Texas Pension Review Board

Actuarial Committee Minutes
August 6, 2020

1. **Meeting called to order (0:20)**

   The Pension Review Board (PRB) Actuarial Committee Meeting was called to order by Chair Keith Brainard on Thursday, August 6, 2020 at 10:00 am via teleconference.

2. **Roll call of Committee members (0:33)**

   Board members present:

   Chair Keith Brainard
   Marcia Dush
   Stephanie Leibe

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

3. **Roll call of members of the public (1:32)**

   Pre-registered members of the public present (representatives from Orange and Midland):

   On behalf of Orange: Mike Kunst; John Bilbo; Tony Kay; Brad Heinrichs; Guy Goodson; and Cheryl Zeto

   On behalf of Midland: Brian McGary (did not respond); David Stacy; James Martin; Van Pearcy; Mayor Patrick Payton; Mark Mason; Shera Crow; Mark Fenlaw; and Claude Parenteau

4. **May 7, 2020 Committee meeting minutes (4:50)**

   Chair Brainard entertained a motion to suspend the reading of the minutes of the May 7, 2020 joint meeting of the Investment and Actuarial committees and approve them as circulated.

   The motion was made by Ms. Dush and seconded by Ms. Leibe.

   The motion passed unanimously.

   Chair Brainard entertained a motion to suspend the reading of the minutes of the May 7, 2020 Actuarial committee meeting and approve them as circulated.

   The motion was made by Ms. Dush and seconded by Ms. Leibe.

   The motion passed unanimously.

5. **Systems subject to the Funding Soundness Restoration Plan (FSRP) requirement, including the following (6:11):**

A. Update on second revised FSRP from City of Orange and Orange Fireman's Relief and Retirement Fund (6:38)

Mike Kunst, City Manager for the City of Orange (the City), discussed future increases in contributions and acknowledged the Orange Firemen's Relief and Retirement Fund (the Plan) still would not achieve the recommended 30-year amortization period with the changes. He noted the Plan recently hired a new investment consultant, but plan benefits remained unadjusted.

John Bilbo, Plan Chair, echoed Mr. Kunst's statement and noted a positive change in the City, Plan, and union leadership in past years led to a unified outlook of all involved to improve the Plan's funding soundness.

Ms. Dush noted the Plan's 7.75% assumed rate of return had not been achieved, which contributed greatly to its unfunded liability. She encouraged the Plan to employ an achievable interest rate.

Tony Kay of AndCo Consulting, an investment consultant for the Plan, discussed how the Plan moderately increased its exposure to equity and intended to diversify assets. He noted the Plan implemented a stricter investment benchmark measurement and a quarterly compliance checklist.

Ms. Dush recommended the City work with the Plan's actuary and board to determine a reasonable asset allocation while considering the Plan's negative cash flow. She stated an achievable portfolio should be built before calculating a reasonable rate of return.

Chair Brainard discussed with the Plan the reasonability of a 7.75% rate of return while concurrently experiencing a large negative cashflow. Brad Heinrichs, the Plan's actuary, commented that the increase in contributions would help lower its annual payroll deficit. He added voting regulations had made enacting a benefit reduction difficult. Chair Brainard noted Plan members were paying the entire cost of their benefit which produced a need for the City to put forth a more substantial effort to fund the Plan.

B. Update on revised FSRP from City of Midland and Midland Firemen's Relief and Retirement Fund (33:35)

David Stacy presented on behalf of Midland Firemen's Relief and Retirement Fund (Midland Fire). He explained the fact that Midland Fire's extensive use of overtime had not been properly taken into consideration, which greatly contributed to the reason the plan now showed an infinite amortization period. He stated that Midland Fire's board was in the process of examining ways to change its benefit structure.

Mark Mason, Midland Fire board member and Finance Director for City of Midland (the City), stated that after the 2019 actuarial valuation was completed, the City planned to hire a consultant to secure Midland Fire's funding and shorten its infinite amortization period.

Ms. Dush cautioned Midland Fire that the combination of several of its current assumptions may not be reasonable. She noted the plan provision concerning an automatic cost-of-living adjustment (COLA) once Midland Fire reached 8.25% rate of return over five years should temper its investment assumption. Ms. Dush asked Mr. Stacy whether another problem the Midland Fire was having was due to pay periods and the calculation of highest average salary. Mr. Stacy confirmed, noting that switching from twice monthly to biweekly pay periods artificially created months with higher gross salary amounts.

