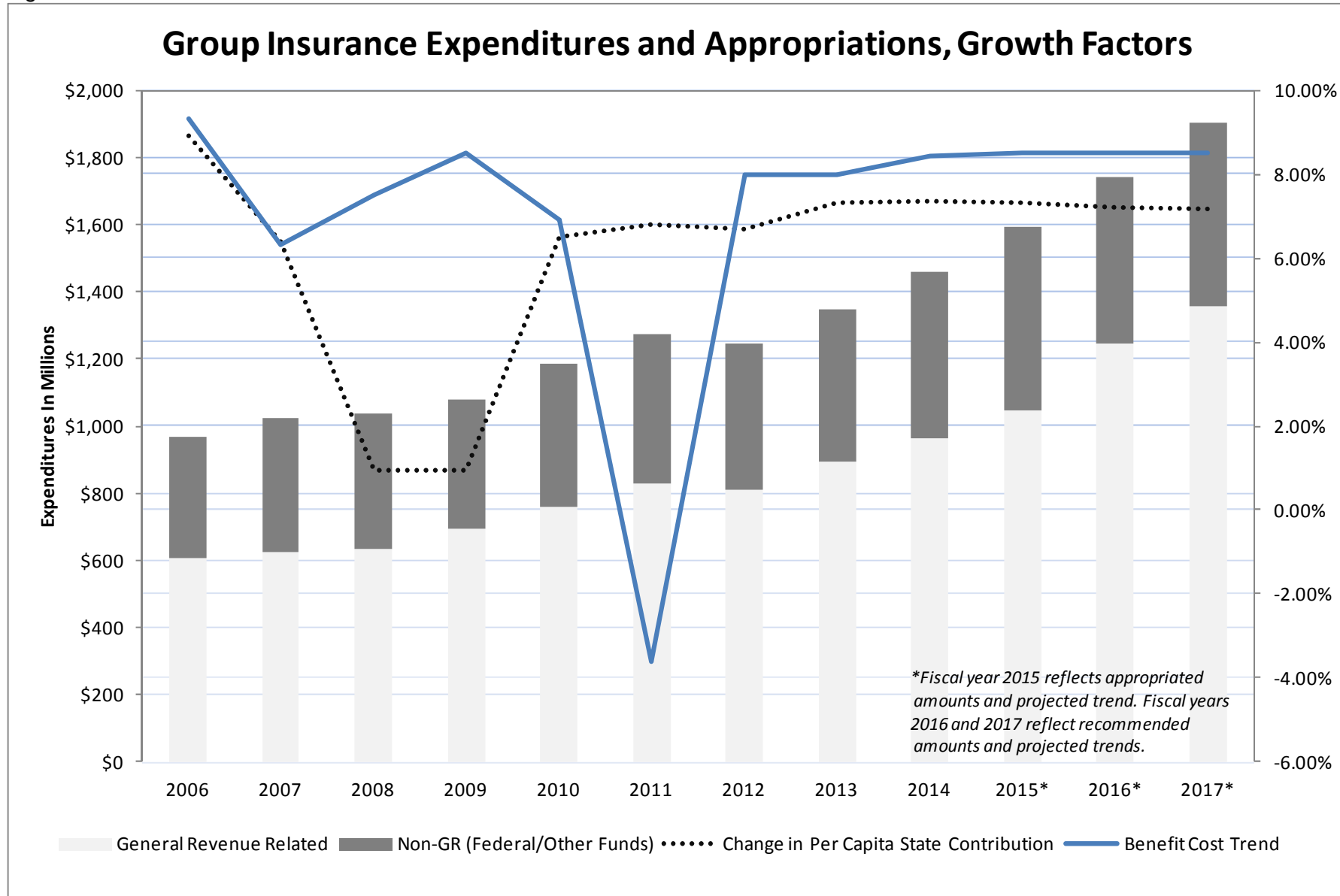
8. **Analysis of the Benefit Cost Trend, Per Capita State Contribution and Expenditures.** Figure 1 provides a 12-year history of GBP expenditures in General Revenue-Related funds and All Funds. Fiscal year 2015 reflects appropriated amounts and fiscal years 2016 and 2017 reflect recommended amounts.

