Pension Review Board
Actuarial Committee Meeting Minutes
Thursday, January 25, 2018

1. **Meeting called to order (0:08)**

   The first meeting of 2018 of the Pension Review Board (PRB) Actuarial Committee was called to order by Chair Bob May on Thursday, January 25, 2018 at 10:37 AM at Capitol Extension, Committee Room E1.012, 1400 N. Congress Avenue, Austin, Texas 78701.

2. **Roll call of Committee members** (0:44)

   Board members present:

   Robert May
   Keith Brainard
   Josh McGee

3. **Approval of the October 13, 2017 Committee meeting minutes** (01:11)

   Chair May entertained a motion to suspend the reading of the minutes of the PRB Actuarial Committee meeting held October 13, 2017.

   Motion made by Mr. Brainard and seconded by Mr. McGee.

   MOTION CARRIED UNANIMOUSLY

4. **Discuss and consider system actuarial reviews of the following:**

   a. **Galveston Employees' Retirement Plan for Police** (52:24)

   Kenny Herbold delivered a summary of the intensive review of the plan. He stated that the results for Galveston were similar to Greenville Fire. He pointed out that Galveston recently voted to decrease their assumed rate of return from 8% to 7.5%, effective 1/1/2018, and that was not included in the projections within the report.

   He stated that Galveston's funded ratio was less than 42%, which does not cover their inactive liability. He added that the unfunded accrued liability (UAAL) had grown drastically over the last 17 years. Mr. Herbold stated that the primary reason for that was the actual investment returns being lower than the assumed rate of return and actual contributions being less than the normal cost plus interest on the UAAL.

   Mr. Herbold stated that the discount rate was 7.5% net of all expenses at one time, but increased to 8% to account for a change in how expenses were being handled, he added that the rate was now back down to 7.5%.

   He stated that the negative cash flow, while typical in mature plans, combined with the low funded ratio, could cause some concerns in the scenario where assets need to be sold off to meet current expenses and benefits.

   He stated that the system provided a special 2017 valuation that reinterpreted state statute, which stated that the employer was required to pay the employer normal cost plus administrative expenses and interest on the UAAL; however, the City had not yet agreed to the changes in the reinterpreted valuation. He added that historically, the contributions were fixed at 12%, but employer contributions were recently raised to

12.83%, so the majority of the projections in the report were based on that contribution, rather than the system's special valuation.

Chair May called representatives from the City and the Plan to provide testimony; including Dan Buckley, Deputy City Manager for the City of Galveston, Mike Loftin, Assistant City Manager for the City of Galveston, David Sawyer, Actuary for the Police Plan, and Stefan Smith, from Locke Lord and outside counsel for the plan.

Mr. Buckley expressed apologies from the Mayor and City Manager for not attending the meeting, since they had a council meeting.

He stated that since his employment with the City, both the Employee and Fire plans have shown progress toward improvement, but the Police Plan has not made a lot of progress.

Mr. Buckley stated that the City Council budgeted up to a 2% increase in contributions to the Police Plan, and instructed staff to work with the pension board to try to reach a compromise and make plan changes to bring the Plan into reasonable actuarial soundness. He stated that so far, they have not had success.

He stated that there have been some changes to the Police Plan, and the new chairman has expressed a desire to work with the City to bring the plan into compliance. He stated that the issue now is that the police union has stated that they are not willing to make any changes and are looking to the City to fund the balance of the unfunded liabilities. Mr. Buckley stated that the City did not believe it was their obligation to work independent of the trustees of the plan, as the plan is controlled by the trustees with one representative from the City Council.

He stated that going forward, the City would be able to focus primarily on the Police Plan. He added that the City holds weekly meetings on the pension plans and they will do what they need to do to get the benefits to the workers, but he stated he believed it should be a collaborative effort.

Mr. Brainard asked whether the Police Plan trustees could set the benefit levels of the plan. Mr. Buckley affirmed and stated that they have not changed anything other than the vesting period since his tenure with the City.

Mr. Brainard asked what the disagreements were between the City and the Police Plan and what decisions the Plan trustees made or did not make that troubled the City. Mr. Buckley stated that the problem was the inability of the board to make benefit changes or discuss other options, such as defined contribution plans, or prospective benefit changes to help solve the Plan's funding problem.

