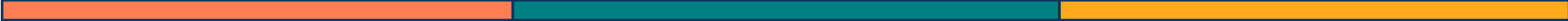


Texas Pension Review Board: Interim Charges #1 and #3



House Committee on Pensions, Investments
& Financial Services
August 16, 2022





Charge #1

Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 87th Legislature.

House Bill 3898



Summary

- **Charge #1—HB 3898 Implementation**
 - Funding Soundness Restoration Plans
 - Overview
 - Rulemaking
 - Investment Practices and Performance Evaluation and Funding Policy
 - Overview
 - Guidance Updates
- Resources



Funding Soundness Restoration Plans (FSRPs)

- Created by HB 3310 (84R) in 2015 to help ensure systems can meet their long-term obligations
 - Systems would create a plan to improve their funding status if funding period higher than maximum over time
- Requirements updated in 2021
 - Maximum funding period reduced; additional triggers created
 - More direct sponsor involvement and tied to funding policy requirement
 - Revised FSRP requirement strengthened to prevent repeated, ineffective revisions
 - More time to create FSRP, shorter time to reach target
 - Additional changes to process and material requirements



FSRP Proposed Rule Summary

- **General:** Applicability, definitions, etc.
- **Member Communication:** Valuation that puts a system at risk of an FSRP would prompt the requirement to notify members in the annual report.
- **Legacy FSRPs:** Helping ensure a smooth transition for systems with FSRPs prepared under the old law.
- **New FSRPs:** Clarifying the necessary documentation for submission and progress updates, timelines, voluntary FSRPs, and qualification for revised FSRP exemption.



Rulemaking Timeline & Stakeholder Feedback

- January—Initial rule concepts to PRB Actuarial Committee
 - Posted initial concepts for stakeholder feedback
- February—committee concepts to the full board
 - Sent updated concepts to stakeholders for feedback
- May 2022—Initial draft rules to PRB Actuarial Committee
- July 2022—PRB meeting; Draft rules presented to board to approve before posting; **Proposed rules posted in July 29th *Texas Register*.**
 - August 2022: Official public comment period
- October 2022—Board reviews comments on posted rules; final approval



Investment Practices and Performance Evaluations (IPPEs)

- Created by SB 322 (86R) to improve investment practices
- Systems of at least \$30 million in assets must have an independent firm:
 - Evaluate the investment practices and performance
 - Recommend ways to improve the investment policies, procedures, and practices
- Requirements updated in 2021
 - Added additional disclosure requirements about experience of evaluators, conflicts of interest, and reasons for not including recommendations
 - Added formal review-and-comment process
 - Sponsor may help pay the cost, and current investment consultants can be hired to prepare a system's IPPE



IPPE & Funding Policy Guidance Updates

- Staff is currently in the process of updating the *Informal Guidance for Investment Policy and Performance Evaluations* to reflect the statutory changes in HB 3898.
 - Draft has been sent out to systems for stakeholder feedback to be presented at the Oct. PRB meeting.
- Planning to update the *Informal Guidance for Systems Developing a Funding Policy* next.

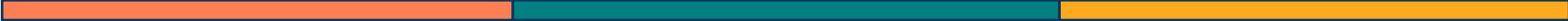


Resources

- FSRP and rulemaking resources:
<https://www.prb.texas.gov/actuarial/funding-soundness-restoration-plan-fsrp/>
- Funding policy information:
<https://www.prb.texas.gov/actuarial/funding-policy/>
- Investment Practices and Performance Evaluations:
<https://www.prb.texas.gov/investments/ippe/>

www.prb.texas.gov
512-463-1736





Charge #3



Review the Texas Local Fire Fighters Retirement Act (TLFFRA) to ensure proper governance and financial oversight. Examine whether the Pension Review Board has proper oversight and authority to implement necessary corrective measures.



