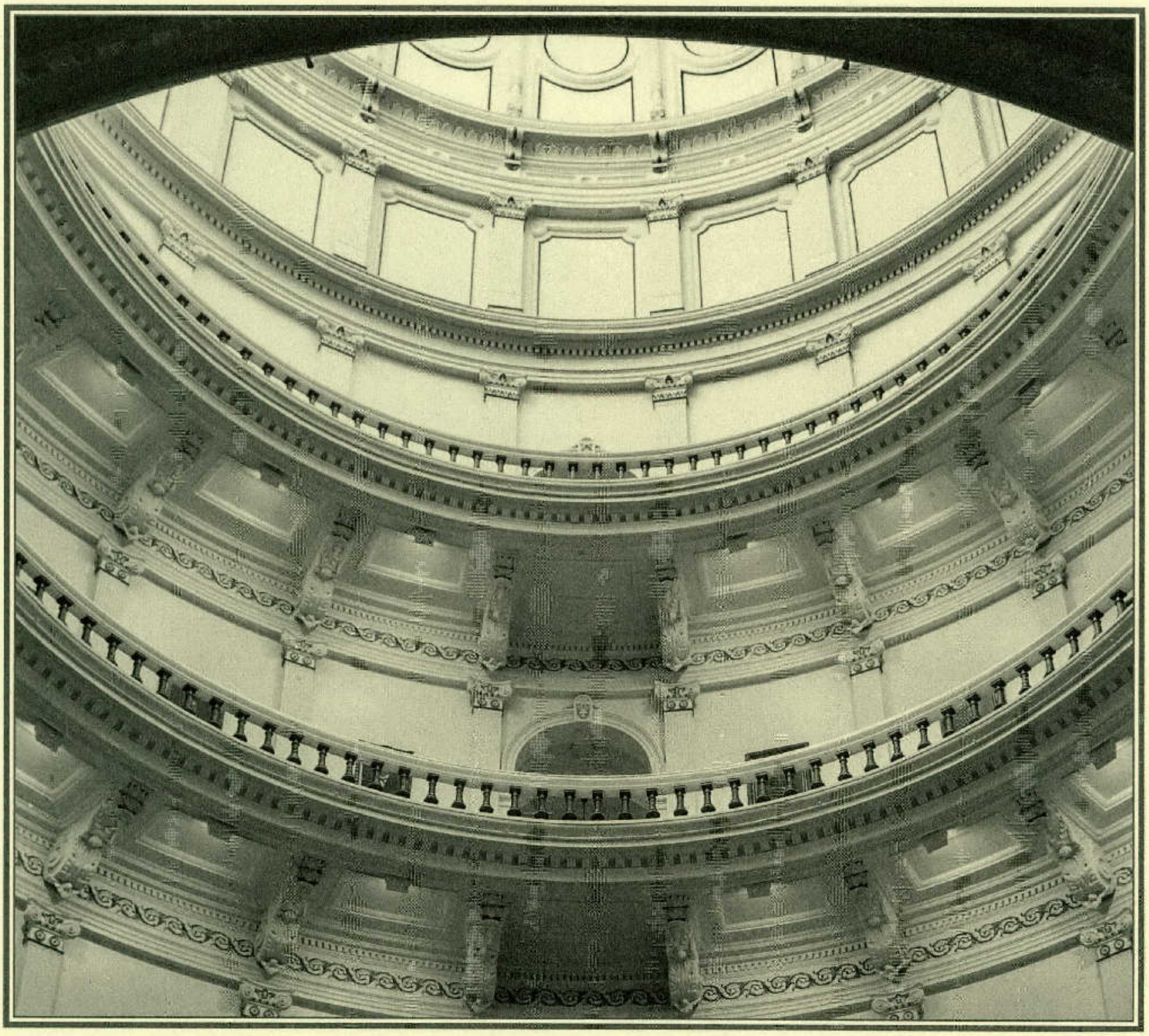
INTERIM REPORT
to the 86th Texas Legislature



HOUSE COMMITTEE ON PENSIONS

November 2018

HOUSE COMMITTEE ON PENSIONS
TEXAS HOUSE OF REPRESENTATIVES
INTERIM REPORT 2018

A REPORT TO THE
HOUSE OF REPRESENTATIVES
86TH TEXAS LEGISLATURE

DAN FLYNN
CHAIRMAN

COMMITTEE CLERK
MADISON ALBRECHT

Committee On
Pensions

November 30, 2018

Dan Flynn
Chairman

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

The Honorable Joe Straus
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 of the Eighty-fifth Legislature hereby submits its interim report including recommendations and drafted legislation for consideration by the Eighty-sixth Legislature.

Respectfully submitted,

Dan Flynn

Roberto Alonzo

Rafael Anchia

Dan Huberty

Justin Rodriguez

Dennis Paul

Cole Hefner

Roberto Alonzo
Vice-Chairman

Members: Rafael Anchia, Dan Huberty, Justin Rodriguez, Dennis Paul, Cole Hefner

TABLE OF CONTENTS

Interim Charges

Charge 1.
Oversight of Local Pensions
Review the state's oversight of pension systems and study the effectiveness of corrective mechanisms, including the Funding Soundness Restoration Plan and Pension Review Board Funding Guidelines. Make recommendations to enhance state oversight and to maintain or achieve soundness among local pension systems.

Charge 2.
Governance and Oversight of State Retirement Systems
Evaluate the governance structures, including investment oversight, of the Employee Retirement System (ERS), Teacher Retirement System (TRS), Texas Municipal Retirement System, Texas County and District Retirement System, and Texas Emergency Services Retirement System. Identify best practices and make recommendations to strengthen oversight within the systems.

Charge 3:
Health Insurance
Review and evaluate health incentive programs within the group benefit programs at ERS and TRS. Identify best practices among similar programs and barriers to implementation. Make recommendations for achieving further savings through existing and/or new programs.

Charge 4.
Committee Jurisdiction and Legislation
Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 85th Legislature.

Introduction

The Texas House Rules for the 85th Legislature state that the House Committee on Pensions is made up of 7 members with jurisdiction over all matters pertaining to: benefits or participation in benefits of a public retirement system and the financial obligations of a public retirement system; and the following state agencies: The Texas Emergency Services Retirement System, the Board of Trustees of the Teacher Retirement System, the Board of Trustees of the Employees Retirement System, the Board of Trustees of the Texas County and District Retirement System, the Board of Trustees of the Texas Municipal Retirement System, and the State Pension Review Board.

At the beginning of the 85th Legislative Session, Speaker Joe Straus appointed Chair Dan Flynn, Vice-Chair Roberto Alonzo, Representative Rafael Anchia, Representative Dan Huberty, Representative Justin Rodriguez, Representative Dennis Paul, and Representative Cole Hefner to the House Committee on Pensions.

During the 85th regular legislative session, 45 House Bills and 10 Senate Bills were referred to the House Committee on Pensions. Nine public hearings were conducted to consider the legislation on February 27th, March 13th, March 27th, April 3rd, April 10th, April 17th, April 24th, May 1st, and May 16th, 2017. The committee then favorably voted to send 25 bills to the Calendars Committee for consideration by the full House of Representatives. 14 of those bills passed the House and 10 were passed by the Senate, signed by the governor and are now effective as state law. Among the bills enacted into law are the pension oversight laws to save the Dallas Police and Fire Pension System as well the Houston police, municipal, and fire pension plans. Others included Sunset Review legislation for the Employees Retirement System of Texas, clean up bills for the Teacher Retirement System of Texas, provisions for the participation in the Texas Municipal Retirement System, and repealing obsolete laws in state pensions. During the 85th 1st Called Special Session, the committee was referred four bills and conducted a hearing on August 9th, 2017 to consider the legislation.

Over the interim, the committee held two public hearings on May 10th and October 12th, 2018 to consider the four interim charges.