Mr. Brainard asked whether it was correct that per City Ordinance, the City is obligated to pay the actuarially determined contribution (ADC) amount to the Plan. Mr. Buckley stated that it was correct, and in the last actuarial valuation, the actuary recommended a rate of 12.83% and the City increased contributions to that amount.

Mr. Brainard asked whether the City had consistently contributed the ADC. Mr. Buckley stated that he believed before he began working for the City, the City and Police Plan negotiated a contribution rate.

Mr. McGee noted that the PRB's report includes a chart showing the percentage of ADC paid by the City, and he stated he believed that the rate of 12.83% was not the ADC, but rather the actuary's recommendation based on his interpretation of state law, which was below the ADC.

Mr. Mike Loftin, Assistant City Manager for Finance for the City of Galveston, stated that he was not able to get every actuarial valuation from the last 17 years, but he believed that Mr. McGee's statement was correct.

Mr. Brainard asked whether the Council was aware that it had failed to live up to the word of its ordinance for 17 years. Mr. Buckley stated that the Council was aware of the negotiated contribution rate, and they based their contribution amount on what the actuary recommended. He added that he could not speak for what prior councils were aware of regarding contributions to the Police Plan.

Mr. Brainard and Mr. McGee inquired whether the City Ordinance required the contributions to be negotiated between the City and the Plan. Mr. Buckley stated that it is a bargaining agreement.

Mr. Smith summarized the history of the Plan's governing statute, stating that it was first a city ordinance plan, but was then incorporated into state statute. He stated that through the transfer from ordinance to statute, there was a change in contribution requirements, so that the language in statute is not consistent with the ordinance, but that the different City contributions in state statute and city ordinance or plan document did not raise any issues in the past because the plan was better funded. He stated that he believed that the funding issues came to light because of several issues occurring around the same time – the economic downturn, Hurricane Ike, etc.

Mr. Brainard asked whether the City was paying the required contribution amount on an actuarial basis.

Mr. Herbold clarified that within the review, the ADC was being calculated on a rolling-30 rate, not specifically in accordance with the Vernon's Statute definition. He stated that the City had been contributing on a fixed-rate basis and the actuary had not necessarily been calculating the ADC.

Mr. McGee asked whether the City paid the state statute required contribution rate – including paying the normal cost, administrative expenses, and interest on the UAAL – or paid the city ordinance rate, or neither. Mr. Buckley stated that the City followed the ordinance rate, which was to pay the negotiated rate.

Mr. Brainard clarified with Mr. Buckley that the Plan fiduciaries negotiated to accept the City's contribution rate which is below the ADC. Mr. Buckley confirmed. Mr. McGee added that the negotiated rate was also less than the State's required amount.

Ms. Kumar stated that back in the early 2000s, the plan was nearly 100% funded, so the statute was probably not invoked at the time.

Mr. Buckley stated that economic downturn, Hurricane Ike, as well as benefit increases made prior to 2008 led to a $10 million increase in UAAL for the Police Plan. He added that the negotiated rate did not improve circumstances.

Mr. McGee stated that all parties involved in the decision-making for the Police Plan in the past made decisions that consistently underfunded the plan and his concern was that the situation could roll into a crisis. He commended the City and Plan for trying to work the situation out.

Mr. Buckley stated that he sought clarification on why member contributions should be treated as City contributions, because he could not see how the City could work it into the budget if they have no say in benefit levels. He stated that if the trustees increased the benefit, they could place a burden on the City. He added that he would prefer a more collaborative approach to making reasonable benefit decisions for the Plan.

Mr. Smith clarified that the pickup contributions section of the state statute allows the member contributions to be treated as city contributions for tax purposes only.

Mr. McGee encouraged the City and Fund to continue negotiations, and stated that it will take more money and shared sacrifice to improve plan funding.

Mr. Loftin stated that after Hurricane Ike, there was a layoff of 26 police officers in 2011 that caused the active-to-retiree ratio to decline. He added that the current proposed budget would bring the budget back to pre-Ike levels.

Chair May stated that it seemed the Dallas Police & Fire Pension System may have had similar issues to Galveston and that the City of Galveston or the Plan may want to reach out to them.