Summary

- **Charge #3—TLFFRA Governance and PRB Oversight**
 - Background
 - Research & Previous Legislative Changes
 - Intensive reviews
 - Funding policies
 - Funding Soundness Restoration Plans
 - Minimum Education Training Program
 - Investment reporting
 - Asset Pooling
 - Governance Study
- Resources



Background

- Intro to the Pension Review Board
- Texas Public Retirement System Landscape
- Texas Local Firefighters Retirement Act (TLFFRA)



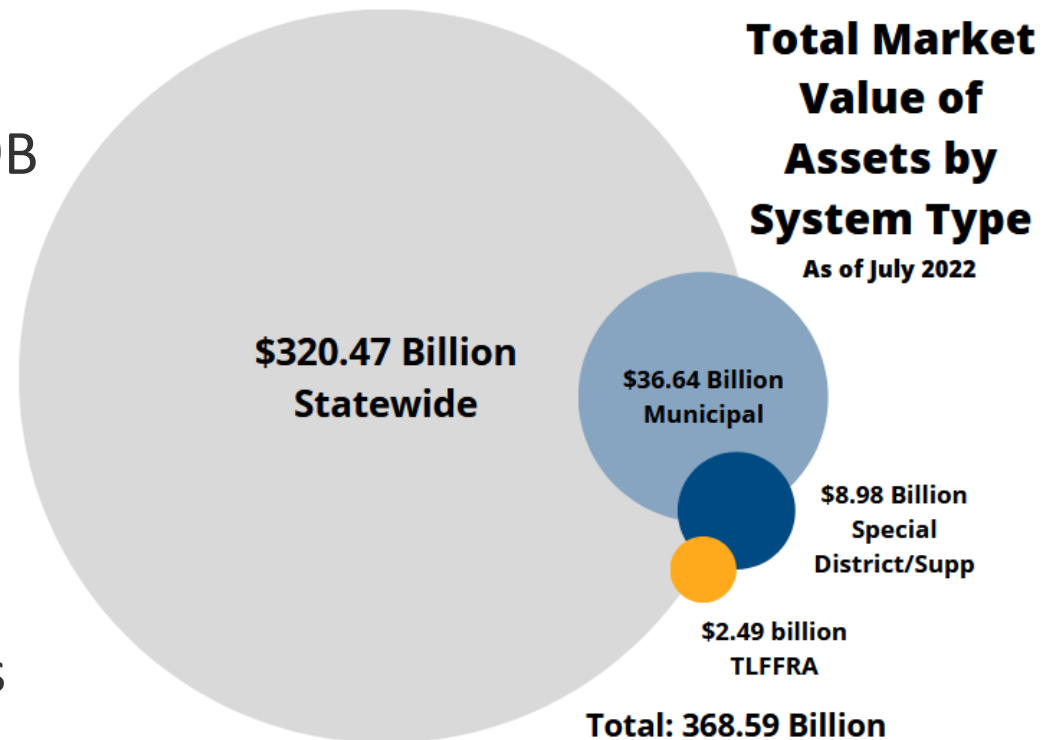
PRB Overview

- The PRB provides information and recommendations to help ensure that Texas public retirement systems are properly managed and actuarially sound.
- Oversight vs regulatory: PRB is an oversight entity
 - Agency provides technical assistance, collects and reviews reports, and provides data and research to stakeholders.
 - The board offers guidelines for best practices and works with systems to encourage statutory compliance.
 - If necessary, the PRB can use a subpoena or Writ of Mandamus to get reports, but it is a rarely-used last resort.
 - The PRB does not manage systems; benefits, contributions, investments, etc. are based on factors like governing statute, sponsor decisions, and individual choices of the system board and membership.