Overview

While improvements continue to be made, the public pensions across Texas and throughout the United States are in need of continued oversight and reform to ensure that benefits remain available for current and future retirees while protecting taxpayer investments in these systems. Growing unfunded liabilities pose a risk to the financial stability and solvency of the retirement systems, the cities, and the state of Texas. When systems are at risk, credit ratings are reduced signaling decreased financial stability which contributes to rising bond and interest rates for the municipality. While the state economy is thriving, the growing unfunded liabilities present a risk of long-term solvency for current systems if no changes are made. As of the October 4th, 2018 Actuarial Valuation Report produced by the Texas Pension Review Board, the Unfunded Actuarial Accrued Liabilities totaled more $69.4 billion,[1] though some estimates put this number as high as nearly $80 billion once calculations take into account recently lowered discount rates for statewide systems. These unfunded liabilities grew significantly from 2011 when the Unfunded Actuarial Accrued Liabilities totaled $41 billion, therefore nearly doubling in the past seven years. Additionally, during this same period, the Funded Ratio decreased from 82.93% to 79.43%.[2]

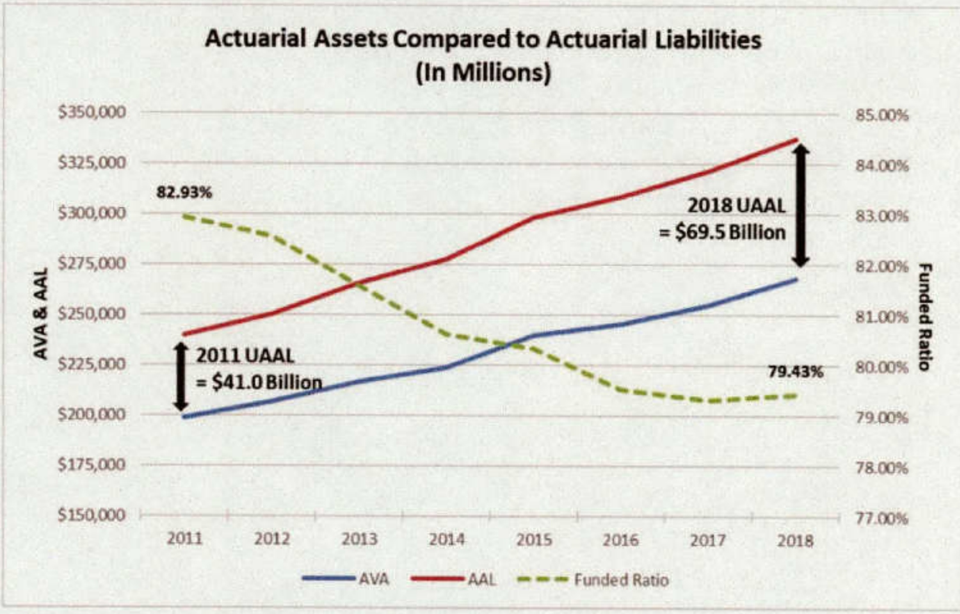
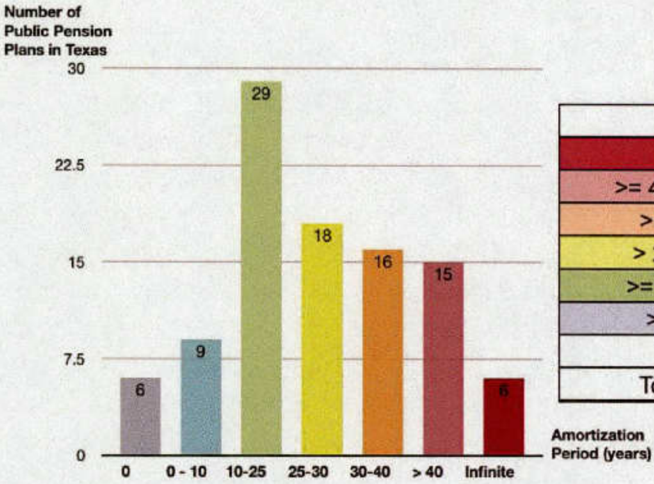


Chart utilizes information received by the PRB current through the dates listed. [3]

Currently out of the 99 registered defined benefit plans across Texas, 6 plans have an infinite amortization period, 15 plans have an amortization period that is between 40 and 104 years, and an additional 16 plans have an amortization period of 30-40 years. As of the last PRB Actuarial Valuation, only 62 of the 99 plans in Texas have an amortization period of less than 30 years.[4]



Plan Amortization Periods

	Number of Plans as of 10/4/18
Infinite	6
>= 40 years, but not infinite	15
> 30 years, < 40 years	16
> 25 years, <= 30 years	18
>= 10 years, <= 25 years	29
> 0 years, < 10 years	9
0 years	6
Total Plans Registered	99

PRB Data - October 4, 2018 Actuarial Valuation

5

Changes have been made over time, both within the systems and at the statewide level, to reduce these unfunded liabilities including efforts to raise retirement ages, increase employer and employee contributions, create new tiers for new hires, eliminate or change deferred retirement option programs (DROP), and eliminate automatic cost of living adjustments (COLA's). These changes are necessary to adequately fund the system while ensuring that unsustainable benefits are not continued at a detriment to the plan's long-term solvency.

Charge 1.
Oversight of Local Pensions

Review the state's oversight of pension systems and study the effectiveness of corrective mechanisms, including the Funding Soundness Restoration Plan and Pension Review Board Funding Guidelines. Make recommendations to enhance state oversight and to maintain or achieve soundness among local pension systems.

Local Pension Oversight

While local pension systems are operated by a board of trustees and local laws, these plans are also subject to state-wide laws and oversight by the Texas Legislature and the Texas Pension Review Board. In order to provide appropriate guidance, information, and oversight, there have been multiple mechanisms put into place to instruct systems and provide transparency to the public to ensure the continued soundness of local systems.

In addition to oversight exercised by the Texas Legislature in providing guidance, standards, and reform for failing systems, the Texas Pension Review Board provides the continual review, resources, and reporting to inform the individual systems as well as the legislature and governor. The responsibilities of the PRB include conducting reviews of all public retirement systems in Texas, recommending policies practices and legislation to systems and their sponsoring governments, conducting intensive studies of problems facing public retirement systems, providing technical assistance, and reporting to the governor and legislature each biennium.

Resources and Transparency

Minimum Education Training Program

The Minimum Education Training Program (MET) was created by the Texas Pension Review Board after the passage of HB 13 during the 83rd Legislature in 2013 which established section 801.2011 of the government code directing the PRB to administer an educational training program for trustees and administrators.[6] The training requirement further expanded through SB 220 which required training to meet the specific needs of TLFFRA trustees in small and medium plans.[7]

In February 2016, the PRB published the 'Curriculum Guide for Minimum Educational Training' detailing the content requirements and objectives for the curriculum topics of each training areas. The seven required core content areas are fiduciary matters, governance, ethics, investments, actuarial matters, benefits administration, and risk management. Current trustees have one year to complete the 7 hours of core training with additional continuing education every two years with required completion of 4 hours in courses of core or non-core training.[8] Continuing Education (CE) training can be made up of core training content or non-core training to include: compliance, legal and regulatory matters, pension accounting, custodial issues, plan administration, Texas Open Meetings Act, and the Texas Public Information Act. The MET program is required to be completed by new and continuing trustees and administrators to ensure a basic understanding of the core topics relating to public pensions in Texas.[9]

While training may be provided by MET accredited sponsors or through individual courses approved by the board, the Pension Review Board also created an online version of the MET through which all seven core training components are offered through interactive slides and follow up questions to test material comprehension. These online courses were designed and created by Pension Review Board staff, and copyright for the program was secured in early 2018.

Interim Reports and Studies

A report on the status of Texas public pensions is published by the Pension Review Board each biennium before the legislative session to provide information and recommendations to policymakers and retirement systems as well as updates on research and developments. Additionally, February of the Legislative session, the PRB publishes the updated Guide to Public Retirement

Systems in Texas which serves as a valuable primer to describe PRB guidelines, financial, benefit, and investment summaries, as well as details of many of the retirement systems across Texas. Additionally, 3-4 times a year at each board meeting, the PRB reports on the current status of the public retirement systems across Texas with the Actuarial Valuation Report as well as the Funding Sounding Restoration Plan Report. Additionally, a current list of plans non-compliant in either their reporting or MET requirements is provided. Other reports produced by the PRB include the February 2018 TLFFRA Pension Report, and the 85th Legislative Session Summary on Pension Legislation Passed. Currently, the Pension Review Board is developing research and legislative recommendations on two issues: funding policies for fixed rate pension plans and asset pooling for smaller pension plans.

Online Pension Dashboard
The Public Pension Search Tool hosted on the Comptroller's website using data reported to the Pension Review Board provides current, historical, and comparative data on Texas defined benefit plans. It includes information on both state and local pension plans, and searches can be done to review information individually by pension name or groups of systems can be viewed comparatively and ranked by key indicators. Selecting a plan provides additional details on investment returns, asset values, funded ratio, unfunded liabilities, contribution rates, plan membership, and expenses.[10]

System Oversight

Pension Review Board Guidelines
One of the duties of the Pension Review Board is to recommend policies, practices, and legislation to public retirement systems and their sponsoring governmental entity. These PRB guidelines were written to recommend the best practices for plan design and funding guidelines.

