

## Funding Soundness Restoration Plans: Staff Recommendations for Rulemaking

### Overview

House Bill 3898 (87R) adjusted several aspects of the Funding Soundness Restoration Plan (FSRP) requirement to better ensure the long-term financial health of Texas public retirement systems. Some of these changes took effect on September 1, 2021. However, other changes will not take effect until September 1, 2025.

The Pension Review Board (PRB) is authorized to adopt rules to implement the provisions of these statutory changes. At its November 2, 2021, meeting, the board directed staff to work with the Actuarial Committee to develop rule recommendations. Subsequently, at its January 28 meeting, the Actuarial Committee requested staff incorporate committee and stakeholder feedback to update the rule concepts for review by the full board.

This conceptual document provides a starting point to consider rulemaking to facilitate implementation with the following goals in mind:

- Provide guidance and streamline reporting for FSRPs after the changes made in HB 3898 (87R).
- Preserve the work of systems that have previously submitted effective FSRPs and are committed to following their plans and achieving full funding.
- Support systems in unusual situations due to when they became subject to the new FSRP requirement.

### RECOMMENDATIONS

The following material describes staff recommendations for potential PRB rulemaking to provide clarification for systems subject to the requirements now and in the future. Staff will draft the rule language upon board feedback and direction. Staff will incorporate stakeholder feedback on the draft language where possible.

### Defining Terms

Staff expects some terms may need formal definitions in rules to clarify meanings as this is a standard component of the rulemaking process. For example, *automatic risk-sharing mechanisms* and *adjustable benefit or contribution structures* (Tex. Gov't Code Sec. 802.2015(e-1)(d)) are required components of a Revised FSRP (R-FSRP) and may require definitions in rule to provide guidance to plans in formulating an R-FSRP. As the rulemaking process continues, staff will continue to identify and clarify terms as necessary.

### Legacy FSRPs: Transition Plan

These rules relate to the FSRP requirements **prior to September 1, 2021**, and the systems subject to an FSRP under those requirements. House Bill 3898 (87R) includes a narrow grandfathering provision to preserve the work of retirement systems that had already submitted FSRPs before the law changed; to distinguish from new FSRPs, staff has been referring to FSRPs covered by the grandfathering provision as

**legacy FSRPs or L-FSRPs.** Staff is recommending rulemaking on these topics to clarify the transition to the new standards.

**Recommendation 1A: Clarify how the PRB will determine whether a system with an L-FSRP is adhering to its plan to restore funding.**

L-FSRPs can continue operating under the previous law. However, if a system with an L-FSRP would have been subject to a revised FSRP under the previous law, they will now prepare an FSRP under the current law instead. A system would have had to prepare an old revised FSRP if it had a funding period greater than 40 years and it had not adhered to the existing FSRP, so these will also likely be the main conditions used to determine when an L-FSRP system would need to prepare an FSRP under the current law.

**Recommendation 1B: Set the threshold for completing, or graduating, an L-FSRP to the earliest of either the L-FSRP’s target date or the date the system completes an AV reflecting a funding period below 30 years.**

Previously, systems would be considered to have **completed** or **graduated from** an FSRP before the goal year by submitting an AV that reflected a funding period below 40 years.

Based on our current understanding, once a system completed its L-FSRP, it would no longer be able to continue under the previous version of the law, even if it continued to follow the terms of its L-FSRP. If the threshold for completing an L-FSRP remained at 40 years, a system could potentially trigger a new FSRP before reducing its funding period to 30 years in line with the new requirement, even if the terms of the L-FSRP are still being followed.

**Recommendation 1C: Resolve ambiguity about the effective date of a statutory provision exempting certain systems from the new revised FSRP requirement, which, if left unaddressed, could prevent some systems from continuing to follow their legacy FSRPs as intended.**

As stated before, HB 3898 includes a grandfathering provision meant to preserve the work of systems with effective FSRPs created under the previous law. The bill also exempts plans meeting certain criteria from the new, more stringent 25-year revised FSRP requirement. See the textbox on the following page for more detail regarding these provisions.