Texas Public Retirement System Landscape

- 347 public retirement systems
 - 100 actuarially funded defined benefit plans with total assets of approx. \$369B
 - 7 statewide
 - 17 municipal
 - 42 local firefighter (TLFFRA)
 - 34 district/supplemental
 - 166 defined contribution plans
 - 81—volunteer TLFFRA plans



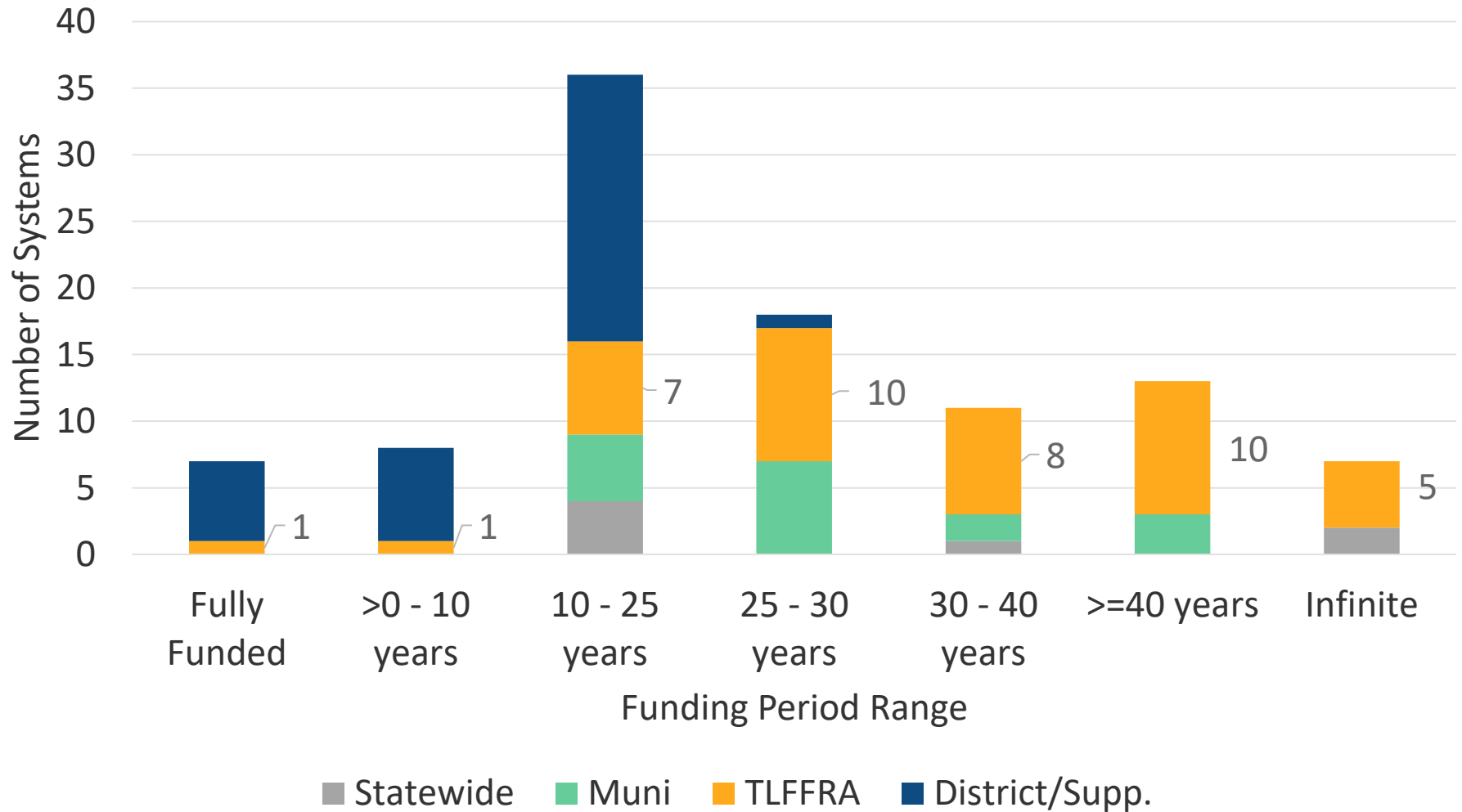
Texas Local Fire Fighters Retirement Act

- Originally Firemen's Relief and Retirement Act in 1937. Restated under Article 6243e, Vernon's Civil Statutes, as Texas Local Fire Fighters Retirement Act (TLFFRA) in 1989.
 - Includes instructions for paid/part-paid and volunteer fire departments
- Some aspects mandated in statute.
 - composition of seven-member board of trustees
 - sponsor contribution minimum—lesser of 12% of payroll or match member rate
- Other aspects controlled locally.
 - Prospective benefit and member contribution changes made by system board and approved by actuary & membership vote