Effective June 2017, the new Pension Review Board Funding Guidelines recommend that the actual contributions to the plan should be sufficient to cover the normal cost and to amortize the unfunded actuarial accrued liability in a target period of 10-25 years but not to exceed 30 years. Additionally, benefit increases should not be adopted if plan changes would cause the amortization period to exceed 25 years. Current plans with amortization periods over 30 years should seek to reduce their amortization period as soon as practicable but no later than 6/30/2025. Along with the recommended reduction in amortization period, the PRB recommends that both the funding of the unfunded actuarial accrued liability and the allocation of the normal cost portion of contributions should be level or declining as a percentage of payroll allocation over time.[11]

In June 2018, the Pension Review Board adopted the PRB Principles of Retirement Plan Design. Recognizing that a secure, sustainable retirement is vital and that benefits should be protected through sound plan design and adequate funding, these principles were created to guide systems and government entities on how to structure retirement plans. The listed principles include that public employers should offer a retirement benefit with mandatory participation, employers and employees should share the cost, and benefits should be designed to place employees on the path to financial security.[12] Additionally, retirement plan assets should be pooled and professionally invested while governance should represent the interest of all stakeholders, respect fiduciary standards, and be publicly accountable. The PRB considers these key ideas to be guiding principles for public systems because retirement benefits are critical elements of employee compensation, recruitments, and retention while the prudent design and financial management of these benefits are necessary to maintain budgetary stability to provide essential services.[13]

Funding Soundness Restoration Plan

The Funding Soundness Restoration Plan was developed in the 84th legislative session through HB 3310. This legislation established that retirement systems which receive several consecutive actuarial valuations with an amortization period over 40 years, trigger a requirement to jointly formulate a Funding Soundness Restoration Plan with the system board and sponsoring entity to be submitted to the Pension Review Board within six months. The established Funding Soundness Restoration plan must reduce the amortization period to 40 within ten years and updates must be reported to PRB every two years.[14]

Currently, 15 systems have submitted FSRPs. Of those, two systems have successfully gotten below 40 years, ten systems are working towards 40 years, and three systems are developing a revised plan since the initial FSRP was not met. One system, the Fort Worth Employees Retirement Fund, has been subject to the FSRP requirement since January 2017 but has not yet submitted their required FSRP.[15] Six additional systems will be subject to the FSRP requirement if the next actuarial valuation shows an amortization period over 40 years.

Intensive Actuarial Reviews

In line with the duty to conduct intensive studies of potential or existing problems threatening the actuarial soundness of public retirement systems, the Pension Review Board established a selection and review process to identify and analyze at-risk systems. This review process involves the PRB conducting Intensive Actuarial Reviews of specific retirement systems facing potential risks threatening their long-term stability. Key metrics that are analyzed include amortization period, funded ratio, UAAL as a percent of payroll, assumed rate of return, payroll growth rate, actual contributions as a percent of actuarially determined contributions, DROP balance as a percent of fiduciary net position, and non-investment cash flow as a percent of fiduciary net position.[16] By providing a background on the plan, detailing a risk analysis, funding levels, and discussing the investment experience and asset allocation, the PRB offers information on key metrics and concerns that systems should address. Recommendations are then made for plans to adopt a funding policy that requires payment of an actuarially determined contribution to fully fund the plan in 30 years or less and continually review and update actuarial assumptions. Adopting a formal risk/cost sharing network is recommended to reduce uncertainty and set a plan for modifying benefit and contribution levels in changing economic conditions. Concerning investments, the PRB recommends an in-depth study of risk based on current asset allocations and monitoring investment performance to reevaluate based on investment experience. The review process also includes an invitation for sponsors and systems to provide a written response to be included in the final report as well as a request to discuss the review at the Pension Review Board meeting. This allows a continued dialogue as well as a chance for PRB staff and board members to provide recommendations and guidance for continued improvement.

The Pension Review Board has completed 7 Intensive Actuarial Reviews in 2018. Beginning in January, the PRB addressed Galveston Employees' Retirement Plan for Police and Greenville Firemen's Relief and Retirement Fund. Continuing in April, Beaumont Firemen's Relief and Retirement Fund and Marshall Firemen's Relief and Retirement Fund were completed. In October 2018, the PRB finished three more systems, Longview Firemen's Relief and Retirement Fund, Orange Firemen's Relief and Retirement Fund, and Irving Firemen's Relief and Retirement Fund.

Strengths and Limitations of the Oversight Mechanisms

Current oversight of local systems has been largely successful; however, there are limitations which should be addressed. While many current systems operate successfully by following general guidelines and ultimately most systems do seek to comply, without enforcement mechanisms, there lacks a method to compel noncompliant systems to act. The methods currently enacted through guidelines and resources provide adequate information and suggestions however without requirements enforced by law, there can be a significant delay with systems taking sufficient action to remedy the problems. With a legislature only meeting every two years, much damage can be done in a local system before there is a chance for adequate intervention. The changes in PRB Funding Guidelines are necessary to keep Texas standards in line with accepted practices. While there is a phase in with systems having until 2025 to make these reductions, this committee will continue to observe these plans carefully to ensure systems across Texas are moving in the right direction to decrease amortization periods while reducing the unfunded actuarial accrued liability.

While the Funding Soundness Restoration Plan has been shown to motivate systems to work together with plan sponsors to bring down the amortization period, limitations of FSRP include a lack of enforcement and well as a long implementation timeline. Currently, while systems are required to submit a plan within six months, there is nothing compelling them to do so. Because systems have ten years to get below the 40 year amortization period, some plans that have an amortization period of less than 50 years wouldn't necessarily have to make any reductions at all. Additionally, because the new PRB guidelines recommend systems have a target amortization period of 10-25 years but not to exceed 30 years, by allowing this extra 20 year leeway, the impacted plans are not moving as quickly as necessary to make necessary adjustments and many plans outside of PRB guidelines may take several more valuations before becoming subject to FSRP requirements.

The introduction of the Intensive Actuarial Review process has been shown to be an informative resource both to local systems looking to make plan changes as well as for legislative oversight purposes. These reviews provide valuable insight both in regards to the specific plan itself as well as offer examples to systems facing similar concerns. Providing these conclusions and recommendations to the systems offer an additional perspective on what is most critical and allow observers to better understand the concerns and possible solutions. While the current limitation is the number of Intensive Actuarial Reviews that can be conducted due to the extensive time and individual analysis required, this committee would be interested in the expansion of this program to assist a greater number of systems.

Recommendations

Additional legislation that could bolster the current Funding Soundness Restoration Plan would require a lower amortization period threshold to trigger FSRP requirements while requiring the FSRP goal to be in line with current PRB guidelines. The FSRPs submitted would require a reduction in the amortization period with a scaled timeline based on the current amortization period. Therefore, plans with an infinite or 100 year amortization periods would have a longer time to achieve their goal than a system currently at 40 or 50 years. This would require plans to act sooner and design their funding plans to be more in line with industry standards and PRB guidelines.

Additionally, increased funding is necessary to provide the Pension Review Board with additional staff and resources to analyze and research many of these failing systems. Through creating suggestions for faltering systems and general recommendations for success, the PRB provides necessary information to both local systems and the state legislators seeking to make improvements. In order to continue and expand the research and analysis currently available, additional resources would provide the necessary support for increased intensive actuarial reviews, additional studies, and in-depth state-wide analysis of the current problems facing public pensions. Because the issues facing public pensions are growing, in Texas and across the nation, the state cannot afford to stand by if additional changes can be made now to limit the impact of future problems.

Charge 2.
Governance and Oversight of State Retirement Systems

Evaluate the governance structures, including investment oversight, of the Employee Retirement System (ERS), Teacher Retirement System (TRS), Texas Municipal Retirement System, Texas County and District Retirement System, and Texas Emergency Services Retirement System. Identify best practices and make recommendations to strengthen oversight within the systems.

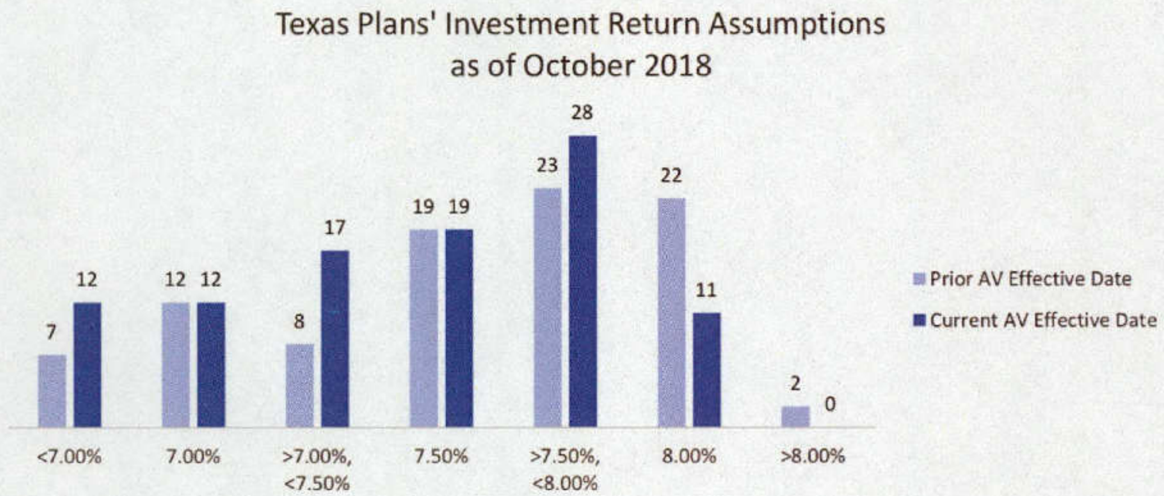
Statewide Retirement Systems

Currently, Texas state-wide retirement systems have a varied investment portfolio, with strong investment returns ranging from 9.54% to 14.7% last year. However, both the three year and ten year returns average below the assumed rate of return. Additionally, the funded ratio and high actuarial assumptions continue to cause concerns amongst the systems. Most prominently, ERS and TRS have been watched closely as a result of the change in the assumed rate of return. Even if systems that appear to be doing well, strong governance will need to continue working to allocate investments accordingly and change the assumed rate of return as necessary to prevent unnecessary investment losses or unrealistic predictions.

