State Pension Review Board
Actuarial Committee Meeting
Minutes
August 14, 2014

1. **Meeting called to order**

The fourth meeting of 2014 of the State Pension Review Board (PRB) Actuarial Committee was called to order by Chair Bob May on Thursday, August 14, 2014, at 1:00 p.m. at the William P. Clements Building in Austin, Texas.

2. **Roll call of Committee members**

Board Members Present:
Robert M. May
Andrew W. Cable
Keith W. Brainard

3. **Approval of the June 17, 2014 Committee meeting minutes**

Mr. May entertained a motion to suspend the reading of the Minutes of the PRB Actuarial Committee meeting held June 17, 2014.

Motion made by Mr. Brainard, seconded by Mr. Cable that the PRB Actuarial Committee suspend the reading of the minutes of its meeting held on June 17, 2014.

MOTION CARRIED UNANIMOUSLY

4. **Discuss and consider the study of the financial health of public retirement systems in the state as required by Section 7 of House Bill 13 (83rd Texas Legislature)**

Mr. Hanson reviewed the preliminary draft of the study of the financial health of public retirement systems in the state. He stated the information included in the draft report is the most current information the PRB has received as of August 1, 2014.

Mr. Hanson noted that both the Texas County and District Retirement System (TCDRS) and the Texas Municipal Retirement System (TMRS) have provided charts for their individual systems identifying all of their sponsors. There will ultimately be one essential chart that will include all of the approximately 1600 retirement systems in the state followed by TMRS and TCDRS's individual reports, and lastly a chart including the 93 systems which will count as an aggregate system.

Mr. Hanson stated that the PRB conducted a review of historical information of Texas public retirement systems, and has received the final 2013 reports over the last two months. He noted that as the primary audience of the report will be the Legislature, the goal is to keep the core content of the report not longer than 15 pages. Many of the historical charts shown in the draft will be moved to an appendix. The main objective is to link the key findings to the datasets and make the final report more narrative.

The PRB has tried to be consistent with each amortization chart. Each chart reflects an infinite period, a forty to infinite period, a 25 to 40 period, a 15 to 25 period, a 1 to 15 period, and a zero amortization period.

Mr. May noted that on page 12 of the preliminary draft, under the Investment Rates of Return by Amortization Period chart, the numbers are in the 12 – 15% annual rate under the 1 year gross amortization period, yet for the zero amortization period, the amortization period is at 5.35%. Mr. Hanson clarified that only one plan is included and that particular plan is a plan for seasonal and temporary employees in the city of Arlington.

Mr. May suggested including footnotes as it is counterintuitive to have rates in the 12 – 15% range for each of the systems except for the one plan.

Mr. Brainard stated that the addition of a row for zero in each of the charts presents a distraction and suggested removing the row and addressing them separately with a brief summary that describes the plan.

Mr. Hanson referenced the chart on page 11 of the draft which shows the number of systems within each funded ratio range in 2000 and 2013, and noted that there were approximately 24 systems that were overfunded in 2000 which included the Employees Retirement System of Texas (ERS) and the Teachers Retirement System of Texas (TRS) along with several other systems. Mr. Hanson noted that currently the City of Arlington is the only system that is overfunded and; therefore, has a zero amortization period.

Mr. Brainard suggested leaving the zero amortization period in the amortization period comparison chart on page 11 of the draft, and to otherwise include footnotes.

Mr. Hanson stated the PRB performed a correlation analysis and zoned in on a few areas to find a correlation. He noted that the reason why the correlation to amortization period is negative is because it is correlating to the high end of the amortization period. A high amortization period is negatively correlated to the percent of ARC funded and negatively correlated to non-investment cash flow. The key findings indicate that the actuarially required contribution (ARC) funding and the contribution policy is the most important determinant of the ability to have a sustainable amortization period. The report to date has consistently proven that. There was a slight correlation to cash flow, but not as strong. There was not any correlation between the difference in the retirement system's ten year net rate of return and the assumed rate of return. The PRB performed a similar correlation analysis and analyzed factors impacting a retirement system's asset to liability growth, and the strongest correlation of a plans asset to liability growth was its average annual non-investment cash flow. The next strongest correlation was the difference between its 10 year return and its assumed rate of return.

Mr. Brainard referenced page 18 of the report, and stated that the key line is under the Correlation Analysis and Amortization Period paragraph where it states that based on the results, the strongest correlation to a retirement system's amortization period is the percent of the ARC funded. He suggested that staff bullet point that section and reference each sentence as an individual key finding.

Mr. Brainard noted that it would be helpful to add the investment return information from TMRS and TCDRS to one of the charts.

Mr. Hanson noted that on page 10 of the report, under the key findings, the strongest correlation staff has found is to receiving an adequate contribution. This is the most important element to the long-term financial health of public retirement systems in the state, and staff has identified that several times through their datasets and analysis. Funded ratios have declined and asset to liability growth supports that. Overall, research has shown that plans with better amortization periods have stronger non-investment cash flows. The active to retired ratio has declined since 2000, and lastly, systems with amortization periods above the recommended range under the PRB *Guidelines for Actuarial Soundness* had a higher percentage of benefit enhancements since 1995.