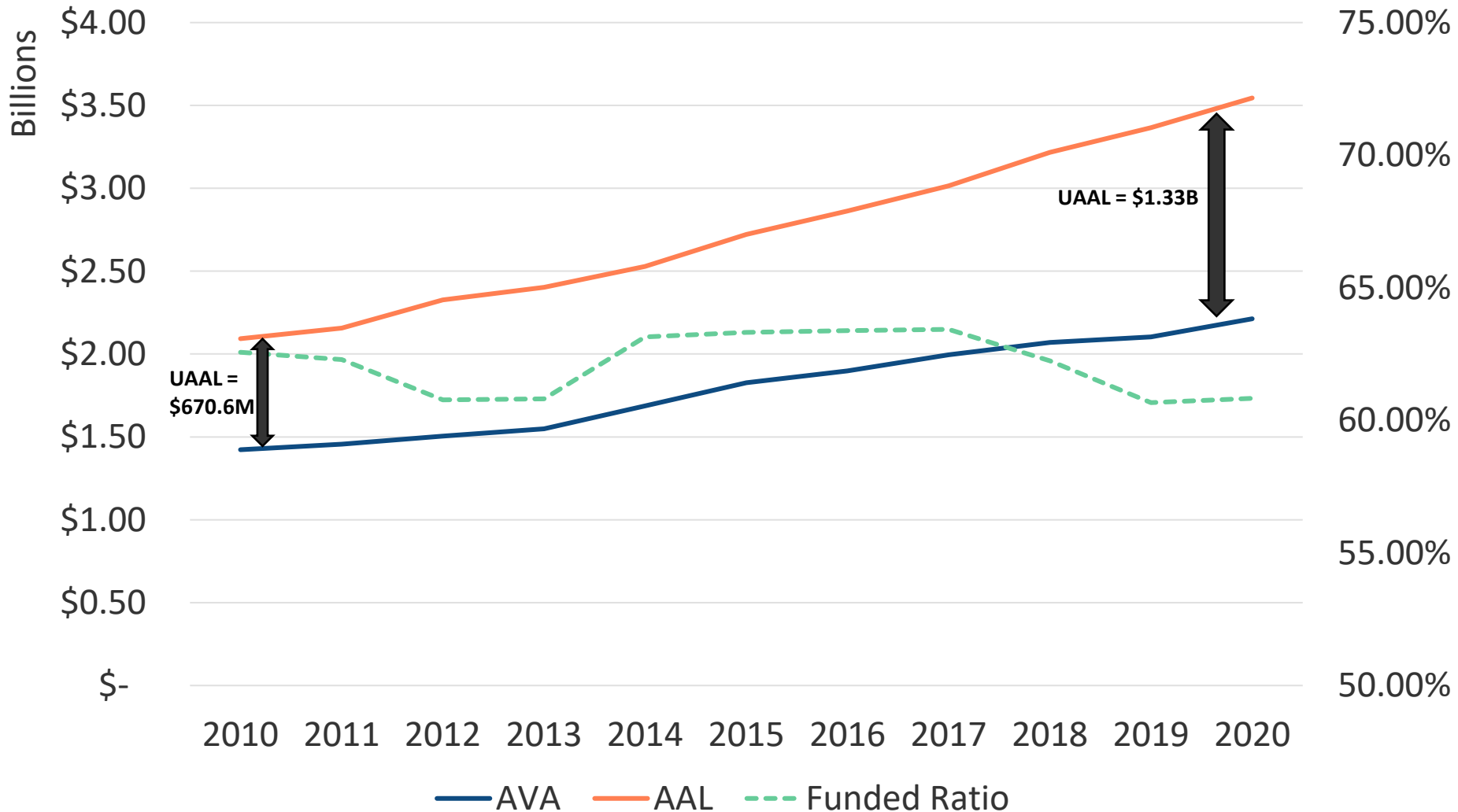




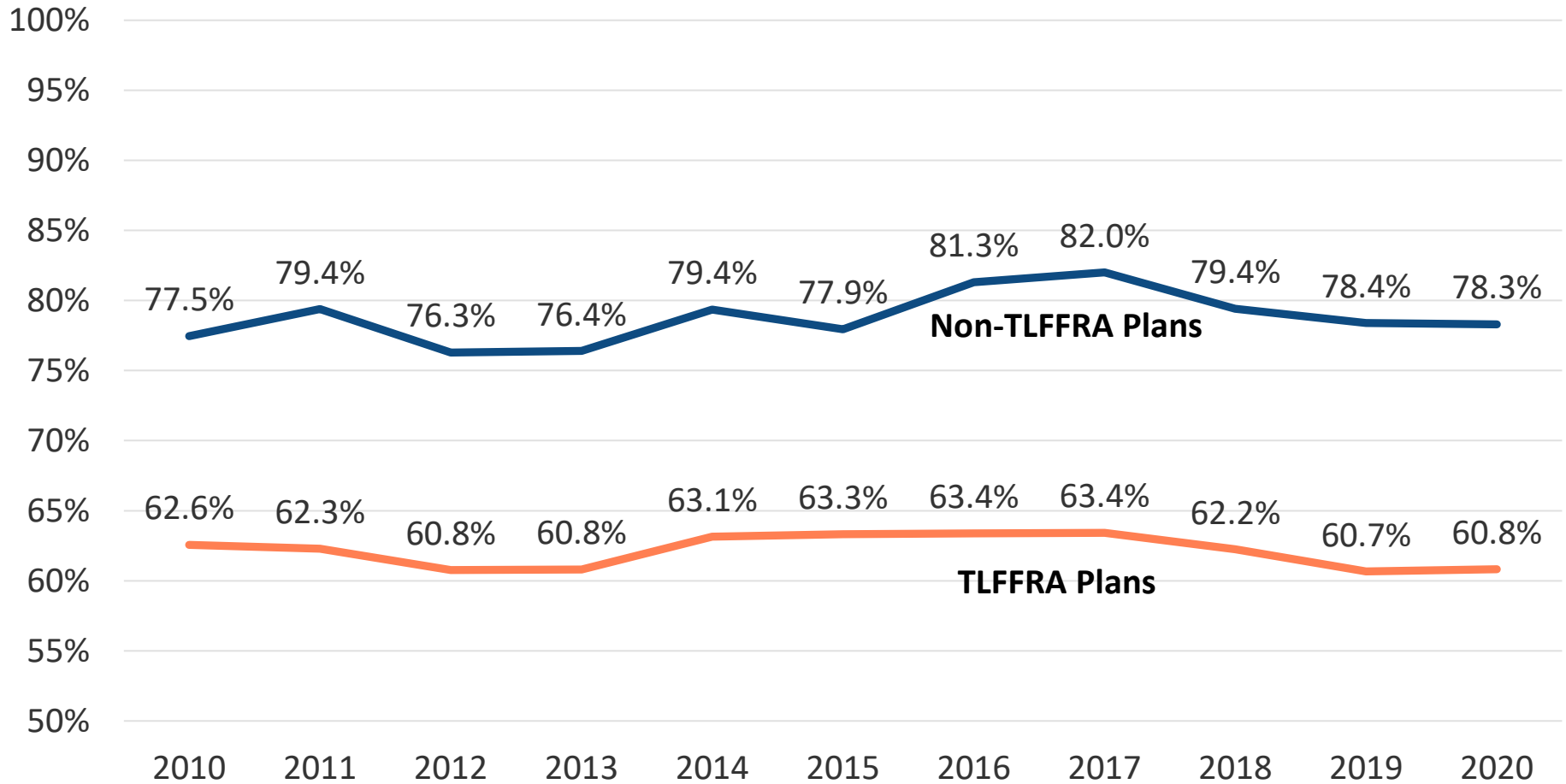
Latest Funding Period By Plan Type



Asset-Liability and Funded Ratio of TLFFRA Funds



Average Funded Ratio for Texas Retirement Systems by Year



Research & Previous Legislative Changes

- Intensive reviews
- Funding policies
- Funding Soundness Restoration Plans
- Minimum Education Training Program
- Investment reporting
- Asset Pooling Study
- Governance Study