Mr. Brainard inquired about future goals to bring Midland Fire into compliance with state reporting requirements. Mark Fenlaw, from Rudd and Wisdom, Inc., replied Midland Fire was provided two options with amortization periods below 30 years in a January 2020 special study. He noted the City and Midland Fire were at an impasse on how to correct the City's payroll system to exclude unscheduled overtime from salary used to calculate employee benefits.

Mr. Mason stated he had been unaware of the options provided by Rudd and Wisdom, Inc. Mr. Brainard noted that as a plan sponsor, the City is an equal party to the plan. He encouraged the City to help improve Midland Fire's funding status.

Anumeha Kumar stated close contact with staff and regular updates to the Actuarial committee from Midland Fire would be beneficial to help Midland Fire achieve compliance.

6. Funding policies received as required by Government Code Section 802.2011 (SB 2224), including actuarially determined contribution benchmarks based on rolling amortization periods (1:00:15)

Ms. Kumar summarized staff's contact with plans that utilized a rolling 30-year ADC benchmark in their funding policies. She noted the Dallas Police and Fire Pension System converted from a rolling 30-year ADC benchmark to a closed 30-year ADC benchmark. Ms. Kumar stated El Paso Firemen & Policemen's Pension Fund, Big Spring Firemen's Relief & Retirement Fund, and The Woodlands Firefighters' Retirement System indicated to staff that each was working on updating its rolling ADC benchmark to a closed period.

Ms. Kumar stated plans using the actuarial firm Foster & Foster, provided identical responses to a letter from the PRB which asked how the plans would target a 100% funding while utilizing a benchmark that resets annually and was therefore not designed to move towards 100% funding. The plans' responses stated that if all assumptions were met and its fixed contribution rate were at or above a 30-year rolling ADC benchmark, then the plan would achieve 100% funding within 30 years. Ms. Kumar recommended inviting these systems to speak to the committee at its September meeting.

Ms. Dush stated her belief that through Senate Bill 2224 (SB 2224) and SB 322, the Legislature attempted to address a needed change in Texas public pension funding management. She noted the PRB's interim study on Funding Policies for Fixed Rate Plans showed that the funded status for fixed-rate plans deteriorated, performing worse after a 10-year bull market in 2019 than in 2004. Conversely, she noted, plans funded with an ADC were able to increase their funded ratios back to almost where they were in the early 2000s. She believed it to be due to three main contributing factors: overly optimistic actuarial assumptions, investment returns below actuarial interest rate assumptions, and contributions that have been lower than the "tread water" rate.

Ms. Dush stated her belief that setting a benchmark contribution using a rolling 30-year period did not meet the requirements of the law to target 100% funding. She added that the Legislature was looking for plans, especially those with low funded ratios, to improve their funding in ways unique to the individual plan. Prior to the Board's report to the Legislature in November, Ms. Dush recommended that staff continue communicating with plans concerning rolling ADC benchmarks and whether plans are targeting 100% funding or greater, as the legislation intended.

Chair Brainard entertained a motion to direct staff to reach out to plans with funding policies that used ADC benchmarks based on rolling amortization periods and ask those plans to appear before the Actuarial committee at its September meeting.

The motion was made by Ms. Dush and seconded by Ms. Leibe.

The motion passed unanimously.

7. Review of Funding Policy requirement under Section 802.2011 and Funding Soundness Restoration Plan (FSRP) requirements under Sections 802.2015 and 802.2016 of the Government Code (1:22:15)

Michelle Downie Kranes presented an overview of objectives and potential changes to the funding policy and FSRP statutory requirements. She provided relevant examples from funding remediation processes employed by other states. Ms. Downie Kranes noted funding policies and FSRPs had different goals that could be revised in statute to be more compatible with one another.

Chair Brainard commented that the PRB intended to set standards with these objectives, which would create transparency and incentives for plans to reach sustainable funding. He instructed staff to return to the September committee meeting with suggested statutory language which would better align FSRP and funding policy requirements.

Chair Brainard noted the Governmental Standards Accounting Board (GASB) did not intend 30-40-year amortization periods to be the standard amortization period, but rather a maximum. He added that the recommendation was now outdated.

Ms. Dush commented that she preferred a 20-year closed amortization period to become the goal for all Texas plans in the future, as any ADC benchmark above 20 years would have negative amortization.