Mr. Buckley stated that they have reached out to the City of Dallas.

Mr. Sawyer summarized the PRB's report and stated that it was troubling that the members are contributing more than the normal cost of the plan, so they are contributing more than the value of the benefits that they are receiving. He stated that the trouble with reducing benefits was that members would then contribute well over the normal cost at a higher rate than what they are now.

Mr. McGee asked whether the Plan recalculated the normal cost using the new rate of return assumption.

Mr. Sawyer stated that it is closer to the normal cost, but the member contribution is still higher.

Mr. McGee stated that he felt the issue seemed fixable and there should be a solution that was not overly punitive to the members or City. He encouraged the City and Plan to choose to be less risky in assumptions going forward.

Mr. Buckley stated that the City encouraged the three plans to lower their assumed rates of return.

Mr. McGee stated that using additional consultants could be helpful in a risk discussion. He added that trustees should take responsibility for the decisions they are making.

Mr. Brainard added that with fixed rate plans, or when the ADC is not contributed, the investment return assumption was somewhat academic because it was not being used to drive the funding of the plan. He stated that it would be nice for all pension plans to get to a point where the amount they are contributing is based on the true actuarial methods and assumptions and in this case, the investment return assumption. He commended the City and Plan for identifying the problem and stated that the current contribution is extremely low. Mr. Brainard asked whether the three Galveston plans considered pooling the funds, thus reducing fees and raising investment return potential.

Mr. Buckley stated that since there are three independent boards of trustees, the likelihood of pooling assets was very low. He added that the City does not have control.

Mr. Loftin stated that the PRB's review did not find true peer plans in the State. He added that there are no other police departments that are the size of Galveston with their own plan, and stated that the peers in the report are all fire departments.

Mr. Sawyer asked what the next steps were, and how staff would finalize the report.

Mr. Brainard asked for an up-to-date analysis so staff can update the report.

Mr. McGee added that staff could caveat in the report that it is the most up-to-date information that is on hand at the time being and stated that the effort made by the City and Plan will be reflected in the final report.

Ms. Kumar stated that for the next steps, once staff receives the up-to-date information from the Plan, staff will update the report to be included in the final draft and presented to the full board at the March 1, 2018 meeting. She stated that the end goal is to include the report in the Biennial Report to the Legislature in November.

Chair May entertained a motion to direct staff to finalize the draft, incorporating changes in the Galveston Employees' Retirement Plan for Police, including any technical updates, to present to the full board.

Mr. Brainard requested that the staff include language to clarify that contributions need to be made pursuant to state and city law.

Motion made by Mr. McGee and seconded by Mr. Brainard

MOTION CARRIED UNANIMOUSLY

b. <u>Greenville Firemen's Relief & Retirement Fund</u> (02:05)

This item was taken prior to Galveston Employees' Retirement Plan for Police.

Kenny Herbold delivered a summary of the intensive review of the plan. He stated that based on the information the PRB had at the time, the amortization period of the plan was 55 years, which was one of the highest in the state, while the funded ratio was below 48%, which was one of the lowest in the state. Mr. Herbold stated that it indicated that their inactive liabilities were not fully-funded, much less the active liabilities.

He noted that the UAAL quadrupled since 2000. Mr. Herbold stated that staff examined the causes of the growth of UAAL and the overwhelming majority was due to investment returns being lower than the assumed rate of return. He stated that the second largest cause was due to the actual contributions being less than the normal cost plus the interest on the UAAL.

Mr. Herbold stated that the Fund did lower their assumed rate of return in 2016, but the data staff had available showed the actual compound rate of return did not achieve 8%. He also stated that the ADC was underpaid for a long time.

Mr. Herbold explained the risk section of the review, and noted that the Fund was more likely to underperform its expected return on assets in the future.

He stated that the conclusions of the report indicated that the Fund should continue to take advantage of the funding soundness restoration plan (FSRP) requirement to work together with the City to resolve issues. He added that the Fund should continue to monitor actuarial assumptions for appropriateness.

Chair May invited Mayor David Dreiling from the City of Greenville, the Fund's actuary, John Crider, and Greenville Firemen's Relief & Retirement Fund's Board Chair, to provide their updates on the plan.

