INTERIM REPORT

TO THE 88TH TEXAS LEGISLATURE

HOUSE COMMITTEE ON PENSIONS,
INVESTMENTS & FINANCIAL SERVICES

JANUARY 2023

HOUSE COMMITTEE ON PENSIONS, INVESTMENTS, AND FINANCIAL SERVICES
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2022

A REPORT TO THE
HOUSE OF REPRESENTATIVES
88TH TEXAS LEGISLATURE

RAFAEL ANCHÍA
CHAIR

COMMITTEE DIRECTOR
JEFF MADDEN

Committee On
Pensions, Investments, and Financial Services

January 3, 2023

Rafael Anchía
Chair

P.O. Box 2910
Austin, Texas 78768-2910

The Honorable Dade Phelan
Speaker, Texas House of Representatives
Members of the Texas House of Representatives
Texas State Capitol, Rm. 2W.13
Austin, Texas 78701

Dear Mr. Speaker and Fellow Members:

The Committee on Pensions, Investments, and Financial Services of the Eighty-seventh Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Eighty-eighth Legislature.

Respectfully submitted,

Rafael Anchía

Tan Parker

Giovanni Capriglione

Sergio Muñoz Jr.

Mary Ann Perez

Glenn Rogers

Shelby Slawson

Phil Stephenson

Hubert Vo

TABLE OF CONTENTS

PREFACE

The Pensions, Investments, and Financial Services Committee is composed of nine members from across the state, with districts ranging from North Texas, to Southeast Texas, to the Rio Grande Valley. It has legislative jurisdiction over all matters pertaining to: banking and the state banking system; savings and loan associations; credit unions; the regulation of state and local bonded indebtedness; the lending of money; benefits or participation in benefits of a public retirement system and the financial obligations of a public retirement system; the regulation of securities and investments; privacy and identity theft; and the following state agencies: the Finance Commission of Texas, the Credit Union Commission, the Office of Consumer Credit Commissioner, the Office of Banking Commissioner, the Texas Department of Banking, the Department of Savings and Mortgage Lending, the Texas Treasury Safekeeping Trust Company, the Texas Public Finance Authority, the Bond Review Board, the Texas Emergency Services Retirement System, the Board of Trustees of the Teacher Retirement System of Texas, the Board of Trustees of the Employees Retirement System of Texas, the Board of Trustees of the Texas County and District Retirement System, the Board of Trustees of the Texas Municipal Retirement System, the State Pension Review Board, and the State Securities Board.[1]

The Comptroller of Public Accounts estimates that we will have a $27 billion surplus in the upcoming legislative session, and it comes at a time when the global economy is showing signs of a looming recession. This report will outline a few areas that we believe the members of the 88th Legislature should consider as investment opportunities for the state.

The first is our teachers. As this report will illustrate, TRS-ActiveCare premiums could increase over 20% over the next two years absent the federal relief funds which we used to offset rising costs in the past. Without increasing our state contribution in the program, our teachers may have to pay thousands of dollars more each year for their healthcare benefits.

The second is our retirees. The Legislature is responsible for deciding when to provide benefit enhancements including cost-of-living adjustments for retired educators in the Teacher Retirement System, as well as retired state employees in the Employees Retirement System. This is a tremendous responsibility, and we must hold ourselves accountable when we have the resources to provide this to our retirees so that they may have what they need in order to live their years of retirement comfortably as we promised throughout their careers in public service.

Lastly, we need to make LECOS and JRS 2 pension funds actuarially sound, and pay down our unfunded liabilities. This report will provide a few specific opportunities where the state could invest by increasing annual contributions, as well as provide additional one-time cash infusions towards these liabilities, which would have the potential to save the state billions over the next 30 years.

INTERIM CHARGES

1. Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 87th Legislature. Conduct active oversight of all associated rulemaking and other governmental actions taken to ensure the intended legislative outcome of all legislation, including the following:
   - HB 1258, relating to data matching with financial institutions to facilitate the collection of certain delinquent taxes;
   - HB 1585, relating to the operations and functions of the Teacher Retirement System of Texas;
   - HJR 99, proposing a constitutional amendment authorizing a county to finance the development or redevelopment of transportation or infrastructure in unproductive, underdeveloped, or blighted areas in the county; authorizing the issuance of bonds and notes; and
   - SB 1444, relating to participation in the uniform group coverage program for active school employees and to a study concerning health coverage for school district employees.

2. Review and evaluate the actuarial soundness of the Employees Retirement System (ERS) and Teacher Retirement System (TRS) pension funds.

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

4. Evaluate the actuarial soundness of the Law Enforcement and Custodial Officer Supplemental Retirement Fund and Judicial Retirement System of Texas Plan 2. Identify strategies to reduce and eliminate existing unfunded liabilities and recommend structural enhancements that improve the financial health and viability of the funds moving forward.

5. Review the impact of investments by public retirement systems of their endowment and other trust funds in businesses and funds owned or controlled by the Russian government or Russian nationals, and determine the need for investment restrictions. Consider the impact of any proposed investment restrictions on fund performance.

I: Oversee the implementation of relevant legislation passed by the 87th Legislature

Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 87th Legislature. Conduct active oversight of all associated rulemaking and other governmental actions taken to ensure the intended legislative outcome of all legislation.

HB 1258, relating to data matching with financial institutions to facilitate the collection of certain delinquent taxes

The Comptroller of Public Accounts (CPA) is the agency tasked with collection of state taxes. When a taxpayer fails to properly collect, report, and remit taxes to the state, certain enforcement actions are taken in order to collect the delinquent taxes. One of these steps includes the freezing of bank accounts associated with the taxpayer. Prior to the passage of HB 1258, when the specific banking information was unknown, the CPA would send freeze requests to financial institutions in proximity to the taxpayer's location. HB 1258 streamlined this process for the CPA as well as financial institutions. It establishes an automated data matching program where financial institutions exchange data with the CPA or authorized agent to facilitate the matching of delinquent taxpayer information with financial institution depositor records in an effort to collect certain delinquent tax liabilities. The bill, authored by Rep. Ashby, was heard in PIFS with no registered opposition, supported unanimously in committee and on the House floor.

Phillip Ashley provided an interim update on the bill implementation and rulemaking, on behalf of the office of the CPA. He told the committee that they had partnered with a third party to implement the program, selected through an RFP process during the Spring of 2022. That third-party vendor, Informatix, Inc. has implemented a similar data matching program in at least 14 other states, as well as a child-support program in Texas.[2] The CPA adopted a rule during implementation of the bill, receiving a single public comment, which Mr. Ashley shared was from a representative of the Independent Bankers Association of Texas (IBAT), commenting that the proposed rule "accurately tracks and appropriately implements the legislation."[3]

Christy Bussey of IBAT reiterated their support of the bill to the committee, thanking the CPA for the smooth implementation process. She testified that the automated data matching system will be much more efficient for the industry, sharing that things are likely missed under current system which was a manual and time-consuming process for financial institutions.[4]

Final steps for implementation included an outreach program by the CPA to financial institutions, including working with them to execute data sharing agreements, setting up secure file-transfer protocol, and other necessary information-technology related changes before going live in the Fall of 2022.[5]

HB 1585, relating to the operations and functions of the Teacher Retirement System of Texas

This was the Teacher Retirement System (TRS) Sunset bill that was authored by Rep. Lambert and sponsored by Sen. Lucio. It was passed unanimously out of both the House and Senate. TRS is Constitutionally created, and thereby not subject to abolishment during this review, unlike most other state agencies in Texas. This is still an important process for them to go through, however, because the Sunset Advisory Commission and its staff do an extensive review involving the public and other stakeholders, and provides a detailed analysis to the Legislature with recommendations on areas that should be focused on to further improve the agency in serving retirees in the state. In the final report from the Sunset Advisory Commission, they concluded that TRS generally manages their funds well, but that they need to focus more on improving communications with their members, so that they can ensure that they are providing them with the necessary support and information needed for their retirement.[6] The Legislature agreed and passed HB 1585 containing major provisions including requiring the creation of an ombuds position within TRS; simplifying the rules related to employment after retirement, including implementing a warning system for retirees that are found to be in violation; as well as administerial and other changes aimed at improving customer service with their members. All of the recommended changes have been implemented by TRS following enactment of the bill.

Office of Ombuds

HB 1585 required TRS to create an ombuds position in order to address and investigate complaints more effectively, as well as identify methods to increase communication and engagement from its members. Operating as an independent office, the Office of the Ombuds is designed to offer a neutral and impartial review of member and retiree concerns, and serve as an escalated resource for members seeking assistance related to issues such as their TRS pension or healthcare benefits.[7] The following demonstrates the range of services provided by the Ombuds.[8]

The Ombuds <u>does</u>:

- Listen to a member's concern or complaint regarding a process or result they are unsatisfied with, or are concerned that the information received is incorrect, and provide information or assistance.
- Make referrals to appropriate TRS resources or departments.
- Provide information or assistance with researching a concern or issue, if normal channels were unable to resolve the item.
- Conduct investigations in coordination with business departments in response to a member's concern or complaint.
- Escalate or report complaints to the Board consistent with privacy laws and rules.
- Review and analyze trends in concerns and complaints.

