Texas Pension Review Board

House Pensions Committee

May 10, 2018

Pension Review Board

PRB Mission and Current Activities

- PRB mission: to provide the State of Texas with the necessary information and recommendations to help ensure that Texas public retirement systems are properly managed and actuarially sound
- Service population consists of the members, administrators and trustees of **342** individual public retirement plans, state and local government officials, and the public
- Current PRB activities to help improve actuarial soundness of plans:
  - **online pension dashboard** to provide accessible current, historical, and comparative data on Texas defined benefit plans
  - **interim studies** to develop legislative recommendations on the following topics: Funding Policies for Fixed Rate Pension Plans and Pooling of Assets for Smaller Plans (for publication in Nov. 2018 Biennial Report)
  - **intensive actuarial reviews** of certain retirement systems facing potential risks that threaten long-term stability

Intensive Actuarial Review Process

- PRB statutory duty to conduct intensive studies of potential or existing problems threatening the actuarial soundness of public retirement systems (Gov’t Code 801.202(2))
- Adopted criteria for selecting systems for review
- Established a review process which includes:
  - drafts sent to the system and its sponsor with invitation for written response
  - written responses included in final report
  - request for system and sponsor to attend committee meeting to discuss review
- Conducted in-depth reviews focusing on assessment of major risks
- Intensive review results (and updates) will be provided to the legislature in PRB Biennial Report (Nov. 2018)

Intensive Actuarial Reviews to date

- Beaumont Firemen’s Relief & Retirement Fund, Galveston Employees Retirement Plan for Police, Greenville Firemen’s Relief & Retirement Fund, Marshall Firemen’s Relief & Retirement Fund
- Recommendations:
  - Adopt a funding policy that requires payment of an actuarially determined contribution, or at minimum, that fully funds the plan over a finite period of 30 years or less
  - Adopt a formal risk/cost-sharing framework with “guardrails” or trigger mechanisms that reduce uncertainty and guide stakeholders in how benefit and contribution levels will be modified under different economic conditions
  - Closely monitor investment performance and evaluate asset allocation decisions
  - Conduct an in-depth asset-liability study of potential risks associated with existing asset mix and liabilities they support. Perform scenario testing of large PROP withdrawals coupled with potential adverse investment experience
  - Regularly review actuarial assumptions against experience, making necessary changes

PRB Pension Funding Guidelines
(effective 6/30/17)

1. The funding of a pension plan should reflect all plan obligations and assets.
2. The allocation of the normal cost portion of the contributions should be level or declining as a percentage of payroll over all generations of taxpayers, and should be calculated under applicable actuarial standards.
3. Funding of the unfunded actuarial accrued liability should be level or declining as a percentage of payroll over the amortization period.
4. Actual contributions made to the plan should be sufficient to cover the normal cost and to amortize the unfunded actuarial accrued liability over as brief a period as possible, but **not to exceed 30 years, with 10-25 years being a more preferable target range**.* For plans that use multiple amortization layers, the weighted average of all amortization period should not exceed 30 years.* Benefit increases should not be adopted if all plan changes being considered cause a material increase in the amortization period and if the resulting amortization period **exceeds 25 years**.
5. The choice of assumptions should be reasonable, and should comply with applicable actuarial standards.
6. Retirement systems should monitor, review, and report the impact of actual plan experience on actuarial assumptions at least once every five years.

*Plans with amortization periods that exceed 30 years as of 6/30/2017 should seek to reduce their amortization period to 30 years or less as soon as practicable, but not later than 6/30/2025.

Assets - Liabilities Trends

In the last seven years, the difference between the AVA and AAL has steadily increased, from $41 billion in 2011 to over $69 billion as of March 2018. The average funded ratio was highest in 2011, and has slowly decreased through 2018.