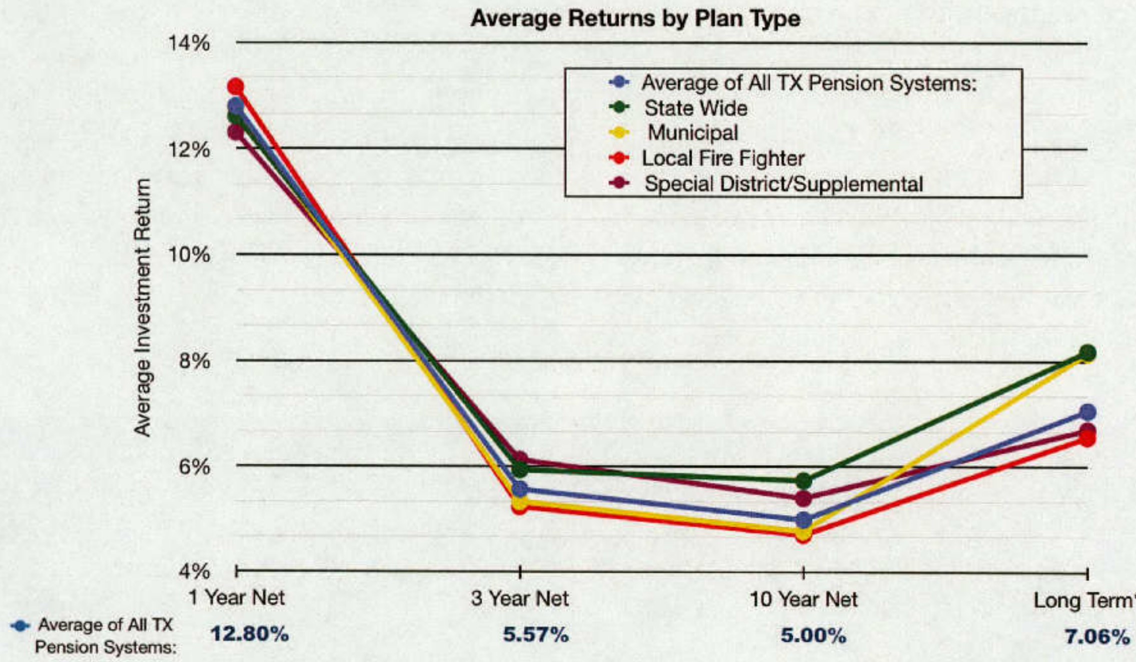
Investment Allocation and Fees

Looking at public pension plans across the nation, a September 2018 report by The PEW Charitable Trusts found that retirement systems' allocations to alternatives investments have increased greatly in recent years, increasing from 11% of the portfolio in 2006 to 26% of the portfolio in 2016.[17] While at times has been a successful strategy, it has also proven to be a greater risk and higher cost on plans.

Another concern is the increased fees associated with investments. While some higher fees lead to an adequate increase in investment returns, others fail to sufficiently make up for that cost. Nationwide, reported fees have increased from an average of 0.26% in 2006 to 0.33% in 2016, though this varies widely across the various systems. Amongst the 73 largest systems in the country, over $9.2 billion were paid in fees and investment expenses in 2016.[18] It is critical for trustees to consider the effectiveness of current investments by asset class while considering the management fees involved.



19



While these systems have a potential for better returns, higher risk alternative and equity investments also have an increased vulnerability due to the market volatility. Public sector pensions continue to have returns fall short compared to the actuarial assumptions creating an increased gap in funding.

Assumed Rate of Return

Nationwide, the assumed rate of return in both Texas systems and nationally have continued to be reduced. Currently, the average investment return assumption for Texas systems is 7.40% this is compared to nationally with an average of 7.36%[20] and as these numbers decrease, this trend is expected to continue in the future.

Actuarial experience studies are required to be conducted every five years for public retirement systems with assets over $100 million. These are done to determine if actual plan behavior, provisions, and investment returns have matched assumptions. In response to changing market conditions and actual plan experience, retirement systems across the country have reduced their return assumption in recent years, and this is expected to continue. The assumed rate of return is an assumption with a direct impact on the liability measurement of a plan. These higher return assumptions, while optimistic at best, serve to underestimate the liability of the plan, therefore, underfunding the plans and causing instability in the future once the returns are not achieved if the recommended contributions are not raised accordingly.

Earlier this year, both ERS and TRS completed an experience study during which both systems decreased the inflation assumption, updated their mortality tables, adjusted the salary growth, retirement rate, and termination rate assumptions, and recommended a lower nominal investment return assumption. The TRS Actuarial Experience Study recommended a 7.25% and provided a table showing the probability of achieving these projections over the 10-year and 30-year expected rate of returns. In this table it showed a 7.25% return as a 48.9% probability for the next 10 years, and 51.6% for the next 30 years. After reviewing their respective Actuarial Experience Studies, both TRS and ERS chose to lower their assumed rate of return to 7.25% for the Teacher Retirement System and 7.5% for the Employees Retirement System. The trends nationwide show a decreasing assumed rate of return, and retirement systems should not delay these changes based on concerns of the impact that it will have on funded ratio or amortization period. While initially, these changes do cause the unfunded liabilities to increase substantially, ultimately, this is a necessary change to bring the future outlook of the plan closer in line with the likely investment outcome going forward so that contributions and benefits can be addressed as needed.

Average Returns by Plan Type

Plan Type	1-Year Net	3-Year Net	10-Year Net	Long-Term Net*
Statewide	12.61%	5.94%	5.74%	8.18%
Municipal	12.76%	5.34%	4.78%	8.14%
Local Fire Fighter	13.16%	5.24%	4.71%	6.56%
Special District/Supplemental	12.31%	6.13%	5.41%	6.70%
All	12.80%	5.57%	5.00%	7.06%

According to the most recent fiscal year-end Investment Returns and Assumptions Report.

**Long-term return is 30 years or longest term available between 11-30 years that plans reported to the PRB.*

21

Recommendations

The committee recommends that systems look closely at the assumed rates of return as well as investment allocations to ensure that both are the most realistic that can be expected while not unnecessarily risky. This is the responsibility of the board and trustees are asked to evaluate this critical factors carefully to protect these funds in a changing market.

Additional oversight of investment practices and performance by independent evaluators to review the systems' investments could be a valuable tool to ensure that best practices are followed and to protect the funds of employees and retirees throughout the state.

Charge 3:

Health Insurance

Review and evaluate health incentive programs within the group benefit programs at ERS and TRS. Identify best practices among similar programs and barriers to implementation. Make recommendations for achieving further savings through existing and/or new programs.

Health Insurance

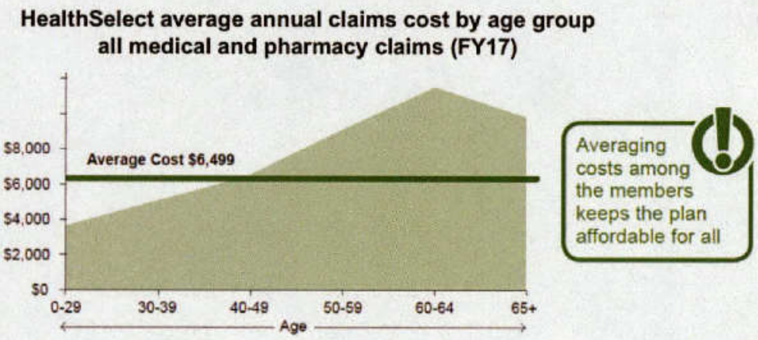
The rising cost of healthcare is apparent nationwide and shows no sign of stopping. This increase is especially pronounced when funding is allocated as a stagnant number per employee or as a percentage of payroll since these appropriations fail to account for the rising cost of healthcare. Therefore tough decisions must be made time and again to account for the increasing costs to ensure the continuance of health benefit options in TRS-Care, TRS-ActiveCare and other plans across the state.