Mayor Dreiling thanked the PRB for allowing them the opportunity to comment on the review and the current issue. He stated he believed that with analysis of information, they could come forward with a plan.

Mayor Dreiling gave an overview of the contribution levels provided by the City and the members to the Fund. He stated that the Fund and City agreed to an FSRP, which was accepted by the PRB as compliant. He noted that in the last three years, the City increased its contributions by 2%, which is a large amount for a City.

The Mayor noted that he worked with the Finance Director for the City of Greenville, as well as John Crider (Fund's Actuary), to come up with a plan that would be voted on in September of 2018.

He stated that when the Fund lowered its investment return assumption to 8% from 8.25%, it raised the amortization period and provided a more realistic picture for the Fund. He stated that the next step was to increase the City contribution to the Fund by about 2%, noting that it should bring the amortization period closer to 38 years.

He noted that the City provided the plan to the PRB, showing that the Fund should be under the 30-year goal before 2024.

Mr. Brainard thanked Mayor Dreiling and stated that he appreciated the actions the City was taking to restore funding to the Fund. He stated that he was concerned that the

Fund was on the outer limits of where they should be, and noted payroll growth assumption, amortization period, and investment return assumptions. He strongly encouraged the City to further review the actuarial assumptions and methods.

Mr. Brainard asked Mayor Dreiling what was the basis of the investment return assumption.

Mr. Crider replied that the actuarial standards called for a building block rate of return method, and he stated that the documentation of the formulation of the assumption was included in materials sent to the PRB.

Mr. Brainard asked Mr. Crider if he used a 30-year projection.

Mr. Crider explained that the building block approach called for a rate of return history of each asset class, and noted that for the Fund, it included rates of return from 1995 forward.

Mr. Brainard asked if any models that Mr. Crider was using utilized real rates of return of 5%. Mr. Crider explained that the nominal rates of return used by the various models year-over-year with inflation removed would bring the rate to 8.49% for Greenville Fire.

Mr. Brainard asked whether Mr. Crider based the assumption on retrospective numbers. Mr. Crider stated that he did, but looking at the period from 1995 forward, there were both good and bad years included.

Mr. Brainard stated that every capital market projection that he had seen in the last 12-18 months projected 7-7.5% return for a typical portfolio, and that the federal government was struggling to get inflation to 2%. He stated that his concern was that the Fund was being very optimistic on both components of the building blocks; inflation and real rate of return. He also noted that many public pension plans used capital market projections to set their investment return assumption, and that he had never seen a public pension fund use retroactive returns solely to justify what might happen in the future. He strongly encouraged Mr. Crider to reconsider the methodology that he used to arrive at the 8%.

Mr. McGee added that the Fund's peers have lowered returns because they looked at capital market assumptions and went through the same procedure and arrived at a go-forward rate of return of 6.5% to 7%. He stated that it was problematic that this Fund was only at 8%. He asked Mr. Crider if he was responsible for determining the retroactive approach to setting the return assumption.

Mr. Crider answered that he could only go back that far, and that the time period was the beginning of a market cycle. Mr. McGee asked whether Mr. Crider consulted any investment professionals.

Mr. Crider answered that he did not, but he had spoken with asset managers who stated that for the short term, it was a high assumption, but for the long term, many felt that it could happen.

Mr. McGee stated that if the Fund lowered the assumption to 7%, the funded ratio might fall to about 30%, which he found problematic.

Mr. McGee noted that he appreciated the Mayor coming to the meeting and encouraged him along with the Fund's chair to seek outside guidance on capital market assumptions beyond the actuary. He stated that given the sensitive nature of the key assumption, he felt the Fund and City should seek multiple opinions.

Mayor Dreiling stated that the capital market projections would look vastly different in two years, but he felt it was important to do in-depth analysis every two years. He stated that the City Council and the Board would look at the funding plan at every in-depth analysis and adjust as needed.

Mr. McGee stated that the fund has stabilized, but projections showed that the fund would be around 50% funded for the next 30 years. He stated that he was encouraged that the City would be reassessing the status of the fund every two years, but there were many more steps needed to help the Fund.