The Ombuds <u>does not</u>:

- Represent active or retired members in any formal hearings, processes, or procedures.
- Engage in any decisions or determinations relative to the outcome of any appeal, request or dispute.
- Review complaints where the member is seeking the same remedy through an active

administrative appeal.
- Provide legal representation or advice.
- Review complaints that do not involve members or retirees or related TRS processes.
- Address open records requests.
- Handle pension benefits appeals.

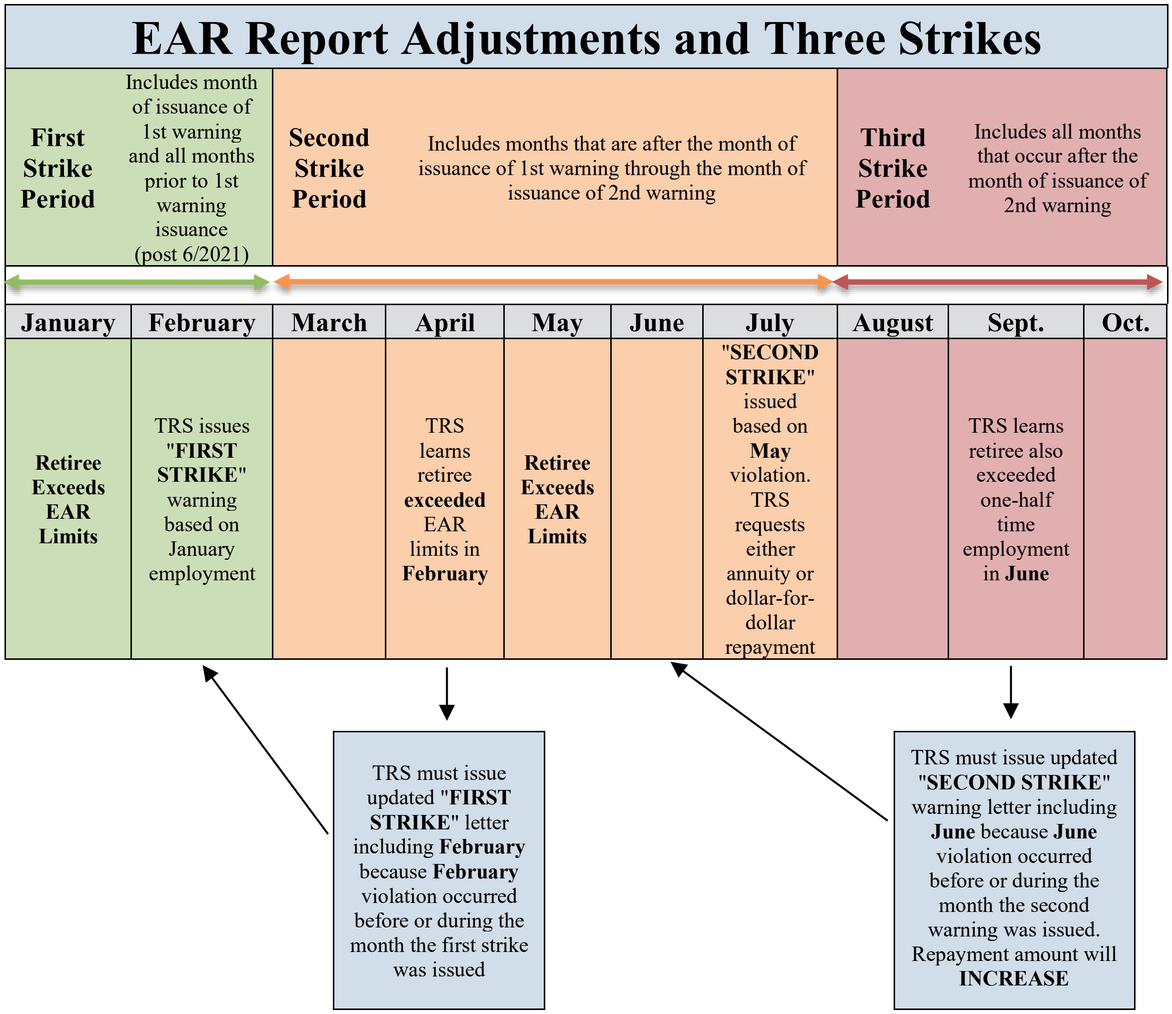
TRS created the Office of the Ombuds immediately upon the conclusion of the 87th Legislative Session, and after an extensive candidate search, hired Lori LaBrie as Ombuds beginning in September, following the passage of HB 1585. Lori joined TRS after serving in a similar role for Texas Southern University for over a decade.[9]

Employment After Retirement (EAR)

The Sunset bill made significant changes to how TRS handles employment after retirement for its members. In testimony before the committee in June, TRS Executive Director, Brian Guthrie shared that they had heard feedback from retirees that under the old system, the employment after retirement (EAR) provisions were confusing; and often retirees found themselves in violation, even when they thought that they were in compliance.[10] HB 1585 clarified those provisions and implemented a three-strike system for violations moving forward.

Under the old rules, if a retiree returned to employment and exceeded the number of hours that they were allowed to work, they would have been subject to losing their entire monthly annuity payment. Now under the new system, they are issued a warning, or first-strike, from TRS. If the retiree violates the limit in a subsequent month, they are issued a second warning, as well as issued a fine (amounting to the lesser of their employment earnings or annuity payment for that month). If it happens a third time, the retiree is then subject to the old system where they will lose the annuity payment for that month, as well as any months following in which they are in violation. Mr. Guthrie reported that since this system was implemented, there have been a "handful of first or second strikes issued, but that no one had been subject to the third-strike," indicating that the warning system was working as envisioned.[11] Brock Gregg of Texas Retired Teachers Association (TRTA) echoed the sentiment regarding the effectiveness and implementation of the new system. "The Sunset bill was a smashing success, as far as we are concerned. I haven't had to take any calls this year for the first time in about five years, where a member is telling me, 'I just lost my entire pension check.' That is wonderful, because that is a tough phone call to take."[12]

Below is a chart depicting how TRS would handle the issuance of strikes and report adjustments, if this situation were to occur with a retiree who returns to work and finds themselves in violation of the EAR provisions set forth in HB 1585.[13]



TRS Headquarters and Regional Offices

There was a significant focus in HB 1585 on improving customer service and member services at TRS. In testimony to the committee, Mr. Guthrie said, "We have been struggling-- to be quite frank-- to provide the service levels that our members deserve, and that we expect to provide them. Many of those issues are related to resource constraints."[14] In response, TRS is taking action to increase their availability and communicate more effectively with their members.

In an effort to improve service to its members, TRS is in the process of constructing a new headquarters outside of downtown Austin; engaged in the sale of their old property on Red River; and expanded their physical presence in the state by opening a regional office in El Paso. This will increase the availability of in-person counseling visits for members that may not be willing or able to make the commute to downtown Austin. When speaking on the opening of the El Paso branch of TRS, Mr. Guthrie added, "This is not about redirecting traffic from the Austin office. Rather, it's about meeting unmet need for members."[15]

On October 4, 2022, TRS announced the successful sale of its Austin headquarters property on Red River in downtown Austin. The $108 million sale to a subsidiary of a publicly traded real estate investment trust completed an extensive competitive sale process to ensure the best value for the 3.8-acre property and buildings.[16] As part of the sale, TRS will be able to continue occupying the buildings for two years while its new Austin headquarters in the Mueller Business District is completed and readied for move-in. The new facility will offer more space outside of downtown Austin, which will allow TRS to better serve their members, while also being more administratively efficient, because they will be able to move the investment team to that new facility as well.

The next Sunset review of TRS will take place 93rd Legislative Session (2032-2033).

HJR 99, proposing a constitutional amendment authorizing a county to finance the development or redevelopment of transportation or infrastructure in unproductive, underdeveloped, or blighted areas in the county; authorizing the issuance of bonds and notes

HJR 99 was posted for a PIFS public hearing during the 87th Legislative session and received unanimous public support. In the hearing, supporters of the measure told the committee that transportation infrastructure was severely underfunded in many areas of the state. The Texas Constitution grants the Legislature the power to authorize, by general law, an incorporated city or town to issue bonds or notes for the purpose of financing the development or redevelopment of certain areas and to pledge increases in property tax revenues for the repayment of those bonds or notes. However, it was noted that the constitution does not expressly give the legislature the power to grant that same authority to counties. HJR 99 eliminates this discrepancy between the treatment of cities and counties with regard to this authority and provides counties more tools to develop and redevelop transportation and infrastructure projects.

The joint resolution ultimately passed the House and Senate, and was filed with the Secretary of State to be submitted for voter approval in the November 2021 election as Proposition 2, using legislatively prescribed ballot language as it appeared in HJR 99. Proposition 2 passed by a margin of 63% "For" and 37% "Against." Following that election, there was an election challenge filed on November 8, 2021 naming the Secretary of State in his official capacity as Defendant, challenging the constitutionality of the ballot language for Proposition 2; and preventing the certification of the election results.

