RESPONSE TO: The Texas House of Representatives Committee on Pensions, Investments & Financial Services Request for Information on Interim Charges dated August 4, 2020. RE: Interim Charge 4 – "Review and evaluate the actuarial soundness of the Employees Retirement System and TRS pension funds…"

1. **Employees Retirement System (ERS)**

The ERS Pension Trust Fund was a strong, fully funded (104.9%) pension in 2001 that as of FYE 2019 was funded at 70.5% with a "Never" period to fully fund. In fact, the 2019 actuarial estimate of fund depletion was 2075, with a 25% chance of depletion by 2050. The actuaries reported that as of 2019 "The current financial outlook for ERS is very poor." While many factors (demographics, investment earnings, etc.) are part of the measurement model, one very key factor was the extended period of time when the State underfunded the ERS Trust Fund (1991-2011). While the current contribution rates were a result of increases bringing the State to 9.5% of compensation, the employee to 9.5% and the State Agency at .5% in recent years, the underfunding damage and accompanying loss of earnings on those reduced contributions over the years had taken its toll. And without an increase in contributions, the actuaries project increases to the unfunded liability of approximately $1 billion per biennium.

Since the FY 2019 Actuarial Report, two significant things have occurred: (1) Economic/Investment Market downturn related to the Covid-19 pandemic and (2) the ERS Board recently lowered its assumed investment earnings rate from 7.5% to 7.0% - much more in line with future expectations. Regarding #1, ERS did take a hit, but has also had substantial recovery. And, earnings over time will go up and down. In #2, the ERS Board made a difficult, but very prudent decision, to not overstate future earnings and, as a result, not overstate the funded status of the ERS Trust Fund. <u>The adoption of the 7.00% investment return, along with other updated actuarial assumptions in May, now shows ERS at 67.3% funded with a projected depletion date of 2061, as of FYE 2019. Legitimacy and accuracy through more current assumptions are necessary, and the numbers from which to work should now be very valid – little to nothing material obscured!</u>

There may "alternative" suggestions that materialize such as issuing pension bonds, or converting from a DB Plan to a DC Plan for new employees. Without dwelling on the problems of these, the former (if allowed) creates more State public debt and the latter only exacerbates the unsound current DB funded position jeopardizing the pension for those who remain on it.

The answer – is NOT easy! It is time to "sink or swim" and sinking is not an acceptable answer. Supplemental funding from the State is a must! Being realistic in today's environment, a one-time forever fix is likely out of the question. But, <u>a long-term supplemental State appropriation plan, over several bienniums, will make needed progress toward soundness. It is our layperson understanding that this may require an ERS "emergency" declaration due to the constitutional maximum contribution rate limit of 10% from the State. We believe that the groundwork for this must start now</u>.

2. **Teacher Retirement System (TRS)**

SB 12-2019 (Huffman, G. Bonnen, et al) was close to, if not a full, masterpiece, in taking appropriate steps to return to (and maintain) an actuarially sound TRS pension plan. It was logical, fiscally prudent, and equitable in its funding approach. It not only dealt with prompt funding action for actuarial soundness, it also established a 6-year increased funding plan to make it more realistic to retain future soundness with a UAAL funding period of less than 31 years. During this time period, the State contribution rate goes from 6.8% of compensation to 8.25%, the employee rate from 7.7% to 8.25%, and the public education employer from 1.5% to 2.0% - sound, logical, fair, and balanced!

Yes, TRS was also hit by the investment market valuation drop. But, due to its structural characteristics – "large, long-term, and liquid" – the fund is able to weather market drawdowns and it is also rebounding. Again, the market will go up and down, but the assumed investment earnings rate is established as a realistic average over time. The TRS Board had also been prudent in lowering its investment return expectation from 8% to 7.25% in 2018.

<u>At this point, the main objective for the coming (and subsequent) biennium(s) is to maintain the funding plan increases as legislated in SB 12. In spite of the financial challenges ahead, under-appropriation from the TRS statutory rates will only serve to return us to the same challenges faced in 2019. SB 12 will contribute to soundness and improve opportunities for benefit enhancements.</u>

Additionally, one of the alternatives previously noted – conversion of the DB plan to a DC plan for new employees – will increase the State's funding challenge (UAAL) of the remaining DB plan by approximately $15 billion and would put the plan in significant jeopardy for those remaining on the DB plan. This conversion has been proposed previously, fortunately with no traction, but will likely come up again. Understanding the whole 360° of the terrain is necessary – seemingly simple solutions can create complex problems!

3. **Epilogue**

Putting things in perspective, it is important to note that between ERS and TRS, there are currently about 550,000 retirees/beneficiaries receiving monthly pension payments. We estimate that this includes 10% (or more) of the Texas senior population that the Texas Silver-Haired Legislature represents. These are folks that have paid into their pension while working with the expectation of a secure, predictable pension in retirement. But, they not only receive pension payments, they also positively impact the State's economy through their consumer spending. They are important!

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Attachments: TSHL Resolution R032 (2020)
TSHL Resolution R033 (2020)