Texas Pension Review Board

Joint Meeting of the Investment and Actuarial Committees Minutes
May 7, 2020

1. **Meeting called to order (0:02)**

   The Pension Review Board (PRB) Joint Meeting of the Investment and Actuarial Committees was called to order by Chair Keith Brainard on Thursday, May 7, 2020 at 9:02 am via teleconference.

2. **Roll call of Committee members (1:33)**

   Board Members Present:

   Chair Keith Brainard
   Chair Christopher Zook
   Marcia Dush
   Stephanie Leibe
   Shari Shivers

   A quorum being present, the meeting was called to order by Chair Brainard.

3. **Roll call of members of the public (2:40)**

   Pre-registered members of the public present:

   David Stacy
   Kathleen McBride

4. **Chairmen's remarks regarding the purpose of the meeting (3:37)**

   Chair Brainard noted that the meeting was the first meeting of the PRB's Investment Committee and introduced the members of both committees.

   Chair Brainard recognized that it was a difficult time for public pension plans and their sponsors and noted that the current investment environment and economy were challenging, and both state and local governments were facing potential revenue declines that were likely to impact the ability of public employers to make their pension contributions. He emphasized that plans should continue to examine their actuarial assumptions and plan sponsors needed to be involved with their plans to ensure adequate funding.

   Chair Zook echoed Chair Brainard's remarks and noted that many individuals covered by public pension plans worked in essential services and he thanked all frontline workers. He stated that there would be more challenges moving forward so it was critical to anticipate the worst while hoping for the best. He noted that if actuarial assumptions and payroll growth assumptions were not lowered, there would be future funding problems. He stated that he wanted to ensure everyone was focused on what long-term steps may be taken considering plans and their sponsoring entities would be experiencing lower revenue, returns, and payroll growth.

5. **Key issues for Texas systems to consider regarding COVID-10 crisis and its potential impacts: (08:35)**

   a. **Market disruptions, including volatility, asset price declines, and possible effects on average returns for various asset classes (09:20)**

   Robert Munter provided a report on the potential Covid-19 market impacts. He noted fixed income securities of various qualities were impacted the most so far, noting that the first quarter of 2020 had record high returns which then led to the fastest declines into a bear market in history. He stated the extreme market volatility was giving pension plans an actual stress test.

   Mr. Munter discussed unemployment claims, noting the United States overall experienced a spike in unemployment claims and that these disruptions to the economy would be severe and continue to have an impact. He added that given the market downturn, plans would ultimately need to exceed their rate of return by an excess of 110 basis points or more depending on how quickly they recover from a 10% drawdown.

   Ms. Dush asked Mr. Munter to clarify whether the determined rate of return plans needed to adopt to get back on track considered the negative cash flow. Mr. Munter stated that the rate was determined by solely looking at investments and that plans with negative cash flow could have more of a difficult time recovering.

   The Committee discussed whether recent events had fundamentally changed expected returns on major asset classes. Mr. Zook noted it was highly unlikely the economy would recover at a fast rate and also unlikely that Texas plans would be able to receive the returns they were used to receiving in the past.

   b. **Short and long-term actuarial impact, including cash flows and funding shortfalls (30:12)**

   Kenny Herbold presented the short- and long-term actuarial impacts the Covid-19 crisis had on plans. Mr. Herbold stated that in the short-term, plans would need to consider cash flow and liquidity issues; long-term, plans would need to be mindful of legislative requirements that triggered plans to make changes if certain conditions were not met.

   He acknowledged that many Texas plans were small, conducted actuarial valuations every other year and might lack the budget to conduct regular intensive studies, in which case they could use the PRB's data tables as indicators of whether they should reach out to their consultants.

   Mr. Herbold introduced metrics that assessed the short-term health of a pension plan, such as non-investment cash flow and liquidity ratio. He noted that analyzing non-investment cash flow could help identify plans that might have liquidity concerns, which might indicate how easily those plans would be able to pay benefits. The liquidity ratio metric was nearly identical to non-investment cash flow, but also considered cash on hand, which would allow plans to pay benefits without selling assets. He noted that evaluating liquidity ratios allowed for comparison of all plans and it was a good metric to examine in conjunction with other factors and analyses to observe data trends.

