Texas Pension Review Board

ACTUARIAL COMMITTEE MEETING

MAY 9, 2024

TEXAS PENSION REVIEW BOARD
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TEXAS PENSION REVIEW BOARD
ACTUARIAL COMMITTEE MEETING AGENDA

Thursday, May 9, 2024 – 10:00 AM

William P. Clements Building, Fourth Floor, Room 402

300 W. 15th Street, Austin, TX, 78701

Committee members may attend this meeting by videoconference pursuant to Texas Government Code §551.127. One or more committee members, including the presiding officer, will be physically present at the physical location of the meeting listed above. The meeting will be accessible to the public at the physical location listed above. The public may access the meeting virtually by joining via the Zoom link: https://us02web.zoom.us/j/83915411722. A livestream of this meeting, agenda materials of the meeting, and a recording of the meeting will be made available at www.prb.texas.gov.

The Committee may discuss or take action regarding any of the items on this agenda. A quorum of the Administrative Committee will be present during the Actuarial Committee meeting, but no Administrative Committee matters will be discussed.

1. Meeting called to order
2. Roll call of committee members
3. Consideration and possible action to approve January 25, 2024, meeting minutes
4. Invitation for public comment
5. Update on status of Midland Firemen's Relief and Retirement Fund's FSRP progress
6. Texas Local Fire Fighters Retirement Act (TLFFRA) governance project
    a. Stakeholder feedback
    b. Staff recommendations
7. PRB Pension Funding Guidelines and Guidance for Developing a Funding Policy
    a. Stakeholder feedback
    b. Updated guidelines, guidance, and example funding policy
8. Draft Guidance for Calculating and Administering Lump Sums
9. Future meetings: Agenda items, dates, locations, and related matters
10. Adjournment

NOTE: The committee may go into closed session concerning any item on this agenda as authorized under the Texas Open Meetings Act, Government Code, Chapter 551. Persons with disabilities who plan to attend this meeting and who may need special assistance are requested to contact Lindsay Seymour at (512) 463-1736 as far in advance as possible, but no less than three business days prior to the meeting date so that appropriate arrangements can be made.

How to provide public comment: Members of the public who wish to provide public comment to the committee may attend the meeting in person at the address above or register for the meeting using the Zoom link provided above. If you wish to provide comment remotely by Zoom, you must contact Lindsay Seymour (lindsay.seymour@prb.texas.gov) no later than Wednesday, May 8, 2024. Note that public comments will be limited to no more than three minutes.

Item 3: January 25, 2024 meeting minutes

TEXAS PENSION REVIEW BOARD

Actuarial Committee Meeting Minutes
January 25, 2024

1. **Meeting called to order (0:00)**

   The first meeting of 2024 of the Pension Review Board (PRB) Actuarial Committee was called to order Thursday, January 25, 2023, at 10:01 a.m. in the William P. Clements building, room 402, 300 W. 15th Street, Austin, Texas, 78701.

2. **Roll call of committee members (0:01)**

   Board members present:

   Keith Brainard, Chair
   Marcia Dush
   Stephanie Leibe

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

3. **Administrative matters (0:23)**

   a. **Consideration and possible action to approve July 27, 2023, meeting minutes**

   Chair Brainard entertained a motion to suspend reading the minutes of the July 27, 2023, committee meeting and approve them as provided.

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

   The motion passed unanimously.

4. **Invitation for public comment (1:01)**

   There were no public comments.

5. **Update on Dallas Police & Fire Pension System, including actuarial analysis required by Section 2.025, Article 6243a-1, Vernon's Texas Civil Statutes (1:14)**

   Chair Brainard asked representatives from the City of Dallas, Dallas Police & Fire Pension System (DPFP), and actuary firm Cheiron to provide prepared remarks. Bill Hallmark and Elizabeth Wiley from Cheiron discussed their independent actuarial analysis and preliminary recommendations with the committee, explaining that they had three preliminary scenarios based on the 2022 actuarial valuation.

   DPFP board chairman Nick Merrick spoke on the progress that the system has made over the past seven years to address the system's underfunding. He gave an overview of the system's investments and the changes that have been made to the program. Executive Director Kelly Gottschalk discussed the system's current funding issues and noted that the system expects a final report from Cheiron in the coming months. The committee discussed the funding soundness restoration plan (FSRP) requirement with the system. Ms. Gottschalk and Mr. Merrick both noted that the system's board has not yet taken any official position on the recommendations offered by Cheiron.

The City of Dallas Chief Financial Officer Jack Ireland provided information about the city's efforts to assist DPFP in achieving actuarial soundness. He noted that he felt the city, Cheiron, and the system can work together to develop a plan to achieve a 30-year funding period by the summer. Dallas Mayor Pro Tem Tennell Atkins reaffirmed the city's commitment to solving the system's funding issues sooner rather than later. Chair Brainard requested that the city and system keep the PRB apprised of developments.

6. <u>Update from Austin Firefighters Retirement Fund on potential plan changes (1:04:59)</u>

Austin Firefighters Retirement Fund Executive Director Anumeha Kumar discussed potential changes that the system may take to reduce their amortization period under 30 years. She noted that the system's board developed a working group and chose to undergo a voluntary FSRP to take a proactive approach to addressing future funding issues. The system's board is currently consulting with members, the City of Austin, and the system's actuary to develop the plan. The committee discussed aspects of these potential changes and asked that the system keep the PRB updated.

The committee took a ten-minute break from 11:21 a.m. to 11:31 a.m.

7. <u>Texas Local Fire Fighters Relief and Retirement Act (TLFFRA) governance study (1:20:19)</u>

Mariah Miller provided an overview of governance within the scope of public pensions and of TLFFRA systems. She provided details from previous TLFFRA research conducted by the PRB, the 2023 House Committee on Pensions, Investments, and Financial Services Interim Report, and the 2023 LBJ student report. Ms. Miller provided background on the TLFFRA stakeholder work group, detailing work group goals, members, and findings.

Staff preliminary recommendations fell into four topic areas:

1. System funding and decision-making practices
2. Board structure and membership
3. Transparency and communication
4. Additional areas for research and consideration

Ms. Miller explained that the document including preliminary recommendations would be available in early February for stakeholder feedback. Final recommendations could come in the form of suggesting statutory changes, new guidance, and/or additional training and resources. The committee discussed the preliminary recommendations and provided initial feedback for staff.

8. <u>Review of the PRB Pension Funding Guidelines and Guidance for Developing a Funding Policy (2:03:15)</u>

David Fee and Ms. Miller presented preliminary updates to the PRB's Pension Funding Guidelines and Guidance for Developing a Funding Policy. Ms. Miller noted it has been several years since both documents were revised. Potential changes to the guidelines and guidance incorporate language reflecting statutory changes, updating the documents for best practices, and other technical changes.

Ms. Dush requested staff to add a suggestion that systems compare the employee contribution rates to the normal cost rates in the guidelines. Ms. Leibe asked that staff incorporate language into the guidelines clarifying that a sponsor and system must adopt the same funding policy.

9. Update on research on systems authorized under Texas Government Code Chapter 810 that offer 100 percent lump sum options (2:14:59)

Mr. Fee presented updated research on lump sum options that was requested at the July 2023 Actuarial Committee meeting. He reminded the committee that some systems use updated assumptions in their actuarial valuations but not in their lump sum calculations. Mr. Fee's analysis included 12 district or supplemental systems under Chapter 810 of the Texas Government Code. He explained that most systems under his analysis are using outdated practices which may leave the annuitant uninformed about the comparative value of their benefits. He then provided next steps, including that staff will share the findings with respondents, report at the next board meeting, and consider drafting guidance in this area if directed. The committee discussed the research and spoke in favor of increased transparency regarding assumptions and economic impacts of full lump sums.

10. Future meetings: agenda items, dates, locations, and other arrangements (2:33:57)

Chair Brainard announced that the next Actuarial Committee meeting will be held May 9, 2024, at 10 a.m. with the location to be decided. The next full board meeting will be held March 6, 2024, at 10 a.m. with the location to be decided.

11. Adjournment (2:34:21)

The meeting was adjourned at 12:46 p.m.

PRB staff in attendance:

Amy Cardona	David Fee	Mariah Miller	Tamara Aronstein
Ashley Rendon	Robert Munter	Wes Allen	Jasmin Loomis
Bryan Burnham	Noah Jones	Lindsay Seymour	Miranda Chen

Members of the public in attendance:

Kelly Gottschalk - Dallas Police & Fire Pension

Eddie Solis - Dallas Police & Fire Pension

Josh Mond - Dallas Police & Fire Pension

Tina Hernandez Patterson - Dallas Police & Fire Pension

Nick Merrick - Dallas Police & Fire Pension

Jesse Moreno - City of Dallas

Tennell Atkins - City of Dallas

Gay Donnell Willis - City of Dallas

Jack Ireland - City of Dallas

Clifford Sparks - City of Dallas

Paula Blackmon - City of Dallas

Carrie Rogers - City of Dallas

Elizabeth Wiley - Cheiron

Bill Hallmark - Cheiron

James Parnell - Dallas Police Association

Jeff Patterson - Dallas Fire Fighters Association

Chris Peterson - Dallas Firefighters Association

Pattie Featherston - Austin Police Retirement System

Anumeha Kumar - Austin Firefighters Retirement Fund

Art Alfaro - TEXPERS

John Posey - LBB

Tyler Grossman - El Paso Firemen & Policemen's Pension Fund

Lily Tu - Sage

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Keith Brainard, Chair

Item 6. Texas Local Fire Fighters Retirement Act (TLFFRA) Governance Project

Mariah Miller

Project Status

- Public comment period from Feb. 12, 2024, through March 29, 2024.
- Received seven comments.
- Discussed during the TLFFRA Peer Review on Friday, May 2, 2024.

6a. Stakeholder Feedback

Feedback Summary

Recommendations	In Favor	Against
TOPIC AREA 1: SYSTEM FUNDING AND DECISION-MAKING PRACTICES		
1.1 Sponsoring entity approval of ballot options prior to vote	1	3
1.2 Experience-based guidance for improving overall plan governance	2	0
1.3 Continuing education (CE) course on successful system reforms	1	0
TOPIC AREA 2. BOARD STRUCTURE AND MEMBERSHIP		
2.1 Updates TLFFRA board structure	1	5
2.2 Statutory authorization for removal of disengaged/noncompliant board members.	5	0
2.3 Guidance and resources for identifying citizen members with qualifications and example policies used by systems to set standards for engagement of their board members, including attendance policies and education policies.	3	0

Feedback Summary

Recommendations	In Favor	Against
TOPIC AREA 3. TRANSPARENCY AND COMMUNICATION		
3.1 Sponsoring entities make reports submitted to the PRB by the system available on their websites	4	0
3.2 Guidance or continuing education on transparency and communication	4	0
TOPIC AREA 4. ADDITIONAL AREAS FOR RESEARCH AND CONSIDERATION		
4.1 Statutory updates as recommended from stakeholders	N/A	
4.2 Course on reporting requirements and the role of the PRB for new administrators and trustees	3	0
4.3 Create a process to collect, share and regularly update example polices, requests for proposal and other relevant resources	2	0

6b. Staff Recommendations

Updated Legislative Recommendations

Topic Area 1: System Funding and Decision-Making Practices

- 1.1 Require sponsoring entity to approve ballot options prior to a member vote.
- New option 1.1a for discussion:
  - Sponsors receive notice of plan changes with time to provide comments preceding a member vote. Any comments would be made publicly available to members before a vote.

Updated Legislative Recommendations

Topic Area 2: Board Structure and Membership.

- 2.1 Consider statutory changes to TLFFRA board structure such as eliminating one citizen seat and adding one city appointee seat.
- New board structure options for discussion:
  - 2.1a Statutory authority for boards to adopt policy to modify structure when citizen seats cannot be filled
  - 2.1b Increase total number of board seats and have three active members, three sponsor representatives, and three citizen seat positions
  - 2.1c Prohibit retired system members from filling citizen seats

Updated Legislative Recommendations

Topic Area 2: Board Structure and Membership.

