

**HOUSE OF REPRESENTATIVES  
COMPILATION OF PUBLIC COMMENTS**

Submitted to the Committee on Pensions, Investments & Financial Services  
For HB 3495

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Hearing Date: April 12, 2023 8:00 AM

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Chair Capriglione and members of the committee:

Thank you for the opportunity to offer our perspective on House Bill 3495 (HB3495), which would remove the cap on hedge funds in the Teacher Retirement System of Texas (TRS) investment portfolio.

My name is Steven Gassenberger, and I serve as a policy analyst based in Houston for the Pension Integrity Project at Reason Foundation.

HB3495 (and its Senate companion SB1246) includes several policy changes, including removing the 10% cap placed on hedge fund assets within the TRS investment portfolio, which is the focus of the following comments. Given that TRS already holds \$52 billion in unfunded pension liabilities and relies on contribution rates that are politically and not actuarially determined, we believe it is important to contextualize the potential risk implications of the proposed investment class expansion based on our analysis of TRS data.

TRS, like many public systems around the country, has pointed to alternatives like private equity and hedge funds as their highest performing asset class over the last five years. With an investment return assumption set at 7% and low-risk bonds yielding less than 4%, the TRS board wants the option to move more of the TRS investment portfolio to high-risk/high-reward-style alternative assets. Like many public pension plans throughout the country, TRS remains underfunded by over \$52 billion and hopes that the internal rate of return reported from alternatives will help them avoid the need for higher contributions from the state government and its taxpayers. SB1246 and HB3495, in their current forms, would allow the TRS board to continue down this path of risk taking, exposing more taxpayer and member contributions to private and opaque money managers. Today, TRS already holds a higher proportion of private assets than the average public pension system. Removing the cap on hedge funds would be the last limit the legislature has placed on TRS investments at a time when concerns about public money being used by private asset managers for political activism has never been more worrisome.

TRS historically assumed an investment return rate as high as 8.00% before lowering the assumption to 7.25% in 2018. The plan adjusted the assumption again in 2022 to the current 7%. With the experience of the last few decades, there is a concern that TRS is still depending on an outdated and artificially high investment return assumption, which may be a source of pressure to take undue investment risks in expensive and generally higher-risk alternatives.

Actively managed assets come with management, administrative, and performance fees that can drain hundreds of millions from the TRS trust fund. Such hefty fees are not inherently bad for TRS if they result in equally hefty returns for the fund, but just like other investments, there is no guarantee those extra fees will generate returns that exceed those gained by passively managed investments.