Intensive Review Overview

January 2018	April 2018	October 2018	October 2019	November 2021	Current
Galveston Police Greenville Fire	Beaumont Fire Marshall Fire	Longview Fire Orange Fire Irving Fire	Odessa Fire Paris Fire	Midland Fire	Wichita Falls Fire

- In-depth examination of a system's issues and contributing factors, with recommendations to address problems.
 - TGC §801.202(2) instructs PRB to conduct intensive studies of potential or existing problems that threaten actuarial soundness.
- Systems selected based on actuarial health, compared by several factors including assumptions, amortization period, and depletion dates.
- 10 Intensive Reviews completed since 2018; 9 TLFFRA systems
 - Wichita Falls Firemen's Relief and Retirement Fund review in progress



Issues Identified and Linked to Governance

- Growing unfunded liability and low funded ratio
 - Chronically insufficient contributions
 - Investment returns not meeting assumptions
- Governance design may be slow to react or otherwise make it difficult to make necessary improvements.
 - Sponsor contribution and benefit decisions made separately.
 - Sponsor/plan relationship
 - Ex. Sponsor may be reluctant to increase contributions due to separate benefit decisions controlled by fund and members.
 - Ex. Poor communication between system and sponsor creates a disconnect between system decisions and city's collective bargaining negotiations.
 - Lack of stated policies and goals for different aspects of plan administration, such as criteria for enhancing benefits.

Updates & Highlights: Longview & Irving

- PRB conducted intensive reviews for both in 2018.
- Pension Obligation Bonds (POBs) to pay UAAL
- POBs linked to agreement between system and sponsor
 - Longview: MOU created along with planned \$43 million POB issuance to ensure plan changes do not prevent the system from reaching full funding or make assumption changes.
 - Irving: City issued \$80 million in POBs but proceeds go towards reducing the UAAL. ADC changes due to benefit increases must be paid with member contributions.

Updates & Highlights: Orange Fire

- PRB conducted intensive review in 2018.
 - Recommended review of investment expenses and changing funding policy to include actuarially determined contributions (ADC) and risk-sharing.
 - System and sponsor have increased contributions, reduced investment consultant costs, and lowered payroll growth assumption.
- Triggered an FSRP requirement in 2019 and completed the requirement by reducing funding period to 20.7 years.
 - Active members pay 13.8% of pay, which is higher than the cost of their benefits. City contributes 18.8% of pay, up from 14.5% in 2019.
 - Contributions cover cost of current retirees, but benefits for active members are not being pre-funded at all.
- Sought sponsor input on funding policy.



Updates & Highlights: Odessa Fire

- PRB conducted Intensive Review in 2019
 - City of Odessa requested the review.
 - Fund had a depletion date, and it was effectively operating as a pay-as-you-go plan rather than pre-funded.
- Several changes since:
 - City contributions increased from 20% to 26%; member contributions lowered from 18% to 16%
 - Assumed rate of return reduced from 7.75% to 7.5%, then 7%
 - Assumed payroll growth rate reduced from 3.5% to 3%
 - Feb. 2022: Funding period 27.7 years; funded ratio 37.18%

Funding Policies

- 2019 Interim Study: Funding Policies for Fixed Rate Pension Plans
 - SB 2224 (86R): Required systems to adopt funding policies and submit to PRB and sponsor.
 - HB 3898(87R): Linked funding policy and FSRPs; sponsor participation
- PRB provided guidance and policy template to aid development.
- Nov. 2020: Summary Report
 - 96/100 funding policies submitted; 40/42 TLFFRA funding policies submitted
 - 6 TLFFRA with specified risk-sharing mechanisms
 - 3 TLFFRA with contribution/benefit parameters beyond statute
- Statutorily-mandated process for plan changes can be slow, unwieldy