The effective date of this exemption from the revised FSRP is ambiguous under the new law. If the effective date were prior to September 1, 2025, plans qualifying for this exemption from the revised FSRP could be excluded from the grandfathering provision, possibly preventing some plans from continuing to follow their legacy FSRPs. The actual revised FSRP requirement does not apply until after September 1, 2025, when the first

**HB 3898 Grandfathering and Revised FSRP Exemption Provisions**

Grandfathering of legacy FSRPs

House Bill 3898 (87R) includes a narrow provision to preserve the work of retirement systems following an effective FSRP created before the law changed on September 1, 2021. As long as the system is adhering to their legacy FSRP, they should be covered by this grandfathering provision.

Exemption from the revised FSRP requirement

The bill also includes an exemption from the new revised FSRPs (R-FSRPs) requirements— with a more stringent maximum funding period of 25 years and required plan changes. This exemption applies to a system that has a funding period of between 30 and 40 years and is either adhering to an FSRP formulated before September 2025 OR uses or will use an actuarially determined contribution rate structure.

new 30-year FSRPs are due; as such, the effective date of the exemption should logically not be before September 1, 2025.

If the PRB does not address the effective date of the exemption in rule, the impact of the new law could run counter to the PRB's recommendation to preserve the effort of systems that made difficult changes to improve plan funding and ensure benefit security for their members.

## **New FSRP Process: Establish methods to determine compliance**

The changes to the FSRP requirements also necessitate clarification of how the PRB will determine systems' compliance with the new law. Clarifying criteria for determining adherence under the new law is particularly important since one route to qualify for the R-FSRP exemption is to adhere to an FSRP formulated before September 1, 2025; this would include any active L-FSRPs as well as the initial 30-year FSRPs prepared under the new law submitted before that date.

Staff recommends rulemaking to clarify three aspects of determining compliance, as described below.

### **Recommendation 2A: Adopt a method that the PRB will use to determine if a system has fulfilled the requirements of an FSRP or R-FSRP.**

An FSRP prepared under the current law requires some of the same components as FSRPs prepared under the previous law, but some new components have been added:

- The maximum allowable funding period is 30 years rather than 40 years.
- It is due either within two years of the date of the triggering AV or by September 1, 2025, whichever is later.
- The actions in the FSRP must be approved by the governing bodies of both the system and sponsor before the FSRP is adopted.
- It must be adopted at open meetings of both the system and sponsor.
- It must be submitted to the PRB within 31 days once the governing bodies of the system and sponsor have adopted it.
- The system's funding policy must be updated based on the FSRP. A rule may be necessary to lay out a required timeline for submitting a funding policy revised because of an FSRP.

Most of the requirements for R-FSRPs are the same as new 30-year FSRPs, with some additions:

- The maximum allowable funding period is 25 years rather than 30 years.
- It **must** also include automatic risk-sharing mechanisms, an ADC structure, and other adjustable benefit or contribution mechanisms. As previously noted, staff anticipates terms such as "adjustable benefit or contribution mechanisms" and "risk-sharing mechanisms" may require formal definitions in rule to provide clarity to systems subject to an R-FSRP.

Statute also requires an AV or supplemental analysis be submitted to the PRB. An AV is required within 90 days of the date the FSRP or R-FSRP is adopted by the governing bodies of the system and sponsor, and the supplemental analysis would be due within 90 days if requested by the PRB. The AV or analysis must include certain components:

- It must have an actuarial projection of the system's assets and liabilities between the date the FSRP is due and the date the plan is expected to achieve full funding.
- It must include a description of all assumption and methods used to perform the analysis, and those must comply with actuarial standards of practice.

### *Compliance and Enforcement*

Many of the new requirements are very specific, but some aspects may need more detailed clarification.