More than nine months later, on August 10, 2022, the Office of the Attorney General (OAG) responded by filing a plea to the jurisdiction; and a subsequent hearing was held on the plea to the jurisdiction on August 30, 2022. At that hearing, the OAG argued that the separation of powers doctrine prohibited the court from ruling as to the validity of the ballot language because the proposal of constitutional amendments is committed to the Legislature. The court took the plea to the jurisdiction under advisement. There has been no decision or ruling to date.

SB 1444, relating to participation in the uniform group coverage program for active school employees and to a study concerning health coverage for school district employees

The Legislature created TRS-ActiveCare in 2001 to provide a healthcare program for public school employees and their dependents. It is a self-insured model, working in partnership alongside a third-party plan administrator, with TRS assuming the risk and paying the claims. The program currently serves about 1,000 school districts throughout the state, including nearly 450,000 educators and their families.[17] Prior to the passage of SB 1444, once a school district joined Active-Care, they were unable to exit the program. This was designed to help ensure a healthy balance of plan participants, and allow for market predictability in modeling and amortization schedules.

During the interim leading up to the 87th Legislative Session, PIFS Committee chaired by Rep. Murphy studied TRS-ActiveCare and concluded that, "Some school districts have used the district of innovation (DOI) waiver process to exempt themselves from TRS-ActiveCare participation, sometimes resulting in lower costs compared to TRS-ActiveCare plans."[18] This was found to be in part because TRS-ActiveCare offered a single statewide premium for all plan participants, and many school districts throughout the state found more affordable healthcare coverage options available in their area. Utilizing this DOI waiver process allowed districts a loophole in which they could offer competing coverage, whereas they otherwise were unable to do so. However, the use of this loophole contributed to higher costs for the remaining participants, while undermining the long-term sustainability of the program. In testimony provided from the Texas Classroom Teachers Association, it was stated that this practice was "hardly the type of innovation that was intended when DOIs were authorized in 2015."[19] The Committee agreed, and in a report to the 87th Legislature, they recommended, "Explicitly prohibiting independent school districts from using District of Innovation status as a method for opting out of TRS-ActiveCare."[20]

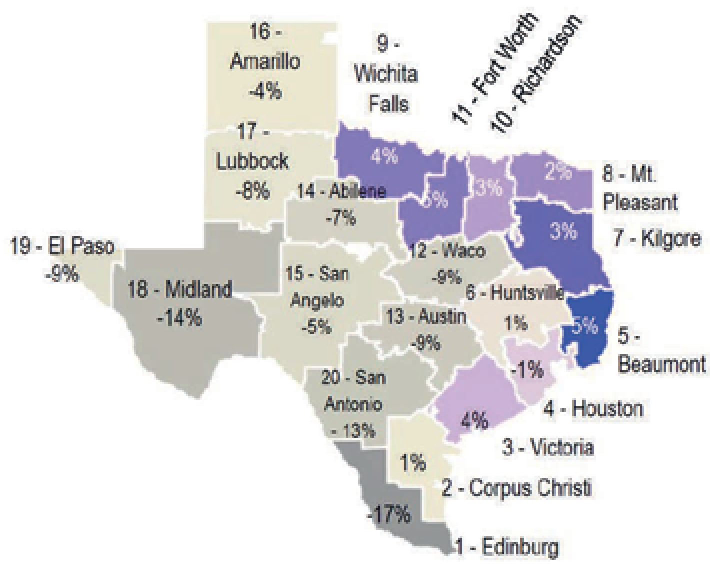
SB 1444 was a product of that interim study and committee recommendation. TRS Chief Healthcare Officer, Katrina Daniel stated, "The changes made to the TRS-ActiveCare program (in SB 1444) are the most significant changes to the program since it was created."[21] Its passage closed the DOI loophole, while also creating a pathway for school districts to leave TRS-ActiveCare if that is their preference. Additionally, TRS has moved away from the single statewide rate to a regional system, considering regional factors to determine rates based on the wide variance of healthcare costs throughout the state. Under the new rules, districts wanting to exit TRS-ActiveCare and districts currently not in TRS-ActiveCare wishing to join must provide notice to TRS by December 31. Once a district opts-out, it must wait 5 years before being eligible to reenroll in the program, and a new enrollment requires a 5-year commitment. Current districts that remain in the program can still evaluate their decision in later years.

Regional Rating and Funding

Regional rate calculation is based on TRS-ActiveCare participants and claims in the area, not the local population. In consultation with an actuary, TRS first calculates the state average rate. They then adjust the regional rate based on the cost of care for that region, by taking into consideration the costs for medical services in the region. These costs often vary by the access to medical care including the number of doctors and hospitals available to the participants in the area. The rates are then adjusted based on demographic factors of the TRS-ActiveCare participants in the region including age, gender, and risk. They then evaluate historical costs for participants in the area by reviewing the region's historical health care costs along with expected costs. Lastly, they take into account benefits and network, considering factors such the deductible amount for the plan, as well as the network of doctors and hospitals available to the participants.[22]

Funding for the TRS-ActiveCare benefits is derived from the state, employer, as well as active member contributions. They are provided directly through the school finance formula. When created in 2001, it was decided to set the state and employer costs as fixed contributions of $75 and $150, respectively, with the active member responsible for the remainder of the monthly premium. At that time, $225 covered the costs of the monthly premium. Unfortunately, that is no longer the case. We have seen healthcare costs increase substantially over the last two decades, while the fixed-rate contribution amounts have not changed since inception.

The map on the right shows the regional costs of healthcare for the TRS-ActiveCare population relative to the statewide average before factoring in the Federal funding that was allocated to TRS in order to offset the impending rate increases for our public educators.



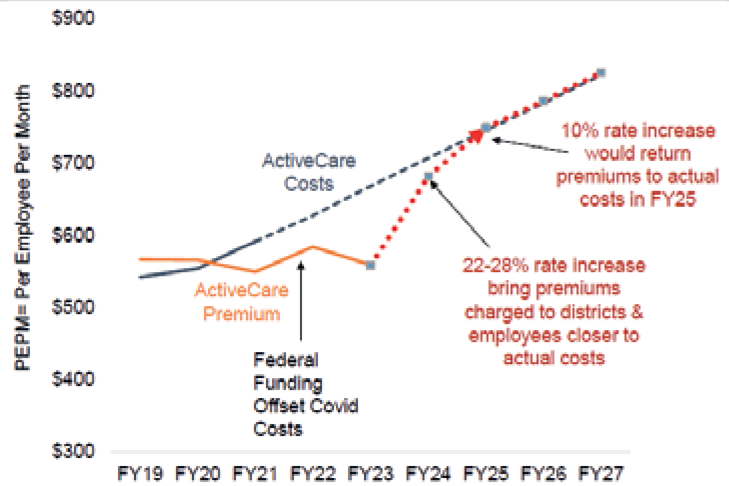
Additional Federal Funds Impact (ARPA and CARES Act)

During the third special session of the 87th Legislature (87-3), SB 8 was passed which contained an allocation of $203M in American Rescue Plan Act (ARPA) funds to TRS-ActiveCare to help offset future premium increases by 5% for public educators. This supplemental appropriation reduced the overall statewide premium increase to 9.5%. TRS also identified an additional $435M in claims made that were eligible for Coronavirus Relief Fund (CARES Act) reimbursement. The use of these federal funding sources into the program allowed for a reduction of the statewide premium increase to at or below 0%, along with corresponding decreases in regional rates for upcoming plan year.[23]

It is important to note that these one-time allocations of federal funds were able to buy us some time. However, there remains a need for significant premium increases for future plan years, beginning in fiscal year 2023.

The chart to the right shows the per-employee-per-month (PEPM) historical costs, and the impact that the Federal funds had on those PEPM premiums; along with the projected TRS-ActiveCare costs moving forward. If we do not replace these supplemental funds, it is estimated that by fiscal year 2025, educators would pay an average of $2,280 more per year for health benefits, as premiums would increase by 22-28% over the next two years.[24]

Impact of Federal Funds on TRS ActiveCare Per Employee Per Month Costs



SUMMARY OF COMMITTEE ACTION

The committee met in a public hearing on Monday, June 6, 2022 at 10:00 AM in order to hear invited and public testimony on the following: Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 87th Legislature. Conduct active oversight of all associated rulemaking and other governmental actions taken to ensure the intended legislative outcome of all legislation, including the following:

- HB 1585, relating to the operations and functions of the Teacher Retirement System of Texas; and
- SB 1444, relating to participation in the uniform group coverage program for active school employees and to a study concerning health coverage for school district employees.

June 6, 2022 - 10:00 AM

<u>HB 1585 implementation and rulemaking</u>

1. Gregg, Brock (Texas Retired Teacher Association)
2. Guthrie, Brian (Teacher Retirement System)

<u>SB 1444 implementation and rulemaking</u>

1. Daniel, Katrina (Teacher Retirement System)
2. Exter, Monty (Association of Texas Professional Educators)
3. Guthrie, Brian (Teacher Retirement System)
4. McPeters, Pamela (Texas Classroom Teachers Association)

The committee met in a public hearing on Thursday, August 25, 2022 at 11:00 AM in order to hear invited and public testimony on the following: Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 87th Legislature. Conduct active oversight of all associated rulemaking and other governmental actions taken to ensure the intended legislative outcome of all legislation, including the following:

- HB 1258, relating to data matching with financial institutions to facilitate the collection of certain delinquent taxes; and
- HJR 99, proposing a constitutional amendment authorizing a county to finance the development or redevelopment of transportation or infrastructure in unproductive, underdeveloped, or blighted areas in the county; authorizing the issuance of bonds and notes.