FSRPs and TLFFRA Systems

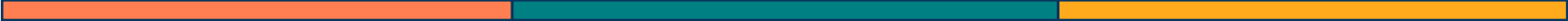
- 16 systems have been subject; 13 TLFFRA systems.
- As of July 2022:
 - 7 of 8 systems currently subject to an FSRP are TLFFRA systems
 - 5 of 7 systems at risk of triggering the requirement are TLFFRA systems
 - 24 of 42 TLFFRA systems have funding periods >30 years
 - 24 of 42 TLFFRA systems have funding ratios <65%
- Requirement established in 2015; overhaul in 2021
 - Funding period maximum reduced; more time to develop, and shorter period to reach the range
 - Sponsor now required to adopt and help develop FSRP
 - Revised FSRPs adjusted to prevent serial, ineffective FSRPs
 - Funding policies must be updated to reflect an FSRP



Minimum Education Training (MET) Program

- Created in 2013—established 7 core educational areas for trustees to have a baseline knowledge of their responsibilities.
 - New trustees must complete 7 total hours of training that includes each of the 7 core content areas in their first year of service.
 - Continuing trustees must complete 4 hours of continuing education every two years.
 - PRB provides free training in core content areas and a list of other accredited courses and providers.
 - Courses were developed and designed by PRB staff; core courses are currently being updated with plans for continuing education options.
- Compliance
 - Report training in September each year
 - Compliance statistics included in PRB Biennial Report to the Legislature





Investment Expense & Performance Reporting



Since 2020:

- Systems' annual financial reports are required to include a list of investment fees and commissions paid, organized by asset class.
- Systems with assets >\$30 million required to evaluate investment practices and performance and to make recommendations for improvement.
 - 22 TLFFRA systems included in the PRB summary report
 - Many TLFFRA plans were below the \$30-million threshold.
 - For 19 of those systems, existing investment consultant performed evaluation rather than an independent third-party.
 - PRB found existing investment consultants were less likely to recommend changes.

2021: HB 3898 (87R): Made changes to improve transparency and allow sponsor to pay for the evaluation.



2018 Asset Pooling Study

- 2018 Interim Study: Asset Pooling for Small Pension Plans
 - Focused on investment-related governance and management.
 - Analyzed investment return and fee data for Texas systems between 2007 and 2016, excluding statewide systems.
 - Evidence suggested potential benefits of pooling assets for investment purposes as well as administrative functions.
 - Diversification—small systems often cannot access many types of investments
 - Economies of scale—can reduce per capita management and administration costs
- Further study could provide more information about asset pooling services, associated legal requirements, and include input from systems.



Future Research: Governance Study

- Board directed staff to conduct a governance study.
- PRB's 2020 legislative recommendations revealed several governance issues that have created challenges for systems, especially TLFFRA systems.
 - Systems have reported difficulty with sufficient sponsor contributions and participation in funding policy/FSRP processes—HB 3898 (87R)
 - Requested clarity on FSRP process and requirements—Rulemaking ongoing
 - TLFFRA statutory provisions have made it difficult to make changes.
 - Membership votes
 - Contribution minimums



Resources

- PRB studies: <https://www.prb.texas.gov/additional-resources/prb-studies/>
- PRB Policy for Regulation of Non-Compliant Retirement Systems:
<https://www.prb.texas.gov/txpen/wp-content/uploads/2019/05/Regulation-of-NonCompliant-Plans.pdf>
- Contribution and Benefit Decision-Making for Texas Public Retirement Systems:
<https://prb.box.com/shared/static/exw7omb4suws3vsf74sw01je40si63xb.pdf>
- Intensive Reviews of public retirement systems: <https://www.prb.texas.gov/intensive-reviews/>
- TLFFRA information: <https://www.prb.texas.gov/local-firefighter-tlffra/>
- PRB Public Pension Data Center: <https://data.prb.texas.gov/>

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