- For example, it could be useful to provide a method for systems and sponsors to document their adoption of FSRPs at open meetings to demonstrate they have satisfied that aspect of the requirement.
- Additionally, compliance standards could specify that either the actuarial value of assets or the market value of assets could be used to calculate the funding period for FSRPs to allow more flexibility and encourage meaningful changes to funding policies to meet the requirement.<sup>1</sup>
- Statute requires funding policies to be revised to align with any changes made during the FSRP process; however, a rule may be necessary to lay out a required timeline for funding policy revisions made as a result of an FSRP.

Staff plans to address certain FSRP compliance elements within the PRB's *Policy for Determination of System Actuarial Review*, which currently reflects the prior FSRP process. The policy will be updated along with the rules draft and will include staff and board actions to be taken with corresponding timelines, such as reminders, notices, reports, and invitations to systems and sponsors to provide testimony at PRB meetings. The PRB's statute also provides subpoena power and writ of mandamus authority. However, staff has determined that if the board were to ever use these tools, rules are not required beyond guidance already provided in the statute.

### **Recommendation 2B: Clarify how progress updates should be submitted, such as in writing or by a report at a PRB meeting.**

There are also additional requirements for periodic progress updates to the PRB. The first update report to the PRB would be due within a year of the triggering AV, and additional updates would be required every six months after the first until an FSRP is adopted and submitted. These updates must include a draft of the plan and a description of any changes under consideration.

Note: Systems that are currently subject to the FSRP requirement have already passed the first anniversary of the AV that triggered the FSRP. These systems would likely benefit from a rule specifying a progress update schedule for the transitional period.

### **Recommendation 2C: Adopt methods to determine when a system qualifies for the revision exemptions, including potential options for voluntary submission of FSRPs from systems that are not currently subject to the requirement.**

The revision exemption includes an allowance for systems **adhering** to FSRPs prepared between September 1, 2021, and September 1, 2025, which would be prepared under the current law rather than

---

<sup>1</sup> Section 802.2011, Texas Government Code, specifies that the actuarial value of assets must be used to calculate the funded ratio, and that is the definition referenced in the FSRP statutes.

the previous law. Since the new law includes different requirements, staff cannot use the same compliance standards as L-FSRPs. For example, the staff actuary might make a determination based on comparing future AVs to the materials submitted with the previous FSRP to determine if the system qualifies for the exemption.

In addition, to incentivize systems not technically subject to the FSRP requirement to proactively take steps to improve funding for the long term, the PRB could consider rules allowing these plans to submit voluntary FSRPs or updated funding policies by September 1, 2025, to obtain access to the R-FSRP exemption. Allowing voluntary submission of FSRPs or updated funding policies to qualify for an exemption to the stricter R-FSRP requirement would encourage systems to take a long-term approach to addressing funding issues before becoming subject to an FSRP. Staff would need to develop a process and specify requirements in rule for accepting these voluntarily submitted FSRPs or funding policies.

Any rules related to the pre-2025 branch of the R-FSRP exemption could expire in September 2035.<sup>2</sup> After September 1, 2025, the only option to qualify for the exemption would be to fall within the 30-to 40-year funding range and use an actuarially determined contribution (ADC) structure.

**Recommendation 2D: Interpret the existing statutory plan member communication requirements on inadequate funding arrangements to also apply to triggering the FSRP requirement, which is a direct result of inadequate funding.**

Section 802.206(d), Texas Government Code, requires a public retirement system to provide to its members a summary of the financial condition of the retirement system if the actuary of the system determines that the financing arrangement of the system is inadequate. The PRB could adopt a rule taking this existing requirement one step further to require plans to communicate with their members upon becoming subject to the FSRP requirement, particularly since the requirement is triggered when the system's funding is not adequate to meet the statutorily prescribed 30-year funding period.

---

<sup>2</sup> To qualify for the pre-2025 branch of the R-FSRP exemption, an FSRP would need to be formulated before September 1, 2025. If a system's FSRP is due September 1, 2025, then September 1, 2035, would be the end of the 10-year period when a system could potentially trigger an R-FSRP as described in Section 802.2015(d), Texas Government Code. Rules clarifying how systems could qualify for the R-FSRP exemption under the pre-2025 branch would not be necessary after systems could no longer trigger R-FSRPs.