August 25, 2022 - 11:00 AM
<u>HB 1258 implementation and rulemaking</u>

1. Ashley, Phillip (Comptroller of Public Accounts)
2. Bussey, Christy (Independent Bankers Association of Texas)

<u>HJR 99 (Proposition 2, Nov. 2021) status update</u>

1. Hilton, Christopher (Office of the Attorney General)

RECOMMENDATIONS

- Consider options to alleviate barriers for retirees that seek employment after retirement, including the surcharge, without impacting the actuarial soundness of the pension fund.

- Monitor feedback from TRS members, retirees, and advocates regarding the newly opened El Paso regional branch of TRS. Evaluate the need to open additional regional offices throughout the state in order for the agency to better serve our active and retired educators.

- Explore ways to subsidize or increase state's contribution for TRS-ActiveCare in an effort to offset premium increases for public educators and their families that participate in the program. Consider making fundamental changes to the state's contribution to the program that accounts for rising health care costs, as opposed to the current fixed rate contribution.

II: Employees Retirement System (ERS) and Teacher Retirement System (TRS)

Review and evaluate the actuarial soundness of the Employees Retirement System (ERS) and Teacher Retirement System (TRS) pension funds.

Overview

The Texas Government Code says that a pension fund is considered actuarially sound if the overall contribution rate is sufficient for the plan to achieve and maintain an amortization period that does not exceed 30 years.[25] With the passage of SB 12 in the 86th Legislature, and SB 321 in the 87th Legislature, both TRS and ERS have been the recipients of major changes at the direction of the Legislature in the last few years; particularly related to funding, aiming to improve the actuarial soundness of the systems' pension funds. In that aspect, per the latest data available from each, those features seem to be working as intended-- with the financial health metrics reflecting major improvements for both since appropriating more resources for the funds. This remains true despite the particularly turbulent global investment market that we have seen throughout 2022.

The Legislature is responsible for making benefit enhancements for our retirees for both ERS and TRS, with the important caveat that we can only do so when the pension fund is actuarially sound. While the pension plans are seemingly poised to ride out the variances of the investment market to remain in good financial health during these uncertain times, we need to be continuously evaluating how we are caring for our retirees to ensure that we are providing them the resources that they need so that they are able to do the same.

Teacher Retirement System (TRS)

Teacher Retirement System (TRS) is the largest public retirement system in Texas, serving 38,000 members at its inception in 1937, and growing to nearly 1.9 million people today. Its membership is composed of public-school teachers, education support staff, and professionals at public institutions of higher education. Most of this membership includes active contributing members that are employed at a Texas public school, and nearly a quarter of the membership are retired from their service to the state and receiving a month annuity.[26] TRS' stated mission is to improve the retirement security of its members by prudently investing and managing the trust fund's assets and delivering benefits to members.

Actuarial soundness of TRS pension fund

SB 12 from the 86th Legislature provided for a gradual increase in contribution rates over a six-year period, with base contribution and member rates increasing to 8.25%, and supplemental contribution rates paid by public education employers to 2% beginning in fiscal year 2025. With an assumption that 62.9% of total payroll will be eligible for the supplemental contribution, it is estimated that the effective employer rate will be 9.5% by 2025.[27]

TRS had an impressive 24.8% investment return for fiscal year 2021. This was well ahead of the 7.25% assumed rate of return that was forecasted for this period. This strong performance brought the market value of the pension fund to over $200 billion for the first time in its history.[28] Though the system decided to defer the $21.2 billion gains to be recognized over the next four valuation cycles. This is a common technique that is used as a hedge to make up for any underperforming investment cycles. Additionally, the TRS Board of Trustees lowered the pension fund's return assumption rate, as recommended by the system's actuary from 7.25% to 7%. This essentially lowers the hurdle for future years and lessens the impact if the assumption is not achieved.

These forward-thinking actions already proved beneficial for the system, with the fiscal year 2022 investment return of -6.7%, and the fund's value dropping to $184.2 billion. This negative performance, coupled with a 6.8% average salary increase for active members participating in the system (assumption is 4.1%) contributed to an increase in the Unfunded Actuarial Accrued Liability (UAAL) from $47.6 billion to $51.7 billion. Even after this UAAL increase, the fund is still on track for full funding by 2048-- in line with SB 12 projections; and with a funding period of 26 years, the plan is still considered actuarially sound.[29]

Benefit enhancements, including a COLA for TRS retirees

Currently there are more than 458,000 retirement recipients at TRS. Of those retirees and beneficiaries, the average annuity is $2,145 per month. Nearly half of TRS annuitants receive $2,000 or less per month for their annuity, while a quarter of retirees receive $1,000 or less per month. Many retirees are forced to rely on this annuity to make ends meet, as 95% of Texas educators are not covered by Social Security.[30]

In 2013, TRS retirees leaving service before September 1, 2004 received a 3% cost-of-living adjustment (COLA) capped at $100 beginning in October 2013. This was the last COLA provided by the Legislature for our retired educators since 2004. In fact, it has been so long since the Legislature provided this benefit enhancement, that now more than 50% of all TRS retirees have never received a COLA to their annuity. This situation persists despite the cumulative Consumer Price Index (CPI) rising by 53% since 2004, meaning that a dollar today is only worth 65% of what its value was in 2004.[31]

In that time period, there have been two one-time supplemental payments ("13th checks") made in both 2019 and 2021, capped at $2000 and $2400, respectively. However, the committee members heard testimony from retirees that these supplemental payments, while appreciated, pale in comparison to the financial long-term benefits of a COLA. For example, the 2013 COLA referenced above provided a 3% annuity increase capped at $100 per month. This enhancement increased the average annuity for eligible retirees by about $60, to $2,040 per month. Over the course of 9 years, eligible retirees have received nearly an additional $6,600 to their annuity.

While the Legislature is long overdue in providing TRS retirees with a meaningful COLA, members should also include either a substantial increase in contribution rates or an additional appropriation to the fund in order to cover the increases in liability. In the first actuarial valuation report following the conclusion of the 87th Legislative session, the fund's actuary highlighted the importance of this payment. "Both supplemental payments from the 2019 and 2021 legislatures were fully financed with lump sum contributions. This should be the model used in any future year that a COLA is considered. In past negotiations, there were times that COLAs and retroactive benefit enhancements were granted without additional funding sources and that eventually deteriorated the financial health of the System."[32]

Employees Retirement System (ERS)

Employees Retirement System (ERS) supports current and former state employees through their main pension fund, the State of Texas defined benefit retirement plan. It was launched in 1947 with an initial state appropriation of $25,000, paying their 153 retirees a total of about $38,000 with the average monthly annuity payment of $21.[33] Now, 75 years later, it serves a membership of over 288,000 current and former state employees, providing an additional 122,720 retirees and beneficiaries an average monthly annuity payment of $1,805.[34] ERS also administers two other pre-funded pension plans: Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS), and Judicial Retirement System of Texas Plan 2 (JRS 2). In this Interim Charge, we directed our attention on the actuarial soundness of the main State of Texas pension fund, because LECOS and JRS 2 are the focus in a subsequent charge (Interim Charge IV).

Actuarial soundness of ERS' State of Texas pension fund

At the outset of the 87th legislative session, the State of Texas ERS pension fund was in extremely poor financial health, with a mere 66% of current benefits funded. It had an Unfunded Actuarial Accrued Liability (UAAL) of $14.7 billion, and a projected fund depletion date of 2061. The current funding level at that time was clearly not sustainable for the plan, with $1.5 billion additional debt accruing each biennium at a rate of $2 million per day. In the ERS Actuarial Valuation report released in December 2020, the actuary concluded that, "Doing nothing is no longer an option."[35] The Legislature responded by passing SB 321, which contained two major components: it created a new cash-balance retirement plan for future state employees and required the state to amortize ERS' unfunded liabilities over the next 32 years.