- 2.2 Provide statutory authorization for removal of disengaged/ noncompliant board members such as:
  - Authorize each board to adopt a policy for removing inactive or noncompliant board members.
  - Include language allowing for appointed trustees to be removed by the mayor or elected trustees removed by members in accordance with procedures adopted by the board.
  - Formalize in statute that absences beyond a certain percent of meetings or number of meetings is cause for removal, or a certain number of consecutive meetings.
- Additional options:
  - 2.2 [new] Absence beyond 50 percent of meetings is cause for removal unless formally excused by board
  - 2.2a Mayor may appoint designee from city council if they are unable to actively participate

Updated Legislative Recommendations

Topic Area 3: Transparency and Communication

- 3.1 Require TLFFRA system sponsors to make system reports available on their websites.
- No updates.

Topic Area 4: Additional Areas

- 4.1 Statutory updates based on specific feedback from TLFFRA stakeholders.
- New option 4.1a for discussion:
    - Authorize boards to adopt an education policy.

Updated Timeline

2023:

- Oct.-Dec. - Met with stakeholder work group

2024:

- Jan. - Presented draft findings to the Actuarial Committee
- Feb.-Mar. – Collect stakeholder feedback and provide board update
- **May – Present updated materials and comments to Actuarial Committee**
  - Stakeholder comment period following May meeting
- July – Present materials with committee and stakeholder input to board
- Sept. – Final recommendations presented to board for possible approval
- Nov. – Include any recommendations in PRB Biennial Report to the legislature

Potential TLFFRA Governance Issues and Recommendations
Summary of Feedback Received and Possible Alternatives – May 9, 2024

Staff presented a report on potential Texas Local Fire Fighters Retirement Act (TLFFRA) governance issues and related recommendations to the Actuarial Committee on January 25, 2024. The document was divided into four topic areas covering different aspects of TLFFRA system governance. On February 12, 2024, staff requested feedback from stakeholders on the proposed recommendations.

The PRB received seven responses on the issues and recommendations document. The comments predominantly came from systems, but staff also received comments from a city, a law firm, and other stakeholders. Most of the recommendations received feedback that was generally positive. However, stakeholders expressed concern regarding some of the proposed recommendations, particularly regarding statutory decision-making processes and TLFFRA board structure. To address those concerns, several stakeholders provided alternative options that staff would like to present to the committee. The following are highlights from the feedback, along with a brief discussion from staff and updated recommendations for the committee's consideration.

TOPIC AREA 1: SYSTEM FUNDING AND DECISION-MAKING PRACTICES

Identified Issue:
• TLFFRA statutory decision-making processes may hinder progress toward resolving funding issues faced by many TLFFRA systems and their sponsors.

Staff Recommendations - Statutory/Legislative

1.1 Require the sponsoring entity to first approve any ballot options concerning benefit or contribution changes prior to a member vote. This recommendation would ensure sponsors and systems work collaboratively on potential changes before going to a member vote and could change the incentive structure to make it more likely sponsors would be less hesitant to provide necessary employer contributions.

OR

[New] 1.1a Require the system to provide notice to the sponsor of key plan changes during a comment period preceding a member vote. Any comments would be made publicly available to members before a vote.

1.1 Feedback	
Odessa Firemen's Relief and Retirement Fund	"The board does not support the sponsoring entity voting on fund changes or ballot options prior to a member vote. All board members are fiduciaries of the plan regardless of their individual role. The goal is not to stifle cooperation between board and the sponsoring entity but ensure all parties are represented fairly."
Texarkana Firemen's Relief and Retirement Fund	"We are already required to have actuary approval for any retirement benefits. This requirement is adequate to ensure that no unaffordable benefit increases are issued."
Jackson Walker LLP	"The suggestion to disrupt the existing balance by requiring the plan sponsor to approve any plan changes, or have a formal agreement with the plan, is potentially problematic. Giving municipalities this authority would potentially politicize important plan decisions by making city councils a key decision-maker and shift certain administrative decisions away from the board who serves in a fiduciary capacity. To better address these issues, we might suggest a framework where the plan sponsors are given notice of key plan changes and have the ability to comment on them, as opposed to having actual decision-making authority."
City of Galveston	"Governing boards and plan sponsors should share ownership of needed contribution adjustments and benefit changes in addition to jointly developing written funding policies and amendments to achieve full funding goals. Require a joint "develop, review and concur" partnership role between the plan sponsor and governing board. Such a "checks and balances" decision-making approach over critical plan policies, benefits and contributions prevents deviating from progress towards funding goals. Future significant plan changes should require a super majority vote of the trustees. Also, when the plan underperforms."
Galveston Firefighters Pension Fund	"The fear that plans will increase benefits due to the fact that the changes must be first approved by the system's actuary, as well as by a majority vote of participating members of the system, I can understand. I would truly like to see a study of the 42 TLFFRA funds on when the last time a fund has had a benefit enhancement. I would believe that most funds have been cutting benefits and increasing contributions, as the case with Galveston. Many TLFFRA fund sponsors have not increased their contribution rate in recent years, and I believe the PRB has knowledge of this."

Staff Discussion:

The goal behind the original staff recommendation was to improve collaboration between the two parties by ensuring the sponsor has a formal role in signing off before members vote on ballot options. Given stakeholder concerns, new option 1.1a would ensure the sponsor receives the potential ballot options and has an opportunity to provide feedback prior to a vote, in addition to existing statutory requirements that the system board and actuary approve of those options before members may vote on them. Systems would then be required to publish any received comments when an option goes on the ballot. Sponsors would not be required to approve a ballot option, but there would be a mechanism to ensure sponsors are informed and their publicly available feedback would allow members to see why the sponsor does or does not support a potential ballot option.

Sponsors have expressed concerns about benefit enhancements which has led to some wariness about increasing contributions. Staff may consider researching previous benefit enhancements among TLFFRA systems, including if and how the sponsor was involved and the overall context, including impact on system funded status, of those enhancements. Through discussions with TLFFRA systems regarding their Funding Soundness Restoration Plans and through the TLFFRA governance workgroup meetings, staff have found systems use several approaches to working with their sponsor on plan changes, and further researching these approaches can be part of the guidance recommended under Staff Recommendation 1.2.

Staff Recommendations - PRB guidance/technical assistance

1.2 The PRB may publish guidance based on experiences of multiple TLFFRA systems for improving overall plan governance. This may take the form of best practices for creating a joint working agreement (and ultimately jointly adopted funding policies) between the system and sponsor, encouraging the use of guardrails to limit the system's ability to enact benefit increases or contribution decreases without consideration of factors which may include sponsor agreement and the plan's actuarial health. Such guidance could also highlight methods for effectively educating members in preparation for a vote on plan changes. Included in this effort could be compiling actual agreements and funding policies as examples and making them publicly available.

1.3 The PRB may create a continuing education (CE) course on successful system reforms, potentially featuring a panel of TLFFRA stakeholders.

1.2 Feedback	
Texarkana Firemen's Relief and Retirement Fund	"… I don't see a problem with issuing guidance which may benefit systems who may not have a good relationship between members and the sponsor. Nor do I see a problem with using "guardrails" to help guide benefits. I strongly caution against any mandatory "guardrails" which would require city or sponsor approval of retirement benefit improvements as referenced in Number 1 above."
Jackson Walker LLP	"We would also suggest that plans adopt benefit improvement policies or implement other 'guardrails' for making contribution and benefit decisions." "That said, requiring a separate benefit improvement policy is unnecessary; as the PRB Report notes, many of these guardrails would be appropriate to be addressed through a jointly developed funding policy, which is already a statutory requirement."
City of Galveston	"The Legislature should require sponsors and governing boards to work jointly not only when developing funding policies, but also when acting on benefit and/or contribution changes that could affect plan unfunded liabilities."

	"If contributions are fixed, then other components such as benefits must be flexible to bring the financing equation back into balance in order to avoid additional unfunded liabilities. Governing board actions to increase benefits or reduce contributions should be controlled through the use of an actuarially determined contribution rate (ADCR) along with a closed funding period not to exceed thirty (30) years."
1.3 Feedback	
Texarkana Firemen's Relief and Retirement Fund	"I believe [a continuing education (CE) course on successful system reforms] could be very beneficial for retirement plans who are not performing well. I think it should require attendance by both the membership side and the city or sponsor side of the TLFFRA boards. It would also be beneficial for city or sponsor administrators who are not members of the TLFFRA board."

Staff Discussion:

The proposed guidance would be intended to serve as a resource document for systems to reference when they develop their own policies. The goal would be to showcase successful reforms and agreements from similar systems that a TLFFRA system could use as a starting point. Staff concurs with the suggestion for plans to adopt policies regarding benefit and contribution changes, and further discusses such policies in the *Guidance for Developing a Funding Policy*. The guidance and *Pension Funding Guidelines* address using closed funding periods not exceeding 30 years and also suggest the use of an ADC rate as a best practice.

Staff agrees that the material covered in Minimum Educational Training (MET) program courses would be helpful for sponsors to review if they are interested. The PRB's courses are online and free for anyone to take, and the PRB encourages all interested parties to utilize those resources. At this time, staff is not proposing any changes to recommendations 1.2 or 1.3.

TOPIC AREA 2: BOARD STRUCTURE AND MEMBERSHIP

Identified Issues
• TLFFRA board structure may need updating to address identified concerns and ensure balanced representation. • TLFFRA boards occasionally struggle with disengaged and/or noncompliant trustees, but systems lack tools and policies to address these issues.

Staff Recommendations - Statutory/Legislative

2.1 Consider changes to statutory TLFFRA board structure. A potential option could be to eliminate one citizen seat and make it an additional city appointee and retain one citizen seat. Such a change would provide even representation between city and plan members but still retain one citizen member meant to represent taxpayers.

OR

[New] 2.1a Provide statutory authorization for TLFFRA boards to adopt a policy that would allow for the conversion of one citizen seat to a city appointee position if both citizen seats are unable to be filled.

[New] 2.1b Propose raising the total number of TLFFRA board positions to nine with the following composition:

- Three active members
- Three sponsoring entity designees
- Three Texas citizens

[New] 2.1c Propose statutory language prohibiting retired system members from filling a citizen seat on their system's board.

2.1 Feedback	
Texarkana Firemen's Relief and Retirement Fund	"In Texarkana, both of our citizen board members are financial professionals. The argument for giving the city or sponsor another board member is that both sides are represented equally. On the boards where the two sides don't work well together the city is not going to appoint a financial professional. They will appoint someone who they can make vote for their side. This move will reduce the amount of financial expertise on the TLFFRA board. Particularly, in Texarkana, it will reduce the amount of financial expertise on the board."
Galveston Firefighters Pension Fund	"With this I am against losing a citizen board position since this would impact our current board, but I can see that other TLFFRA funds might struggle to fill these positions. Galveston has never had this issue and most of the Board members are able to search out in the community to find a citizen willing to serve when there is a vacancy."
Port Arthur Firemen's Relief and Retirement Fund	"Each fund, based on their particular needs, should have the option to keep two citizen board members or convert one position to a "city member". This would solve the issue of removing a very productive member(s) and wasting the time, money, and education invested in that person because of a perceived governance issue that not all funds have. If a fund can't fill but one citizen position this option keeps local control, not PRB or state mandate. Changing the statute to a reasonable option lets the boards that are not having issues continue and not suffer the fate of those that are."

Odessa Firemen's Relief and Retirement Fund	"The board does not believe changing the board structure is necessary as each stakeholder is represented fairly. There is no one party that has the majority for any vote without support from the others. If altering the structure is found to be necessary, we would support increasing the total board number to 9 with there being 3 fire representatives, 3 city representatives, and 3 citizen representatives as opposed to removing a citizen (taxpayer) representative. We believe the important part here is that each trustee is obligated by fiduciary duty to act in the interest of the fund over the interest of the parties they represent." "We do believe that added direction could be given in the statute as to the prohibition of a member of the fund (retiree) acting in the role of a citizen trustee member to help eliminate any perceived conflicts of interest or undue majorities."

Staff Discussion:

The feedback indicates that not all TLFFRA systems are having difficulty filling citizen seat positions, so eliminating the seat could be potentially detrimental to some boards. Some systems may still benefit from having only one citizen seat and increased sponsor representation on the board, so staff provide option 2.1a, recommending a statutory change to authorize boards to adopt a policy allowing for the conversion of one citizen seat to a city appointee position if both citizen seats are unable to be filled. This would allow for boards to retain some local control over their board structure and select the option that works best for them.

