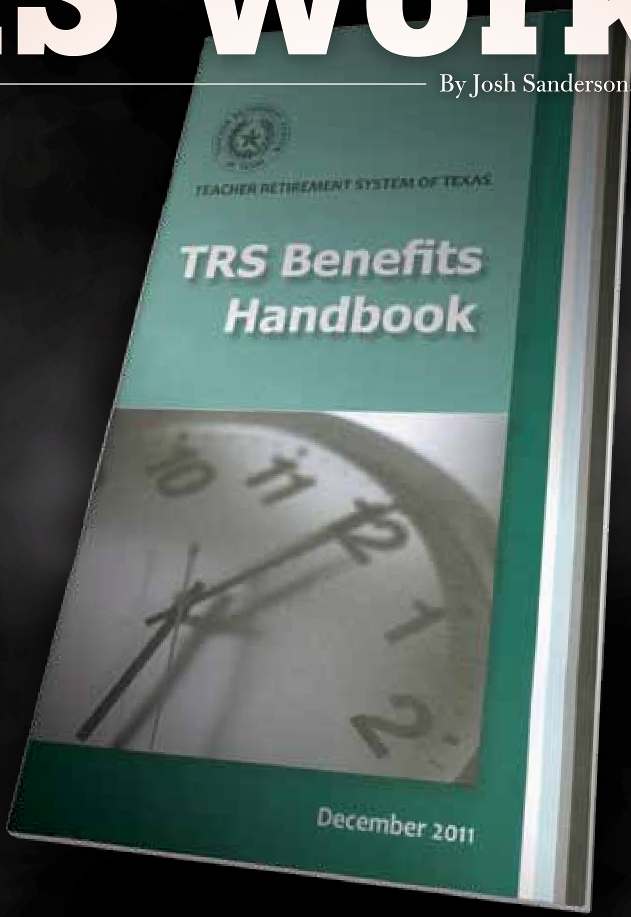
YOUR DEFINED BENEFIT PENSION IS UNDER ATTACK, BUT ITS CRITICS ARE IGNORING THE FACTS:

TRS works

By Josh Sanderson, ATPE lobbyist



Much has been said recently in the media, by candidates on the campaign trail and by special interest groups about the Texas Teacher Retirement System (TRS), a defined benefit pension trust fund. Unfortunately, for anyone who values truth and effective, practical public policy, most of what has been discussed is either based on a misunderstanding of the TRS pension plan or represents a blatant attempt to manipulate the facts. We welcome the conversation about TRS, but those who propose changing the TRS pension plan in detrimental ways are too often driving the discussion.

During the 2011 legislative session, a bill was filed and heard in the House Pension, Investments and Financial Institutions Committee that proposed changing TRS benefits from the current defined benefit model to a defined contribution plan similar to a 401(k). Thanks to the support of several key legislators and the work of the active and retired education community, the bill was never voted out of committee. However, supporters of changing TRS to a defined contribution plan—such as the Texas Public Policy Foundation, former Enron trader and billionaire hedge fund manager John Arnold and Houston attorney Bill King—continue to press forward, hoping to convince legislative leaders that forever changing TRS is in the state's best interests. But the only interests served by moving to a 401(k)-type plan are those of the special variety.

Nearly every article or argument in favor of pension "reform" lumps all pension systems together and almost always includes examples of failing pensions from other states. This tactic is specious and disingenuous at best.

This is Texas. We do things differently here, for right or wrong. We are not Wisconsin; we are not New York; and we certainly do not operate our public school employee pension trust funds like many other states that are in dire straits because of mismanagement.

It is time to clear the air. It is time to present the facts instead of allowing political rhetoric to be presented as truth, as too often happens in policy debates. ATPE has long advocated for the preservation of the TRS defined benefit pension model for a variety of reasons: TRS is efficient, offering reasonable benefits at a fraction of the cost of a defined contribution plan; TRS is effective, generating investment returns well above assumed rates throughout the past 20 years; and, most importantly, TRS is essential, providing a benefit that helps schools attract and retain quality educators.

Defined benefits and defined contributions

Before we get into the details of the TRS debate, let's get some terminology and basic information out of the way. As a member of TRS, you are required to contribute to the TRS pension trust fund, which makes you eligible to receive a defined benefit (DB) pension upon retirement. Under a DB pension system, benefits are funded by employee and employer contributions along with investment returns on those contributions. Under TRS, your benefits are determined by a formula that considers your years of service, the average of your highest three or highest five annual salaries and the current multiplier of 2.3 percent. Once you qualify for a pension through TRS, benefits are paid monthly for life, which makes the DB model a stable, reliable source of income for retirees.