The new cash-balance retirement plan or "Group 4" applies to new state employees hired beginning September 1, 2021. Still considered a defined benefit plan providing a lifetime annuity, it creates a different benefit structure for participating members, compared to Groups 1, 2, and 3. As outlined in the chart below, some of the notable changes in plan design for Group 4 participants include a decrease in member contributions from 9.5% to 6%; a five-year vesting period; state match equal to 150% of the account balance at retirement; guaranteed earnings of at least 4% annually; up to 3% gain-share, when the ERS fund has investment earnings of more than 4% over a five-year average; and the possibility of annuity increases in retirement, when the gain-sharing benefit is achieved.[36]

<table>
<tr><th colspan="5">ERS Benefits Comparison</th></tr>
<tr><th></th><th>Group 1</th><th>Group 2</th><th>Group 3</th><th>Group 4</th></tr>
<tr><td>Vesting</td><td>5 years</td><td colspan="2">10 years</td><td>5 years</td></tr>
<tr><td rowspan="4">Retirement Eligibility</td><td>60 with 5 years</td><td colspan="2">65 with 10 years service</td><td>65 with 5 years of service</td></tr>
<tr><td colspan="4">55 with 10 years of LECO service, or any age with 20 years of LECO service</td></tr>
<tr><td colspan="4">Rule of 80 (age + years of service)</td></tr>
<tr><td colspan="4">Eligible for Proportionate Retirement Program</td></tr>
<tr><td>Defined Benefit</td><td colspan="3">Lifetime Annuity based on salary, service and benefit multiplier</td><td>Lifetime Annuity based on account balance and employer match</td></tr>
<tr><td rowspan="8">Plan Design</td><td colspan="3">Highest Average Salary</td><td>Member Account Balance</td></tr>
<tr><td>3 years</td><td>4 years</td><td>5 years</td><td rowspan="3">6% member contribution (+2% LECOS) and 4% guaranteed annual interest and 50% gain sharing of excess 5-year average investment returns less than 3%</td></tr>
<tr><td colspan="3">Years of Service</td></tr>
<tr><td colspan="3">Service Purchases
ERS/TRS Transfers</td></tr>
<tr><td colspan="3">Benefit Multiplier</td><td>Employer Match</td></tr>
<tr><td colspan="3">2.3% multiplier
(20 years of LECOS get +0.5% multiplier)</td><td>150% employer match
(20 years of LECOS get +300% employer match of LECOS balance)</td></tr>
<tr><td colspan="3">Annuity Reduction based on age</td><td>Annuity based on age</td></tr>
<tr><td>None</td><td>5% per year, 25% cap</td><td>5% per year, no cap</td><td>Calculated from account balance, employer match, and age at retirement
Receives gain sharing during retirement</td></tr>
</table>

In addition to this new cash-balance benefit change, SB 321 also increased state funding to the plan. Specifically, the Legislature committed to making an actuarially determined payment to ERS in the amount necessary to amortize the system's unfunded actuarial liabilities by 2054. This is known as a "legacy payment" because it is specifically dedicated to paying off the accrued debt that the plan already owes. It is a level dollar amount, and not tied to payroll or headcount figures. This legacy payment is projected to be $510 million per year through 2054, and is in addition to the state's biennial contribution, as well as the contributions from members and agency employers.

As we saw with TRS, ERS also achieved favorable returns during fiscal year 2021, reaching an impressive 25% on market investments. With a 7% assumed rate of return, this equated to three and a half years worth of expected investment earnings generated over the course of one year; and the ERS Board of Trustees voted to smooth their $3.5 billion in earnings over the next four years as well. The ERS investment portfolio sustained losses in the market during fiscal year 2022, netting returns of -1.59% on the year. However, funding and benefit changes from SB 321 combined with the strong market performance from 2021 still puts the pension fund on a path to fully funded by 2054 and brought the UAAL down to $14.2 billion.[37]

In speaking to ERS participants and public employee advocacy groups on this topic, members heard compelling testimony regarding the need for benefit enhancements for retired state employees in ERS. Texas Public Employees Association reminded the committee that in the 1980s and 1990s, the Legislature granted several benefit increases for ERS retirees, when investment returns were high and the fund was not in debt; noting that the last benefit enhancement provided for these retirees was in 2002.[38] With the average monthly annuity payment this year being $1,805, a benefit enhancement is overdue and should be a House priority. However, because the fund is still not considered actuarially sound, the state is not permitted to provide enhancements during this period. Nonetheless, members should begin the necessary steps to provide a cost-of-living adjustment (COLA) for ERS retirees, so that once the pension fund is considered actuarially sound, the Legislature is prepared to move forward with providing this benefit enhancement to our retired state employees.

SUMMARY OF COMMITTEE ACTION

The committee met in a public hearing on Monday, June 6, 2022 at 10:00 AM in order to hear invited and public testimony on the following: Review and evaluate the actuarial soundness of the Teacher Retirement System (TRS) pension fund; and study benefit enhancements, including a cost-of-living adjustment (COLA) for Teacher Retirement System (TRS) retirees.

June 6, 2022 - 10:00 AM
<u>Actuarial soundness of TRS pension fund</u>

1. Exter, Monty (The Association of Texas Professional Educators)
2. Gassenberger, Steven (Reason Foundation)
3. Guthrie, Brian (Teacher Retirement System)
4. Melendrez, Eli (Texas AFT)

<u>Benefit enhancements, including a COLA for TRS retirees</u>

1. Byler, Nancy (Self)
2. Cackley, Dora (Texas Retired Teachers Association)
3. Carrillo-Valdez, Lydia (Self; San Antonio AFT Retirees Plus)
4. Duncan, Bobbie (Texas State Teachers Association (retired))
5. Exter, Monty (Association of Texas Professional Educators)
6. Gregg, Brock (Texas Retired Teachers Association)
7. Guthrie, Brian (Teacher Retirement System)
8. Hagar, Suzy (Self)
9. Loya, Evelina (Texas State Teachers Association (retired))
10. McPeters, Pamela (Texas Classroom Teachers Association)
11. Owens, Felecia (Texas State Teachers Association (retired))
12. Paull Turner, Jeanne (Self; Texas Retired Teachers Association)

The committee met in a public hearing on Tuesday, August 16, 2022 at 11:00 AM in order to hear invited and public testimony on the following: Review and evaluate the actuarial soundness of the Employees Retirement System (ERS) pension fund.

August 16, 2022 - 11:00 AM
<u>Actuarial soundness of ERS pension fund</u>

1. Bishop, Ann (Texas Public Employees Association)
2. James, Carla (Retired State Employees of Texas)
3. Sheldon, Tyler (Texas State Employees Union)
4. Wilson, Porter (Employees Retirement System of Texas)

RECOMMENDATIONS

- The Legislature should provide a meaningful cost-of-living adjustment (COLA) for TRS retirees and beneficiaries during the 88th Legislative Session.

- The Legislature should continue honoring its commitment to contribute the ERS legacy payment through 2054 for the ERS State of Texas pension fund.

- The Legislature should explore ways to increase contributions to the pension funds. This effort could include one-time cash infusions or increased annual payments to reduce the unfunded liabilities. These actions could save the state billions of dollars in future interest costs.

- The Legislature should begin the necessary steps to provide a cost-of-living adjustment (COLA) for ERS retirees, so that once the ERS pension fund is considered actuarially sound, the Legislature is prepared to move forward with providing this benefit enhancement to retired state employees.

III: Texas Local Fire Fighters Retirement Act (TLFFRA)

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

Overview

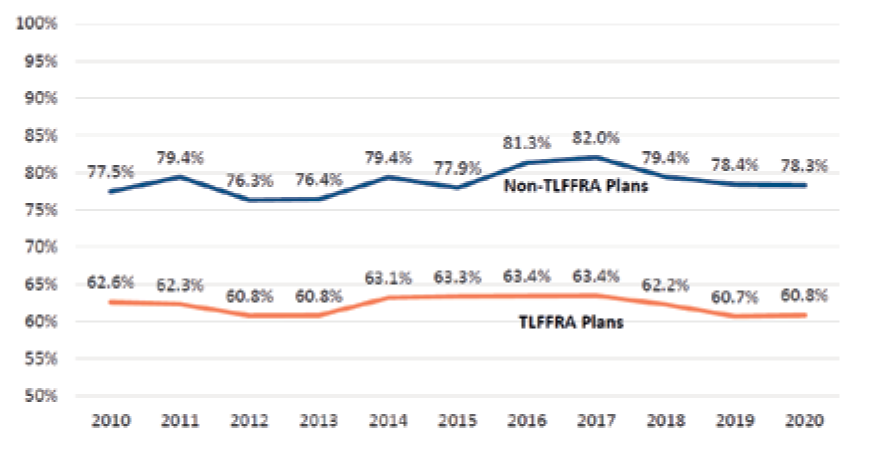
Originally created in 1937, the Texas Local Fire Fighters Retirement Act (TLFFRA) operates as an umbrella statute that allows for fire departments and volunteer fire departments to administer their own local retirement systems in participating cities. TLFFRA sets forth fundamental requirements for plans operating under the Act, but otherwise allows for the remaining aspects to be controlled locally. The Pension Review Board (PRB) identified shortcomings commonly seen in TLFFRA plans including a growing unfunded liability and low funded ratio, citing chronically insufficient contributions, and investment returns not meeting assumptions; as well as governance design problems, specifically related to contribution and benefit decisions.[39] In many cases, this has left sponsoring municipalities no choice but to dedicate an unsustainable portion of their city's budget or seek approval from voters for pension obligation bonds to cover the unfunded liabilities of the plan, in order to avoid jeopardizing their city's bond rating moving forward.

Pension funding and governance

TLFFRA provides guidelines for fund management, including the composition of the seven-member board of trustees consisting of the mayor, or the mayor's designated representative for the sponsoring municipality; the chief financial officer of the municipality; three members of the retirement system elected by participating members; and two persons who reside in the state, who are not officers or employees of the municipality or other political subdivision, and who are elected by a majority vote of the members of the board. It also sets the contribution minimum for the sponsor at 12% of payroll.[40] However, it leaves aspects related to plan design and administration, contribution amounts, and investment decisions to each system's local board of trustees. These latter features are unique to TLFFRA. For example, with municipal plans, the system design is set forth in statute, and any changes to the structure or benefits requires approval from the Legislature.

