LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 82ND LEGISLATIVE REGULAR SESSION

April 4, 2011

TO: Honorable Vicki Truitt, Chair, House Committee on Pensions, Investments & Financial Services

FROM: John S O'Brien, Director, Legislative Budget Board

IN RE: **HB2731** by Truitt (Relating to contributions to, benefits from, and administration of certain public retirement systems; providing penalties.), **As Introduced**

No significant fiscal implication to the State is anticipated.

Section 1 of the bill would amend Chapter 801 of Government Code by adding Section 801.208, which would require the Pension Review Board (PRB) to adopt rules and procedures for receiving and investigating a complaint against a person who provides management or investment services to a public retirement system that allege the person violated, or may have violated, Sections 802.004 through 802.007 or other conflict of interest provisions, or had been or may have been in criminal conduct relating to services provided to the entity. Section 1 also would authorize the PRB or the attorney general to initiate an investigation if either believes that it is appropriate. If the investigation determines that a criminal offense was committed, the PRB or the attorney general may report the offense to the proper authorities for persecution.

Section 2 of the bill would amend Chapter 802 of Government Code to add Sections 802.004 through 802.008 relating to prohibitions and penalties with regard to members of the governing body of a public retirement system. Section 802.004 adds that a member of the governing body of a public retirement system, or an investment consultant or advisor providing investment management services to that public retirement system, must disclose immediately any employment, ownership, or control, directly or indirectly, of a business entity that receives funds from the public retirement system which could likely diminish the person's independence of judgment in the performance of responsibilities that person has to the management of system assets. This disclosure of potential conflicts of interest is also applicable to the person's immediate family. The person would be required to file a statement of understanding of the disclosure requirement with the retirement system each year.

Section 802.007 would add that a person who commits a breach of their fiduciary duty in relation to the service they are providing the public retirement system is liable for a civil penalty not to exceed $250,000 for each violation.

Section 802.008 would prohibit a member of a public retirement system from receiving compensation upon retirement that exceeds 125 percent of that member's compensation received for the same period five years earlier. This provision would address the practice of pension spiking, which occurs when a member of a system receives significant increases in his or her salary near the end of the member's working career, thereby greatly increasing the compensation base for pension calculations. The Pension Review Board reports that by limiting the potential for pension spiking, there may be a positive impact on the actuarial soundness of a public retirement system.

Section 3 of the bill would amend Section 802.101(a) to provide that an actuary performing an actuarial valuation for a public retirement system use the corporate bond yield curve as the funding yield curve third segment rate applicable to the month in which the valuation is made.

Section 4 of the bill would amend Section 802.1012 (b) to reduce the total asset threshold requirement for public retirement systems required to conduct an actuarial audit every five years from $100 million to $10 million.

Section 5 of the bill would add Section 802.1013, which would prohibit a public retirement system from reducing the rate of member or employer contributions, provide a cost-of-living adjustment, or otherwise increase retiree benefits unless an actuarial valuation is conducted in accordance with Section 802.1012(a) that takes into account the proposed action, and the results of the valuation indicate the retirement system is at least 80 percent funded. Also, if a valuation is performed for a cost-of-living adjustment, the valuation must assume the cost-of-living adjustment is recurring.

Section 6 of the bill would amend Section 802.103 by adding Subsections (b-1) and (d), which would authorize the PRB to impose a fine of $50 against each member of a public retirement system's governing body and the executive director or other person appointed or selected to manage or administer the system if the system fails to file the annual financial report with the PRB in the time prescribed by statute. Also, all records and work papers involved in preparation of an annual financial report would be required to be retained for at least six years and be available upon request by the PRB. This provision could result in a relatively small amount of revenue if the PRB chooses to impose the fine against non-compliant systems after the effective date of the legislation. The Pension Review Board also reports it is unclear as to how many systems will remain non-compliant after the provisions of the bill go into effect.

Section 7 of the bill would add Sections 802.2041 and 802.2042, which would direct the PRB to adopt, by rule, guidelines and procedures for the procurement of investment managers for public retirement systems, and would provide that a contract with an investment manager or other person providing services relating to the management and investment of a public retirement system's assets is subject to review by the PRB regarding the fees charged and paid and the services rendered in consideration for the fees.

It is anticipated that any additional costs associated with implementation of the legislation could be absorbed within existing resources.

The bill would take effect September 1, 2011. The provisions of the bill related to Section 802.008 involving the computation of retirement benefits would apply only to members of public retirement systems who retire on or after the effective date.

Local Government Impact

Section 3 of the bill proposes the use of the corporate bond yield curve third segment rate as the discount rate used in a system's actuarial valuation. The Pension Review Board reports that the current third segment corporate bond yield curve rate is 6.44 percent, and that over 95 percent of the state's public retirement systems use a discount rate that is higher than the proposed rate, with the average rate being 7.475 percent. According to the Pension Review Board, based on the average rate used by plans, a 1.035 percent change in the discount rate would result in an approximate increase in the plans' liabilities of 24.84 percent. The actual impact on each affected system would depend on the current discount rate of the plan; however, any increase in liabilities would likely lead to a negative actuarial impact on the affected plan, and could result in an increase in these plans' actuarially required contributions.

Section 4 of the bill would amend the current asset threshold for a plan to conduct an actuarial audit, lowering the threshold from $100 million to $10 million. This would increase the number of plans covered by this section by approximately 36-40 plans. These plans would be required to pay the costs of the required actuarial audits, the costs of which may vary.

Finally, the provision of the bill that adds Section 802.008, which would limit the amount of increase allowed in the calculation of the compensation base for a member of a system would also have a positive actuarial impact on local public retirement systems.

Texas Municipal Retirement System (TMRS) assumes that the provision limiting the compensation used in calculation of a retirement benefit of a member of a public retirement system would apply only to traditional defined benefit plans, and not a cash-balance plan (savings-based plan) structured like TMRS. If it were determined that this does apply to TMRS, the provision could have a positive fiscal implication. The bill would also prohibit a decrease in member or employer contributions, a cost of living adjustment, or other post retirement increases unless the actuarial valuation shows the plan is 80 percent actuarially funded. TMRS estimates costs of $15,000 associated with modifying the system by which they estimate actuarial costs.

Texas County and District Retirement System (TCDRS) does not anticipate a fiscal impact associated with the bill.

Source Agencies: 302 Office of the Attorney General, 304 Comptroller of Public Accounts, 323 Teacher Retirement System, 327 Employees Retirement System, 338 Pension Review Board

LBB Staff: JOB, AG, MS, DEH, KKR, JM