The committee discussed the fiscal detriment of allowing plans multiple years before being required to complete an FSRP. The committee decided to ask plans to provide input on how to structure immediate FSRP triggers, including a transition or grandfathering mechanism for plans which have recently improved their funding.

Ms. Downie Kranes discussed the need to clarify the role of future actions in FSRPs, highlighting suggested changes that would provide a level of assurance that future actions were supported by the plan and sponsor. Mr. Brainard asked whether state law required plans to implement the actions in their FSRPs. Ms. Downie Kranes stated that plans are only required to adopt the FSRP, which must achieve the maximum threshold amortization period within 10 years. Ms. Kumar added that plans and sponsors must jointly develop the FSRP.

Mr. Brainard asked staff to prepare suggestions for statutory changes that required the FSRP to be implemented in a good faith effort by plans.

Ms. Downie Kranes discussed the need for a clarified FSRP documentation process where plans provided an analysis of the combined effect of changes, including an actuarial projection showing the unfunded liability decreasing to zero within the required period.

Ms. Dush discussed economic assumptions (ASOP 27) and cautioned actuaries of plans subject to an FSRP that assuming the participant group would grow was often not appropriate when performing an actuarial analysis.

The committee supported an enhanced documentation process and stated a preference of input from systems on a more prescriptive format for complying with an FSRP requirement.

Ms. Leibe asked if other states had data that reflected successful implementation after their documentation requirement was changed. Ms. Downie Kranes answered that staff had looked for performance evaluation data, but that the statutes were so new that they had likely not been assessed yet. She stated staff could reach out to those states to inquire directly about remediation plan effectiveness. Ms. Leibe asked staff to consider plans' various internal requirements, such as charter caps or election requirements, when developing suggested statutory changes. Ms. Downie Kranes stated that staff considered various internal requirements for implementing plan changes when reviewing FSRPs and would continue to consider plans' situations when making decisions on suggested changes to current FSRP requirements, such as deadlines.

The committee discussed the fact that plans' individual governance provisions could require alteration before the desired FSRP and funding targets were able to become achievable.

Ms. Downie Kranes noted the issue of plans submitting perpetual revised FSRPs, which meant a plan may never achieve the minimum amortization period threshold. She stated staff sought input from the committee and systems on how to incentivize meaningful changes.

The committee discussed shortening the 10-year period that statue allowed for a plan to get to a 40-year rolling amortization period. Mr. Brainard supported a 10-year period for a plan to get to a 30-year rolling amortization period but stated his preference for plans to be compliant with the PRB's more stringent *Pension Funding Guidelines*. The committee discussed required pairing of projected milestones when a plan submitted an FSRP with interim progress reports on achieved objectives over a 10-year period. Mr. Brainard noted the need for interim progress reports to be spaced out in a way that allowed for external factors that could affect a plan, such as a stock market crash, to be smoothed out.

Mr. Brainard asked staff to create, in consultation with systems, a proposal that reduced the likelihood of plans continually being subject to multiple FSRPs.

Ms. Downie Kranes stated statute could be updated to include a six-month deadline and possibly provide for an extension process if a reasonable draft was submitted with an extension request so that all interested parties could be made aware of the plan and sponsor's intended course of action. She noted a standardized form could be useful for this requirement.

Ms. Leibe asked generally how long the plans and sponsors had taken to develop their FSRPs, and whether a six-month deadline was reasonable. Ms. Downie Kranes responded staff could investigate that and follow up with the information.

Ms. Dush encouraged staff to structure the changes in a way that gives credit to the plans that have made recent reforms and worked towards fiscal soundness compared to those who had not.

Chair Brainard entertained a motion to direct staff to work with the Chair to finalize a funding policy and funding soundness restoration plan requirements, policy objectives, and considerations document to be sent to the systems and other stakeholders for public comment. Staff would summarize the comments for the Actuarial committee at its September meeting.

The motion was made by Ms. Dush and seconded by Ms. Leibe.

The motion passed unanimously.

8. Date and location of next Actuarial Committee meeting- September 29, 2020 (2:31:51)

Chair Brainard stated the next meeting of the Actuarial committee would be held on September 29, 2020.

9. Invitation for public comment (2:32:38)

There were no comments from the public.

10. Adjournment (2:33:17)

Chair Brainard adjourned the meeting at 12:34 PM.

<u>**In Attendance:**</u>

PRB Staff Present

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

Chair Keith Brainard