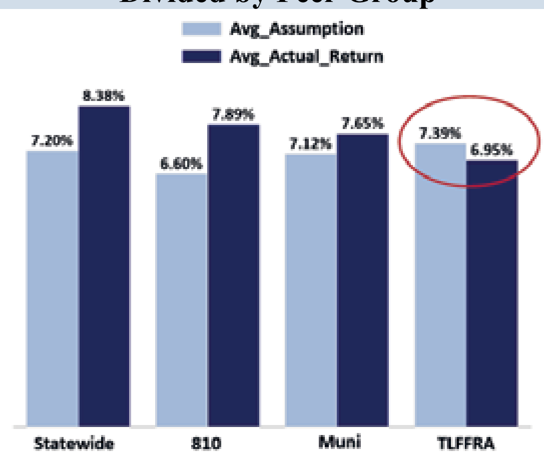
TLFFRA plans are also consistently underfunded as a group. When we look at the funded ratio, which is the actuarial value of assets shown as a percentage of its actuarial accrued liability, they trend worse as a peer group, compared to statewide plans, 810-plans, and municipal plans by about 20% on average over the last decade. Annual funded ratios are shown in the below chart from the PRB depicting TLFFRA vs. non-TLFFRA plans.

Average Funded Ratio for Texas Retirement Systems by Year



Not only are TLFFRA plans underfunded, but they are also at the bottom when it comes to investment performance. The National Association of State Retirement Administrators (NASRA) Research Director, Keith Brainard testified that in reviewing public pension revenue data provided by the US Census Bureau, all of the money that has come into public pension systems in the last 30 years can be divided into three categories: employee contributions (11%), employer contributions (25%), and investment earnings (64%).[41] This is an important data point, because it shows that pension funds' heavy reliance on investment earnings. Data from the PRB shows that TLFFRA funds, despite having some of the smallest plans in asset size, have the highest investment return assumption rates as a peer group, compared to statewide plans, 810-plans, and municipal plans. As shown in the chart to the right, TLFFRA plans average a 10-year return assumption of 7.39%, with actual returns coming in nearly a half-percentage point lower at 6.95% -- the lowest actual return compared to the other groups of plans. While this may seem like a reasonable projection, it is a clear indication that the TLFFRA return assumptions are generally too high across the board. With decisions for plan changes such as contribution amounts or benefit enhancements implemented because of these forecasting assumptions, shortfalls are usually borne by the sponsoring municipalities, and in turn, taxpayers in those cities. Mr. Brainard testified that, "To not change your investment return assumptions in the face of evidence like this is essentially kicking the can down the road, and handing the bill to future taxpayers and plan participants."[42]

Average Assumed vs Actual 10-Year Returns
For Periods Ended in 2020
Divided by Peer Group



The low investment return average is not an indictment of the work of the investment managers at TLFFRA plans. Rather, it is just a fact that plans with smaller assets are going to be charged higher investment fees and will not have the same range of access to investment opportunities compared to large, statewide funds. TLFFRA plans make up 42% of the retirement plans that PRB oversees but hold only $2.49 billion out of the $369 billion total assets, with some plans having less than $10 million in assets individually.[43] In 2018, the PRB studied the idea of asset pooling for small pension plans, analyzing investment return data from 2007 to 2016. For purposes of the study, they considered small plans the bottom 20% of all Texas plans when sorted by asset size (less than $12.5 million in assets in 2016). They found that asset pooling could have resulted up to an additional 39% increase ($32 million) in total assets for small plans between 2007 and 2016.[44]

We heard from representatives of numerous cities desiring to address these unfunded liabilities as the sponsoring municipality but concerned because there exist no adequate guardrails in the TLFFRA statute that prevents a retirement board from adopting benefit enhancements as soon as the sponsoring municipality allocates more resources to help stabilize the fund. Chris Hillman, the City Manager of Irving shared with the Committee that the Irving Firemen's Relief & Retirement Fund ("Irving Fire") found themselves in significant financial stress after the plan's approval of benefit rates for its members based on return assumptions of 8.25%, with an actual 25-year investment return of 6.27%. S&P notified the City that their AAA bond rating was in jeopardy unless the unfunded liability was addressed, and contributions were increased. The City of Irving and Irving Fire agreed to a contractual agreement to raise their contribution levels to 26% and 13%, respectively; as well as the issuance of $80 million in pension obligation bonds that were ultimately approved by the voters in order to address the unfunded liability and retain the favorable S&P rating.[45]

Pension Review Board (PRB)

The Pension Review Board (PRB) operates as an oversight body, whose role is to oversee all Texas public retirement systems, monitoring their actuarial soundness and compliance with state law. Their primary duties are to conduct a continuing review of public retirement systems, compile and compare information about benefits, creditable service, financing, and the administration of systems; conduct intensive studies of potential or existing problems that threaten the actuarial soundness of or inhibit an equitable distribution of benefits in one or more public retirement systems; provide information and technical assistance on pension planning to public retirement systems on request; and recommend policies, practices, and legislation to public retirement systems and appropriate governmental entities.[46]

Through their intensive review process, PRB selects the retirement system to undergo the review based on actuarial health, compared by several factors including assumptions, amortization period, and depletion dates. They then take an in-depth examination of a system's issues and contributing factors, and provide recommendations to address the problems identified. This process was first created and implemented by PRB in 2018 and is now a key component of their oversight process. Over the course of 5 years since the intensive review process was implemented, 11 reviews have been completed-- 10 of which have been TLFFRA systems. PRB

Executive Director Amy Cardona told the committee, "That's really a reflection of the fact that TLFFRA systems tend to be more poorly funded than other systems in the state."[47]

There are also Funding Policy and Funding Soundness Restoration Plan (FSRP) reports for retirement systems and their sponsors that are required to be developed and submitted to the PRB. A funding policy is designed to help a system achieve three fundamental goals of public pension funding: benefit security, contribution stability, and intergenerational equity;[48] with the FSRP being an additional requirement triggered for systems whose plan funding periods are more than 30 years. Texas Government Code says that the governing body of a public retirement system and, if the system is not a statewide retirement system, its associated governmental entity shall jointly develop and adopt a written funding policy that details a plan for achieving a funded ratio equal to or greater than 100%; and timely revise the policy to reflect any significant changes to the policy, including changes required as a result of formulating and implementing a funding soundness restoration plan, including a revised funding soundness restoration plan.[49]

PRB testified that as of July 2022, 24 out of the 42 TLFFRA systems have funding periods greater than 30 years.[50] While the FSRP is required in these instances, the PRB does not have many available tools to compel a non-compliant system to participate; rather, the PRB will "work with the systems to try to collaboratively achieve compliance."[51] Their policy guide for compliance includes a series of courtesy notifications to the system; late notifications at 15, 30, and 60 days; the name of the non-compliant system and sponsor posted on the PRB website; possible discussion at next board meeting; notification of legislative and governor's offices; and lastly further action could include inspections by the board, issuance of subpoenas, and other legal action as set forth in the Texas Government Code.[52]

The PRB also has a Minimum Education Training Program (MET) for trustees. It was created in 2013 and established 7 core educational areas for trustees to have a baseline knowledge of their responsibilities. The MET requirements for new trustees are that they 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 as well as a list of other accredited courses and providers. Currently, only 60.44% of TLFFRA trustees are compliant with their required MET training, per the latest report from PRB.[53]

SUMMARY OF COMMITTEE ACTION

The committee met in a public hearing on Tuesday, August 16, 2022 at 11:00 AM in order to hear invited and public testimony on the following: 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.

August 16, 2022 - 11:00 AM
<u>TLFFRA governance and oversight</u>

1. Beckham, Kolby (Longview Firemen's Relief & Retirement Fund)
2. Brainard, Keith (Self)
3. Buckley, Dan (City of Galveston)
4. Cardona, Amy (Pension Review Board)
5. Hillman, Chris (City of Irving)

RECOMMENDATIONS

- Require that the full Actuarially Determined Contribution be made each year, in lieu of the 12% statutory minimum employer contribution rate. The contribution should be what the fund actuary recommends each year in order to eliminate the unfunded liability. This is recognized as a best practice and can be phased in over a period of several years.

- Require joint city council and board approval of changes to employee contribution rates and benefits. Pension obligations represent long-term public liabilities and should be known, understood, and approved by the city's elected representatives.

- Create a process for asset-pooling small pension systems. Work with interested parties to determine the appropriate trigger and consider the possibility of including a release mechanism if they hit specific funding metrics after a certain period of time.

- Instruct the Pension Review Board to perform an interim study on pension plan governance with submission to the Legislature in advance of the 88th Legislative Session.

- Give the Pension Review Board tools to work with non-compliant retirement systems more effectively.