One of the major cost drivers for the GBP is the benefit cost trend, which is the rate by which GBP health benefit costs are increasing annually. The trend is comprised of hospital costs, prescription drug costs, and other medical expenses. The largest cost driver for the trend is prescription drug costs. The solid line in the following figure shows a 12-year history of the actual benefit cost trend experienced by the GBP. The percentages take into account any interventions by ERS that affect the overall trend, such as in fiscal year 2011 when the Board approved co-pay increases to address an expected funding shortfall. For fiscal years 2015 through 2017, the trend is projected to be 8.5 percent.

Recommendations for the 2016-17 biennium reflect ERS' request to fund a 6.9 percent benefit cost trend in each fiscal year, which assumes spending down approximately \$231.0 million of the contingency reserve fund to cover any increase in actual GBP costs. The state contribution that the Legislature appropriates to fund the benefit cost trend is the per capita state contribution rate increase. The dotted line in Figure 1 represents the per capita cost trend, or percent increase in funding over the prior fiscal year.

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Figure 1



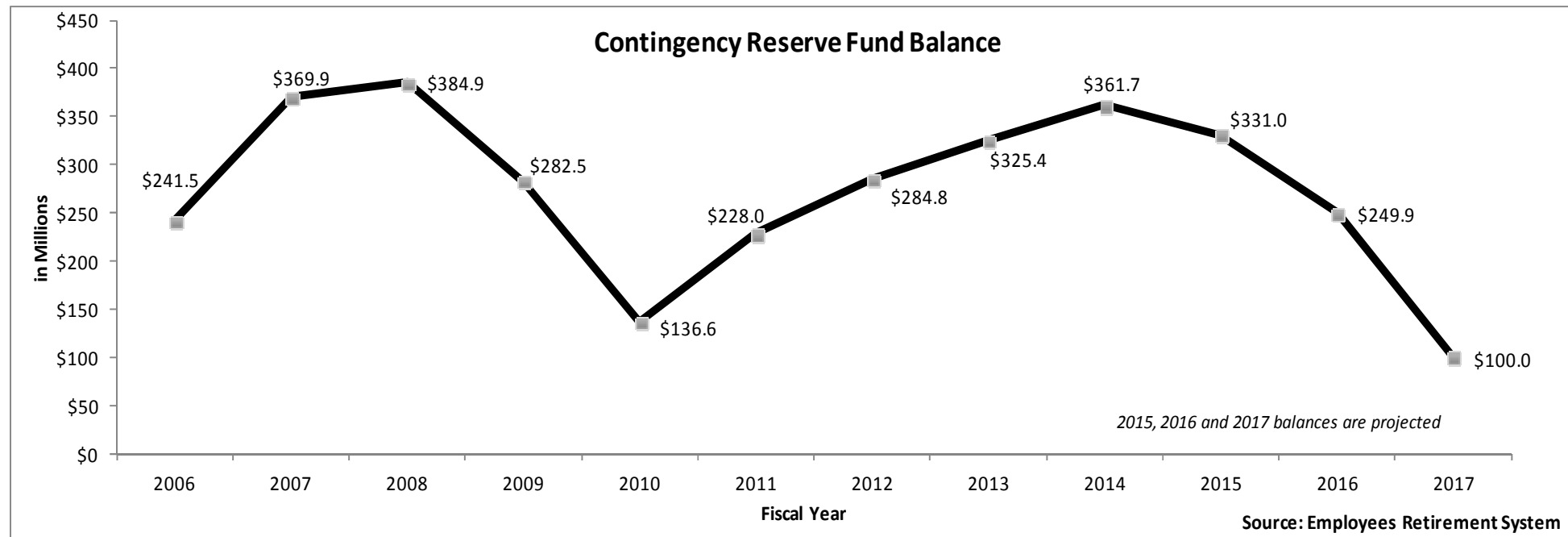
Source: Legislative Budget Board, Employees Retirement System

Section 3

9. **Contingency Reserve Fund Balance.** Recommendations fund an 8.5 percent benefit cost trend by providing a net state contribution increase of 7.19 percent in fiscal year 2016 and 7.17 percent in fiscal year 2017 and spend down approximately \$231.0 million in contingency reserve fund balances during the 2016-17 biennium, which is reflected in the figure. ERS is also requesting \$330.4 million in All Funds in 2016-17 to maintain a 60-day reserve fund balance as required by Chapter 1551, Section 211 of Texas Insurance Code (see Section 6 – Items Not Included in Recommendations). Recommendations do not include the agency’s request to maintain a 60-day reserve fund balance.

