Public Retirement System Issues and Trends

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Public pensions in the U.S.

- ~$3.86 trillion in assets
- ~14 million active (working) participants
  - 13 percent of the nation's workforce
- ~10 million retirees and their survivors receive ~$250+ billion annually in benefits
- Annual contributions = $180 billion
  - $132 billion from employers; $48 billion from employees
  - Approximately 5.0 percent of all state and local government spending goes to public pensions
- Of 6,000 public retirement systems, the largest 75 account for 80+ percent of assets and members
- Aggregate funding level = ~74%

US Census Bureau, Public Fund Survey

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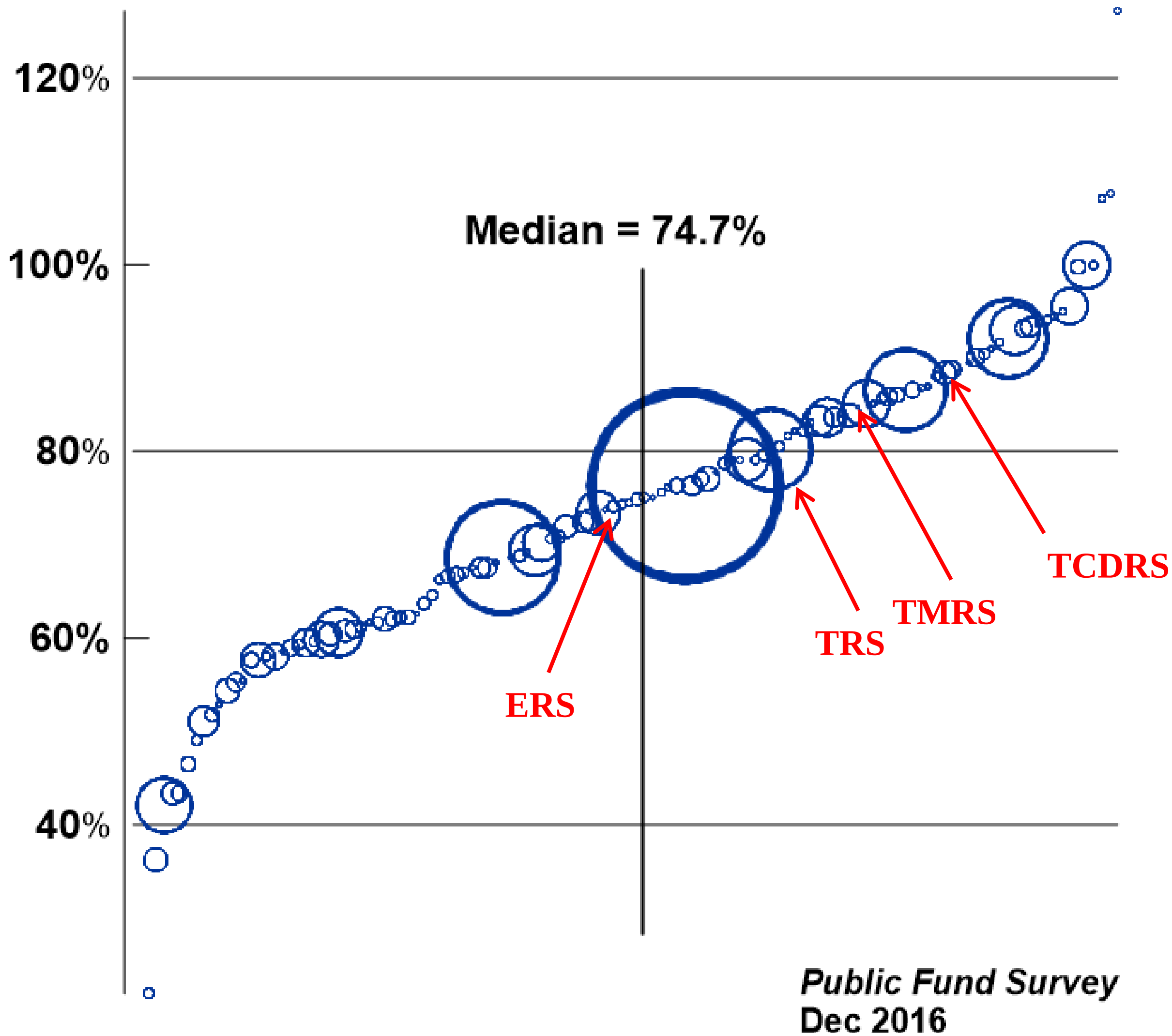
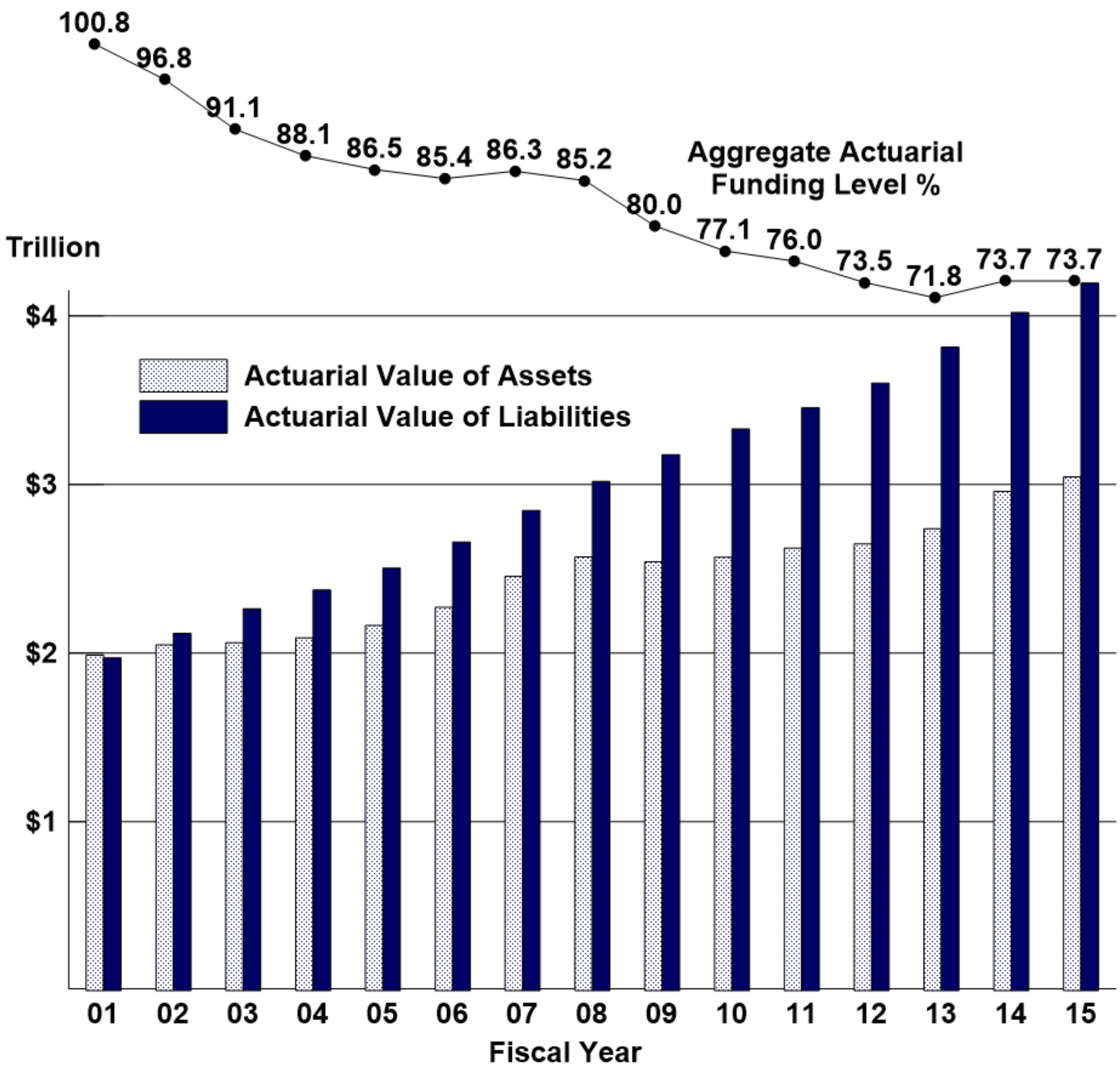
Public pension funding levels and Texas statewide plans, FY 15