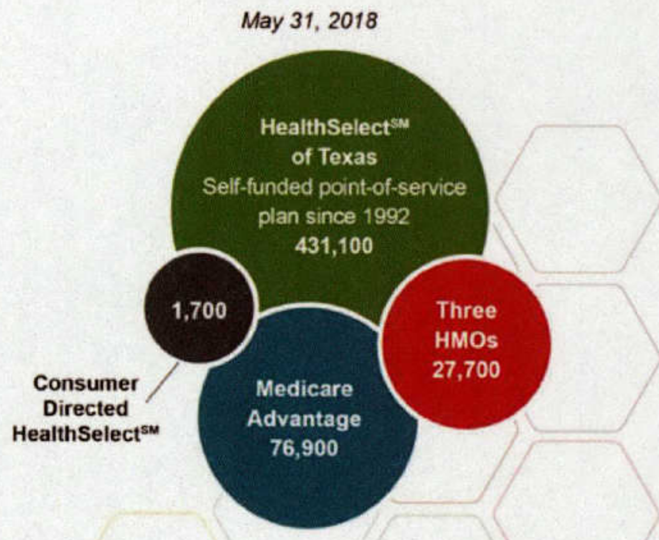
Employees Retirement System

The Employees Retirement System of Texas has managed insurance benefits for state employees and retirees since 1976. Currently, the ERS Group Benefits Program (GBP) covers more than half a million people, 1 in 52 Texans.[22] GBP membership (not including dependents) is currently 214,592 employees and 109,446 retirees. Looking at the benefits program by the numbers, in Fiscal Year 2017 there was $9.6 million spent daily on GBP medical and prescription drug cost, $3.5 billion in payments to hospitals, pharmacies, and providers across Texas, and 6.1 million HealthSelect medical claims paid.[23]

Participants benefit from large risk pool, and by averaging costs amongst the members, the plan is affordable for all, with an average cost of $6,499. Through the ERS Group Benefits Program, several options are offered to meet employees and retirees needs to include: HealthSelect of Texas, Consumer Directed HealthSelect, Medicare Advantage, and HMOs. Currently, 80% of all participants are enrolled in HealthSelect of Texas. About 65% of members chose member-only coverage across all enrollment options (Consumer Directed HealthSelect, HealthSelect, and HMO's) while in Medicare Advantage plans, 75% chose member-only coverage.

24





Cost Reduction Efforts

In order to save money for participants and the state, ERS has made extensive efforts to contain costs, offer preventative measures, implement competitive bidding, reduce pharmacy expenses and administrative costs.

Administrative Costs: The ERS Board of Trustees contracts for the administrative services which are less than half that of the average large private sector employer plan. Since 2005, the external administrative costs were reduced from 5.4% of total group benefit spending to 1.8% in 2017.[25]

Pharmacy Costs: Pharmacy costs have been reduced significantly through increased generic dispensing which has grown by 12% since 2012, from 73.4% to 85.7%. To make generic prescriptions more affordable, in 2015 ERS reduced generic copays from $15 to $10 per prescription.[26]

Preventative Care: Preventive services provided by a network doctor are covered 100%. These services includes annual check-ups, vaccinations, and routine preventative care.

Virtual Visits: Virtual Visits connect participants with a Texas-licensed physician directly through their mobile devices or computers with Doctor on Demand or MD Live. September 1, 2017, ERS eliminated the copay for virtual visits that was previously $10, which has led to a significant increase in participation. The average number of virtual visits per month in 2016 was 88, which grew to 384 in 2017, before spiking to 2,150 visits per month in the first half of 2018. These virtual visits offer an alternative option for participants to increase convenience and reduce expenses. Virtual Visits saves money for both the HealthSelect Plan and participants due to the copay elimination estimated at $1 million.[27]

Pre-Diabetes Prevention Programs: Real Appeal was implemented April 2016 as an online weight loss program that uses coaches to motivate participants to get active and lose weight. Available at no cost to eligible participants enrolled in HealthSelect or Consumer Directed HealthSelect with a BMI of 23 or higher. 23,654 participants enrolled with 90% medically at risk either obese or pre-diabetic. Since then, 41% of participants completed nine or more weeks of the program, and over 123,000 pounds were lost. This program has a projected net savings of $11 million after three years. Another program, Naturally Slim was implemented in September 2017 and uses clinicians and coaches to focus on behavioral modification to lose weight and improve health.[28]

Consumer Directed HealthSelect

In September 2016, ERS implemented a high-deductible health plan (HDHP) paired with a health savings account (HSA) for eligible employees and retirees in the Texas Employees Group Benefits Program. The 85th Legislature through SB 1 required ERS to analyze the experience of the plan as well as to research and develop alternative cost-neutral plan design options for high deductible health plans.

Because the statute requires cost neutrality (equivalent in value to HealthSelect of Texas), any change in the value of a benefit requires an offset to balance changes in plan benefits. Currently, the Consumer Directed HealthSelect Plan 2018/2019 in-network deductible is $2,100 for individuals and $4,200 for families. While the cost-sharing structure of the Consumer Directed HealthSelect plan is designed differently from the other plans, the covered services and coinsurance percentages are the same for most medical services. All plans cover in-network preventive services at 100% and carry the same out of pocket maximum.[29]

Members enrolled in Consumer Directed HealthSelect are eligible for benefits of a health savings account (HSA) which can be used to pay for eligible out of pocket costs for current expenses or in the future. Members are encouraged to make additional tax-free contributions to their HSA through payroll deductions. The triple tax protection on HSA's helps save participants money since contributions are tax-free, earnings on savings grow tax-free, and funds withdrawn for eligible medical expenses are income tax-free. The State contributes $45 month for individuals or $90 month for families which totals an annual contribution of $540 individuals and $1080 for families.[30] These balances carry over from year to year, even if the employee no longer works for the state.

Comparing Consumer Directed HealthSelect to public- and private-sector HDHPs (FY18)

	Consumer Directed HealthSelect℠ (member / family)	State health plans median[8] (member / family)	Private sector median[9] (member / family)
Network deductible	$2,100 / $4,200	$1,750 / $3,400	$1,750 / $3,600
Employee's monthly contribution rate or premium	$0 / $535	$42 / $212	$83 / $318
Employer contribution to HSA or HRA	$540 / $1,080	$599 / $1,000	$500 / $1,000
Maximum out-of-pocket for in-network services	$6,550 / $13,100	$4,000 / $8,000	$3,500/ $7,000

[31]

When the Consumer Direct HealthSelect (CDHS) was established September 1, 2016, 669 participants enrolled with enrollment steadily increasing to 1,782 participants as of June 31, 2018. Active Employees who participate in CDHS tend to be younger, with shorter employment tenure, and higher salaries than participants in the HealthSelect and HMO plans.[32] 78% of Consumer Directed HealthSelect members made personal contributions during the first year of the plan. FY17 Contributions were $776,373. Once HSA holders have a base of $2,000 they are eligible to invest a portion of the balance in mutual funds, of which 50% chose to do so. For the FY 2017, the median CDHS member contribution was $868 with a median expenditure of $540.[33]

Teacher Retirement System

The Teacher Retirement System manages healthcare benefits for over 700,000 participants in both TRS-Care and TRS-ActiveCare health benefit plans.

TRS-Care

Created in 1985, TRS-Care provides health benefits through medical and pharmacy networks for retired public education employees and their dependents. Operating through a separate trust fund, TRS-Care is funded on a pay-as-you go basis. When TRS-Care was created, the law required that a no-cost basic health plan be offered to retirees while also allowing premium coverage plans and additional coverage for spouses and dependents.

Prior to the action taken in the 85th Legislature, projected TRS-Care shortfalls for the biennium reached $1.06 to $1.3 billion with a projected shortfall between $4 and $6 billion in the following biennium.

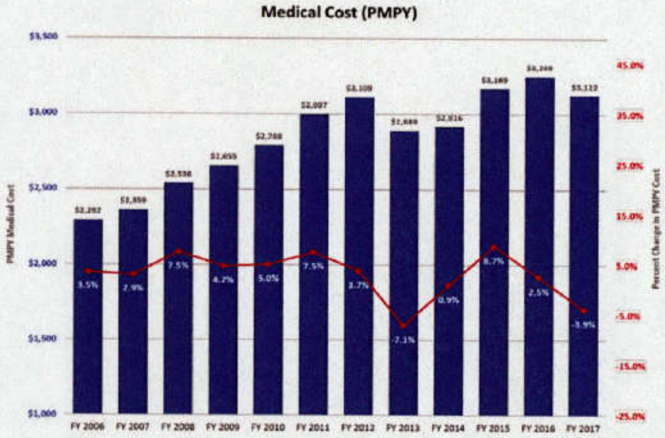
Plan Changes during the 85th Legislature:
During the 85th regular legislative session, through SB 1 and HB 3976, the funding structure was changed to reduce the impending shortfall facing the plan. The school district contribution increased from 0.55% to 0.75% of the active employee payroll and the state contribution was raised from 1.0% to 1.25% of active employee payroll. Additionally, $182.6 million in supplemental state funding was provided.[34] The previous legislative intent to not raise retiree premiums was determined unsustainable, and the no-cost basic coverage was eliminated. The previously available plan options of TRS-Care 1, TRS-Care 2, and TRS-Care 3 plans were eliminated and restructured to create a high deductible health plan for non-Medicare participants and to offer a Medicare Advantage and Medicare Part D plans for Medicare participants. The plans also provide no-cost coverage for certain generic maintenance drugs as well as an additional enrollment opportunity for retirees aging into Medicare, and they maintain a $0 premium for currently enrolled disability retirees.

Because plan changes raised retiree healthcare costs significantly, during the 85th special session, HB 21 and HB 30 were passed to make additional changes to the plan. $212 million in additional state funding was provided to offer relief to every participant in TRS-Care by reducing costs for retirees and their families. As a result of this funding, the Standard Plan deductible was reduced from $3,000 to $1,500.