Option 2.1b would propose recommending increasing the overall number of board seats, as suggested by Odessa Fire. One of the goals of the original recommendation was to help provide equal representation on the board. Increasing the total number of seats would allow for each seat type to have an equal distribution of members.

Texan residency is one of the few qualifications required for a citizen trustee. New option 2.1c would propose specifying in statute that the citizen trustee may not also be a retired member of the system whose board they would be serving. This potential option, as proposed by Odessa Fire, would also help maintain equitable distribution of perspectives on the boards.

<u>Staff Recommendations - Statutory/Legislative</u>

2.2 Provide statutory authorization for TLFFRA boards to remove disengaged/noncompliant board members. Some options may include:

- Authorize each board to adopt a policy for removing inactive or noncompliant board members. The specific criteria would be left up to each system's board.

- Include language allowing for appointed trustees to be removed by the mayor or elected trustees removed by members in accordance with procedures adopted by the board.
- Formalize in statute that absences beyond a certain percent of meetings or number of meetings is cause for removal, or a certain number of consecutive meetings.

OR

[New] additional 2.2 option:

- Formalize in statute that absences beyond a 50 percent of meetings in a fiscal year is cause for removal unless the board formally excuses the absence.

[New] 2.2a Include statutory language allowing the mayor to appoint a designee from city council if the mayor determines they are unable to actively participate on the board.

2.2 Feedback	
Jackson Walker LLP	"We believe that placing requirements on who may serve in that designated role may help in ensuring the plan sponsor is engaged (for example, if the mayor cannot serve as a trustee, the Act could require that a city council member be appointed)." "While this lack of attendance and engagement is problematic, we do not believe that the suggestion to authorize the board to remove trustees, the mayor to remove his designated appointee on the board, or permitting members to hold a "recall" election at any time is the proper solution." "Instead, the PRB Report's recommendation to impose a statutory attendance requirement, with an automatic removal provision if a trustee misses a certain number of consecutive meetings, would help TLFFRA funds address the lack of engagement by applying a clear, objective and consistent standard to all trustees."
Texarkana Firemen's Relief and Retirement Fund	"I believe it would be beneficial to TLFFRA boards to be able to remove absent or disengaged board members. I like the idea of leaving the decision on how to accomplish this to the local board. The board can craft criteria which fits their individual situation. I would caution against setting any minimum attendance requirements in statute. This could result in the loss of a really good board member who has encountered some sort of personal situation that required them to miss a few or a certain number of consecutive members. This criteria should also be left to each individual board which would be able to use some discretion in certain situations."

Staff Discussion:

Current recommendation 2.2 requests that authorizing language be added to statute allowing boards to adopt individualized policies. The individual policies themselves would be up to the systems to create. The agency may offer resources as a starting point.

Per recommendation 2.2a, the committee could also consider including a minimum statutory attendance rate, such as attending at least 50 percent of meetings during a fiscal year. Individual boards could further adopt policies themselves to increase the threshold or apply a limit on the number of consecutive meetings missed. Note that stakeholder feedback regarding specific attendance thresholds is mixed, with some stakeholders preferring an approach in which the specific criteria are left up to each board.

Staff has added new recommendation 2.2a that would allow for the mayor to designate an alternate appointee if they are unable to participate on the board. The appointment of a city council member, an elected official like the mayor, could help maintain communication between the two parties and ensure sponsor input and representation if the mayor is unable to serve on the board.

Staff Recommendations - PRB guidance/technical assistance

2.3 The PRB may compile information and guidance on processes used by TLFFRA systems for identifying citizen members with qualifications and example policies used by systems to set standards for engagement of their board members, including attendance policies and education policies. This recommendation would provide information and assistance to TLFFRA systems while not mandating specific qualifications for citizen members, which may be difficult for some systems to comply with.

2.3 Feedback	
Odessa Firemen's Relief and Retirement Fund	"…giving directions as to the experience or vocation of these trustee position holders could unnecessarily burden TLFFRA boards in filling an already potentially difficult spot. We believe boards do and should consider those kinds of qualifications when seeking volunteers to fill these roles; but we should not be statutorily obligated to do so. We do not mandate that kind of knowledge from the firefighters that fill the trustee roles, nor the mayoral role - we should do nothing other than represent the taxpayers by statute."
City of Galveston	"Education and training requirements will ensure board members have the background to make informed decisions to preserve a healthy and sustainable pension plan.

Staff Discussion:

At this time, staff is not proposing to require any specific education or experience qualifications in statute for citizen seat positions. During discussions with stakeholders, some stakeholders indicated they needed assistance with identifying potential candidates for those positions and what types of experience would be helpful to have on the board. With the current recommendation as is, individual boards would still be able to adopt and customize different qualifications based on the needs of their boards, with the potential for the PRB to facilitate information sharing among systems regarding board member qualifications.

TOPIC AREA 3: TRANSPARENCY AND COMMUNICATION

Identified Issues
• Information may not be easily accessible by all parties, including sponsoring entity and membership. • Some TLFFRA systems have difficulty contacting their sponsoring entity to discuss plan issues. • Minutes and board meeting materials are sometimes incomplete or not comprehensive.

<u>Staff Recommendations - Statutory/legislative</u>

3.1 Require the sponsoring entity of a TLFFRA system to make publicly available on their website reports submitted to the PRB by the system. This change would facilitate access to information about TLFFRA systems even in situations where the system is unable to maintain an independent website.

PRB guidance/technical assistance

3.2 The PRB may issue guidance or conduct continuing education on transparency and communication topics.

3.2 Feedback	
Jackson Walker LLP	"The PRB Report suggests that various additional administrative measures be put in place to enhance communication and transparency. While we agree with some of these suggestions, we believe that the administrative costs and burdens of any additional requirements must be seriously considered."

Staff Discussion:

Staff concurs that administrative costs should be considered and acknowledges that the creation of policies may carry a cost for the system. However, having policies in place that help systems establish and maintain sound governance practices could improve funding overall down the line. Additionally, some of the proposals could reduce administrative costs for the systems, such as having sponsors post reports on their websites rather than requiring systems to allocate resources for this out of small administrative budgets. Finally, the only requirement staff propose would be for cities to post TLFFRA system materials on their own websites, whereas guidance on transparency and communication would be for the purpose of assisting systems to improve in these areas, not imposing new requirements.

TOPIC AREA 4: ADDITIONAL AREAS FOR RESEARCH AND CONSIDERATION

Identified Issues
• Statutory language is potentially outdated in some areas and may not reflect current practices. • Additional information-sharing mechanisms and resources may be helpful for TLFFRA systems.

Staff Recommendations - Statutory/legislative

4.1 Propose statutory updates based on any specific feedback or suggestions received from TLFFRA stakeholders through this process. Proposing any such updates would depend on the PRB receiving specific suggestions from TLFFRA stakeholders.

OR

[New] 4.1a Propose language authorizing boards to adopt an education policy.

4.1 Feedback	
Justin Graham and Eric Stewart[1]	"Standardized Administrative Processes in "Red Flag" Situations: Cities should be compelled to implement processes stipulated by the Legislature or the Pension Review Board for managing their local firefighter pension funds once specific warnings are issued. " "For instance, pension funds would be obligated to alert their respective city sponsors about potential red flag issues, such as subpar investment returns; higher-than-normal employee departures; increased numbers of refunds of contributions; payroll processing problems; reporting issues; or any funding issues raised by actuaries in an AVR. Certain actions could be required once a red flag issue is declared."
Odessa Firemen's Relief and Retirement Fund	"The board supports requiring newly appointed members to complete core training before they may participate in their first board meeting."

[1] Justin Graham and Eric Stewart are trustees of the Midland Firemen's Relief and Retirement Fund. They submitted comments on their own behalf, rather than as representatives of the system.

Staff Discussion:

Staff currently contacts and reports on funding issues according to the *Policy for Promoting Compliance with FSRP Requirements*, and as part of the regular Actuarial Valuation and FSRP reports presented by staff at PRB board meetings. Also, many systems' funding policies already include criteria that would require their pension board to notify their sponsors. The funding policy is a good avenue for systems to customize the exact triggers for a notification system to best suit their needs and is already a statutory requirement to be developed and adopted jointly with the sponsor.

Option 4.1a proposes statutory authorization for boards to adopt an education policy expanding on the existing training requirements for trustees. This could include requiring additional training hours or an advanced training requirement, allowing each system to decide if having new trustees complete training ahead of their first meeting would be feasible. At least one system, Odessa Fire, has adopted an education policy that adds requirements above and beyond MET requirements that apply statewide. This recommendation would provide statutory authorization for boards to adopt stricter education standards but not require these across the board. Staff recommends changes to MET requirements be considered as part of overall MET rulemaking discussion or future changes to statute.

<u>PRB guidance/technical assistance</u>

4.2 The PRB could create a new core or CE course on reporting requirements and the role of the PRB for new administrators and trustees. The PRB may also consider other topics based on TLFFRA stakeholder requests. Such a course could help trustees and administrators more easily learn statutory reporting and education requirements and make compliance easier.

4.3 The PRB could implement a process to collect, share and regularly update example polices, requests for proposal and other relevant resources. This process would ultimately make it easier for systems to access useful examples since they would just have to go to one place.

4.2 Feedback	
Justin Graham and Eric Stewart	"Mandatory Training for Elected Officials: The Legislature should mandate training and certification for all elected officials (not just those on Pension Fund Boards) and relevant City Staff, on City financial responsibilities for pension fund health. "

Staff Discussion:

Requiring training for elected officials and certain city staff members would fall outside of the scope of the PRB's mandate. However, the PRB's pension training is free and available to anyone who wishes to take it through the agency MET website.

Item 7. PRB Pension Funding Guidelines and Guidance for Developing a Funding Policy

Mariah Miller

Project Status

- Public comment period open from Feb. 5, 2024, through March 15, 2024.
- Received a total of six comments
    - Three systems
    - Two cities
    - One actuarial firm

7a. Stakeholder feedback

Stakeholder Feedback

- Pension Funding Guidelines
  - Most comments about Guidelines 4, 5, and 6
  - Received general feedback about technical language and scope.
- Guidance for Developing a Funding Policy
  - Requested certain examples removed
  - Received some comments generally more applicable to other projects or policies
  - Applied some feedback from TLFFRA Governance stakeholder comments

7b. Updated guidelines, guidance, and example funding policy

Major Changes: Pension Funding Guidelines

- Guideline 4
  - Specify that minimum contributions should cover normal cost after system reaches full funding
  - Add upper limit of 120 percent funded
- Guideline 5
  - Replace original target date recommendations with targeting 15 years by Sept. 1, 2040, if funding period is not at least 20 years or less by Sept. 1, 2035.
- Guideline 6
  - Specify parameters around benefit or contribution changes after Sept. 1, 2040.

Major Changes: Funding Policy Guidance

- Removed examples using Fort Worth Employees' Retirement Fund.
- Added clarifying language around the system and sponsor joint development and adoption requirement.