Size of bubbles is roughly proportionate to size of plan liabilities

Aggregate Public Pension Funding Level, FY 01 to FY 15



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National trends

- States are taking a pause from an unprecedented period of public pension reform, from 2009 to 2014
- Troubled plans are receiving growing attention—from the media, policymakers, and others
- Funding levels and costs have stabilized for many plans
- Heightened sensitivity to making required contributions
- Low interest rates persist
- Investment return assumptions remain under scrutiny and pressure

Pension reforms in recent years

- Nearly every state modified public pension benefits, raised employee contributions, or both, since 2009
- Lower benefits:
  - higher retirement age
  - more required years of service
  - lower multiplier
  - longer vesting period
  - reduced, suspended or eliminated COLAs
- Increased use of hybrid retirement plans
- New state hires in Oklahoma as of 11/1/15 have only a defined contribution plan

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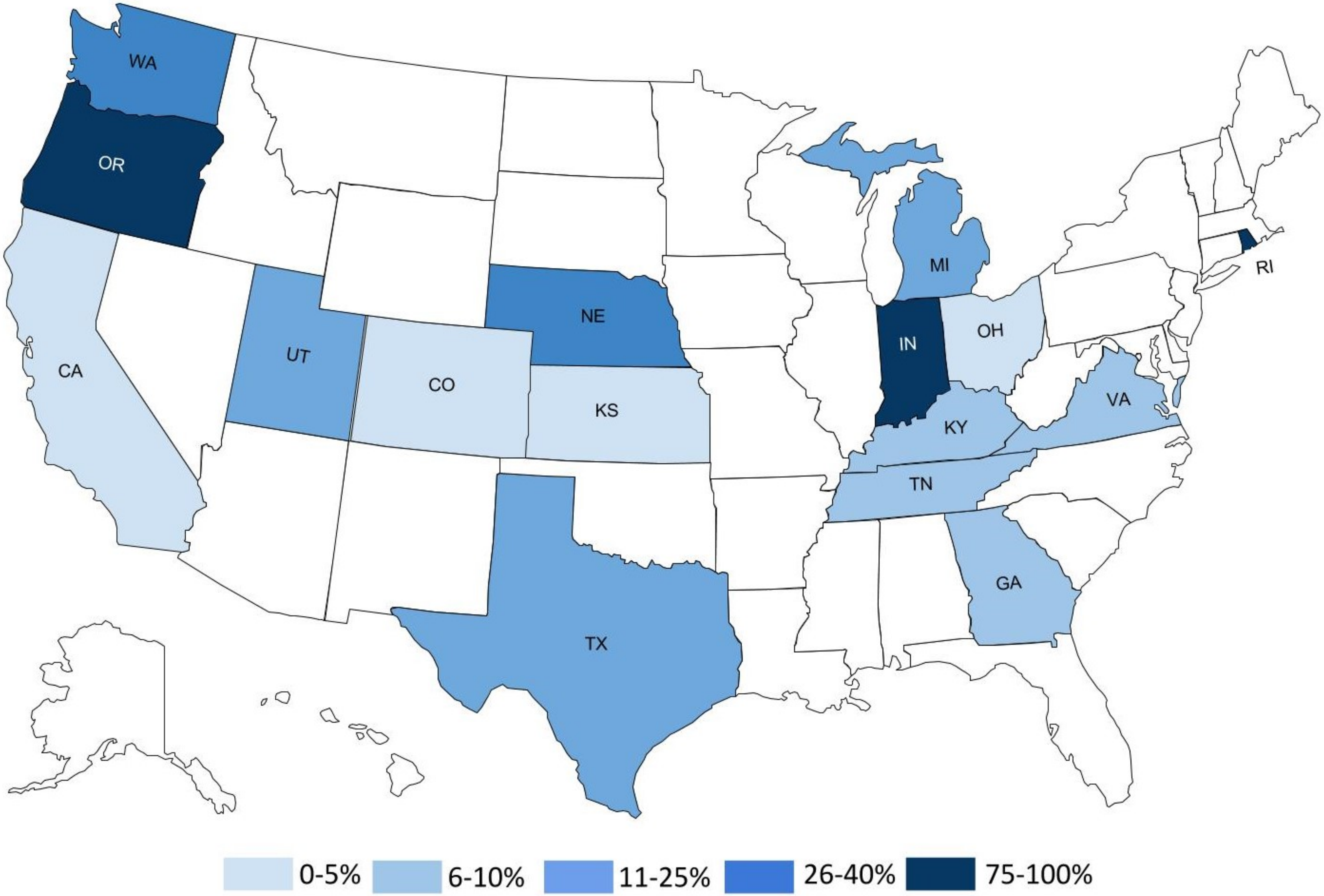
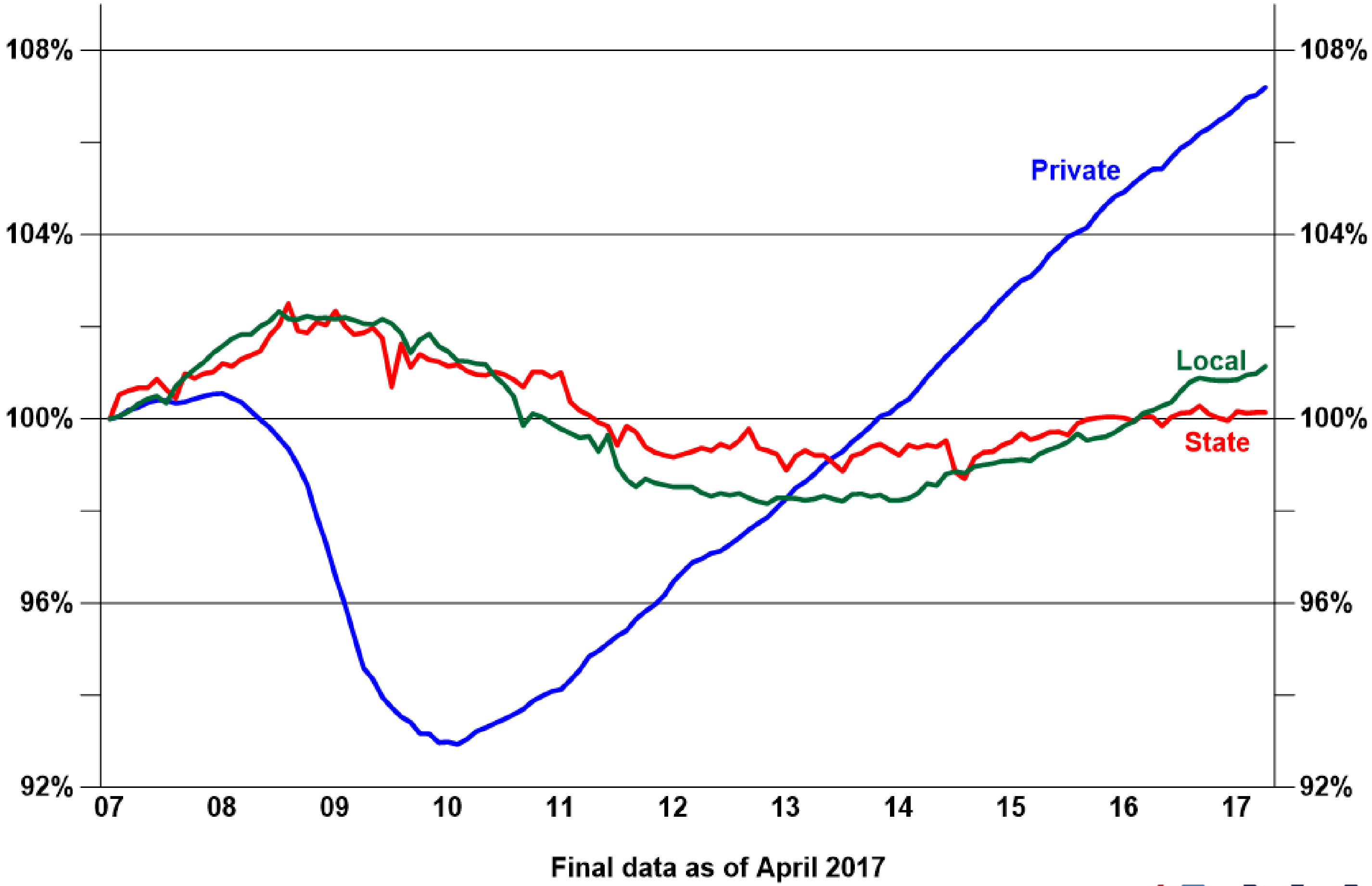
States with hybrid plans