   Mr. Herbold discussed the lowest 25% of plans from each metric and explained if a plan fell on both lists, the plan was more likely to have potential liquidity issues.

Ms. Dush noted that when looking at the liquidity ratio, there was concern that the plans would need to sell assets at low values which would make it harder for them to achieve their rates of return. She noted that there were 14 plans that fell on both lists and stated they were plans that the PRB may need to contact. Ms. Kumar stated that PRB staff could reach out to systems on the list and that the PRB completed intensive reviews on some of the listed plans in the past. She noted that so far, no system had indicated they were unable to make benefit payments.

Mr. Herbold introduced metrics that staff used to evaluate long-term performance. He discussed two types of ratios that gave direct measures of the leverage of a plan's unfunded accrued liability (UAAL) as it related to payroll: asset leverage ratio, which was market value of assets divided by payroll, and liability leverage ratio, which was accrued liability divided by payroll.

Ms. Dush commented that since many Texas plans were mature, both assets and liabilities were large compared to the covered payroll. She noted this made it very difficult to recover from market downturns or increased interest rates like what was recently experienced.

Mr. Herbold described the unfunded liability (UL) percent tread water cost rate, which was a contribution rate that resulted in the total UAAL growing at the payroll growth rate and showed the line between having an infinite and a finite amortization period. He also introduced the UL dollar tread water cost rate, which was the line between negative amortization and a decreasing UAAL. He noted that for some Texas plans, the recommended contribution rate generally fell between the UL percent and the UL dollar tread water cost rate.

Ms. Dush raised a concern about the UL dollar tread water cost with plans that currently had both negative amortization and fixed contribution rates. She noted that of Texas' plans, 2/3rds of plans were not making a contribution that reduced their UAAL.

Mr. Herbold stated that the UL metrics were useful to calculate the expected changes in the UAAL. He noted that higher amortization periods had more volatility, and fixed rate plans were more susceptible to volatile amortization periods.

Chair Brainard commended staff for utilizing different ways to present data and stated that the data had predictive and comparative value. He stated that the PRB was available to provide technical assistance to plans, especially smaller plans who may not otherwise have access to the data.

Mr. Herbold stated that in addition to the previously described metrics, there were also statutory triggers that would impact plans, such as the requirement for a funding soundness restoration plan (FSRP) if a plan's amortization period was above 40 years. He explained that a 10% drop in assets could put plans with amortization periods between 20 and 40 years at risk of being required to complete an FSRP. He stated there were approximately 18 fixed rate plans with an amortization period above 20 years which were very likely to become subject to the FSRP requirement soon.

Mr. Herbold also discussed the statutory requirements for Houston plans, including the contribution corridor. He noted their statute had a trigger for plan design changes, such as establishing a cash balance plan if their funded ratio fell below statutory thresholds.

Mr. Herbold noted that recent news articles that stated city councils were discussing potential furloughs for government employees would impact the contribution base for plans. He added that while amortization periods were generally calculated using asset smoothing, plan sponsors' balance sheets were required to recognize losses immediately. This would make more plans at risk of having depletion dates, causing discount rates to decrease and total liability to increase. Mr. Herbold noted that while credit rating agencies made their own adjustments to reported liabilities, increased totally liability would still impact potential credit ratings.

The Committee discussed pension obligation bonds (POBs), noting that they saw little recent discussion of POBs but as the current situation leveled out, they might be considered due to low interest rates. They noted that the prudence of issuing POBs depended on a plan sponsor's risk tolerance.

6. **Possible delays in reporting by pensions systems (01:26:04)**

   Ms. Kumar stated that staff received questions from systems and stakeholders about potential delays in plan reports and extensions for reporting deadlines. She stated that unfortunately required reports had deadlines set in statute and the PRB did not have the authority to grant extensions. She encouraged systems that experienced disruptions to reach out to the PRB.

7. **Initiation for public comment (01:27:35)**

   There were no public comments.

8. **Adjournment (01:28:28)**

   Chair Brainard adjourned the meeting at 10:34 AM.

PRB Staff In Attendance:

Anumeha Kumar
Michelle Downie Kranes
Ashley Rendon
Benjamin Warden
Bryan Burnham
James King
Kenny Herbold
Lindsay Seymour
Mariah Miller
Robert Munter
Wesley Allen

Chair Keith Brainard

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Chair Christopher Zook