Impact of Recent Legislation:
The current enrollment in TRS-Care is 232,595 as of August 2018 to include 67,923 in the HDHP plan, 161,456 in the Medicare Advantage Plan, and 3,216 in the Alternative Medical plan. Compared to the 268,891 TRS-Care participants in December 2017, this is a reduction of 36,296 participants. Currently, the Fiscal Year 2021 shortfall is projected to be $400-$600 million.[35]

Continuing Challenges:
Despite legislative changes and increased funding, the current structure is still not sustainable. Because the plan's long-term funding is based on percentages of active employee payroll rather than the cost of healthcare, if healthcare costs continue to rise, additional funding will be required, either as increased premiums, additional supplemental payments, or increased percentage of payroll. Non-Medicare eligible retirees cost up to 4 times more than those who are Medicare eligible; therefore additional measures need to continue to be taken to reduce these costs as possible. Because retiree premiums and plan design were frozen from 2005 - 2017, the increase in costs for retirees occurred dramatically and though that increase was mitigated by

one-time supplemental funding, the plan shortfall will continue to increase in the future.



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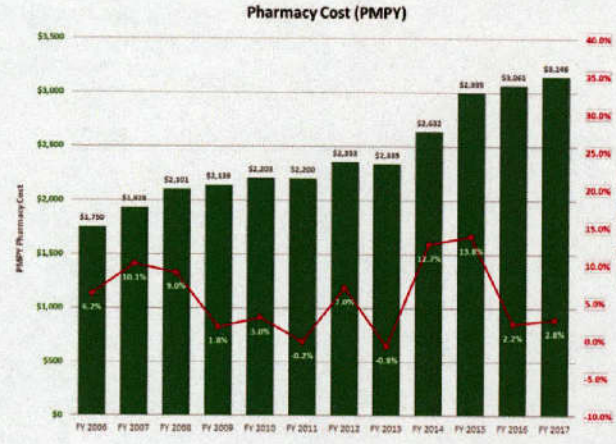

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TRS-ActiveCare

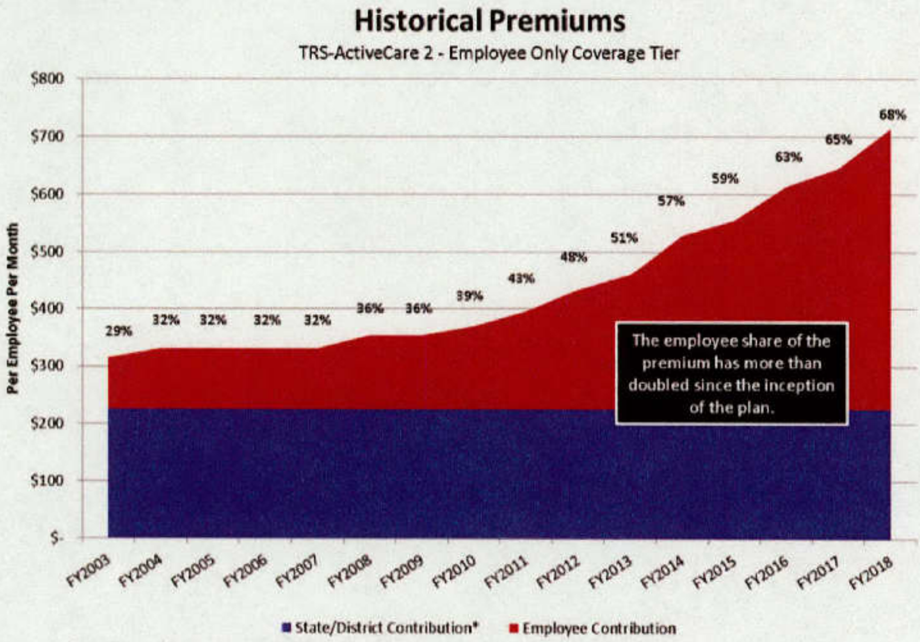
In 2001, legislation was passed to create the Texas School Employees Uniform Group Health Coverage Program, know as TRS-ActiveCare. ActiveCare provides health benefits for active public education employees and their dependents.

Funding

TRS-ActiveCare is a self-funded program with plan designs and premiums set yearly by the board based on funding and experience. The ActiveCare program is funded $75 per employee per month though school finance formulas. The Districts contribute a minimum of $150 per employee per month (some contribute more) and employees contribute the remainder.[38] While the minimum state and district contributions have not changed the the development of the plan in 2002, the employee share has increased from 30% to over 60% in the last 14 years.[39]

Challenges

Because the state and district funding is based on a fixed dollar amount per employee rather than the actual cost of healthcare, the employee's cost share of the total premium has increased significantly as the cost of healthcare goes up. As a result, employees are selecting lower benefit plans. Additionally, because of the variation of healthcare costs across Texas, some schools that originally joined the TRS-ActiveCare plan now wish to offer a separate insurance as a district. However, current law does not allow districts to opt-out in order to avoid adverse selection in which higher-cost regions and smaller districts stay in while others leave, raising the price of insurance for all. While previous bills have failed due to the high cost it placed on the remaining plans, considering options for these districts is something that bears consideration in order to ensure that Texas teachers across the state have affordable health care options.



\ssumes a $75 state and $150 minimum district contribution per month toward the cost of coverage.

Recommendations

While some similarities can be drawn between ERS and TRS healthcare programs, there are crucial distinctions between the two, in regards to funding sources, membership population, and structure. However, beyond the differences in the healthcare benefits itself, differences in cost have been a concern. While many focus on the higher cost of TRS insurance options, it fails to take into account the distinctions in the pensions they receive. Currently, state employees pay 9.5% of their paycheck to ERS while public school employees contribute 7.7%. In retirement, TRS retirees have an average monthly benefit of $2,244,[40] while the average ERS retiree's benefits are less than $2,000 a month. During the 2016 Joint Interim Committee to study TRS Health Benefit Plans, calculations were done to determine what it would cost to offer a single combined plan to active and retired public school teachers and employees in Texas with similar benefits to the current ERS HealthSelect plan. These calculations determined that creating this plan would cost an additional $10.4 billion for a total cost of $15.3 billion for the 2018-2019 biennium; this number would increase even more for the 2020-2021 biennium with $12.7 billion in additional funding necessary.[41] Given the current constraints of the state budget, this is not something that could feasibly be obtained therefore other options need to be considered.

In order to work through the challenges of making changes to a system impacting school districts across the state with size, geographic, and cost variations, the committee recommends forming a TRS-ActiveCare advisory panel to advise the legislature on future changes that could best assist teachers in districts across the state. Made up of teachers and administrative staff from school districts across the state, these members would be able to represent areas with differences in healthcare costs, rural and urban, large and small districts. These individuals will work in conjunction with the TRS staff and members of the legislature to provide potential solutions.

Currently, due to the scope of the funding problem as a result of the funding structure of TRSCare, there is no simple solution, short of once again infusing hundreds of millions of dollars into the system. After listening to testimony from witnesses at the committee hearing and meeting with stakeholders, creating a sustainable health care option for retired teachers continues to be a focus of this committee going forward.

Charge 4.
Committee Jurisdiction and Legislation

Monitor the agencies and programs under the Committee's jurisdiction and oversee the implementation of relevant legislation passed by the 85th Legislature.

Legislative Oversight of the 85th Session

During the 85th Legislature, ten committee bills were signed into law, the two most impactful being HB 3158 and SB 2190, to save and reform the Dallas and Houston retirement systems. After months of negotiations between the plans, the cities, and the employee associations, these laws worked to establish a sustainable future and create long-term solvency for the systems going forward to ensure support for our police, fire, and municipal employees. Without intervention, the unfunded liabilities would have continued to increase at an unsustainable level and the Dallas Police and Fire Pension System would have run out of funds within a decade. While no entity received everything they wanted, sacrifices were made on all sides to develop an equitable outcome for both taxpayers and employees.

H.B. 3158: Dallas Police and Fire Pension System

After unanimous votes in the House and Senate, HB 3158 was signed into law by the governor on May 31, 2017. This law made necessary changes to the Dallas Police and Fire Pension System board composition and governance, increased contribution rates for the city and employees, reduced benefits, and modified the Deferred Retirement Option Plan (DROP) to improve the plan's long-term sustainability.

<u>Changes to the Dallas Police and Fire Pension System through H.B. 3158</u>
In regards to board composition and governance, HB 3158 established that 6 of the 11 board trustees are selected by the mayor in consultation with the city council, 3 are selected by a nominations committee made up of employee associations, and 2 trustees, 1 who is a current or former police officer and another who is a current or former firefighter, elected by their respective members.[42] Additionally, board trustees may not be an elected 37 official and are required to have financial, accounting, business, investment, budgeting, real estate, or actuarial expertise to establish a professional board. All board members are required to complete trustee training as well as annually receive a training manual created by the executive director. These training materials are to cover the following: laws governing the pension systems' operations, programs, rules, and budget of the pension system, scope and limitations of the board's rulemaking authority, recent audit of the pension system, laws relating to open meetings, public information, administrative procedure, and conflicts of interest, laws relating to trustee duties including the board's fiduciary duty, relevant code of ethics and applicable policies, and financial training regarding the risks of alternative investments. While 6 out of 11 trustees are required for most board actions, the law requires a two-thirds vote of the full board (8 out of 11 trustees) to take the following actions: reduce the city contribution rate, increase the member contribution rate, lower benefits, or create an alternative benefit plan.[43]

For the investment process, the board is required to establish an investment advisory committee, composed of investment professional and board member to make recommendations to the board. Additionally, all alternative investments, considered other than traditional assets including private equity funds, private real estate transactions, hedge funds, and infrastructure, must be approved by a two-thirds vote of the board.

