HOUSE RESEARCH ORGANIZATION bill analysis	4/29/2009	HB 2283 Truitt (CSHB 2283 by Anderson)

SUBJECT: Automatic enrollment of state employees in TexaSaver program

COMMITTEE: Pensions, Investments, and Financial Services — committee substitute recommended

VOTE: 7 ayes — Truitt, Anchia, Anderson, Flynn, Hernandez, Hopson, Veasey

0 nays

2 absent — Parker, Woolley

WITNESSES: (*On original version*:)
For — Andy Homer, Texas Public Employees Association

Against — Derrick Osobase, Texas State Employees Union; (*Registered, but did not testify*: Rene Lara, Texas AFL-CIO)

On — Ann Fuelberg, Robert Kukla, Employees Retirement System of Texas; Jennifer Jones, Legislative Budget Board; Martin McCaulay, Texas Pension Review Board

BACKGROUND: The Employees Retirement System (ERS) administers two tax-deferred savings plans as employee benefits. As part of the TexaSaver program, employees of state agencies can choose to participate in a 401(k) plan, a Section 457 plan, or both. Plan contributions are made through payroll deductions.

These plans allowed in the TexaSaver program are deferred compensation plans governed by sec. 401(k) and sec. 457, respectively, of the Internal Revenue Code of 1986. Currently, a 457 plan participant cannot make designated Roth contributions, but participants in 401(k) plans can.

Government Code, ch. 609 contains provisions for deferred compensation plans for state employees.

The 80th Legislature in 2007 enacted HB 957 by Orr, which required the automatic enrollment of employees of state agencies hired on or after

January 1, 2008, in the TexaSaver 401(k) plan, unless they elect not to participate.

DIGEST:

CSHB 2283 would expand automatic participation in a 401(k) plan to all employees of state agencies, at a default rate of one percent of their compensation, regardless of when they began employment, unless they elected not to participate. Existing employees who began employment before the bill's effective date automatically would participate in a 401(k) plan, unless they elected not to participate, as soon as practicable after the effective date, but no later than August 31, 2010.

CSHB 2283 also would amend Government Code, ch. 609 to allow ERS to establish a Roth 401(k) contribution program, under which employees of state agencies could designate all or part of their contribution as a Roth contribution. Additionally, ERS could establish a program to allow all or part of an employee's contribution to a 457 plan to be designated as a Roth contribution.

Through separate specific appropriation, ERS could make matching contributions to a state employee's 401(k) plan if the retirement system:

- received a sufficient amount to cover normal cost; and,
- maintained a funded ratio equal to or greater than 90 percent.

Employees participating in a 401(k) plan through automatic enrollment could at any time designate all or a portion of their contribution as a Roth contribution should a Roth contribution program become available.

The bill also would make conforming changes to sec. 609.006(a) to determine federal income tax for a state employee's deferred amount as a Roth contribution.

The bill would take effect September 1, 2009.

SUPPORTERS SAY:

CSHB 2283 would encourage greater participation by state employees in the TexaSaver program, a voluntary, deferred compensation investment plan, by automatically enrolling all employees of state agencies in a 401(k) plan, potentially providing an incentive for participation by authorizing the state to match 401(k) contributions, and providing greater choices by adding a Roth option. The enhancements that CSHB 2283 would provide would help increase personal retirement savings by state employees. Its provisions are based on recommendations made by the Legislative Budget Board staff in the 2009 *Texas State Government Effectiveness and Efficiency* report.

State policies should support the recommended three-tiered approach to retirement — state pension, personal savings and investments, and social security — so that state employees can have a balanced retired program. Social security and pension benefits may not be enough to support state retirees, who may need to rely on their personal savings and investments. As such, increasing personal savings and investments, as would be achieved through CSHB 2283 by enhancing the TexaSaver program, should be encouraged as much as possible.

Enlarging the pool of participants to all employees of state agencies through automatic participation would help address low participation rates in the TexaSaver program. According to a July 2008 Legislative Budget Board (LBB) survey of state agencies, as of October 2008, just over 27 percent of state employees were actively deferring compensation to the TexaSaver 401(k) plan. Of those, over 44 percent were auto-enrollees, which show the success of automatic participation. Additionally, of the respondents not participating in the TexaSaver program, almost 65 percent had no other voluntary retirement savings.