“State Hybrid Retirement Plans,” NASRA, November 2016

Public sector employment growth remains muted, especially among states

Relative change in private and state & local government employment, Jan-07 to Apr-17



Bureau of Labor Statistics, compiled by NASRA

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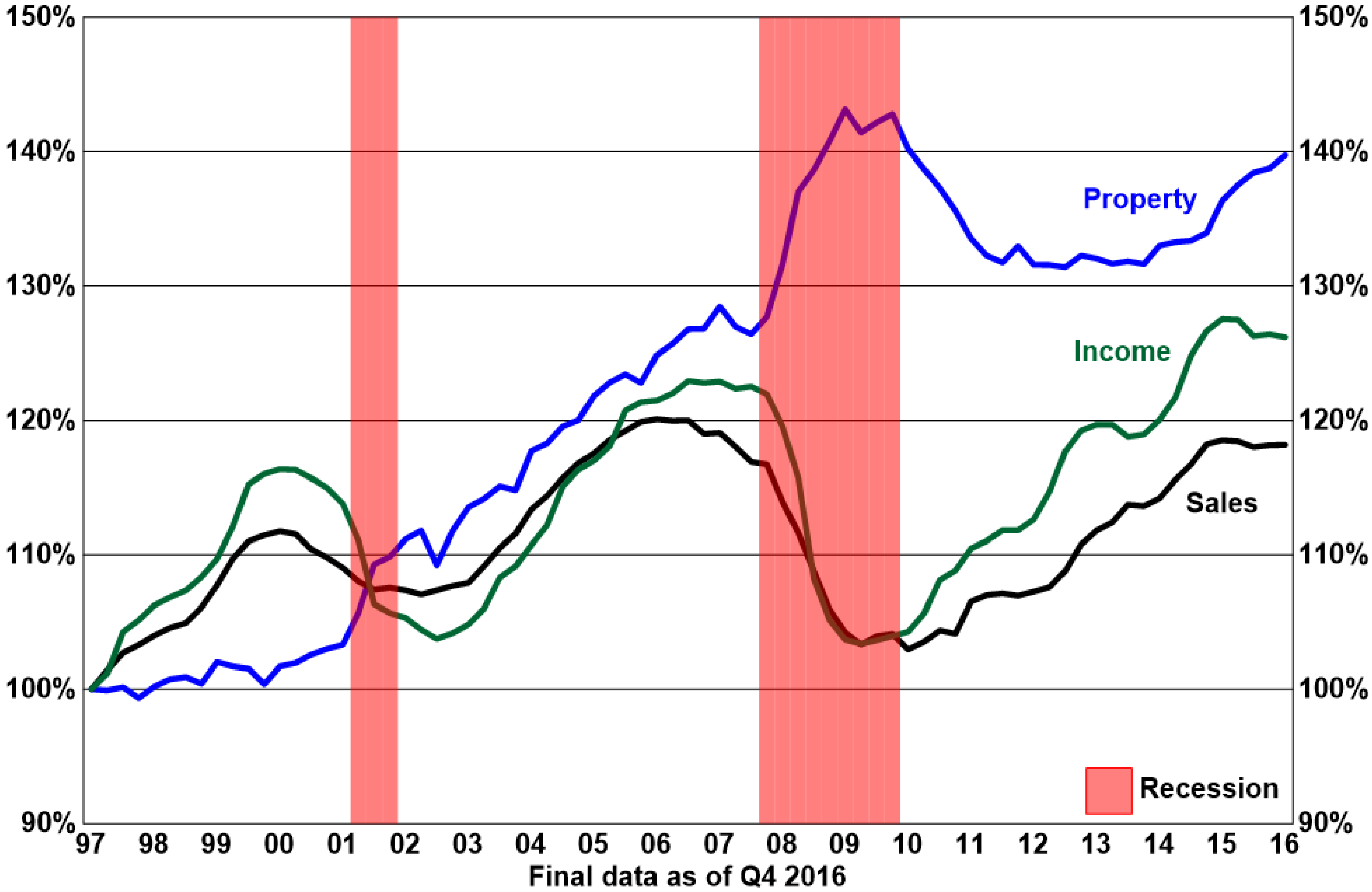
Relative change in primary state & local government sources of revenue, inflation-adjusted, 1997 - 2016