Sample Funding Policy

- Representative of what a potential funding policy could look like.
- Updates:
  - Technical language
  - Statutory requirements
  - Includes two-year review period
  - Adds a surplus management policy
  - Adds signature lines for system official and city official

Project Timeline

2023:

- Aug.-Sept. – Research and review
- Oct. – Drafting of updated Guidelines/Guidance
- Nov.-Dec. – Revision and editing of Guidelines/Guidance

2024:

- Jan. – Presented deliverables to the Actuarial Committee
- Feb.-Mar – Collect stakeholder feedback and provide board update
- **May – Present updated materials and updated sample policy to the Actuarial Committee**
- July – Present final drafts of the following to the board for possible approval:
    - Updated Guidelines
    - Updated Guidance
    - Updated Sample Policy

Commenter	Comment Received	Staff Discussion
Introduction		
Texas County & District Retirement System	"As a threshold matter, the Proposed Guidelines appear to be rooted in Section 802.2011 of the Texas Government Code. See Proposed Guidelines, at 1, note 1. Subsection (b) of that section provides that the governing body of a public retirement system and, if a system is not a statewide retirement system, its associated governmental entity must jointly develop a written funding policy. TEX. GOV'T. CODE § 802.2011(b) (emphasis added). TCDRS, along with certain other retirement systems, is included within the definition of a "statewide retirement system" for purposes of Section 802.2011. TEX. GOV'T CODE §802.2011(a)(3)(C)."	**Recommendation:** Staff has clarified in the guidelines that statewide systems are exempt from certain funding policy requirements.
1. Reflecting obligations and assets		
No comments received		
2. Allocation of normal cost		
No comments received		
3. Funding of UAAL		
No comments received		
4. Actual contributions cover normal cost		
Texas County & District Retirement System	"...Paragraph 4 of the Proposed Guidelines, as amended, would say that "[o]nce a system reaches 100 percent funded, contributions should continue to cover the normal cost." While this may be advisable in some contexts, it may not be in others. Some pensions may have reasons for wanting to contribute more than their normal costs; others may determine that funding their normal costs would result in a funding level that is higher than the actuarially determined rate." "Instead, we would recommend a more general statement, such as one that encourages (but does not require) a plan to develop a surplus management policy that addresses how the plan will manage a funding surplus."	**Recommendation:** The PRB staff concurs that there may be instances where a system that has reached 100 percent funding chooses to fund more than the normal cost. Staff suggests updating the language on Guideline 4 to specify that *minimum* contributions should continue to cover normal cost and added a 120 percent funded ratio upper limit to account for instances when a system may opt to fund less than the normal cost while maintaining strong funding levels. The *Guidance for Developing a Funding Policy* provides more information on creating a surplus management policy.
Rudd and Wisdom, Inc.	"We recommend that the last sentence of guideline 4 be changed to include the following phrase to emphasize that the contributions could exceed the normal cost to cover any potential unfunded liability that occurs from gains and losses: '...to cover the normal cost, at a minimum.'"	

<table>
<tr><th>Commenter</th><th>Comment Received</th><th>Staff Discussion</th></tr>
<tr><th colspan="3">5. Target dates</th></tr>
<tr><td>Texas County & District Retirement System</td><td>"...the establishment of these target dates may be worthwhile goals for a particular plan in a particular set of circumstances (such as a fixed-rate plan that is operating under an FSRP), but it is important to realize that those dates could – and most likely will – evolve as circumstances (e.g. payroll, workforce health and age, market fluctuations) change. To suggest that these dates should not (or could not) change from year to year could have material and adverse effects on a plan if it is then not allowed (or even encouraged) to adapt to changing circumstances. Our recommendation then, would be that this language focus on amortization periods, rather than on fixed amortization dates. We think that this would be the more appropriate guidance for plans facing these circumstances."</td><td rowspan="2">Recommendation: Staff has updated the proposed language on Guideline 5, removing the two date recommendation for reducing and eliminating the UAAL. Instead, staff proposes that Guideline 5 recommend that systems target a funding period of 15 years by September 1, 2040 if their funding period has not decreased to 20 years or less by September 1, 2035. These dates allow for systems to have fluctuations in funding periods year over year in response to various assumptions and circumstances changing while still remaining on a long-term track toward full funding.</td></tr>
<tr><td>City of El Paso Employees Retirement Trust</td><td>"It is not entirely clear, but it seems that you are suggesting that a funding method that amortizes unfunded liabilities on a 'level percent of pay' basis should state the number of years it will take before the unfunded liabilities start to decrease often referred to as 'negative amortization.'

Our concern, as identified by our actuary, is that the period of negative amortization depends on the payroll growth rate. As the payroll growth rate increases, the number of years of negative amortization increases. Our specific request is to add clarification to proposed guideline number five and to consider how assumption changes could complicate or conflict the satisfaction of this guideline."</td></tr>
<tr><td>Rudd and Wisdom, Inc.</td><td>"We recommend that guideline 5 not be included in the Pension Funding Guidelines but instead be part of the Funding Policy Guidelines, as it references “the funding policy.”

5a is already addressed in the Funding Policy Guidelines under Section II, under the heading Negative Amortization. 5b should be incorporated into the Funding Policy Guidelines under Section I."</td><td>Recommendation: Guideline 5 has been updated to reflect dates in accordance with FSRP requirements that will help systems stay on track to have a decreasing funding period over time. The Guidance for Developing a Funding Policy includes information about negative amortization, but is intended to serve as a basis for discussion between systems and sponsors.</td></tr>
</table>

Commenter	Comment Received	Staff Discussion
6. Benefit increases and contribution decreases		
City of El Paso Employees Retirement Trust	"Our concern is that the phrase, "material increase" is not defined and is subjective in nature. A clarification regarding what might be considered a "material increase" or a guideline that would require that a plan achieve certain quantifiable parameters before a change may be made may be preferable for purposes of compliance."	**Recommendation:** PRB staff proposes updating Guideline 6 to specify parameters around benefit or contribution changes after September 1, 2040. Staff recommends systems discuss with their actuary what a material increase would look like for them since it may differ between systems.
Rudd and Wisdom, Inc.	"Guideline 6 is too restrictive to be practical." "Consider small changes to ancillary benefits such as death benefits or vesting provisions. We recommend a maximum acceptable amortization period of 20 years with a preferrable target maximum amortization period not to exceed the average future working lifetimes."	
Fort Worth Employees' Retirement Fund	"Consider whether to add footnotes to Items 6 and 7 on page 2 of the PRB Pension Funding Guidelines to acknowledge that certain plan sponsors may negotiate their benefits with its employees."	**Recommendation: No change.** The Guidelines currently support benefit negotiations between system sponsors and employees.
7. Benefit decreases and contribution increases		
No comments received		
8. Reasonable assumptions		
No comments received		
9. Experience studies		
No comments received		

Commenter	Comment Received	Staff Discussion
General Feedback		
City of El Paso	"Our initial comment is that it should be stressed in these documents that the proposed guidelines are suggestions and they are not intended to supersede the professional advice provided by enrolled actuaries or specific legislative requirements or other factors that Trustees should consider in making funding policy decisions for each specific plan. These guidelines should not be interpreted as "best practices" but resources for consideration in developing funding policies as no "one size fits all" in the development and implementation of a pension funding policy."	**Recommendation: No change.** The Pension Funding Guidelines preamble currently states that the guidelines serve~~s~~ to provide guidance to public retirement systems and their sponsoring governmental entities.
City of Fort Worth	"One addition that we would propose to the new draft Guidelines and/or Guidance would be to reaffirm directly that some of the documents' provisions would not apply to funds with an established, legacy Funding Soundness Restoration Plan (FSRP) such as ours, so long as a legacy fund continues to adhere to its plan and remains within a 40-year funding period."	**Recommendation**: **No change.** The Guidelines are not a required policy for systems. The 30-year funding period in the Guidelines has not changed. The legacy FSRP rules continue to provide a way for systems such as FWERF to remain compliant with statute while operating outside the guidelines.
Fort Worth Employees' Retirement Fund	"The document fails to note that some pension plans, such as FWERF, previously implemented an FSRP and should be grandfathered into the Guidelines. One application of this grandfathering is that FWERF could be outside the 30-year amortization but still compliant. It is critical that the Guidelines account for FSRP-grandfathered plans."	
Rudd and Wisdom, Inc.	"Despite the use of the term “funding period” in the Texas Government Code, we prefer “amortization period” to help distinguish it from so many other places where the word “funding” is used."	**Recommendation: No change.** Staff will continue using "funding period" to be consistent with statute.

Commenter	Comment Received	Staff Discussion
Overview		
Texas County & District Retirement System (TCDRS) - *via email*	"I'm wondering if this guidance is intended to be for the statewide systems too. The reason I'm asking is that, if this is the case, I am noticing a few places where I might suggest a change. For example, the Government Code section 802.2011(b) exempts the statewide systems from having to jointly adopt a funding policy with 'its associated governmental entity.'"	**Recommendation:** Staff has clarified in the guidance that statewide systems are exempt from certain funding policy requirements.
I. Establishing Clear and Concrete Funding Objectives		
No comments received		
II. Selecting Actuarial Methods		
City of Galveston	"...PRB guidance should include more detailed discussion in the Draft Guidance on the use of the Actuarial Estimated Rate of Return (a.k.a., assumed investment return) and creating an asset allocation plan consistent with achieving the estimated rate of return."	**Recommendation: No change.** At this time, staff believes that this would be better suited for a different type of guidance. Staff has made a note of this recommendation and will consider it in the future.
III. Developing a Roadmap to Achieve Funding Objectives		
Fort Worth Employees' Retirement Fund	"On redline page 4, "examples" are listed under the Benefit & Contribution Change Parameters. FWERF requests not to be used as an example in this context."	**Recommendation:** Staff has removed the FWERF example from this section of the Guidance.
IV. Adopting Actions to Address Actual Experience That Diverges from Assumptions		
City of Fort Worth	Suggested technical changes to the Fort Worth example in the risk-sharing paragraph.	**Recommendation:** Staff has removed the FWERF example from this section of the Guidance.
Fort Worth Employees' Retirement Fund	"On redline page 7, FWERF requests not to be used as an example in this context. To the extent FWERF is used as an example, a few corrections are needed in the paragraph describing FWERF's funding policy... "	

Commenter	Comment Received	Staff Discussion
General Comments		
City of Galveston	"Given the complexities with pension funding issues and the significant financial implications for beneficiaries and taxpayers, the City of Galveston strongly recommends the additional best practices: 1. Board Composition. Equal governing board and plan sponsor professional representation with an experience requirement to ensure a qualified board. Management of pension assets can often be complex and require a level of understanding beyond that of a layman or even a journeyman, yet many plans are administered by volunteer boards with little or no background in the complexities of investment and asset management. 2. Education Requirements. Education and training requirements will ensure board members have the background to make informed decisions to preserve a healthy and sustainable pension plan. The importance of education and training as well as the principle that no pension board should be comprised principally of plan beneficiaries and appointees was emphasized with HB 2763, Galveston's police pension reform legislation enacted in 2019."	**Recommendation: No change.** The PRB is currently undertaking other projects that entail researching governance practices and will make note of the feedback for the future.
City of El Paso Employees Retirement Trust	"Our initial comment is that it should be stressed in these documents that the proposed guidelines are suggestions and they are not intended to supersede the professional advice provided by enrolled actuaries or specific legislative requirements or other factors that Trustees should consider in making funding policy decisions for each specific plan. These guidelines should not be interpreted as "best practices" but resources for consideration in developing funding policies as no "one size fits all" in the development and implementation of a pension funding policy."	**Recommendation: No change.** The PRB *Pension Funding Guidelines* serve to provide guidance to public retirement systems and their sponsoring governmental entities. This information is captured in the guidelines preamble.

Commenter	Comment Received	Staff Discussion
General Comments (cont)		
City of Fort Worth	"One addition that we would propose to the new draft Guidelines and/or Guidance would be to reaffirm directly that some of the documents' provisions would not apply to funds with an established, legacy Funding Soundness Restoration Plan (FSRP) such as ours, so long as a legacy fund continues to adhere to its plan and remains within a 40-year funding period."	**Recommendation: No change.** The guidance is intended to serve as a starting point for systems when creating a funding policy and offers suggestions for material they may want to include. The guidance document is not intended to supersede provisions in an FSRP.
Fort Worth Employees' Retirement Fund	"Anywhere “Fort Worth Employees’ Retirement Fund” is referenced, please include the plural possessive apostrophe, as follows: Employees’."	**Recommendation:** Staff has removed the examples from FWERF from the guidance but has noted the technical feedback for the future.

PRB Pension Funding Guidelines

Introduction:

The purpose of the Pension Review Board's Pension Funding Guidelines is to provide guidance to public retirement systems and their sponsoring governmental entities in meeting their long-term pension obligations. The Guidelines are intended to foster communication between systems ~~plans~~ and their sponsors as they determine a reasonable approach to responsible funding, whether the contribution rate is fixed or actuarially determined.

According to state law, each public retirement system and its sponsoring governmental entity shall jointly develop and adopt a written funding policy.[1] The system and sponsor must revise this policy to reflect any significant changes, including changes required after implementing a funding soundness restoration plan (FSRP).[2]

~~Public retirement systems should develop a funding policy, the primary objective of which is to fund the obligations over a time frame that ensures benefit security while balancing the additional, and sometimes competing, goals of intergenerational equity and a stable contribution rate.~~

Guidelines:

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 funding ~~amortization~~ period. State law requires a funding policy to include a plan for achieving a 100 percent or greater funded ratio.[3] Starting September 1, 2025, funded ratio will be a factor in the triggering mechanisms for the FSRP requirement.[4]

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, in accordance with state law.[5] ~~with 10 – 25 years being the preferable target~~

[1] Statewide systems are exempt from Section 802.2011(b), which includes the requirement for the system and sponsor to jointly develop and adopt the funding policy.