Figure 2 represents a 12 year history of the contingency fund balance at the end of the fiscal year. The contingency reserve fund receives all revenues for the GBP, including state and member contributions, the one percent employer contribution, the tobacco user fee, federal subsidies, prescription drug rebates, and investment income, and makes expenditures to cover GBP-related claims costs.

Figure 2



Section 3

**Employees Retirement System
FTE Highlights - House**

Full-Time-Equivalent Positions	Expended 2013	Estimated 2014	Budgeted 2015	Recommended 2016	Recommended 2017
Cap	332.0	332.0	332.0	356.0	360.0
Actual/Budgeted	323.7	329.7	349.0	NA	NA
Schedule of Exempt Positions (Cap)					
Executive Director	\$312,000	\$335,010	\$348,410	\$348,410	\$348,410
Director of Investments	\$312,120	\$375,272	\$375,272	\$375,272	\$375,272

The State Auditor's Office Report, *Executive Compensation at State Agencies* (Report No. 14-705, August 2014), indicates a market average salary of \$291,457 for the Executive Director Position. Pursuant to Government Code, Sec. 815.208, the salary of the Executive Director is set by the ERS Board of Trustees and is not subject to the limits in the GAA since the salary is paid by funds outside the Treasury. The salary for the Executive Director position was increased from \$312,000 to \$335,010 in fiscal year 2014 and to \$348,410 in fiscal year 2015.

The SAO report did not address the Director of Investments position. Recommendations include identifying the Director of Investments position, which was previously unclassified, as an exempt position. The salary of the Director of Investments is not subject to the limits in the GAA since the salary is paid by funds outside the Treasury.

Pursuant to Government Code, Sec. 815.202(e), the Executive Director prepares an itemized budget annually that the Board of Trustees reviews and adopts. In 2015, the Board of Trustees approved an FTE cap increase to 375.33 and is projected to remain constant for the 2016-17 biennium. Increases in ERS FTEs are primarily related to expanding the agency's Investments Division due to the Board's decision to further diversify the ERS investment allocation by adding new asset classes. Historically, the agency has projected a vacancy rate of 3.5 to 5 percent, and the recommended caps for fiscal years 2016 and 2017 reflect the agency's expected FTEs. Because ERS employees are paid with funds outside the Treasury and not appropriations made by the GAA, ERS is not subject to the Article IX, Sec. 6.10, Limitation on State Employment Levels.

Section 3

**Employees Retirement System
Performance Measure Highlights - House**

	Expended 2013	Estimated 2014	Budgeted 2015	Recommended 2016	Recommended 2017
<ul style="list-style-type: none"> <i>Investment Expense as Basis Points of Net Position</i> <p><i>Measure Explanation: Increase in anticipated investment expense in fiscal year 2015, and subsequent increase in targets for fiscal years 2016 and 2017, is due to increased diversification of investment assets requiring additional staff and higher legal fees to administer transaction, as approved by the ERS Board.</i></p>	14.1	13.7	17.0	17.0	18.0
<ul style="list-style-type: none"> <i>Number of ERS Accounts Maintained</i> <p><i>Measure Explanation: Anticipated number of ERS Retirement accounts maintained in fiscal year 2015, and subsequent adjustment in targets for fiscal years 2016 and 2017, is due to slower growth than anticipated in number of accounts maintained related to the decreasing employee population and increasing retirement rates.</i></p>	231,100	232,569	235,000	237,000	239,000

Section 4

**Employees Retirement System
Performance Review and Policy Report Highlights - House**

Reports & Recommendations	Savings/ (Cost)	Gain/ (Loss)	Fund Type	Included in Introduced Bill	Action Required During Session
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NO RELATED RECOMMENDATIONS