A defined contribution (DC) plan can be thought of as a 401(k). In a DC plan, the contributions from the employee and employer are specified, but the benefits are not. The employee's benefits upon retirement consist of contributions and any investment gains or losses. The risk lies solely with the employee, and benefits are finite; when the contributions are exhausted, so are the benefits. As an example of the individual risks of DC accounts, the average 401(k) lost 30.5 percent of its value during the market downturn between 2007 and 2008, according to the Employee Benefit Research Institute and the Investment Company Institute. If someone is nearing retirement and experiences this loss, his retirement will almost certainly be delayed.

Of course, it is not as simple as comparing DB and DC plans. Some states have implemented hybrid plans that consist of both DB and DC components. In fact, the TRS Board of Trustees is currently conducting a legislatively mandated study not only on the effects of changing to a DC plan but also of changing to a hybrid model. Still, it is imperative to know that the only way the state's costs would be decreased would be if benefits were reduced or risk were shifted to the employee.

How does TRS stack up?

The following might be the most important aspect of the TRS pension discussion for any supporter or opponent of the current DB plan. It is irresponsible to propose altering a system that one does not properly understand.

The DB pension to which TRS members contribute is quite literally one of the best-managed and best-performing pension systems in the world. This year, TRS was named Private Equity LP of the Year by *Private Equity International*, and in 2009, TRS was recognized as the Public Pension Fund Investor of the Year by *Alternative Investment News*.

"The report of my death was an exaggeration."

—Mark Twain

Aside from being recognized for performance, TRS provides benefits at a cost of approximately $40 per member per year. This administrative cost is unheard of in the private sector, where, according to the Department of Labor, fees often range from 0.5 percent to 1.5 percent of investment returns and result in thousands of dollars in earned returns being realized by the fund manager instead of the investor. Further, the National Institute on Retirement Security concluded that a DB plan, such as TRS, provides retirement income comparable to a DC 401(k) plan at a cost that is 46 percent lower than the 401(k) plan.

In 2011, TRS generated investment returns of more than 15.5 percent, adding more than $15 billion to the pension trust fund, which is currently valued at more than $107 billion. Even with this superb investment performance, pension benefits paid out through the system are anything but lavish.

The average TRS monthly pension check is approximately $1,900, and more than 55 percent of the 300,000 TRS retirees receive monthly pension checks of less than $2,000. This relatively small amount is all the more important to Texas teachers because more than 95 percent of Texas school districts do not participate in Social Security, meaning that nearly all retirees under TRS do not receive Social Security income.

The 95 percent of Texas school districts that do not participate in Social Security are exempt from the 12.4 percent payroll tax (6.2 percent employer and 6.2 percent employee) that they would otherwise pay on every employee. These districts are exempt because TRS is considered a qualified retirement plan under Internal Revenue Service guidelines. If Texas lawmakers choose to change TRS to a DC pension plan, there are serious questions as to whether it would retain its qualified retirement plan status, and if it doesn't, then every district and employee would be required to contribute to Social Security, thus effectively increasing expenses by 12.4 percent of all employee salaries. Neither the state nor school districts can absorb this added cost, especially at a time when school funding has been reduced by $5.4 billion.

There is a reason why many other states are experiencing pension problems, and the issue is not an inherent defect in DB plans. Many states have instituted mandatory cost of living adjustments (COLAs) for retirees even when investment returns could not fund these increases, or they have enacted "contribution holidays" where either the active members or the employer does not contribute to the pension trust fund for a period of time. Mismanagement has been rampant—but not in Texas.

TRS members pay for their benefits, and benefits are only increased when Texas can pay for them (benefits have not been increased since 2001). The state requires each employee to contribute 6.4 percent of his income to TRS. The Texas Constitution requires the state to contribute no less than 6 percent and no more than 10 percent of aggregate TRS member payroll to the TRS pension trust fund. Currently, the state is contributing at the constitutional minimum of 6 percent; however, that rate is scheduled to increase to 6.4 percent in 2013. Further, no regular COLAs are provided to TRS retirees. Because of a requirement in the constitution, no COLAs can be provided unless the fund is 100 percent actuarially sound. The effect of the lack of COLAs in Texas is that TRS retirees absorb inflation costs. Although this requirement can be onerous for retirees by stifling much-needed adjustments in benefits to compensate for inflation, the requirement ensures that benefit increases are not given when they cannot be afforded.