[2] Section 802.2011, Texas Government Code

[3] Section 802.2011, Texas Government Code

[4] Section 802.2015, Texas Government Code specifies that on or after September 1, 2025, systems with a funding period of between 30 and 40 years and a funded ratio of less than 65 percent will trigger the FSRP requirement after one actuarial valuation.

[5] Section 802.2015, Texas Government Code establishes a 30-year funding period as the state's minimum funding standard for public retirement systems as part of the Funding Soundness Restoration Plan (FSRP) requirement.

~~range.*~~ For plans that use multiple amortization layers, the weighted average of all ~~amortization~~ funding periods 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.]~~ Once a system reaches 100 percent funded, at minimum, contributions should continue to cover the normal cost unless the funded ratio exceeds 120 percent.

5. If the funding period has not decreased to 20 years or less by September 1, 2035, the funding policy should be updated to target a funding period of 15 years by September 1, 2040.

6. After September 1, 2040, benefit increases and contribution decreases should not be adopted if the proposed changes cause a material increase in the funding period and if the resulting funding period exceeds the greater of 15 and the average future working lifetime of the current active members.[6]

7. Benefit decreases and contribution increases should not be adopted without studying how the resulting normal costs compare to the contribution rates of each tier, and board discussion of whether members in each tier will receive a benefit that is worth more than their contributions.

~~5~~8. The choice of assumptions used by a system should be reasonable and should comply with applicable actuarial standards.

~~6~~9. Public 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 06/30/2017 should seek to reduce their amortization period to 30 years or less as soon as practicable, but not later than 06/30/2025.~~

Any systems that subsequently become subject to the Revised FSRP requirement must meet a stricter 25-year funding period and implement an actuarially determined contribution, among other requirements.

[6] For example, if members on average have accrued 12 years of service and are expected to retire after 25 years of service, any benefit increases should be paid for within the 13 expected remaining service years of the current active members.

TEXAS PENSION REVIEW BOARD

Guidance for Developing a Funding Policy

~~As required by Senate Bill 2224 (86R)~~

(Adopted ~~October 17, 2019~~TBD)

Overview

Section 802.2011, Texas Government Code ~~§802.2011~~ requires **the governing board of a Texas public retirement system and, if the system is not a statewide system, its sponsor to jointly develop and adopt ~~a~~the same written funding policy ~~by January 1, 2020.~~and timely revise the policy to reflect any significant changes, including those made because of a funding soundness restoration plan (FSRP)**. To jointly develop and adopt means that the governing bodies of both the system and sponsor should work together to develop, adopt, and review the funding policy periodically. The policy is intended to be ~~used as a retirement system's~~ a roadmap to fully fund ~~its~~the system's long-term obligations.

The ~~policy should be created with input from the system's sponsoring governmental entity whenever possible.~~

~~The~~ funding policy ~~is required to~~requirement includes several components. By statute, the policy must be filed with ~~its sponsor and~~ the Texas Pension Review Board (PRB) no later than the 31st day after the date the policy is changed or adopted. The most recent version of the funding policy must also be available on a publicly available website.

A funding policy is required by law to be revised in a timely manner to reflect any changes a system and its sponsor make due to an FSRP. For purposes of a revised FSRP, the funding policy revisions must include any risk-sharing mechanisms, the adoption of an actuarially determined contribution structure, and other adjustable benefit or contribution mechanisms.[1] For more information about the FSRP requirement, including applicable statute, rules and policy, see the PRB's FSRP webpage.

A funding policy helps a system achieve the three fundamental goals of public pension funding: benefit security, contribution stability, and intergenerational equity. ~~While different pension plans~~Different retirement systems and their governmental sponsors may prioritize these goals differently, but the funding policy should strive to **balance** these three primary pension funding goals~~ so that member~~. Member benefits ~~are~~should be secure~~;~~, employers and employees ~~are~~should be afforded some level of contribution predictability from year to year~~;~~, and liabilities ~~are~~should be managed so that plan members and future taxpayers are not burdened with costs associated with a previous generation's service. For a more detailed discussion of the benefits of adopting a funding policy, please see the PRB's *2019 Interim Study: Funding Policies for Fixed-Rate Pension Plans*.

A funding policy should include ~~the following components:~~

[1] Section 802.2011(c), Texas Government Code

~~I.~~ ~~Clear~~clear and concrete funding objectives~~;~~
~~II.~~ ~~Actuarial~~, actuarial methods~~;~~
~~III.~~ ~~A~~, a roadmap to achieve funding objectives~~;~~, and

~~Actions~~ actions that will be taken to address actual experience that diverges from assumptions. The following material provides more detail on each of these necessary components of a funding policy. While this guidance uses examples of Texas retirement system funding policy provisions under various components, the use of such examples is for informational purposes and does not constitute endorsement or recommendation by the PRB.

Components of a Funding Policy

I. Establishing Clear and Concrete Funding Objectives

A funding policy should clearly establish the retirement system's funding objectives. ~~Per Government Code §802.2011, the~~ The **funding policy must target a funded ratio of 100~~%~~ percent or greater~~.~~ and be jointly developed and adopted with the system's sponsor.**[2] The PRB recommends that systems adopt a funding policy that fully funds the plan **over as brief a period as possible**, ~~with **10 – 25 years** being the preferable range,~~ using a finite, or **closed, funding period**.

II. Selecting Actuarial Methods

An important role of a funding policy is to **set boundaries on what is allowable for actuarial calculations**. The system's actuary should be involved with the development of a funding policy by advising the board on selecting actuarial methods that align closely with the system's funding objectives, reducing volatility in returns, allowing a more predictable budget and increasing the likelihood of meeting obligations.[3] At a minimum, the three actuarial methods that should be addressed are the actuarial cost method, the asset-smoothing method, and the amortization policy.

Actuarial Cost Method	Asset Smoothing Method	Amortization Policy
An actuarial cost method is a way to allocate pieces of a participant's total expected benefit to each year of their working career. The most common actuarial cost method used in Texas, and the cost method required by GASB for financial reporting disclosures, is the entry age normal (EAN) method. Under the EAN method, benefits are assumed to accrue as a level	Asset smoothing techniques can help keep contributions stable and more predictable over time. Under smoothing, asset gains and losses are generally recognized over a period of years rather than immediately. A five-year smoothing period where 20~~%~~ percent of any gain or loss is recognized in each subsequent year is typically used in Texas.	An amortization method is a procedure for determining the amount, timing, and pattern of recognition of a plan's gains and losses. Amortization amounts can be level dollar amounts or determined as a percentage of covered payroll. Level dollar amounts are preferable unless payroll is expected to decrease in the future. One approach that helps minimize annual contribution volatility while maintaining a finite, closed funding period is the use of layered amortization, where a single

[2] Section 802.2011, Texas Government Code
[3] "Sustainable Funding Practices for Defined Benefit Pensions and Other Postemployment Benefits (OPEB)" *Government Finance Officers Association* 3, 5-7, approved March 3, 2023, https://www.gfoa.org/materials/sustainable-funding-practices-for-defined-benefit-pensions

percentage of pay over the period from the member's entry into the ~~plan~~system until ~~his/her~~their assumed termination or retirement. A funding policy should state the desired goals and purpose of the cost method if it does not specify the exact cost method to be used.	The funding policy should specify the amount of return subject to smoothing (i.e~~.~~., how much is deferred), the time period of the deferral, and if the smoothed value is subject to a corridor. FSRP rules allow a system to use the greater of the market value of assets and the actuarial smoothed value of assets when determining the funding period to compare against the FSRP 30-year threshold.	closed-period amortization base is established for each year's realized experience. Another approach is to establish closed-period amortization bases with varying recognition periods dependent upon the cause of a gain or loss. For example, one approach might be to amortize investment and/or actuarial experience gains or losses over a ~~5~~five-year period, gains or losses attributable to assumption changes over a 10-year period, and gains or losses attributable to plan amendments over as short of a ~~25~~period as possible. A well-developed amortization policy will help a system maintain an amortization period below the 30-year ~~period.~~statutory threshold and avoid triggering a funding soundness restoration plan.

A funding policy may also include directions on how to account for expected ~~plan~~system administrative expenses, how often experience studies should be completed to maintain up-to-date demographic actuarial assumptions, and how to set the interest discount rate.

Negative Amortization

Negative amortization occurs when contributions are insufficient to cover the cost of benefits accrued and the interest accrued on the unfunded liability during the year. ~~Plans~~Systems should be careful in their use of negative amortization. If a ~~plan's~~system's amortization policy results in negative amortization, the funding policy should outline the expected period over which negative amortization will occur and provide justification for the use of negative amortization.

III. Developing a Roadmap to Achieve Funding Objectives

A funding policy should provide a clear plan detailing how the system's funding goals will be met.

Contribution Rates

An actuarially determined contribution (ADC) structure requires the payment of an ADC rate. An ADC is defined as the cost of benefits earned by workers in the current year (the normal cost) plus an amortization payment to recognize prior gains and/or losses. ADC contribution structures ~~inherently~~automatically adjust to the ~~plan's~~system's changing funded status to maintain the overall trajectory towards fully funding benefit promises. This approach contrasts with fixed-rate funding structure which does not change from year-to-year unless proactive steps are taken.

If contributions are not made based on an ADC rate, the ~~plan's~~system's governing body should establish and include the following items in the funding policy:

1. Determine an ADC that can be used as a benchmark to monitor whether the actual contributions are guiding the ~~plan~~system toward the stated funding objectives.

2. Establish what conditions will trigger action when the current actual contribution rate moves away from the benchmark ADC. For example, a certain funded ratio or difference between actual contribution and ADC could be used.

3. Identify tangible steps that will be taken to mitigate the differences between the actual and benchmark contribution rates, such as contribution and benefit changes. See Section IV for examples.

Benefit and Contribution Change Parameters

A funding policy should include elements designed to impede deviation from progress toward funding goals. This may be done by establishing parameters under which future benefit increases and contribution reductions can be considered.

Examples

~~A funding policy might state~~**Irving Firemen's Relief and Retirement Fund.** The board agrees that~~:~~

- any benefit enhancements~~ can~~/changes to be ~~made only if~~submitted to the ~~funded ratio~~membership for vote will~~ remain at a certain level after the increase; or ~~:
  - require that member contributions solely cover any increases to the ADC as a result of such benefit enhancements/changes, to the extent such sole coverage by members is permitted under TLFFRA statute; and
  - have been analyzed pursuant to the actuarial analysis process agreed to with the sponsor.[4]
  -

- **San Antonio Fire & Police Pension Fund**. Every two years, the board may review potential changes to the governing statute. The board may not recommend actions that result in a funding ratio less than 90 percent or an effective amortization period of over 15 years.[5]

- **Longview Firemen's Relief and Retirement Fund.** The funding policy states that the board supports:
  - A reduction in the employer contribution rate only when the funding ratio would be above 105 percent and the total contribution rate is not less than the normal cost.
  - Benefit enhancements only if the amortization period is below five years, the resulting amortization period after reflecting the enhancements is above 10 years, and the average experience of three consecutive annual actuarial valuations must be used to evaluate actual fund status before any plan improvements can be brought to a vote.[6]

Working With the Sponsor

[4] Funding Policy, *Irving Fireman's Relief and Retirement Fund*. 2023. https://www.prb.texas.gov/wp-content/uploads/2023/12/Irving-Funding-Policy.pdf

[5] Actuarial Funding Policy, *San Antonio Police and Fire Pension Fund*. 2020. https://www.prb.texas.gov/wp-content/uploads/2023/12/SAFPPF-Funding-Policy.pdf

[6] Longview Firemen's Relief & Retirement Funding Policy, *Longview Firemen's Relief & Retirement Fund*, 2022. https://www.prb.texas.gov/wp-content/uploads/2023/12/Longview-Funding-Policy.pdf

A system and its sponsoring governmental entity are required to jointly create and approve the same funding policy.[7] Working together will allow a system and its sponsoring entity to craft a funding policy that will achieve the system's objectives while maintaining agreed upon boundaries. Some Texas systems have established parameters like contribution levels or funding objectives in agreements with sponsors such as collective bargaining or meet and confer agreements.