Chair May noted that Mr. Crider was using a five-year smoothing method, which smooths the gains and losses over five years, rather than using market value. Mr. Crider added that the gains from 2017 and 2018 have not been fully recognized just yet.

Mr. McGee noted that since 2008, the market did not cause the system to experience a negative return, yet the Fund did not reach the assumed rate of return. He stated that basing a forward-looking assumption on the 1990s, a time during which there was an immense upswing in the economy due to the technology industry growth, should cause the system to question the assumption and seek outside consultation.

Mr. Brainard mentioned that ASOP 27 provides that assumptions should be based on the future expectations, yet Mr. Crider has used retrospective returns only.

Mr. Crider stated that he could include projections in the future.

Mr. McGee stated that the Fund needed to acknowledge that they should lower the return assumption to secure the benefits of the workers.

Mayor Dreiling stated that the City would consider it and keep monitoring the Fund.

Chair May stated that there were plans across the nation with a rate of return assumption of 8%.

Mayor Dreiling noted that the reason he believed the Fund to be in a better situation after they lowered the assumption to 8% was because many plans were at 8% at the time.

Mr. McGee stated that even though there were a lot of plans at 8%, they were still well above the national average, which was 7.5%.

Ms. Kumar stated that the working relationship was an advantage for all parties and would help the PRB aid the Fund going forward.

Mr. McGee asked whether PRB staff planned to update the report for the full board to include the increase in the City's contribution rate.

Ms. Kumar stated that since the report would be included in the Biennial report to the Legislature, it was only fair to include the increases made by both the City and the Fund.

Mr. McGee agreed and stated that he would prefer the report to be as up to date as possible.

Chair May entertained a motion to direct staff to finalize draft for the Greenville Firefighter's Relief & Retirement Fund, incorporating changes agreed upon by the committee and any technical changes to present to the full board for final review at the March 1 meeting.

Motion made by Mr. McGee and seconded by Mr. Brainard

MOTION CARRIED UNANIMOUSLY

5. **Discuss and consider system actuarial review metrics and process** (1:46:24)

Mr. Herbold directed the committee to the actuarial review metrics spreadsheet and stated that the spreadsheet helps staff prioritize plans for review. He added that it would not be the only deciding factor in considering plans for review.

He stated that market value of assets was added to the spreadsheet, but it would not be used for deciding which plans to review.

Ms. Kumar stated that staff would begin the next review cycle based on the information in the spreadsheet. She added that at the last Committee meeting, the Committee expressed interest in the discussion of coming up with a framework to quantify metrics and so staff updated the spreadsheet to facilitate the discussion.

Ms. Kumar stated that the updates to the spreadsheet were color coding, adding market value of assets, and updating the numbers to reflect the newly received valuations.

Mr. McGee stated that he enjoyed the process and asked how staff would select the next plans and how many would be selected.

Ms. Kumar stated that because of time constraints, staff had to pause the Marshall Fire's review during the current cycle, so Marshall would be included in the next cycle. She stated that the process would begin by looking at amortization and funding ratios to examine systems that are coded as red, then look at other factors on the metrics spreadsheet. She stated that staff looks at plans holistically rather than at just one metric alone and added that historical data may also be used to make the determination. She noted that staff has not assigned weights to any particular metric, but stated that it could be an option to consider.

Mr. Brainard stated that for some plans it is obvious that the PRB would need to hear from them. He also stated that the committee could move in the direction of developing a quantitative summary of the data and suggested that staff come up with a simple variance from the mean for each of the factors, then accumulate the variance from the mean for each plan that could indicate how far from the norm a plan was. He stated that it could begin to give an idea of what plans were in the most trouble, and then from there, the committee and staff could continue to refine the process.

Mr. McGee stated that there needed to be a standard unit across metrics and added that there should be a national benchmark for some. Mr. Brainard agreed.

Ms. Kumar stated that staff would work with the Committee to draft the proposal.

Chair May entertained a motion to direct staff to develop proposals of a framework to quantify the system actuarial review metrics, incorporating committee discussion to present to the committee at its next meeting.

Motion made by Mr. McGee and seconded by Mr. Brainard.