Section 5

Employees Retirement System Rider Highlights - House

1. (revise) **Informational Listing of Appropriated Funds.** Revise rider to reflect LBB recommendations for each benefit type.
 4. (revise) **State Contribution to Employees Retirement System.** Revise rider to reflect a state contribution rate of 7.5 percent for the ERS Retirement fund for each fiscal year of the 2016-17 biennium and remove unexpended balance and contingency language.
 11. (revise) **Tobacco User Monthly Premium Fee.** Revise rider to update tobacco user fee estimated revenues for each year of the 2016-17 biennium.
 13. (new) **HealthSelect of Texas Contract.** Add new rider requiring the agency to comply with recommendations made by the SAO and provide reports to the LBB and the SAO verifying contract planning, procurement, formation and oversight comply with statutory and contracting guidelines.
 13. (delete) **Life and Disability Insurance and Education.** Delete rider requiring agency to provide additional education to state employees on life and disability insurance since the agency is achieving this initiative.
 14. (delete) **Basic Life and Health Coverage.** Delete rider due to completion of the simulation and related report released on September 1, 2014.
- Art. IX, (revise) **Payroll Contribution for Group Health Insurance.** Revise rider to update estimated contributions for the 2016-17 biennium.
Sec.17.04
- Art. IX, (revise) **Additional Payroll Contribution for Retirement Contribution.** Revise rider to update estimated contributions for the 2016-17
Sec. 17.08 biennium.

Section 6

**Employee Retirement System
Items not Included in Recommendations - House**

	2016-17 Biennial Total	
	GR & GR- Dedicated	All Funds
Agency Exceptional Items - In Agency Priority Order		
1. Increase contribution rate by 4.44 percent to 11.94 percent in each fiscal year to provide an actuarially sound level of funding to the ERS retirement fund per Government Code, Sec. 811.006 (total average biennial contribution of 19.79 percent based on the state contribution of 11.94 percent, agency contribution of 0.5 percent and member contribution of 7.2 percent in fiscal year 2016 and 7.5 percent in fiscal year 2017). If funded at a state contribution rate of 11.94 percent, the state would exceed the constitutional maximum of 10.0 percent.	\$ 376,980,960	\$ 538,412,016
2. Increase contribution rate by 0.96 percent to 1.46 percent in each fiscal year to provide an actuarially sound level of funding to the LECOS retirement fund per Government Code, Sec. 811.006 (total average biennial contribution of 3.16 percent based on the state contribution of 1.46 percent, member contribution of 0.5 percent, and the additional court fee contribution of approximately 1.2 percent).	\$ 30,906,986	\$ 31,019,614
3. Increase contribution rate by 1.277 percent to 16.94 percent in each fiscal year to provide an actuarially sound level of funding to the JRS-II retirement fund per Government Code, Sec. 811.006 (total average biennial contribution of 24.29 percent based on the state contribution of 16.94 percent and member contribution of 7.2 percent in fiscal year 2016 and 7.5 percent in fiscal year 2017).	\$ 1,228,138	\$ 1,983,084
4. Funding to provide for 60 days of claims in the Group Benefit Program Reserve Fund, per Insurance Code, Sec. 1551.211. Recommendations include spending down the contingency reserve fund balance, projected to be \$331.1 million at the end of fiscal year 2015, by approximately \$231.0 million, leaving an estimated reserve of \$100.0 million at the end of fiscal year 2017.	\$ 237,628,975	\$ 289,870,192
5. Revise Rider 4, State Contribution to Employees Retirement Program to increase the state contribution for each fiscal year of the 2016-17 biennium to 10.0 percent of payroll out of unexpended and unobligated balances in Strategy A.1.1, Retirement Contributions and Strategy B.1.1, Group Insurance remaining at the end of the prior fiscal year.	\$ -	\$ -

Section 7

**Employees Retirement System
Summary of 10 Percent Biennial Base Reduction Options - House**

Priority	Item	Description/Impact	Biennial Reduction Amounts				Reduction as % of Program GR/GR-D Total	Included in Intro Bill?
			GR and GR-Dedicated	All Funds	FTEs	Potential Revenue Loss		
TOTAL, 10% Reduction Options			\$0	\$0		\$0		

The Employees Retirement System is not subject to the 10% biennial base reduction exercise.