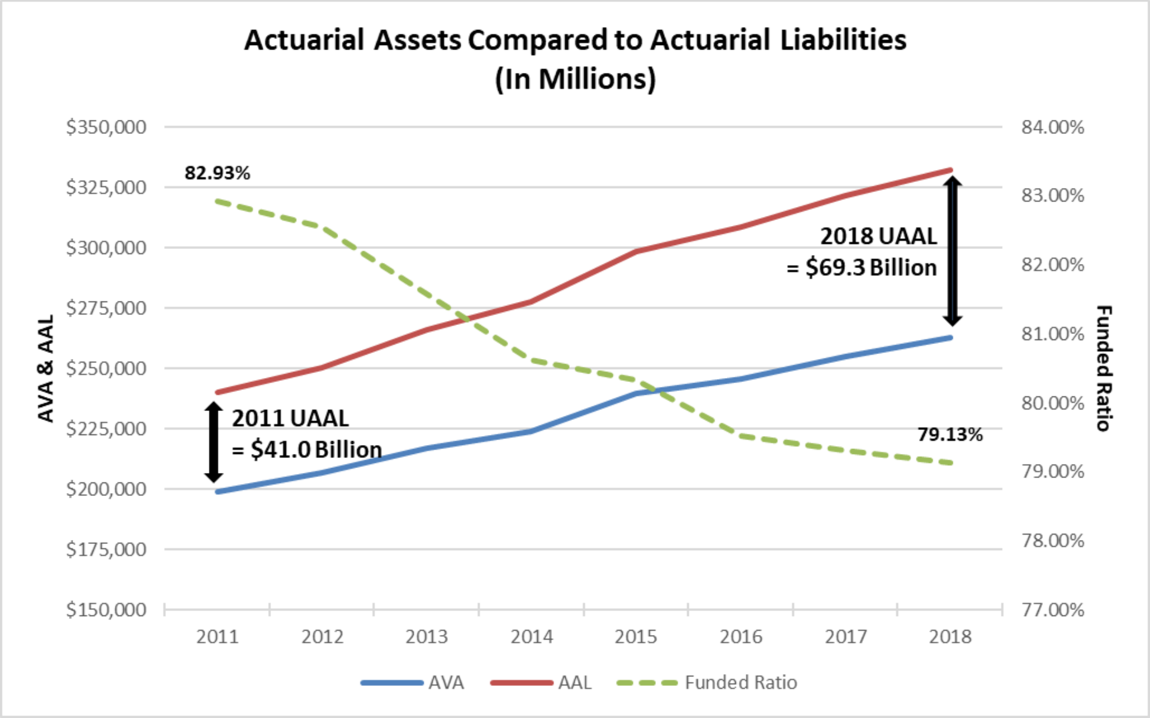
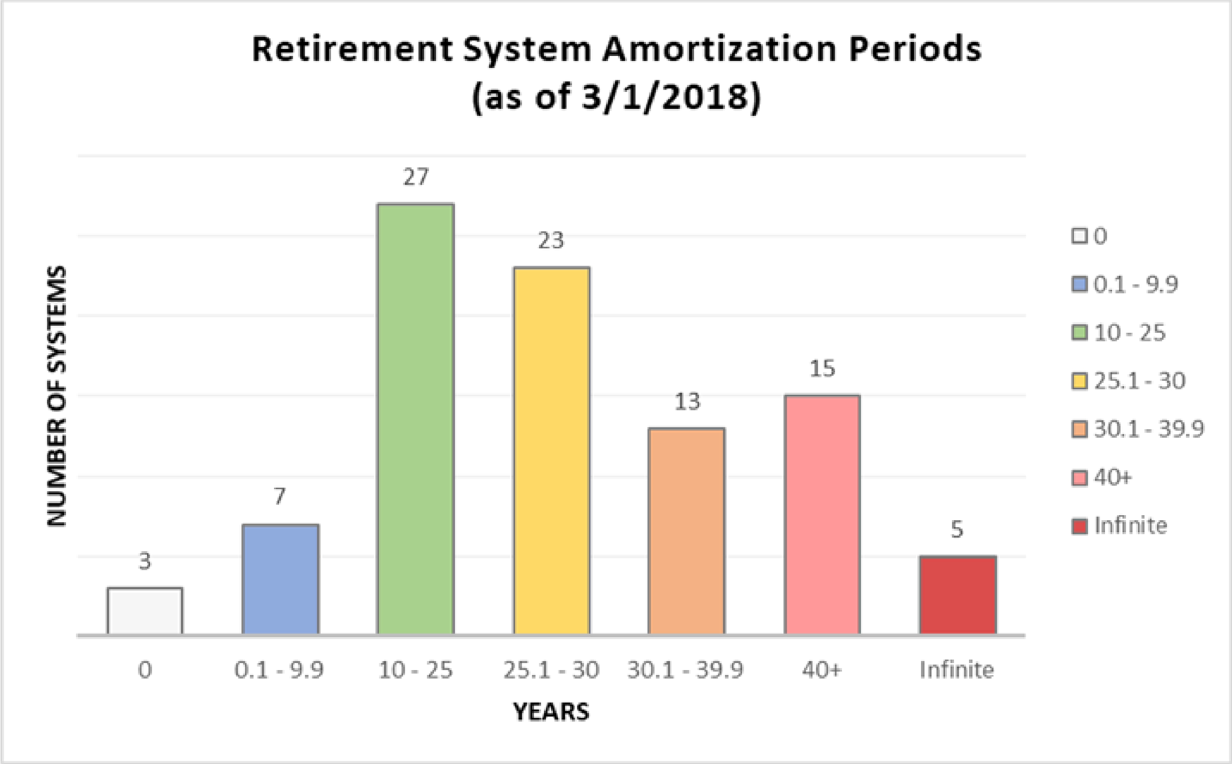