MOTION CARRIED UNANIMOUSLY

6. **Receive staff update on Funding Soundness Restoration Plan (FSRP) for Fort Worth Employees Retirement Fund** (1:57:30)

   Ms. Kumar provided an update on Fort Worth Employees Retirement Fund (FWERF), and stated that the City had appointed a task force to work on the recommendations to develop a plan to fix the funding challenges experienced by FWERF.

   She stated that in November of 2017, the City Manager provided a set of recommendations to the task force for consideration. Included in that recommendation, the two main items gathered from that discussion were to look into a closed 30-year funding approach for the plan, as well as to consider if the return assumption was appropriate. Ms. Kumar stated that in light of that discussion, and as a part of developing the FSRP, they are looking at calculating a contribution rate based on a closed 30-year amortization period for the plan for the legacy liability as well as to further lower their return assumption to 7.5%.

   Ms. Kumar further stated that the City was also considering options moving forward to use a layered approach for future gains and losses. The two main changes that they were considering were to increase both City and member contribution rates; to increase the City contribution rate by 2% and increase the member group contribution rates by 1% for all three groups.

   Ms. Kumar stated that the discussions were still ongoing and the City Manager requested that the member groups return with any other proposals that the members might have. She added that the hope was for the negotiations to reach a point where the task force could recommend the funding plan sometime in March or April.

   Mr. McGee asked whether staff had a copy of the City's proposal. Ms. Kumar stated that she would share the proposal with the members.

   Mr. Brainard asked whether the additional proposed contributions would get FWERF to the required actuarially determined contribution.

   Ms. Kumar stated that there was some analysis within the proposal, but the analysis they included was based on the suspension of the COLA. She added that there was additional discussion that needed to happen with regards to COLA, but based on the recommendation and based on the analysis of the actuary, it did appear that with those contribution rate changes, FWERF would be able to meet the funding gap.

   Mr. McGee asked that staff keep the Committee informed during the process, including any proposals from any group involved.

   Ms. Kumar reminded the Committee that there were some intermediary steps that would have to be taken once they reached the agreement. She added that they were looking at a risk and cost-sharing structure so the burden would be spread among the taxpayers and the member groups.

Mr. McGee stated that he was pleased to see that they incorporated some of the PRB recommendations.

Mr. McGee stated that the process was facilitating a good discussion, and moving toward good solutions.

Ms. Kumar added that that they looked at Houston as well as other states that have a plan for a cost/risk-sharing structure for funding their pension plans.

7. **<u>Date and location of next Actuarial Committee meeting – TBD</u>** (2:06:30)

   Chair May noted that the next Actuarial Committee meeting will take place sometime in April of 2018.

8. **<u>Invitation for audience participation</u>** (2:06:49)

   There was no audience participation.

9. **<u>Adjournment</u>** (2:07:26)

   Chair May adjourned the meeting at 12:40 PM.

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Thursday, January 25, 2018

In Attendance:

Staff

Anumeha Kumar
Reece Freeman
Kenny Herbold
Michelle Kranes
Eloisa Mata
Bryan Burnham
Eusebio Arispe

Guests

Michael Trainer, San Antonio Fire & Police
David Dreiling, City of Greenville, TX
Craig Himes, City of Greenville TX
Bryan Ausmus, Greenville Firefighters
Mike Loftin, City of Galveston
Dan Buckley, City of Galveston
Dan Wattles, TMRS
Derek Sheets, Greenville Firefighters
Eloise Raphel, Houston Firefighters
Paul Brown, TEXPERS
Stefan Smith, Galveston Police
David Sawyer, Galveston Police
John Crider, Greenville Firemen's Relief & Retirement Fund
Nancy Fisher, Austin Firefighters
Pat Haggerty
Max Patterson, TEXPERS
Jeff Murdock, Galveston
Jen Jones, ERS
Robert Nathan, CPS Energy
David Keller, Houston Firefighters' Relief & Retirement Fund
Tyler Grossman, El Paso Fire & Police Pension
Jason McElvaney, TCDRS
Chris Noonan, Senator Larry Taylor's Office
Lois Emerson, CPS Energy
Joe Gimenez, TEXPERS
Eddie Solis, TEXPERS

Keith Brainard

Chair Keith Brainard