Example

- **Denton Firemen's Relief and Retirement Fund**. The system and the City of Denton use a Meet and Confer Agreement to establish certain responsibilities and funding goals shared by both parties. For example, the members agree to not raise benefits during the term of the agreement and the city agrees to only adjust contributions based upon an actuarial valuation.[8]

Monitoring and Evaluation

A governing board should periodically review and revise their funding policy to better reflect the system's goals. A regular review policy could be adopted by the board by including a clause detailing the timeline or conditions for re-evaluating the funding policy using updated information from actuarial valuations and experience studies.

A board should proactively monitor its system's financial condition. Monitoring requires that a board continually analyze investment returns, contributions, and benefits. A board can also establish actions to provide the system with a roadmap when it encounters adverse investment returns, unexpected member behavior, or other unforeseen events.

- *Example*~~contribution reductions may only occur if a minimum amortization period is maintained.~~

- **City of Austin Employees Retirement System**. The Benefits and Services Committee will review the policy at least every two years and make recommendations to the COAERS board necessary to maintain progress towards the goals and objectives in this policy.[9]

- **San Antonio Fire & Police Pension Fund**. Actuarial experience studies are completed no less than every five years or at the board's direction. The board will also review the Actuarial Funding Policy in conjunction with the experience review.[10]

IV. Adopting Actions to Address Actual Experience That Diverges from Assumptions

[7] Section 802.2011, Texas Government Code

[8] Meet and Confer Agreement Between the City of Denton and the Denton Firefighters Association, *Denton Firemen's Relief and Retirement Fund.* 24 September 2019, https://www.prb.texas.gov/wp-content/uploads/2023/12/Denton-Funding-Policy.pdf

[9] Funding Policy, *City of Austin Employees' Retirement System.* 2020. https://www.prb.texas.gov/wp-content/uploads/2024/01/2020.09-COAERS-Funding-Policy.pdf

[10] Actuarial Funding Policy, *San Antonio Police and Fire Pension Fund*. 2020. https://www.prb.texas.gov/wp-content/uploads/2023/12/SAFPPF-Funding-Policy.pdf

A funding policy should develop predetermined steps for how a ~~plan~~system should respond to **both positive and negative experiences that differ from the ~~plan's~~system's assumptions**. The following methods can be used to manage funding risk.

Risk-Sharing

A funding policy should identify key risks faced by the ~~plan~~system and how those risks, and their associated costs, will be distributed between the employer and employees. This structure prevents one party from bearing all the risk in a funding policy. Often when there is no formal risk-sharing policy, benefit reductions or cost increases are imposed on employees, retirees, or both after the ~~plan's condition has deteriorated, rather than proactively, in advance, and in a manner transparent to members and stakeholders.[1]~~

~~*Example:* If investment returns~~system's condition has deteriorated, rather than proactively, in advance, and in a manner transparent to members and stakeholders.[11]

There are ~~not as high as projected, the associated costs will need~~multiple methods a system can utilize to ~~be covered by additional contributions or~~implement a formal risk-sharing policy:

Total ADC Driven	**Normal Cost Driven**	**Milestone Driven**
Employee contributions are determined in relation to the ADC rate. Under this system, employees are given the most direct exposure to the system's total experience. Systems can also decide the exact risk sharing ratio (i.e. 50/50, 60/40, etc).[12]	Employee contributions are calculated in relation to the normal cost. This may result in a variable contribution rate. Employees are exposed to less risk due to their contributions not accounting for the system's unfunded liability.[13]	A system keeps employee contributions fixed until certain funding or investment thresholds are met.[14]

Examples:

- **Houston systems**. The three Houston systems (Houston Firefighters' Relief & Retirement Fund, Houston Municipal Employees Pension System, Houston Police Officers' Pension System) have a statutory funding policy that established a target contribution rate and a corridor around that rate. The systems and the city are required to take corrective action, including negotiating benefit

[11] Brainard, Keith, and Alex Brown, *In Depth: Risk Sharing in Public Retirement Plans. National Association of State Retirement Administrators*, January 2019, https://www.nasra.org/content.asp?contentid=124

[12] Keith Brainard and Alex Brown, "In-depth: Risk Sharing Retirement Plans" National Association of State Retirement Administrators. 7-13, December 2018 https://www.nasra.org/files/Spotlight/Risk%20Sharing%20in%20Public%20Retirement%20Plans.pdf

[13] Brainard and Brown, Risk Sharing

[14] Brainard and Brown, Risk Sharing

reductions ~~distributed amongst~~, if the recommended contribution falls outside the corridor. [15, 16, 17]

- **Galveston Firefighters Relief & Retirement Fund.** When the calculated amortization period deviates significantly from the benchmark ADC amortization period, the system and city will work together to implement a contribution rate that is reasonably close to the ADC. The rate increase will be no more than 2 percent of pay, can be phased in with two increases one year apart, and will initially be split equally between the members and ~~the sponsor.~~

[15] Funding Policy, *Houston Firefighters' Relief and Retirement Fund*, 17 December 2019. https://www.hfrrf.org/_files/ugd/d179ef_e3cad5759f124ee59364ccff4f4eb1b6.pdf

[16] Houston Municipal Employees Pension System Funding Policy, *Houston Municipal Employees Pension System*, 19 December 2019. http://www.hmeps.org/assets/hmeps-funding-policy---12-19-19.pdf

[17] Funding Policy, *Houston Police Officers' Pension System*, 12 March 2020. https://www.hpops.org/media/46525/funding-policy-20200312_reformatted.pdf

city.[18]

Contributions

A solution to ensure the ~~plan~~system meets its funding objectives is to require that the actual contribution rate is equal to or exceeds the ADC. If that is not achievable, the funding policy should identify what the trigger should be for a required adjustment to actual contribution rates. If the contributions to the fund are consistently below the ADC, the fund becomes insolvent.[19] Techniques such as the following could be used to help move the actual contribution rate in the proper direction.

Contribution Corridor

Example: If the actual total contribution rate is within 2~~%~~ percent of the ADC, no change is required. However, if the total contribution is more than 2~~%~~ percent *over or under* the ADC, a change in contribution rates is required.

Maximum and Minimum Contribution Rates

Example: If the ADC exceeds a pre-determined maximum contribution rate, the funding policy may require the ~~plan~~system to adopt benefit changes. Conversely, if the ADC drops beneath a pre-determined minimum rate, the funding policy may require certain benefit increases, such as a COLA.

Contribution Smoothing

Examples:

- ~~*Example*:~~ If the actual total contribution rate needs to be increased by 2~~%,~~ percent, the rate could be increased in increments until the total contribution rate meets the ADC. Similarly, if the contribution rate needs to be decreased by 2~~%,~~ percent, the rate may be slowly decreased over time. The funding policy may state that the contribution rate may not increase or decrease by more than a given percentage each fiscal year.

- **Texas County and District Retirement System**. The board sets aside investment reserves at its discretion to offset negative future returns. The reserves are not counted as a part of the participating employer's (district or county) assets until the reserves are used.[20]

While the above techniques can stand alone, they are often included in risk-sharing provisions. The three Houston municipal plans' risk-sharing provisions mentioned in the previous section include contribution corridors. Galveston Fire's risk-sharing provisions include contribution smoothing.

Benefits

[18] Galveston Firefighters' Pension Fund, Funding Policy, 1 February 2023, p. 4, https://galvestonfirepension.com/GAFULF/GAFDCS/Funding_Policy_for_the_Galveston_Firefighters_PensionPOSTWEBSITE.pdf
[19] "The Role of the Actuarial Valuation Report in Plan Funding" *Government Finance Officers Association,* Approved February 28, 2013, https://www.gfoa.org/materials/the-role-of-the-actuarial-valuation-report-in-plan
[20] TCDRS Funding Policy, *Texas County and District Retirement System.* 2015. https://www.tcdrs.org/globalassets/policy-documents/tcdrs-funding-policy.pdf

A funding policy may also establish when benefit adjustments will occur and include provisions that specify how both positive and negative experience will be addressed. ~~Plans~~Systems may allow for increased benefits or an increased COLA as a result of a positive deviation, but ~~plans~~systems will need to ensure they are able to consistently meet the new funding demands of the changes.

Example: The funding policy could require that if sponsor contributions are increased, member benefits must be decreased in some proportional manner. ~~Or~~Alternatively, the policy may include provisions that grant a COLA to retirees if the funded ratio, after the benefit change, remains above a specified percentage. Caps may also be placed on maximum COLAs, or COLAs can be tied to inflation, to manage ~~plan~~system costs.

~~**Examples of Funding Policy Components**~~

- ~~Many pension plans across~~ **City of El Paso Employees Retirement Trust.** Any benefit increase (including COLAs) may be adopted if:
  - The funded ratio of the ~~United States~~system is above 80 percent after the benefit increase, and the decrease of the funded ratio is not more than 1 percent after the benefit increase.

  The system also outlines provisions specifically for COLAs:

  - The maximum amount of a COLA should not exceed the actual increase in the Consumer Price Index since the last COLA was granted.
  - A COLA will only apply to members who have ~~already adopted a~~ been retired for over one year.
  - The board can choose to grant the COLA as a one-time payment or a monthly benefit increase.[21]
- **San Benito Firemen Relief and Retirement Fund.** COLAs are tied to investment returns. The crediting rate for the COLA is lesser of the consumer price index or 100 percent of the five-year smoothed return minus 5 percent, not less than 0 percent, not greater than 4 percent.[22]

Some factors to keep in mind when setting such parameters:

- Evaluating the impact of the plan provision on the amortization period and funded ratio after the plan provision takes effect, including whether the system will still meet is target date to reach full funding.
- Putting thresholds in place such that an increase can take effect only if the amortization period is below a specified threshold and the funded ratio is above a specified threshold after the benefit increases are factored in.
- Assessing whether the benefit increases are paid for by current active members to avoid passing down benefit costs to future generations.

Surplus Management

If a system is consistently funded at a rate above the ADC, there is a stronger likelihood of the system achieving a high funded ratio. A funding policy~~, including several in~~ should include provisions detailing steps to follow if a system achieves full funding. A surplus management policy should include the following elements:

- Reviewing system risk management policies to evaluate their efficacy.
- Evaluating current assumptions to ensure reasonableness.
- Considering what changes should be made to employer and employee contributions (if any) when the system is in a surplus.

[21] City of El Paso Employees Retirement Trust Funding Policy, *City of El Paso Employees Retirement Trust,* December 12, 2019. https://www.eppension.org/documents/fund-overview/Funding%20Policy%20and%20Resolution_19-12-12.pdf?1704385439
[22] San Benito Firemen Relief and Retirement Fund Funding Policy, *San Benito Firemen Relief and Retirement Fund*. December 17, 2019. https://www.prb.texas.gov/wp-content/uploads/2024/01/2019-San-Benito-Firemen-Relief-and-Retirement-Fund-Funding-Policy.pdf

- Working with the sponsor to establish acceptable conditions for possible benefit enhancements, especially permanent ones, and provide accurate estimations for the immediate and long-term costs.[23]

Examples:

- **San Antonio Fire & Police Pension Fund.** If the system is overfunded, the surplus will be amortized over an open amortization period of 30 years.[24]

- **Texas**~~. Below are examples of components from those funding policies.~~ **Municipal Retirement System**. If the system is overfunded, all prior bases are erased, and one surplus base would be established. The asset surplus is used to generate a contribution credit for the year that is projected to remain the same over time and keep the funded ratio constant year over year. This practice reduces contribution rate volatility.[25]