Benefit changes made decrease the multiplier for all members to 2.5% for future service and increase the normal retirement age to 58 years for all members. The final average salary is now calculated by the highest 60 months for Tiers 1 and 2, and highest 36 months for Tier 3 while the maximum retirement annuity is lowered from 96% to 90% of the final average salary. The cost of living adjustment was changed to ad-hoc, based on the investment return for the previous five-year period minus 5%, paid only if the system remains over 70% funded. Any changes to increase these benefits can only be made by a two-thirds vote of the board if it is determined that the change will not cause the amortization period to exceed 25 years as confirmed by the Pension Review Board.

Regarding potential future changes to plan structure, the DPFPS board was required to conduct an evaluation by January 1, 2018, to study the impact of establishing one or more alternative benefit plans such as a defined contribution or hybrid plan for new members subject to the following requirements. An alternative benefit plan for new employees may only be established by a two-thirds vote of the board if the pension system's actuary determines (validated by the PRB) that those changes to the pension system will continue compliance with requirements for amortization period and funding as established by Chapter 802 and not cause the amortization period of the system to exceed 35 years.

Lump-sum distributions from the Deferred Retirement Option Program (DROP) were immediately stopped with exceptions for hardships and minimum annual distributions. The new interest rate applied to the funds held by current DROP participants is equivalent to a similar length Treasury note and members who begin participation in DROP after September 1st, 2017, do not accrue interest. The board was tasked with developing annuitization tables based on life expectancy and establishing a schedule for DROP funds to become available to members. If any lump-sum distributions were paid in violation of the bill, prior to August 31st, 2017, the legislative changes would be null and void.

The law changes employee contributions from 8.5% to 13.5%. The City contribution changes from 27.5% to 34.5%. Through the end of 2024, the City contribution is based on a fixed percentage of pay (subject to a minimum dollar floor) plus a flat dollar contribution amount. Prior to July 1, 2024 the Pension review board will select an actuary to be hired by the DPFPS board to perform an analysis to conclude whether the plan meets the current Pension Review Board pension funding guidelines and the actuary will submit recommended changes to the board by October 1, 2024, regarding member and city contributions, and benefits. The board will then adopt changes, taking into account the recommendations of the independent actuary.

Current Implementation Status of H.B. 3158

The Dallas Police and Fire Pension System's implementation of HB 3158 seems to be progressing on schedule with two dozen legislative requirements successfully implemented. Following most provisions taking effect September 1st, the new board was fully seated as of October 12, 2017. By November 2017, the DROP program was annuitized with set interest rates and mortality tables, and the board also tightened the hardship rules and processed the option of DROP revocation. The board's ethics, governance, and conflict of interest policies have been revised as of 12/14/2017.[44]

Regarding investments, DPFPS has sold $300 million in real estate and illiquid assets and is working to move to a simpler asset allocation for liquid assets while carefully evaluating private assets. This previous investment portfolio proved challenging with difficulties faced in the value and liquidity prospects of their private portfolio. Nearly half of the system's $2.1 billion of assets were illiquid which tend to be high cost along with other limitations. The current real estate holdings are complex and illiquid and while not suitable for a public pension fund, the board is working to reduce those holdings without a fire sale to avoid unnecessary losses. The board is also making changes to eliminate high-cost alternative investments with large investment fees.[45] With a focus on reducing costs, lower fees were negotiated with current managers while high cost managers were eliminated. The 2018 budget is $2 million lower than last year, and they have also replaced their prior investment consultant with another firm further reducing associated fees.[46]

The board and staff have worked in a continual effort to educate members on benefit changes as a result of this legislation and will continue to do so through public meetings, presentations, and mailings.

Throughout the implementation and future changes, the Pension Review Board is tasked with reviewing potential benefit changes or alternative plans to ensure compliance with amortization period requirements. Additionally, the PRB is required to select an independent actuary to perform an analysis based on the systems Jan 2024 actuarial valuation. Based on that analysis, the DPFPS will adopt a funding plan based on funding and amortization period requirements which will then be reported to the legislature.

Current Impact to the Dallas Police and Fire Pension System as a result of H.B. 3158:

While there is still significant progress to be made, the Dallas Police and Fire Pension System is back on the right track. As a result of HB 3158, unfunded liabilities were reduced by nearly a billion dollars and the current amortization period is now 44 years compared to the previous infinite amortization period.

	Before HB 3158	After HB 3158
Amortization Period	Infinite	44 years
Funded Ratio	40.2%	49.4%
Unfunded Actuarially Accrued Liability (UAAL)	3,206,255,505	2,209,380,724

[47]

Continued Challenges

Despite the board efforts in shifting investments, achieving the 7.25% assumed rate of return continues to be a struggle given the largely illiquid portfolio with many poor performing assets which have faltered in recent years with the 10 year return at 1.4%.[48] As the board has more time to reallocate assets and successfully invest in the coming years, those changes will need to improve further as they work to exceed previous investment returns.

Beyond investments, concerns of underfunding continue to be a critical factor in future calculations. In the Dallas Police and Fire Pension Systems' January 2018 Actuarial Valuation and Review, Segal identified significant issues to include current assumptions based on the City's Hiring Plan and payroll growth. During the first two years, valuation payroll is $32.5 million less than city projections. While there is currently a floor on City contribution levels in place through 2024, beginning in 2025 continuing at 34.5% of computation pay will impact the projections to become fully funded if these discrepancies between the actual and projected payroll.[49] Additionally, as the departments have fewer employees on the payroll, not only are city contributions down, employee contributions are short as well. Annualizing current employee contributions over a 12 month period, employee contributions will be short $3 million during the first year.[50] While the January 2018 AV projects the full funding date as 2063, it also warns that these discrepancies in payroll will have a significant impact over time because investment returns alone cannot close the funding gap.[51]

While none of these issues can be solved overnight, it is critical to have diligence in future oversight to ensure the continued improvement of investments as well as the adequate funding through city and employee contributions. The Dallas Police and Fire Pension System has come so far and seems to be on the right track we will all work together to continue overcoming past problems to support the pensions of Dallas first responders and their families.

S.B. 2190: Houston Firefighters' Relief & Retirement Fund, Houston Police Officers' Pension System, and Houston Municipal Employees Pension System

After months of negotiation between the City of Houston and the three pension systems, SB 2190 successfully passed the both the House and Senate with over 2/3rds vote before being signed by the Governor on May 31, 2017, taking effect July 1, 2017. This bill made changes to the three Houston pension systems, to reduce benefits, increase employee contributions, outline funding policies, codify actuarial assumptions, and require employer contributions through the implemented cost corridor. These changes in funding policy, the issuance of pension obligation bonds, and reduced benefits together reduced the three systems unfunded liabilities by over $3 billion and implemented a 30 year closed amortization period.

Changes to the Houston Pensions Systems as a result of SB 2190:

The bill establishes a funding policy that created a target contribution rate know as a corridor midpoint with 5% above and below serving as the corridor's minimum and maximum to determine the potential range of city contributions. The corridor was established through the initial risk sharing valuation study (RSVS) and will not change. Annually, a separate RSVS is prepared by the systems and the City to establish contribution rates. If the city and system's estimated contribution rates differ by more than 2%, actuaries must reconcile the rates but if it can't be reconciled than the arithmetic average will be used to determine the city's contribution rate.

Additionally, the bill adds reporting requirements for each of the systems, requiring that each of the systems conduct an actuarial experience study at least once every four years and an investment audit at least once every three years. SB 2190 sets in statute the maximum assumed rate of return for each of the plans at 7.0% While the retirement systems and the City may enter into a written agreement to offer an alternative plan if both parties consider it appropriate, the respective boards are required to close the existing plans to new entrants and establish a separate cash balance plan for new hires if the plan's funded ratio falls below the required levels. For HFRRF and HPOPs, the minimum funded ratio is at or above 65% after June 30, 2021, while for HMEPS the minimum funded ratio is at or above 60% after June 30, 2027.

Specific to Houston Municipal Employees Pension System, increased employee contributions are set on a scale based on the various employee groups. The bill continues to allow a COLA but changes have been made for a future COLA equal to 50% of the 5-year net investment return minus 2% less than the assumed rate of return, to be not less than 0% or greater than 2%. Additionally, modified DROP (for groups A & B) is set with interest based on a rolling 5-year net investment return with COLAs credited after 62 years old.

The changes to Houston Police Officers' Pension System included increased employee contributions from 9% and 10.2% to 10.5% for all members. It also changed retirement eligibility for members sworn in after 10/9/2004 to use the Rule of 70. The COLA was modified to be 5-year smoothed return minus 5% with a minimum of 0% and a maximum of 4%, that included a 3-year freeze for members under 70 years old. Modifications to the DROP plan will eliminate entrants after 2027 and stop future COLA's from after 7/1/2017 from being credited to the account. The DROP interest rate is now 65% of the 5-year compounded average investment return with a 2.5% minimum and participation is limited to 20 years with no recalculation of the annuity at DROP exit.