Bureau of Labor Statistics, compiled by NASRA

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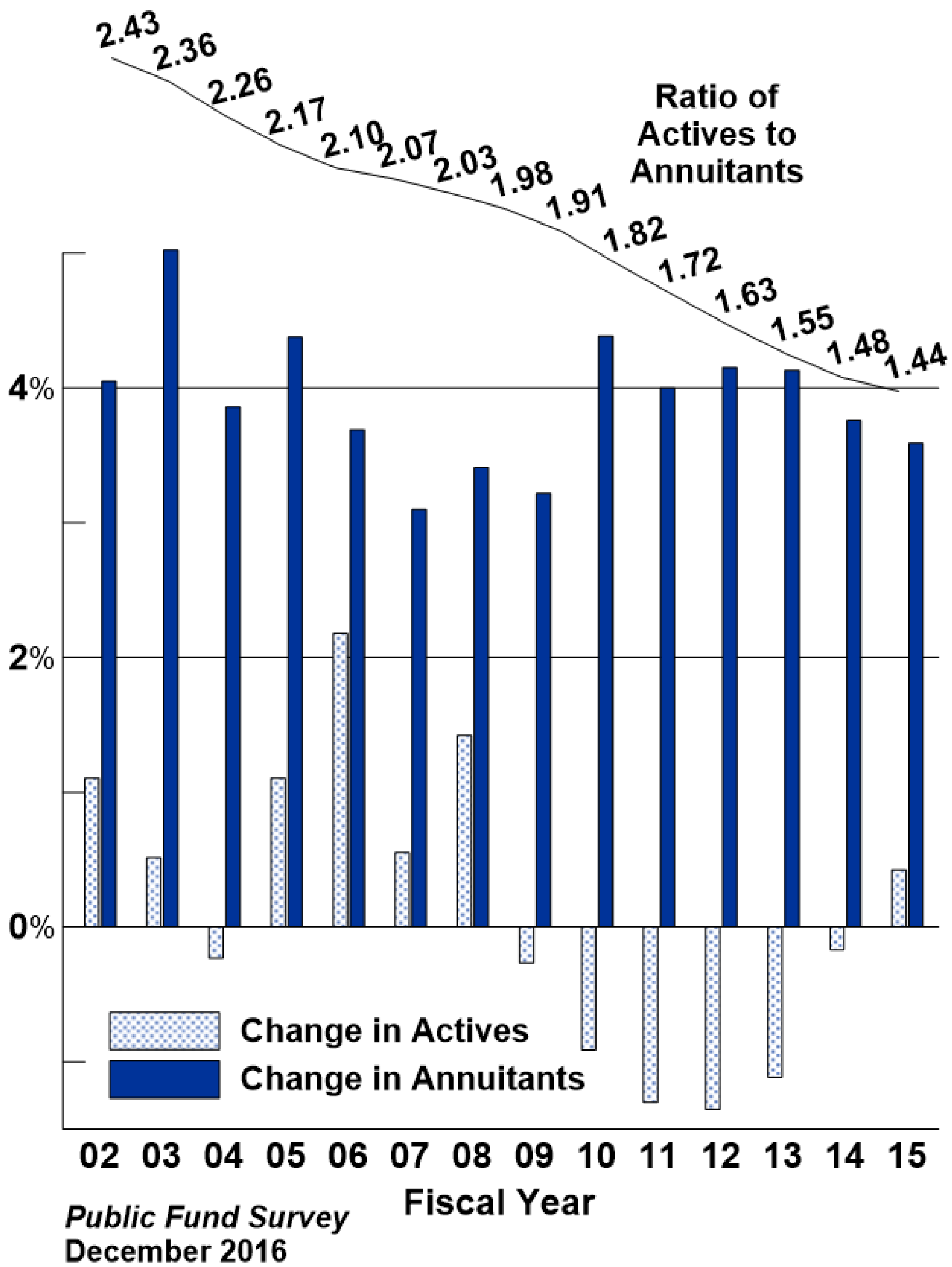