~~Component~~	~~Plan~~	~~Description~~
~~Benefit and Contribution Change Parameters~~	~~South Dakota Retirement System~~	~~The system may not consider **benefit improvements** unless the fair value funded ratio is and will remain after fully funding the cost of the improvement, over 120%.[2] Proposed benefit improvements must be consistent with both the Board's long-term benefit goals and sound public policy with regard to retirement practices.~~
	~~City of Austin Employees' Retirement System~~	~~Employer **contribution** rate reductions should be considered only when annual COLA adjustments are built into funding assumptions and the funded ratio will remain greater than or equal to 105% after the reduction.[3]~~
	~~City of Austin Employees' Retirement System~~	~~A **COLA** may be adjusted only when the adjustment can be financially supported; the funded ratio is ≥ 80% after incorporating the COLA; the amortization period is ≤ 20 years after incorporating the COLA; and the actual employer contribution rate is ≥ the ADC but no more than 18% after incorporating the COLA.[4]~~
~~Contribution Smoothing~~	~~Fort Worth Employees' Retirement Fund~~	~~The contribution rate may not increase more than 2% of pay in one year or 4% in total to account for the ADC increase. If the maximum contribution increase has been applied and the actual contribution is still insufficient, the City Council must consider additional benefit reductions.[5]~~
	~~South Dakota Retirement System~~	~~Should the funded ratio fall below 100% or if the fixed contribution rates are not sufficient to meet the actuarial~~

[23] "Core Elements of a Funding Policy for Governmental Pension and OPEB Plans" *Government Finance Officers Association*, approved March 23, 2023, https://www.gfoa.org/materials/core-elements-of-a-funding-policy

[24] Actuarial Funding Policy, *San Antonio Police and Fire Pension Fund*. 2019. https://www.prb.texas.gov/wp-content/uploads/2023/12/SAFPPF-Funding-Policy.pdf

[25] Actuarial Funding Policy, *Texas Municipal Retirement System*, 2019. https://www.prb.texas.gov/wp-content/uploads/2023/12/TMRS-Funding-Policy.pdf

~~Component~~	~~Plan~~	~~Description~~
~~Risk-sharing~~		~~requirement, the system is required to recommend corrective action, including benefit or contribution changes, in its annual report to the Legislature and Governor.~~[6]
	~~Houston Firefighters' Relief & Retirement Fund~~ ~~Houston Municipal Employees Pension System~~ ~~Houston Police Officers' Pension System~~	~~The 3 Houston plans have a statutory funding policy that established a target contribution rate and a corridor around that rate. The plans and the City are required to take corrective action, including negotiating benefit reductions, if the recommended contribution falls outside the corridor.~~[7]
	~~Galveston Employees Retirement Plan for Police~~	~~Beginning January 1, 2025, if the actuarial valuation recommends an ADC that exceeds the aggregate (employee and City) contribution rate, the excess contribution will be split equally as a percentage of pay between the City and employee contribution rates.~~[8]
~~Risk-sharing~~	~~Maine Public Employees~~	~~COLAs are tied to investment returns. Reductions to COLAs may occur after severe market losses. The reductions will be removed once markets improve.~~[9]
	~~Wisconsin State Retirement System~~	~~Retirement annuities are adjusted using a formula that factors in investment returns.~~[10]
	~~Pennsylvania State Employees'~~ ~~Pennsylvania Public School Employees'~~	~~The employee contribution rate increases or decreases based on investment plan returns.~~[11]

Questions Systems and Sponsors Should Discuss During Funding Policy Development

The process of developing a funding policy presents an opportunity for a system's board of trustees to have an open, robust discussion of their priorities regarding the funding needs of the ~~plan~~system. The policy should be created with input from the system's sponsoring governmental entity whenever possible. The following checklist represents a set of fundamental questions trustees should consider during funding policy development but is not exhaustive.

- ☐ **Introduction**
  - ☐ What is the purpose of the policy? What are we trying to achieve in this policy?
  - ☐ How often should we review the funding policy?
  - ☐ How is the ~~plan~~system governed? What statutes or ordinances govern ~~plan~~system funding?
  - ☐ What are our funding priorities?
- ☐ **Funding ~~Objectives~~objectives**
  - ☐ ~~Over what time period will we~~What is the target date to achieve 100~~%~~ percent funding?
  - ☐ How will we measure progress towards full funding? How will we measure if our funding objectives are being met?
- ☐ **Actuarial ~~Methods~~methods**
  - ☐ What valuation methods do we use to determine the ADC (or benchmark ADC)?
  - ☐ How frequently should we calculate the ADC (or benchmark ADC)?
  - ☐ How will we ensure we are meeting the ADC (or benchmark ADC)?
  - ☐ Will we employ any asset smoothing methods? If so, what are they?
  - ☐ What measures do our system and sponsor need to take to achieve 100~~%~~ percent funding?
  - ☐ How should we prepare for unanticipated changes?
  - ☐ How frequently will actuarial experience studies occur?
  - ☐ How is the interest discount rate determined?
  - ☐ Is a negative amortization period ever acceptable, and if so, under what conditions?
- ☐ **Plan for ~~Achieving Funding Objectives~~achieving funding objectives**
  - ☐ How much money do we need today to pay for future promises?
  - ☐ Will we use contribution smoothing methods? If so, what are they?
  - ☐ What conditions must be met for contribution decreases to occur?
- ☐ **When to allow benefit increases**
  - ☐ What conditions must be met to adopt benefit increases or cost-of-living adjustments?
  - ☐ ~~What conditions must be met for contribution decreases to occur?~~
  - ☐ What will the impact of the benefit increase be on the amortization period and funded ratio?
  - ☐ Will the system still meet its target date to achieve full funding?
  - ☐ Will the resulting amortization period be less than the average remaining future service for current active members?
  - ☐ Will the resulting funded ratio be above the system's desired threshold?
- ☐ **Contribution distribution between members and city**
  - ☐ Will members contribute appropriately for the level of benefits received?

- ☐ Is there a target employer normal cost as percent of pay (total normal cost percent less employee contribution percent)?

☐ **Risk ~~Management Policy~~management policy**

- ☐ What actions will we take should actual investment returns be less than the assumed investment returns used in the actuarial valuation? Should we consider action after a certain margin or threshold (positive or negative)?
- ☐ What actions will trigger changes to our assumptions at the next actuarial valuation?
- ☐ What conditions would trigger a contribution increase and what conditions must be met for contributions to return to their normal rate?
- ☐ Could we increase contributions temporarily?
- ☐ What conditions would trigger a review of our system's funding policy?

☐ **Surplus management policy**

- ☐ What actions will we take should the system receive funding over the ADC?
- ☐ What actions will we take when the system exceeds 100 percent funding?

~~[1] Brainard, Keith, and Alex Brown, *In Depth: Risk Sharing in Public Retirement Plans. National Association of State Retirement Administrators*, January 2019, https://www.nasra.org/content.asp?contentid=124~~

~~[2] South Dakota Retirement System, *SDRS Funding and System Management Policies*, https://sdrs.sd.gov/docs/SDRSFundingPolicy.pdf.~~

~~[3] City of Austin Employees' Retirement System Benefits & Services Committee, *City of Austin Employee's Retirement System Board Approved Policy: Funding Policy and Guidelines*, 20142014. https://www.coaers.org/Portals/0/Resources/Publications/2-c%20F-2%20Funding%20Policy%20and%20Guidelines%202014-11-25.pdf?ver=2015-06-17-102341-677.~~

~~[4] *ibid.*~~

~~[5] Employees' Retirement Fund of the City of Fort Worth, *Annual Actuarial Valuation*, 19 April 2019, p. 9, https://fortworthretirementtx-investments.documents-on-demand.com/?l=f419ce743442e5119795001fbc00ed84&d=64e81193956ae911a2cd000c29a59557.~~

~~[6] South Dakota Retirement System, *SDRS Funding and System Management Policies*, https://sdrs.sd.gov/docs/SDRSFundingPolicy.pdf.~~

~~[7] Retirement Horizons Incorporated, *City of Houston HMEPS Pension Reform Cost Analysis*,15 March 2017, https://www.houstontx.gov/pensions/public/documents/rhi-HMEPS.pdf.~~

~~[8] H.B. 2763, 86th Texas Legislature, Regular Session, 2019, https://capitol.texas.gov/tlodocs/86R/billtext/pdf/HB02763F.pdf#navpanes=0~~

~~[9] Maine Public Employees Retirement System, *Summary: PLD Plan Changes*, www.mainepers.org/Pensions/PLD%202018-Summary.htm.~~

~~[10] Brainard, Keith, and Alex Brown, *Shared-Risk in Public Retirement Plans. National Association of State Retirement Administrators*, June 9, 2014, p. 2, https://www.nasra.org/files/Issue%20Briefs/NASRASharedRiskBrief.pdf; The Pew Charitable Trusts, *Cost-Sharing Features of State Defined Benefit Pension Plans: Distributing Risk Can Help Preserve Plans' Fiscal Health*, January 2017, p. 8, https://www.pewtrusts.org/-/media/assets/2017/05/definedbenefitplansreport.pdf.~~

~~[11] *The Pew Charitable Trusts, Cost-Sharing Features of State Defined Benefit Pension Plans: Distributing Risk Can Help Preserve Plans' Fiscal Health, January 2017, p. 2, https://www.pewtrusts.org/-/media/assets/2017/05/definedbenefitplansreport.pdf.*~~

Texas Pension Review Board

Sample Funding Policy

Section 802.2011, Texas Government Code ~~§802.2011~~ requires the governing board of a Texas public retirement system ~~to "~~and, if the system is not a statewide system, its sponsor to jointly develop and adopt ~~a~~the same written funding policy ~~that details the governing body's~~and timely revise the policy to reflect any significant changes, including those made because of a funding soundness restoration plan ~~for achieving a funded ratio of the system that is equal to or greater than 100 percent."~~. The process of developing a funding policy presents an opportunity for system trustees and their sponsor's governing body to have an open, robust discussion of the ~~plan's~~system's funding needs to establish ~~the board's~~ funding priorities. ~~The policy should be created with input from the system's sponsoring governmental entity whenever possible.~~

The *Guidance for Developing a Funding Policy*~~, adopted by the Pension Review Board (PRB) on October 17, 2019,~~ includes a checklist of potential questions for trustees to consider during funding policy development and, recognizing the wide variety of governing structures throughout Texas, does not attempt to provide a one-size-fits-all approach. However, it should be noted that more than 50 percent of Texas plans currently contribute on a fixed-rate basis, and the governing boards have limited discretionary authority over either benefit or contribution changes. At the request of stakeholders, the PRB developed the following sample funding policy with this governance structure in mind.

This sample funding policy is provided as an example of what a funding policy may look like and is not intended to indicate the specific methods outlined below are the best methods for any given retirement system, nor to imply an endorsement of these specific methods over other actuarial best practices.

Introduction

This funding policy outlines a formal long-term strategy for financing the pension obligations accruing under the ***(system name)*** with the goal of achieving a funded ratio that is equal to or greater than 100~~%,~~ percent, as required by Section 802.2011, Texas Government Code ~~§802.2011~~.

This policy is limited by the authority granted to the board of trustees under ***(governing statute~~).~~)*** and was created in collaboration with ***(sponsoring entity name).*** Therefore, this document creates a framework for proactively managing risks by outlining how the board will approach future changes to benefit and contributions levels under different conditions. In the event this policy conflicts with any statutory language, the statute shall prevail.

Funding Priorities

The primary funding priorities are to:

1. Ensure the security of accrued benefits by making certain contributions and assets are sufficient to pay benefits when due.

2. Limit the volatility of contribution rates for both the members of ***(system name)*** and ***(sponsoring governmental entity)***, consistent with other funding objectives.
3. Ensure that each generation of members and employers incurs the cost of benefits for the employees who provide services to them, rather than deferring those costs to future members and employers;
4. Provide a reasonable margin for adverse experience to help offset risks.
5. Continue progress of systematic reduction of the ~~Unfunded Actuarial Accrued Liability~~unfunded actuarial accrued liability.

Funding Objectives

The system's funding objectives are:

- A funded ratio of 100~~%~~ percent or more by ***(date)***.
- A fully funded system with no unfunded liabilities.

Actuarial Methods

The board has adopted the following actuarial methods for purposes of actuarial valuations and the determination of the benchmark ADC:

I. Cost Method

The individual entry age normal actuarial cost method.

II. Asset Smoothing

A five-year asset smoothing period where 20~~%~~ percent of any gain or loss is recognized in each subsequent year.

III. Amortization Policy

The amortization payment will be calculated as a level percent of payroll, as follows:

The amortization payment will be calculated as a layered closed-period amortization method with a single 30-year closed-period amortization base established for the initial UAAL base and a single 20-year closed-period amortization base established for each ~~year's~~year's realized gains or losses thereafter.