Chart utilizes information received by the PRB current through the dates listed.

Amortization Periods

The PRB *Pension Funding Guidelines* establish a maximum amortization period of not more than **30 years** with a preferred target range of 10 to 25 years.



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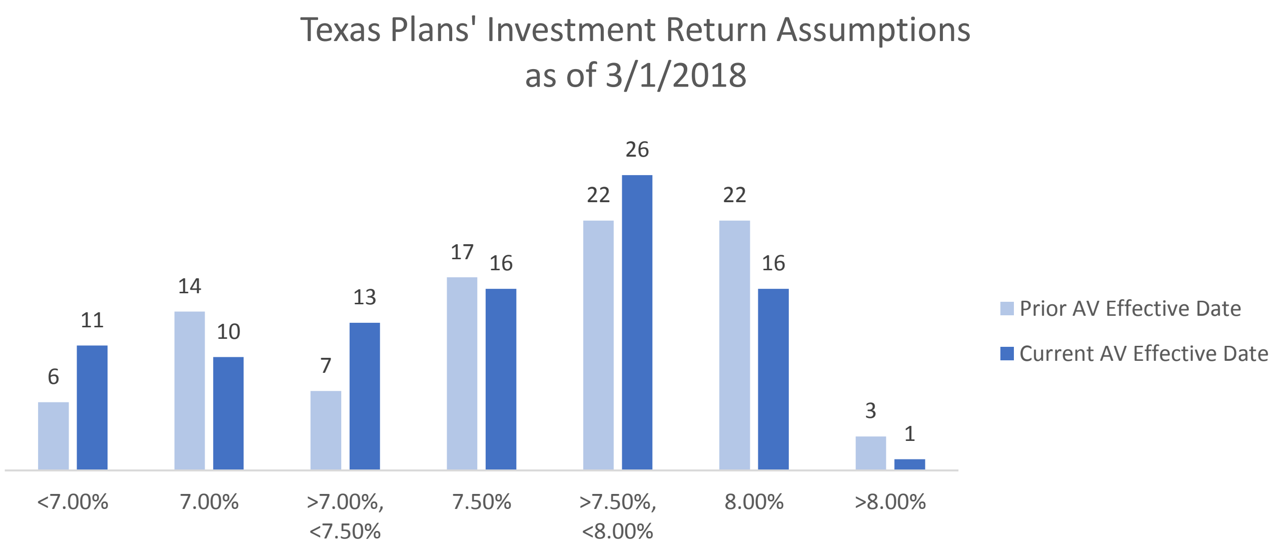
Actuarial Assumptions

Investment Return Assumption Trends

- The average investment return assumption for Texas systems is currently **7.46%**. The national average is **7.36%** (NASRA, February 2018).
- In response to projected market conditions and actual plan experience, retirement systems across the country, including Texas, have reduced return assumptions in recent years. This trend expected to continue.



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Actuarial Assumptions
Impact of Investment Return Assumption

- Has an **inverse correlation** with the liability and expected contribution requirements of a plan
- A higher return assumption leads to a lower liability calculation and vice versa. Therefore, reducing the return assumption leads to an increase in the unfunded liability of a plan
- **Lowering** the **return assumption** results in a **higher contribution requirement**
- If a retirement plan receives the increased contribution, its actuarial soundness should not be affected in the long term

Average Actual Investment Returns

Average Returns by Plan Type				
Plan Type	1-Year Net	3-Year Net	10-Year Net	Long-Term Net*
Statewide	10.62%	5.21%	5.56%	8.04%
Municipal	9.04%	3.63%	4.57%	8.10%
Local Fire Fighter	6.76%	3.08%	4.17%	6.30%
Special District/Supplemental	6.29%	4.18%	4.91%	6.44%
All	7.33%	3.66%	4.56%	6.85%