Mr. Brainard suggested identifying a single number average for a period if it is not obtained year by year, as it is the most important factor in determining the financial health of the systems. He noted that it would be helpful for the reader to be able to see who is and is not getting their required contribution.

Mr. Hanson reviewed the appendices and noted that the goal is to add introductory summaries to each appendix in the final draft to provide more description to the reader.

He noted that Appendix A includes the actuarial valuations report and includes the prior valuation for each system.

Mr. Brainard suggested changing the font in Appendix A to a larger size.

Mr. Hanson noted that Appendix B covers supplemental actuarial information from the AV report.

Mr. Brainard suggested that if it is possible to obtain the ARC experience data, he would recommend adding that information to the report so that the reader can compare.

Mr. Hanson stated that Appendix C and D obtain updates the PRB received from TMRS and TCDRS.

Appendix E represents the projected contribution shortfall calculated by staff on 25, 30, and 40 year amortization periods.

Appendix F provides contribution information comparing current rates to prior rates for all systems reported as of August 1, 2014.

Appendix G provides background on systems' ability to who essentially controls benefit and contribution decisions, and walks through the governing statute.

Mr. May clarified that the benefits reduction column for ERS and TRS is determined by the Legislature. He further suggested clarifying the language under the Constitutional Protection (Article 66) column to read Constitutional Benefit Protection (Article 66).

Appendix H includes the public retirement system sponsor financial information and will include either a footnote or a summary in the final draft identifying that not all funding for pension systems or their employees is taken out of the general fund.

Appendix I includes and defines the different actuarial assumptions for public retirement systems included in the study.

Sam Jordan, Austin Police Retirement System, inquired about proportion of retirement, and why it is not included in the report.

Mr. May noted that as the study is not a benefit study, such benefits as proportion of retirement or various types of COLAs or benefit features have not been included as part of the study.

Mr. Hanson noted that there will be a period of time for each of the systems to provide comments, and the Board will be able to amend the report based on those comments. He noted that the PRB tried to focus primarily on the directive of the study.

5. **Discuss and consider recommendations on how a public retirement system may mitigate its risk of not meeting its long-term financial obligations as required by Section 7 of House Bill 13 (83rd Texas Legislature)**

Mr. Hanson reviewed the possible recommendations intended for discussion to mitigate the risk of not meeting long-term obligations. Mr. Hanson noted that the first recommendation outlines three drafts of language relative to the establishment of an adequate funding policy or contribution policy. Item 1a is a general recommendation between the sponsor and the system establishing an adequate funding or contribution policy that at a minimum meets the Guidelines. Item 1b is similar in language to a piece of legislation filed last session, HB 3356 which focused on 100 percent funding on paying the adequate contribution rate with additional prescriptive measures. Item 1c is similar to the Tennessee Law passed and includes a more prescriptive funding policy recommendation.

Mr. Cable noted that he would like to see as many recommendations as possible included in the report.

The committee unanimously agreed on including the language under recommendation 1a in the final report, and presenting each of the recommendations under item one to the Board on August 28, 2014.

Recommendation 2 pertains to disclosure and reporting. The committee agreed with all recommendations under item 2.

Recommendation 3 pertains to benefit policy decisions.

Mr. Brainard suggested adding language to 3a and 3b conveying that cost-of-living adjustments should be funded and recommended elaborating the language under 3c.

Recommendation 4 identifies actuarial assumptions. The committee agreed with all recommendations under item 4.

Recommendation 5 includes stress testing and solvency analysis.

Mr. Brainard suggested including the language investment return and actuarial outcomes and the very end.

Recommendation 6 pertains to pooled or grouped trust funds.

Mr. Brainard suggested rewording item 6 to imply that systems can take advantage of TCDRS and TMRS.

Recommendation 7 focuses on investment management and due diligence.

Mr. Brainard noted that this item should be addressed through the new educational training requirements. The committee agreed to delete recommendation 7.

Recommendation 8 pertains to reserve funds and surplus management.

Mr. May noted that the idea of creating a reserve fund has a lot of appeal to actuaries. The committee agreed to recommendation 8 with the inclusion of additional language.

6. **Invitation for audience participation**

7. **Adjournment**

Chair May thanked the Committee and the audience for their participation at the meeting. With the business of the Committee completed, Chair May adjourned the meeting at 3:10 p.m.

In Attendance:

Staff:

Christopher Hanson
Reece Freeman
Bryan Burnham
Daniel Moore
Anumeha
Michelle Kranes
Anne Benites

Guests:

Sam Jordan, Austin Police Retirement System
Eloise Raphel, Houston Firefighters' Relief and Retirement Fund
David Stacy, Midland Firemen's Relief and Retirement Fund
Katy Fallon, Legislative Budget Board
Eddie Solis, Texas Association of Public Employee Retirement Systems
Chris Bucknall, Texas County and District Retirement System
Jennifer Jones, Employees Retirement System
Steve Waas, Houston Employees Municipal Pension System
John Lawson, Houston Police Officers' Pension System

Robert M. May

Chair Robert M. May