While participation in the TexaSaver program would be automatic, it would not be mandatory. Employees would have three months to opt-out of the program after their first contribution without facing penalties, a period that could take up to five months. At a one percent default participation rate, state employees could benefit from a vehicle to increase their personal savings, but would not be overburdened in doing so.

CSHB 2283 would provide enhancements to the TexaSaver program that are in demand by state employees and so would encourage further participation. The LBB TexaSaver survey found roughly that 36 percent of state employees declined to participate in the TexaSaver program because of the lack of employer match. Many employer-sponsored retirement savings plans in both the public and private sector offer an employer contribution. Of the 12 states offering an employer match, 11 also have a traditional pension plan. The match would only come through a separate legislative appropriation and so would not affect the retirement fund.

A combination of a Roth and traditional 401(k) is a sound savings strategy, as they provide different tax advantages that together mitigate risks of future tax rates. While a traditional 401(k) offers pre-tax benefits for allocations to grow tax-deferred, a Roth 401(k) would offer an after-tax benefit, as taxes are paid initially and withdrawals, including earnings, are tax-free. According to the LBB TexaSaver survey, both TexaSaver participants and non-participants identified a Roth option as the second-highest priority behind employer match.

While enrolling the over 110,000 employees of state agencies who are not already participating in a TexaSaver 401(k) plan would be an administrative challenge, there would be ample time for the process. Additionally, the benefit gained by increasing employee participation rates would far outweigh inaction.

OPPONENTS SAY:

CSHB 2283, while well intentioned, could provide cause for concern for state retirees. Instead of providing new options to encourage savings for state employees, all resources should be directed toward ensuring that the retirement fund is secure and actuarially sound so it can achieve its purpose of providing a reliable pension for state retirees.

Any attempt to increase participation in a deferred compensation plan could signal a move away from a state pension system, known as a "defined benefit" plan, to a system of individual retirement investment accounts, known as a "defined contribution" plan. It is important to maintain the retirement fund so current and future retired state employees, who have dedicated their careers public service and have paid into the fund, can continue to reap its benefit.

Instead of automatically enrolling state employees in the TexaSaver program with an opt-out provision, employees should have the option to opt-in to the program. State employees face tax penalties if they opt-out of the program outside of the 90-day window. With an average salary of $30,000, many state employees do not have the luxury to expose themselves to the ups and downs of financial markets. At a time when one version of the general appropriations bill would increase state employees' contribution to the retirement system, an automatic enrollment at one percent of an employee's salary with no offsetting salary increase effectively would result in a pay decrease.

The Legislature should provide the employer match for 401(k) participants based on the state's available resources and the merits of state employees' work, not on the position of the pension fund at any given time.

The low participation rate in the TexaSaver program is misleading, as many state employees likely do not participate in the program because they are already contributing 6 percent of their salaries to the ERS retirement fund.

NOTES:

The bill as filed would have made automatic contributions to TexaSaver from state employees starting at one percent and increasing to five percent, through increases of one percent per year. The committee substitute added that state employees participating in a 401(k) plan through automatic enrollment could at any time designate all or a portion of their contribution as a Roth contribution, should a Roth contribution program become available, The original bill would have repealed Government Code, sec. 609.5025 allowing automatic participation in a 401(k) plan for employees of state agencies beginning employment on or after January 1, 2008, while the committee substitute would apply the statute to all employees of state agencies regardless of employment date. The original bill would have allowed a state match from a legislative appropriation, but not specify the source of the match. The committee substitute stipulated that the match would solely be from the appropriation.

The Employee Retirement System would incur $265,000 in start-up costs associated with adding a designated Roth account to the 401(k) program and $202,000 in ongoing costs. These costs would be passed on to plan participants at a cost of $8 per month in addition to the existing administrative cost. The monthly cost would increase or decrease depending on the number of participants in the program. There also would be costs incurred by other state agencies in reprogramming their payroll system to segregate Roth contributions from the existing traditional option.