According to the most recent fiscal year-end Investment Returns and Assumptions Report.
**Long-term return is 30 years or longest term available between 11-30 years that plans reported to the PRB.*

Funding Soundness Restoration Plan
Update

- 14 systems have submitted FSRPs. Of those, two systems have achieved their goal and are below 40 years. The remaining 12 are working towards 40 years
- One system is subject to the requirement but has not yet submitted its FSRP
- Four systems will be subject to the FSRP requirement if their next valuation shows an amortization period greater than 40 years

H.B. 3310 by Paul/Taylor (84th R)

- If a retirement system receives several consecutive valuations showing its **amortization period exceeds 40 years**, the system's board and sponsoring entity must jointly formulate an FSRP and submit the plan to the PRB within 6 months following the trigger of the requirement.
- The FSRP must reduce the amortization period to 40 within **10 years**. Systems must report **updates** to PRB at least **every two years**.

House Bill 3158 – Highlights

Dallas Police and Fire Pension System

- Increased both employee and City contributions:
  - Employee – from 8.5% for non-DROP active participants and 4.0% for DROP active participants to 13.5% for all participants
  - City – from 27.5% of total pay to 34.5% of computation pay with a floor for 7 years, plus $13m per year until 2024
- Modified DROP. No interest or COLAs while in Active DROP; upon retirement, interest earned based on a Treasury-based interest rate; DROP distributed as annuity based on the member's life expectancy; DROP participation limited to 10 years (effective 1/1/18)
- Reduced benefits. Lowered benefit multiplier and raised normal retirement age for all members. Ad hoc COLA for retired members only if funded ratio above 70% based on actual return; minimum 0%, maximum 4%
- Changed board composition. Six of the trustees are selected by the mayor and five are selected by the pension system. All members of the board must be experts in finance, accounting, business, investment, budgeting, real estate, or actuarial science
- Governance changes. Two-thirds vote of the full board required for major actions of the board, for example, implementing any rule change concerning board governance or creating an alternative benefit plan
- Established investment advisory committee. Committee reviews investment-related matters and makes recommendations to the board. Two-thirds vote by the board required to approve each alternative investment

House Bill 3158 – Impact (per 1/1/17 Actuarial Valuation)

	Prior to HB 3158	After HB 3158
Amortization Period	Infinite	44
Funded Ratio	40.2%	49.4%
Actuarially Determined Contribution (ADC)	69.9%	47.25%
Actuarial Value of Assets (AVA)	$2,157,799,730	$2,157,799,730
Market Value of Assets (MVA)	$2,149,836,260	$2,149,836,260
Unfunded Accrued Actuarial Liability (UAAL)	$3,206,255,505	$2,209,380,724
UAAL as % of Payroll	897%	618%

House Bill 3158 – PRB Duties

2017

- **Authorized DROP distributions**: PRB determined DPFPS did not make unauthorized distributions before Aug. 31, 2017, per the bill requirements. Sent letters to DPFPS and the City regarding the determination

2024

- **Independent actuarial analysis**: HB 3158 requires the PRB to select an independent actuary to perform an analysis based on the system's Jan. 1, 2024 actuarial valuation. PRB is developing criteria to make this selection
- **Funding plan:** Based on the independent actuarial analysis and applicable funding and amortization period requirements, DPFPS shall adopt a funding plan by rule. PRB shall report to the legislature on the actuarial analysis and rules adopted by the system

Ongoing

- **Benefit increases**: A DPFPS rule that proposes a benefit increase must be reviewed by the PRB for compliance with amortization period requirements (must not exceed 25 years <u>after</u> the change). PRB is developing a procedure for rule review
- **Alternative benefit plans**: A DPFPS rule that proposes to establish a defined contribution or hybrid plan (for new hires or on a voluntary transfer basis) must be reviewed by the PRB for compliance with amortization period requirements (must not exceed 35 years <u>after</u> the change). PRB is developing a procedure for rule review

Minimum Educational Training Program

- **PRB Online Courses**: Actuarial Matters, Benefits Administration, Investments, Governance, Fiduciary Matters, Ethics, Risk Management
- Available at: http://www.prb.state.tx.us/resource-center/trustees-administrators/educational-training-program/
- Login: enter office and name. No password required

www.prb.state.tx.us
512-463-1736

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