IV: Actuarial soundness of the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS) and Judicial Retirement System of Texas Plan 2 (JRS 2)

Evaluate the actuarial soundness of the Law Enforcement and Custodial Officer Supplemental Retirement Fund and Judicial Retirement System of Texas Plan 2. Identify strategies to reduce and eliminate existing unfunded liabilities and recommend structural enhancements that improve the financial health and viability of the funds moving forward.

Overview

LECOS and JRS 2 are defined benefit plans managed by ERS, with LECOS offered as supplemental plan for members of law enforcement and custodial officers, in addition to their participation in the main, State of Texas fund; and JRS 2 a stand-alone benefit plan for judges and justices in the state. Both plans are in extremely poor financial health, with funding for each failing to cover even the normal cost of operations, let alone meet any additional funding standards. This is particularly troublesome, because even if the state were to pay off the Unfunded Actuarial Accrued Liability (UAAL) for each in full, there would still be an immediate accrual of unfunded liability, because the inherent costs of the plans are not being met. Upon actuarial review in 2021, it was concluded that for both LECOS and JRS 2, "Current contribution levels are not sufficient to sustain the plans; and that benefit security will continue to deteriorate without an increase in contributions over the current schedules."[54]

Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS)

LECOS is a supplemental plan for members of the law enforcement community, including Department of Public Safety Troopers, Texas Parks and Wildlife Game Wardens, Texas Alcoholic Beverage Commission Agents, and Texas Department of Criminal Justice Correctional Officers. There are currently 63,446 LECOS members, with 31,075 active members; and 15,923 retirees and beneficiaries serviced by the fund.[55] Of their annual annuity, roughly 80% is from the main ERS State of Texas fund, and the remaining 20% is additional benefit provided from their participation in LECOS.[56]

There were recent plan design changes in SB 321 (outlined in Interim Charge II) which also included LECOS participants. Any eligible new hires as of September 1, 2022 are part of the Group 4 cash-balance plan that was created by that legislation. Even with these benefit changes, there is still an urgent need to address the unfunded liability that already exists with the plan. The UAAL increased from $652 million in fiscal year 2021 to $715 million in fiscal year 2022, and the fund has a projected depletion date of 2049.[57] Funding for LECOS comes from a .5% gross monthly payment from the participating member, as well as a .5% contribution from the state. However, the normal cost of operation of the plan is 2%.[58] During testimony provided in an interim hearing, ERS Executive Director, Porter Wilson outlined a few possible options for making the fund actuarially sound, but emphasized a two-part process, with the need to cover the normal cost, as well as address the growing UAAL: the first option would be to increase the state's contribution by 1% at an annual cost to the state of $20 million, in conjunction with the increase of an additional payroll contribution of 1.89% at a cost of $37 million. This option (option 1) would have an annual cost to the state of $57 million and would amortize the unfunded liability over 31 years. The second option (option 2) would be to increase the state's contribution by 1% at an annual cost to the state of $20 million, in conjunction with a one-time payment of $750 million to address the unfunded liability. It is noteworthy that the one-time payment (option 2) would save the state $1.2 billion over the next 31 years, compared to increasing the annual payroll contribution (option 1).[59]

In addition to funding shortfalls, data shows a sharp decline in law enforcement and custodial officers in the state. Texas Public Employees Association (TPEA) pointed out that Texas observed an 8% decrease in LECO employees in fiscal year 2021;[60] and in reviewing data for fiscal year 2022, we have seen another 4.5% decrease in active LECO employees.[61] TPEA testified that this is a problematic trend, because that means there are fewer employees performing the work, and that the work is becoming increasingly complex over time.[62] These should be viewed as warning signs that employees may be either unwilling, unable, or both in performing this work for the current compensation and benefits being offered by the state for these positions.

Testimony was also provided on the urgent need for benefit enhancements for LECOS participants. Department of Public Safety Officers Association (DPSOA) President Richard Jankovsky testified that he often hears from many retired members of law enforcement that they are desperate for a benefit enhancement, specifically a cost-of-living adjustment (COLA). The last benefit enhancement for LECOS retirees was over two decades ago, and in the PIFS public hearing Mr. Jankovsky said, "They are struggling to meet even their most basic needs. A COLA is desperately needed."[63] LECOS annuitants are overdue for a benefit enhancement, and we should prioritize making the fund actuarially sound so that we may work to provide these enhancements at the first opportunity when we are eligible to do so.

Judicial Retirement System of Texas Plan 2 (JRS 2)

JRS 2 is a retirement plan for Judges and Justices serving state elected or appointed judicial service beginning on or after September 1, 1985. This includes current or former district judges, appellate judges, and members of the two high courts: The Supreme Court of Texas, and The Court of Criminal Appeals. There are currently 583 active members of the defined-benefit pension plan, with 536 retirees and beneficiaries.[64]

During an interim hearing to discuss the status of the fund, the Office of Court Administration (OCA) Administrative Director, Megan LaVoie testified on the importance of a strong and reliable pension fund for judges in the state. She stated that, "It is not uncommon for judges to leave lucrative law careers as lawyers to take the bench, taking a significant pay cut," adding that, "A pension plan that is on solid footing is an added benefit to encourage lawyers to run for a judicial position."[65] Currently, the majority of appellate and district judges have a minimum of 20 years of law experience, and 40% have at least 30 years experience as a lawyer. Experienced lawyers are still willing to take the bench in Texas; but, if Texas wants judicial service to remain attractive to qualified members of the bar, the JRS 2 pension fund is in dire need of the Legislature's attention this upcoming session.

JRS 2 pension fund has an unfunded liability of $95 million, and a depletion date of 2069. ERS Executive Director, Porter Wilson testified that like LECOS, the current contribution rate for JRS 2 does not even meet the normal cost of operation for the fund. Mr. Wilson outlined a few suggested options for making the JRS 2 pension fund actuarially sound, emphasizing that it is also a two-part process, with the need to cover the normal cost, as well as address the unfunded liability. The first option would be to increase the state's contribution by 3.587% at an annual cost to the state of $3 million, in conjunction with the increase of an additional payroll contribution of 4.17% at a cost of $4 million. This option (option 1) would have an annual cost to the state of $7 million and would amortize the unfunded liability over 31 years. The second option (option 2) would require an increase in the state's contribution by 3.587% at an annual cost to the state of $3 million, in conjunction with a one-time payment of $105 million in order to address the unfunded liability. It is noteworthy that the one-time payment (option 2) would save the state $175 million over the next 31 years, compared to increasing the annual payroll contribution (option 1).[66]

Ms. LaVoie also spoke on a unique disadvantage that JRS 2 participants face when they retire and then are either appointed to the bench or decide to run for a position again. In these situations, she noted, that not only does the annuity payments cease, but the judges do not accrue additional credit towards their years of service. This differs from policies of other retirement plans in the state. Additionally, many judges have not received a benefit enhancement since 2007. The state must first appropriate the necessary funding for JRS 2 to make the plan actuarially sound, and then the Legislature should review these benefit enhancement opportunities for these members of the Judiciary.

SUMMARY OF COMMITTEE ACTION

The committee met in a public hearing on Tuesday, August 16, 2022 at 11:00 AM in order to hear invited and public testimony on the following: Evaluate the actuarial soundness of the Law Enforcement and Custodial Officer Supplemental Retirement Fund (LECOS) and Judicial Retirement System of Texas Plan 2 (JRS 2). Identify strategies to reduce and eliminate existing unfunded liabilities and recommend structural enhancements that improve the financial health and viability of the funds moving forward.

August 16, 2022 - 11:00 AM

<u>Actuarial soundness of LECOS and JRS 2</u>

1. Bishop, Ann (Texas Public Employees Association)
2. Jankovsky, Richard (DPS Officers Association)
3. LaVoie, Megan (Office of Court Administration)
4. Sheldon, Tyler (Texas State Employees Union)
5. Wilson, Porter (Employees Retirement System of Texas)

RECOMMENDATIONS

- Increase the state's contribution to the LECOS plan, along with a lump-sum payment to eliminate the unfunded liability.

- Consider a cost-of-living adjustment for LECOS retirees, once the fund is actuarially sound. Evaluate the impact to the state of adding Texas Juvenile Justice Department custodial officers as eligible participants in the pension plan.

- Increase the state's contribution to the JRS 2 plan, along with a lump-sum payment to eliminate the unfunded liability.

- Review opportunities to provide JRS 2 retirees a benefit enhancement, once the fund is actuarially sound.

V: Public retirement systems' investments in Russia

Review the impact of investments by public retirement systems of their endowment and other trust funds in businesses and funds owned or controlled by the Russian government or Russian nationals and determine the need for investment restrictions. Consider the impact of any proposed investment restrictions on fund performance.

On February 23, 2022, the Russian Federation invaded the independent state of Ukraine, engaging in an unnecessary war of choice. As of the date of publication, Russia continues its war against the people of Ukraine, with casualties estimated in the hundreds of thousands.[67] Many nations around the world, including the United States immediately imposed economic sanctions against Russia in retaliation, cutting off access to financial resources and crippling the nation's economy. As the 9th largest economy in the world by GDP,[68] Texas should consider leveraging its economic power in support of democracy; though we have an obligation to thoughtfully assess whether imposing Russian investment restrictions would interfere with our public retirement systems' fiduciary responsibilities to prudently invest and manage their assets for their members and beneficiaries.