Given the current assumed rate of return of X~~%~~ percent and payroll growth of Y~~%,~~ percent, the amortization payment is expected to result in negative amortization if the single equivalent ~~amortization~~funding period is above Z years. The board's goal is to eliminate negative amortization as quickly as possible and ultimately maintain a contribution rate above the threshold that results in negative amortization.

Actuarial Assumptions Guidelines

A comprehensive experience study will be completed at least once every ~~5~~five years with possible review of individual assumptions more frequently, based on advice from the system's actuary. All assumptions will be determined based on actuarial standards of practice taking into account both actual experience and reasonable future expectations.

Actuarially Determined Contribution Benchmark

This policy has outlined a benchmark ADC for establishing a path towards achieving the goal of 100~~%~~ percent funding. The following will trigger the board to act to adjust or recommend adjustments to benefit and/or contribution levels.

The board will notify ***(sponsoring governmental entity)*** upon receipt of ~~2~~two actuarial valuations showing the actual contribution is more than 2~~%~~ percent over or under the ADC. In such case, a change in contribution rates is recommended. If the actual rate is within 2~~%~~ percent of the ADC, no change is required.

Consideration of Plan Modifications

Guidelines for Future Reductions in Contributions

The board believes it is best to consider supporting a reduction in the actual employer contribution rate only when the following conditions exist:

A. The funded ratio is at least 105~~%;~~ percent.

B. Benefit reductions for current active members implemented within the last 10 years have been reinstated~~;~~.

C. Regular cost of living adjustments are built into funding assumptions~~; and~~.

D. The total contribution rate is not less than the ~~Normal Cost~~normal cost.

Guidelines for Future Benefit Enhancements

For all other benefit enhancements not specifically mentioned above, the board believes it is best to support such enhancements only when the following conditions exist:

A. Annual cost of living adjustments are built into funding assumptions~~; and~~.

B. The ~~funded ratio~~funding period is less than or equal to ~~or greater than 120%~~10 years after incorporating the benefit enhancement~~, and~~.

C. The actuarially determined contribution rate is less than or equal to the actual contribution rate.

Surplus Management Policy

In the event that the system achieves a funding ratio equal to or greater than 120 percent for at least two actuarial valuations, the board may consider the following actions:

A. Review system risk management policies for efficacy.
B. Evaluate current assumptions for reasonableness.
C. Consider changes to employer and employee contributions.
D. Work with ***(sponsoring entity)*** to review guidelines for benefit enhancements and implement potential changes.

Risk-Sharing Mechanisms

The board has determined that the key risk facing the system is when actual experience diverges from actuarial assumptions, resulting in actuarial losses. The following methods for sharing risk between the members and the sponsoring government will be considered/recommended:

- The actual contribution will be compared to the ADC each year. If the actual rate is less than the ADC rate for 2 consecutive years, the sponsor and employee contributions will be increased by no more than 2~~%~~ percent of pay in one year or 4~~%~~ percent total. The increase will be split 60~~%~~ percent sponsor and 40~~%~~ percent employees. If the maximum contribution increase has been applied and the actual contribution is still insufficient, the board shall recommend corrective action, including benefit or contribution changes, to the members and the sponsoring governmental entity.
- COLAs are tied to investment returns. Crediting rate is the lesser of CPI or 100~~%~~ percent of the 5-year smoothed return minus 5~~%,~~ percent, not less than 0~~%~~ percent or greater than 4~~%.~~ percent.

Review of Funding Policy

This policy may be amended from time-to-time to reflect changes in other board policies, emerging best practices for public defined benefit pension plans, prevailing opinions of future board members, and suggested changes by system stakeholders. The board and sponsoring entity will review the policy at least every two years and make recommendations if necessary to maintain progress towards the system's goals and objectives. Suggested changes to the policy may be submitted to the board in writing for consideration at future meetings.

This ~~Policy~~policy was adopted on ***(date)***.

(NAME), System Official   (NAME), City Official

Item 8: Lump Sum Guidance

David Fee

Summary

- Purpose
- Actuarial Equivalence
- Reasonable assumptions
  - Reasonable interest rate
  - Reasonable timeline to update mortality table
- Administrative Practices
  - Relative values
  - Spousal consent
- Next Steps

Purpose

- Inform and remind pension systems
  - Actuarial equivalence plan provisions are often not regularly reviewed and updated
- Provide guidance
  - Pension systems offering lump sums could benefit from a common set of reasonable suggestions and principles
- Provides a resource for systems with suggestions and items to consider

Actuarial Equivalence

- Two components
  - Interest rate
  - Mortality table
- Affect all optional forms, but lump sums especially
  - Lump sums are paid far in advance of other payment forms
  - Both interest and mortality effects are inflated the farther the payment timing is moved from the original date
  - One guaranteed payment at age 65 is very different than 300 potential payments spread over 25 years between age 65 and age 90
- Both can become outdated if not reviewed and updated regularly
  - One Texas public pension system uses a table from 1971
  - Several use tables from 1984
  - Most use tables released in the last decade in their actuarial valuations

Actuarial Equivalence: Reasonable Assumptions

- Reasonable assumptions are important for both the pension system and its members
- To the extent the optional form conversion uses reasonable assumptions:
  - The pension system will not incur gains or losses regardless of the form of payment chosen by the member
  - The member will receive a benefit that is arguably equal in value to the value of the normal form of payment
- There is no agreed-upon definition of “reasonable” actuarial equivalence
- Guidance provides potential definitions of reasonable interest rates and mortality tables

Actuarial Equivalence: Reasonable Assumptions

Actuarial assumptions that approximate the SYSTEM's future experience

Member's choice of one optional form over another will not cause losses for the SYSTEM

Actuarial assumptions that approximate the MEMBER's future experience

Member's choice of one optional form over another will not cause losses for the MEMBER

Reasonable Interest Rate

- A reasonable interest rate will be no higher than the system's best estimate of future investment returns used in the actuarial valuation
  - It is not reasonable to expect the member to achieve an investment return that exceeds the return of the pension system's professionally managed portfolio
- Should the system choose an interest rate below the system's best estimate of future returns
  - The system should take steps to understand the cost to the system of various optional forms of payment

Reasonable Timeline to Update Mortality Table

- Pension systems should review and consider updating this plan provision at least once per decade
  - New widely adopted mortality tables typically come out approximately every 10 years
  - Retiree expected lifetimes grow over time
  - Outdated mortality tables underestimate the number of pension payments under the normal form annuity
  - The underestimation results in smaller lump sums

Administrative Practices

- Two administrative practices are required by IRS for private pensions but not for Texas public retirement systems.
  - Disclosure of relative values
    - Prospective retirees face a difficult decision when presented with various optional forms.
    - This decision requires a substantial amount of information.
  - Spousal consent
    - When a prospective retiree chooses a payment form that does not include payments continuing to the spouse after the member’s death, the spouse is greatly affected by this decision.

Relative Values

- The system should consider including some or all of the following in optional forms election paperwork:
  - The interest rate and mortality assumptions used to calculate the options
  - A statement that the various options may not be of equal value
  - If the interest rate and mortality assumptions differ substantially from those used in the actuarial valuation, the relative value of each option if the valuation assumption had been used.

Spouse Approval

- The best practice is to require the spouse’s signature for acknowledgement and approval of the member’s choice.
  - For any payment form that does not include payments that continue to the spouse after the member’s death.
  - If not required, the spouse may never be informed they are not covered after the member’s death.
  - Per Texas Administrative Code, ERS requires spousal consent for such payment forms.

Next Steps

- Incorporate committee input.
- Invite stakeholder comments and incorporate any feedback.
- Present to the full board at July 25 meeting for possible approval.

TEXAS PENSION REVIEW BOARD

Guidance for Calculating and Administering Lump Sums

(Adopted TBD)

Overview

A pension system may offer its members a choice among various optional forms of payment including the option of taking a full or partial lump sum. When providing optional forms of payment, the system should include plan provisions and administrative practices that help members and their spouses recognize the differences in these optional forms of payment. An optional form of payment can have a significant impact on the ultimate level of benefits received by members and their spouses. An effort should be made to help members make a fully informed decision, especially regarding lump sum benefits.

The following guidance provides more detail on these administrative practices and plan provisions, which can become outdated if not reviewed regularly. This guidance applies to all optional forms of payment but is especially important for lump sums, **where a single payment is traded for a lifetime of payments.**

Lump sums work best for both the plan sponsor and plan members when the definition of actuarial equivalence and administrative practices are reviewed and updated regularly. [1]

Components of Actuarial Equivalence

The pension plan document specifies how to convert the normal form annuity into other optional forms of payment. The specifications will include **an interest rate and mortality table, which together are used to determine actuarial equivalent forms of payment**. To the extent that the conversion uses reasonable assumptions:

- the pension system will not incur gains or losses regardless of the form of payment chosen by the member and
- the member will receive a benefit that is arguably equal in value to the value of the normal form of payment.

Actuarial equivalence assumptions that approximate the system's future experience will help ensure that a member's choice of one optional form over another will not cause losses for the system. Additionally, actuarial equivalence assumptions that approximate the member's future experience will help ensure that a member's choice of one optional form over another will not cause losses for the member.

[1] For example, the lawsuit *Whetstone v. Howard University et al* filed in August 2023 alleges the use of "outdated actuarial assumptions" used to calculate optional payment forms.

At this time there is no agreed-upon definition of "reasonable" actuarial equivalence, or even whether public pension systems must be expected to use a "reasonable" definition; however, the sections below offer potential definitions of a reasonable interest rate and reasonable mortality table.

I. Interest Rate

Because it is not reasonable to expect the member to achieve an investment return after retirement that exceeds the return of the pension system's professionally managed portfolio, **a reasonable interest rate will be no higher than the system's best estimate of future investment returns that is used in the actuarial valuation**.

When a pension system uses an interest rate higher than their best estimate of the system's future investment returns, the plan sponsor benefits financially to the member's detriment when the member chooses a lump sum option. Conversely, should the system choose an interest rate below the system's best estimate of future returns, the system should take steps to understand the cost to the system of lump sum payments. When interest rates that are different from the system's best estimate of future investment returns are used to determine other actuarial equivalent forms of payment, the system should understand if these assumptions are expected to generate gains or losses.

II. Mortality Table

Because retiree expected lifetimes have only grown over time, an outdated mortality table will generally underestimate the number of monthly pension payments expected to be paid to a member under the normal form annuity, causing lump sums to be smaller than they would if calculated with updated expected retiree lifetimes. When systems use outdated mortality tables, the system benefits financially to the member's detriment when the member chooses a lump sum option.

New widely adopted mortality tables typically come out approximately every 10 years. **Pension systems should review and consider updating this plan provision at least once per decade to align with typical timeframes for mortality table updates.**

<u>Administrative Practices: Disclosures and Transparency</u>

Two administrative practices that are required by the Internal Revenue Service for private pensions but are not required for all Texas public pension systems include relative value statements and spousal consent requirements. [2,3]

The system should consider including statements regarding the relative value of each option and requiring spouses to approve any optional form that does not include payments continuing after the prospective retiree's death.

Prospective retirees presented with various optional forms of payment face a difficult decision that requires a substantial amount of information. Should the prospective retiree choose an optional form of

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[2] 26 C.F.R. Section 1.417(a)(3)-1(c)(2)

[3] (Internal Revenue Code) 26 U.S.C. Section 417(a)(2)

payment that does not include payments continuing to the spouse after the member's death, the spouse will also be greatly affected by the decision.

III. Relative Values

When presenting the prospective retiree with the optional forms of payment, the system should consider including some or all of the following in the benefit election paperwork:

- The interest rate and mortality assumptions used to calculate the options
- A statement that the various options may not all be of equal value
- If the interest rate and mortality assumptions differ substantially from those used in the actuarial valuation, the relative value of each option if the valuation assumptions had been used
    - For example, the lump sum may be worth 75 percent of the normal form annuity. The system's actuary can calculate these percentages.

IV. Spouse Approval

For annuity and lump sum optional forms of payment that do not include payments that continue to the spouse after the death of the member, the best practice is to require the spouse's signature for acknowledgement and approval of the member's choice. For example, by rule the Employees Retirement System of Texas requires spousal consent for such payment forms.[4]

If the spouse's signature is not required for approval, the spouse may not ever be informed that they are not covered after the member's death.

[4] 34 T.A.C. Section 73.29