For the Houston Firefighters' Relief & Retirement Fund, employee contributions were increased from 9% to 10.5%. Made changes to the benefit formula for current members and created a second tier for new hires that modified the final average salary calculation, retirement eligibility, benefit calculation, and termination benefit. Implemented a 3-year COLA freeze for members under 70 with a COLA modified based on a 5-year smoothed return minus 4.75% with a minimum of 0% and a maximum of 4% beginning at age 55. There is a modified interest credit with no COLAs or member contributions credited to DROP, while the DROP program is eliminated for new hires.

Changes as a result of SB 2190	HFRRF		HPOPS		HMEPS	
	Before	After	Before	After	Before	After
Funded Ratio	78.80%	81.95%	69.01%	78.24%	43.56%	55.46%
Accrued Actuarial Liability (AAL)	$5,189,396,000	$4,551,412,000	$6,894,274,000	$6,081,391,000	$5,509,951,000	$4,734,999,000
Actuarial Value of Assets (AVA)	$4,089,047,000	$3,729,670,000	$4,758,079,000	$4,758,079,000	$2,400,023,000	$2,625,896,000
Unfunded Actuarial Accrued Liabilities (UAAL)	$1,100,349,000	$821,742,000	$2,136,195,000	$1,323,312,000	$3,109,928,000	$2,109,103,000
Employer Contribution	52.20%	30.60%	52.96%	31.77%	39.22%	27.84%

Pension Review Board SB 2190 Impact, October 2018 Presentation to the House Committee on Pensions

Implementation and Effect of SB 2190

Before, legislative changes were made, the City of Houston estimated a net pension liability of approximately $8.21 billion. After taking effect, July 1, 2018, the legislation reduced this liability to approximately $5.1 billion.[52]

In the Fall of 2017, each of the three pension systems and the city completed their risk sharing valuation study to determine the city's contribution for FY 2018 and set the corridor to establish the upper and lower bounds for the city contribution rate over the next 30 years. The initial RSVS was completed in 2017. Because the differences between the city and the system's calculations for HMEPS and HPOPs was less than 2% of the projected payroll, the system's calculations were used to establish corridor midpoints for future years. Because for HFRRF the differences each year were greater than 2%, the arithmetic means of the city and system calculations were used to establish the corridor midpoints.

While previously the City of Houston had underfunded the pensions, since the reform, the City paid the full actuarially required payments for the 30-year closed amortization period, $178.7 million for HMEPS, $143.2 million for HPOPS, and $83.6 million for HFRRF for a total of $405.5 million.[53]

In December 2017, the City and Systems finalized reports to lay out the city contribution rates for FY 2019 and the city has budgeted a total of $408.9 million. All three rates are well within the corridor rates and represent a modest increase over the prior year which is significantly lower than previous year to year increases of $18 million and $40 million.[54]

On November 7th, 2017, voters approved a referendum on the pension obligation bonds by 77% of the vote. This authorized the City of Houston to issue $1.01 billion in pension obligation bonds in December 2017, to pay $750 million into the HPOPS and $250 million into the HMEPS to account for past required contributions that were underfunded.[55]

Based on the City of Houston's Comprehensive Annual Financial Report released December 2017, as of the end of the City's fiscal year in June 2017, the city's finances have gone from a

$95 million deficit to exceeding liabilities by $1.855 billion a net increase of $1.91 billion primarily as a result of decreasing pension liabilities.[56]

Regarding the systems investment returns, the results are above the discount rate for each of the systems. For the fiscal year 2017, HMEPS had a 12.7% return on investments and in fiscal year 2018 had a 9.3% return. The five-year net investment return as of the end of fiscal year 2018 is 8.6%.[57] For the Houston Police Officers' Pension System the investment rate of return has been 16.8% and 10.3% respectively.[58] Since 2016, the HPOPS 53 funded ratio has gone from 78.2% to an upward trending 79.3%. The Houston Firefighters' Relief & Retirement Fund received a rate of return of 12.01% in 2017 and 8.27% in 2018.[59]

Impact of the Legislation and Ongoing Challenges

While benefit cuts were necessary to fully fund the plan and make reform changes, it did cause an unintended consequence of an increase in retirements. 162 Houston Firefighters retired while the legislation was being discussed and in the last 2 years 115 younger firefighters have left the department and taken refunds of their contributions which is twice the average of the previous 13 years.[60] Over 380 Houston Police Officers have retired, twice the number of officers in a typical year.[61] This has impacted a Police department already short 1,500 to 2,000 officers while recruiting across the nation has been difficult as retirement outpaces recruitment. The recent vote on Houston Prop B to implement pay parity for firefighters may have consequences in pension reform as well. While all of the numbers are still being worked out and additional changes may occur, the initial projections done by the City Comptrollers office has put the cost at over $100 million per year. If this additional cost does trigger restructuring or layoffs across the city, that could have an impact on the pension systems, though that actuarial assessment has yet to be conducted.

Recommendations

While the legislation passed into law during the 85th session has made significant strides to improve pension systems in both Houston and Dallas, the work is not yet done. The Dallas Police and Fire Pension System Board still has work to do in order to increase the investment rate of return to meet their assumptions and replace previous poor investments. The Houston systems will continue to be monitored as potential budget constraints are faced to ensure that the three systems continue to be adequately funded. This committee will continue to observe both cities and their pension systems for their continued improvement over time especially as key actuarial valuations and risk sharing valuation studies are conducted. The Pension Review Board will continue to be overseeing these reports as required by legislation to notify the legislature of any failure of compliance.

Beyond these cities, there continue to be future concerns of local plans across Texas facing increasing worse financial positions with growing unfunded liabilities, increasing amortization periods, out of control DROP, and actual investment returns well below the discount rate. As the economic times change, no longer can systems afford the level of benefits previously offered. Automatic COLAs, low retirement ages, DROP accounts providing high interest rates, and contributions that are insufficient to fund the plan are all serious considerations that need to be addressed in failing systems. Cities and systems need to be willing to work together in a spirit of shared sacrifice to solve their own problems. If it can't be done at the local level, just as in past cases, the legislature will step in to enforce reform as necessary to protect the future soundness of retirement systems across the state.

Conclusion

Texas pensions may at first glance face a grim outlook, but ultimately there is nothing that can't be solved with the commitment of state and local leaders to save these plans for the future. This committee is going to work to ensure the actuarial soundness of our state's pensions in order to maintain the benefits as much as possible in a changing economic outlook. The stability of pensions isn't as secure as it once was years ago, therefore unfulfilled promises cannot continue to be made. There are significant shared sacrifices that will need to be made, on all sides, to continue saving our failing pensions because this is not something that can rest on one entity alone. Taxpayers cannot solely be the ones responsible for footing the bill, but neither can the burden fall only on our public servants. While we are committed to stopping the bleeding across the state to protect our state's employees and economy, there will not be a state bailout of municipal pensions. State legislators are the mediators, the negotiators, the intermediaries, and if necessary, the enforcers, but not the ones who are going to write a check to cover the cost of a failing local system. Our pension systems and cities across the state need to step up and take responsibility, to make the hard choices and think about the future before the problems continue to grow.

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[42] H.B. 3158
[43] H.B. 3158
[44] Dallas Police and Fire Pension System Written Testimony, 5/10/18 Pensions Committee Hearing
[45] William Quinn, DPFPS Board, Testimony at 5/10/18 House Pensions Hearing
[46] Dallas Police and Fire Pension System Written Testimony, 5/10/18 Pensions Committee Hearing
[47] 5/10/2018 Pension Review Board Presentation to the House Committee on Pensions
[48] Public Pension Search Tool, https://comptroller.texas.gov/application.php/pension/
[49] Dallas Police and Fire Pension Systems' January 2018 Actuarial Valuation and Review, Segal Consulting
[50] Dallas Police and Fire Pension System Written Testimony, 5/10/18 Pensions Committee Hearing
[51] Dallas Police and Fire Pension Systems' January 2018 Actuarial Valuation and Review, Segal

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[52] City of Houston Testimony to the House Committee on Pension 10/12/2018, Mayor Turner
[53] City of Houston Testimony to the House Committee on Pension 10/12/2018, Mayor Turner
[54] City of Houston Testimony to the House Committee on Pension 10/12/2018, Mayor Turner
[55] City of Houston's Comprehensive Annual Financial Report, December 2017
[56] City of Houston's Comprehensive Annual Financial Report, December 2017
[57] Houston Municipal Employees Pension System, Sherry Mose Testimony to the House Committee on Pensions, 10/12/2018
[58] Houston Police Officers' Pension System, Terry Bratton Testimony to the House Committee on Pensions, 10/12/2018
[59] Houston Firefighters' Relief & Retirement Fund Testimony to the House Committee on Pensions, 10/12/2018
[60] Houston Firefighters' Relief & Retirement Fund Testimony to the House Committee on Pensions, 10/12/2018
[61] Houston Police Officers' Pension System, Terry Bratton Testimony to the House Committee on Pensions, 10/12/2018