In order to understand the scope of magnitude of the systems' investments in Russia, and evaluate whether there would be any adverse effects on the positions of their funds if the state were to decide to divest and/or bar future investments, the committee held a public hearing to receive testimony from representatives of the following statewide retirement systems: Teacher Retirement System, Employees Retirement System, Texas Municipal Retirement System, Texas County & District Retirement System, and Texas Emergency Services Retirement System.

The systems shared with the committee that prior to the Russian invasion of Ukraine, they had historical target allocations ranging from 0.17%-0.5% of their trust. This was for the purposes of diversifying their investments, particularly in emerging markets asset class of their global equity allocation. These were often equity investments in a number of sectors including energy, finance, consumer products, and raw materials. However, all the systems testified that following the invasion of Ukraine and the subsequent closure of the market in Russia combined with the current U.S. and Russian sanctions, the value of those investments collapsed overnight, and they have already marked those investments down to $0 for the purposes of valuating their portfolios. Additionally, they testified that their current target benchmark for Russian investments is 0%; and as the TRS Chief Investment Officer Jase Auby stated, "When the markets reopen and allow for transactions, we will seek to exit expeditiously in order to maximize value for our members."[69] They were in agreement that because those Russian investments are considered at $0 value, and target allocation for future Russian investments at 0%, there would be no negative impact on the performance of their funds if the state were to decide to impose investment restrictions in the future.

SUMMARY OF COMMITTEE ACTION

The committee met in a public hearing on Thursday, August 25, 2022 at 11:00 AM in order to hear invited and public testimony on the following: Review the impact of investments by public retirement systems of their endowment and other trust funds in businesses and funds owned or controlled by the Russian government or Russian nationals, and determine the need for investment restrictions. Consider the impact of any proposed investment restrictions on fund performance.

August 25, 2022 - 11:00 AM

<u>Public retirement systems' investments in Russia</u>

1. Auby, Jase (Teacher Retirement System)
2. Guthrie, Brian (Teacher Retirement System)
3. Ronn, Ehud I. (McCombs School of Business)
4. Tropea, David (Texas Emergency Services Retirement System)
5. Veal, David (Employees Retirement System)
6. Wescoe, David (Texas Municipal Retirement System)
7. Wilson, Porter (Employees Retirement System)
8. Wolf, Casey (Texas County & District Retirement System)

RECOMMENDATIONS

- Require statewide retirement systems to divest from businesses and funds owned or controlled by the Russian government or Russian nationals and prohibit future investments until such time as Russia withdraws from Ukraine. The Legislature should also consider similar investment restrictions on Russian satellite states such as Belarus.

ENDNOTES

[1] House Rules Manual, Rule 3 Sec. 26, 87th Legislature, 2021, https://house.texas.gov/_media/pdf/House-Rules-of-Procedure-87.pdf
[2] Ashley, Phillip. Comptroller of Public Accounts, PIFS Testimony, 25 August 2022.
[3] Ibid.
[4] Bussey, Christy. Independent Bankers Association of Texas, PIFS Testimony, 25 August 2022.
[5] Ashley, Phillip. Comptroller of Public Accounts, PIFS Testimony, August 25 2022.
[6]Aronstein, Tamara, Project Manager, "Staff Report with Final Results," Sunset Advisory Commission, June 2021, https://www.sunset.texas.gov/public/uploads/files/reports/TRS%20Staff%20Report%20with%20Final%20Results_6-30-21.pdf
[7] TRS, Welcome to the Office of the Ombuds, https://www.trs.texas.gov/Pages/ombuds.aspx
[8] Ibid.
[9] Guthrie, Brian. Teacher Retirement System, PIFS Testimony, 06 June 2022.
[10] Ibid.
[11] Ibid.
[12] Gregg, Brock. Texas Retired Teachers Association, PIFS Testimony, 06 June 2022.
[13] Guthrie, Brian. Teacher Retirement System, PIFS Testimony, 06 June 2022.
[14] Ibid.
[15] Ibid.
[16] TRS News Release, "Teacher Retirement System of Texas Closes on Successful Sale of Red River Property," 04 October 2022.
[17] TRS Presentation, House Select Committee on Health Care Reform, October 2022.
[18] PIFS Interim Report to 87th Legislature, 06 January 2021, https://house.texas.gov/_media/pdf/committees/reports/86interim/Pension-Committee-Interim-Report-2020.pdf
[19] Texas Classroom Teachers Association, written testimony to PIFS, August 2020.
[20] PIFS Interim Report to 87th Legislature, 06 January 2021, https://house.texas.gov/_media/pdf/committees/reports/86interim/Pension-Committee-Interim-Report-2020.pdf
[21] Daniel, Katrina. Teacher Retirement System, PIFS Testimony, 06 June 2022.
[22] TRS Presentation, House Select Committee on Health Care Reform, October 2022.
[23] TRS Presentation, "Impact of One-Time Federal Funding and Future Funding Options for TRS-ActiveCare (Draft)," November 2022.
[24] Ibid.
[25] Texas Government Code, § 802.101.
[26] TRS, "Pension Fund Facts At A Glance," https://www.trs.texas.gov/Pages/media_fund_facts.aspx, Nov. 2022.
[27] Gabriel Roeder Smith & Company, "TRS Actuarial Valuation Report as of August 31, 2021," Nov. 2021.
[28] Guthrie, Brian. Teacher Retirement System, PIFS Testimony, 06 June 2022.
[29] Gabriel Roeder Smith & Company, "TRS Actuarial Valuation Report as of August 31, 2022," Nov. 2022.
[30] Gregg, Brock. Texas Retired Teachers Association, PIFS Testimony, 06 June 2022.
[31] Ibid.
[32] Gabriel Roeder Smith & Company, "TRS Actuarial Valuation Report as of August 31, 2021," Nov. 2021.
[33] ERS, "Message from the Executive Director: 75 years of vital benefits," 12 September 2022, https://www.ers.texas.gov/news/message-from-the-executive-director-75-years-of-vital-benefits-and-an-eye-to-the-future
[34] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2022," Dec. 2022.
[35] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2020," Dec. 2020.
[36] Wilson, Porter. Employees Retirement System, PIFS Testimony, 16 August 2022.
[37] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2022," Dec. 2022.
[38] TPEA, "About SB 321," https://www.tpea.org/index.php/advocacy/legislation-tracker/about-sb-321
[39] Cardona, Amy. Pension Review Board, PIFS Testimony, 16 August 2022.
[40] Vernon's Civil Statutes, Article 6243e, § 19.
[41] Brainard, Keith. National Association of State Retirement Administrators, PIFS Testimony, 16 August 2022.
[42] Ibid.
[43] Cardona, Amy. Pension Review Board, PIFS Testimony, 16 August 2022.
[44] PRB, "Asset Pooling for Small Pension Systems," October 2018

[45] Hillman, Chris. City of Irving, PIFS Testimony, 16 August 2022.
[46] Texas Government Code, § 801.202.
[47] Cardona, Amy. Pension Review Board, PIFS Testimony, 16 August 2022.
[48] American Academy of Actuaries, "Issue Brief: Objectives and Principles for Funding Public Sector Pension Plans," February 2014
[49] Texas Government Code, § 802.2011.
[50] Cardona, Amy. Pension Review Board, PIFS Testimony, 16 August 2022.
[51] Ibid.
[52] PRB, "Policy for Promoting Compliance with Funding Soundness Restoration Plan Requirements," 06 October 2022, https://prb.box.com/shared/static/e1fluofioxdgezu3locif4zxaiy52s49.pdf
[53] PRB, "Biennial Report 2021-2022," 30 November 2022.
[54] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2021," Dec. 2021.
[55] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2022," Dec. 2022.
[56] Wilson, Porter. Employees Retirement System, PIFS Testimony, 16 August 2022.
[57] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2022," Dec. 2022.
[58] Wilson, Porter. Employees Retirement System, Appropriations Testimony, 8 September 2022.
[59] Ibid.
[60] Bishop, Ann. Texas Public Employees Association, Testimony in PIFS, 16 August 2022.
[61] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2022," Dec. 2022.
[62] Bishop, Ann. Texas Public Employees Association, Testimony in PIFS, 16 August 2022.
[63] Richard Jankovsky, Department of Public Safety Officer's Association, Testimony in PIFS, 16 August 2022.
[64] Gabriel Roeder Smith & Company, "ERS Actuarial Valuation Report as of August 31, 2022," Dec. 2022.
[65] Megan LaVoie, Office of Court Administration, Testimony in PIFS, 16 August 2022.
[66] Wilson, Porter. Employees Retirement System, Appropriations Testimony, 8 September 2022.
[67] BBC News, "Ukraine war: US estimates 200,000 military casualties on all sides," 10 November 2022, https://www.bbc.com/news/world-europe-63580372
[68] TxEDC, "Texas enters 2021 as world's 9th largest economy by GDP," 27 January 2022, https://businessintexas.com/news/texas-enters-2021-as-worlds-9th-largest-economy-by-gdp/
[69] Auby, Jase. Teacher Retirement System, PIFS Testimony. 25 August 2022.