Proponents of changing TRS benefits often claim that the pension system is underfunded and, as such, fiscally unstable. The truth is that long-term benefits are not 100 percent funded; however, TRS does meet the actuarial standard for being considered healthy by being more than 80 percent funded. In fact, TRS would be considered 100 percent funded if the state increased its contribution rate to 8.13 percent, which is not substantial considering that as a percentage of the state budget, Texas contributes less to employee pensions than any other state that does not participate in Social Security. Let's say that again: Among states that do not contribute to Social Security, Texas dedicates the smallest percentage of its state budget to teacher retirement, and we are still considered to be healthy by the independent actuaries who are charged with monitoring the fund.

Does the argument for change make sense?

If the argument to change the TRS pension plan to a DC plan is economic in nature, then—as shown by the efficiencies and investment performance of TRS—it is clear that the argument fails; the TRS defined benefit model achieves superior investment returns at nearly half the cost of a 401(k). Any prudent investor would choose this option.

If the argument is politically based, then we object to the notion that politics should be interjected into the management operations of one of the world's highest performing pension systems, let alone our public education system.

Think about it this way, from a macro-level policy perspective: If the ultimate goal of Texas policymakers, who are primarily elected officials, is to create an environment that enhances quality of life—safety, health, job growth, etc.—then they should seek policies that are efficient in the use of taxpayer dollars and effective in achieving the objective at hand.

"'But he hasn't got anything on,' a little child said."

—Hans Christian Andersen, "The Emperor's New Clothes"

"Practical politics consists in ignoring facts."

—Henry Brooks Adams

The TRS DB plan clearly achieves each of these priorities and does it better than would the proposed alternatives.

Even if the data showed that DB plans were too costly and unsustainable (which, again, it does not), then any policymaker doing due diligence should question what effect changing to a DB plan would have on the public education system. The answer: As with any profession, if the incentive to join the industry is diminished, then those who are qualified to enter the profession are less likely to do so.

If Texas' leaders are truly determined to build our education system into one that provides the workforce necessary to fuel our economy, then they must abandon the mistaken notion that weakening educator benefits will improve our state's well-being.

If it ain't broke, don't fix it

Ultimately, every taxpayer, every educator, every business owner and everyone who has a stake in the success of our state should ask: If changing TRS to a 401(k)-like DC plan would not be more efficient and more productive, then why change it at all? The logical answer can only be one of two reasons: politics/political philosophy or personal gain.

Regardless of the reasoning for changing to a DC plan, the end result will be the same; our public education system, students' academic prospects and our overall state economy will be weaker. Texas parents, taxpayers and business owners do not need an economist to see that the best investment we can make for our future is through the existing DB model that we have today. A wise Texas orator once said, "If it ain't broke, don't fix it." This simple rule should be applied in the case of TRS.

The only way we save TRS is by your being informed on this issue and then acting on the information by voting for candidates who support TRS—and encouraging colleagues, friends and neighbors to do likewise. This is a long-term fight that will not be over at the end of the next legislative session. One out of every 20 Texans is a member of the Teacher Retirement System. It is time that these 1.3 million TRS members stand up to the few who wish to obfuscate the facts and weaken our schools, our communities and the economic future of our state.

The economics of the TRS defined benefit (DB) pension

- The Texas Constitution requires a state contribution to TRS of at least 6 percent, and the state is currently contributing at the minimum. Moving to a defined contribution (DC) plan does not eliminate the minimum contribution requirement; therefore, the state would have no direct savings in the form of reduced contributions.
- Moving away from the current DB plan could cause all Texas school districts to have to contribute to Social Security, requiring an additional 12.4 percent in contributions not currently made.
- TRS operates at an administrative cost of approximately $40 per member per year, significantly less than the fees and expenses incurred with 401(k)s.
- The TRS pension trust fund is considered to be healthy by independent actuaries responsible for monitoring the fund.
- Only 2 percent of the state budget is dedicated to TRS.
- Texas' contribution to teacher pensions—as a percentage of employee salary or as a percentage of the state budget—is lower than that of any other state not participating in Social Security.
- Tax dollars make up only 20 percent of the TRS trust fund.
- The current DB model is responsible for creating more than 98,900 permanent jobs and adding $4.3 billion in private-sector income.