Median change in membership, FY 01 to FY 15

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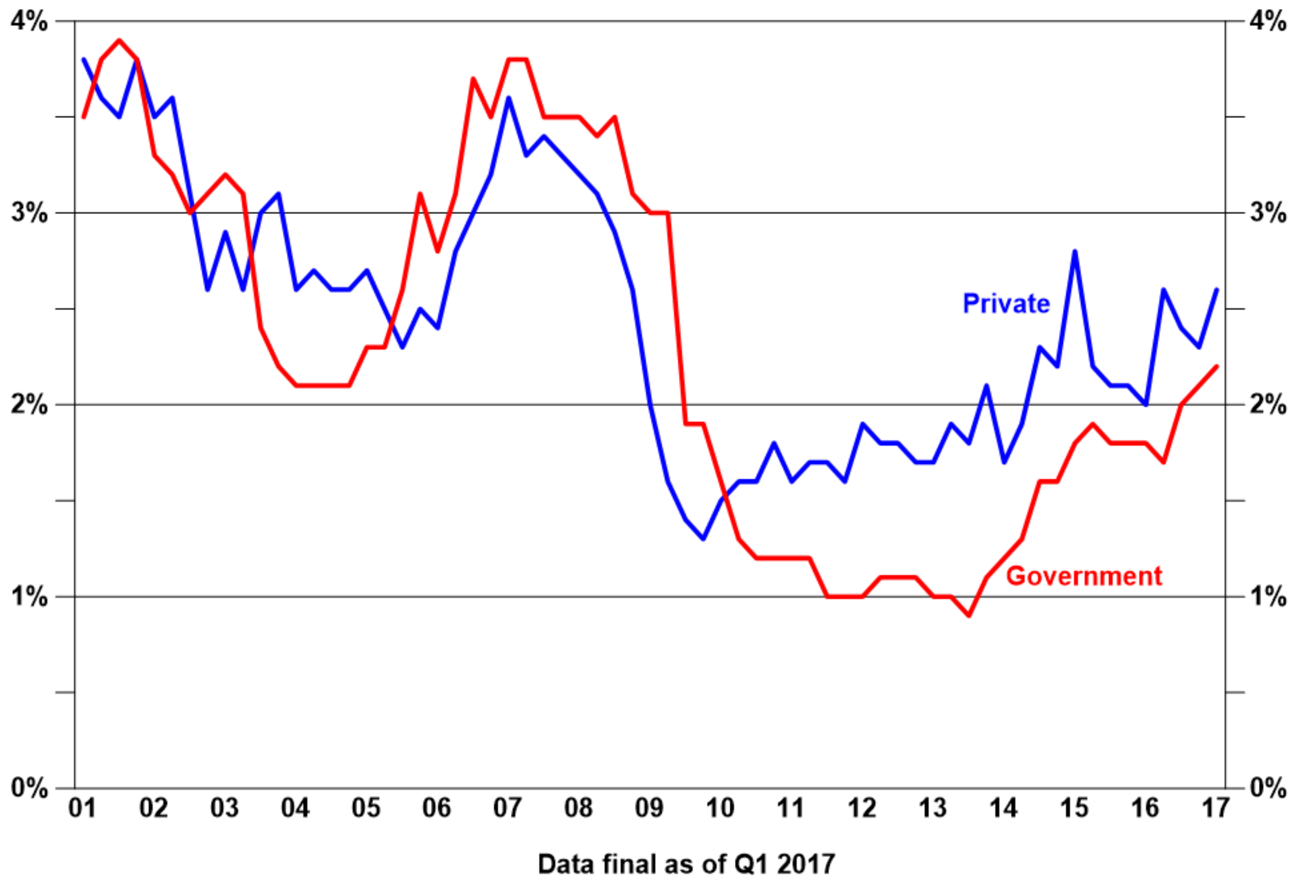
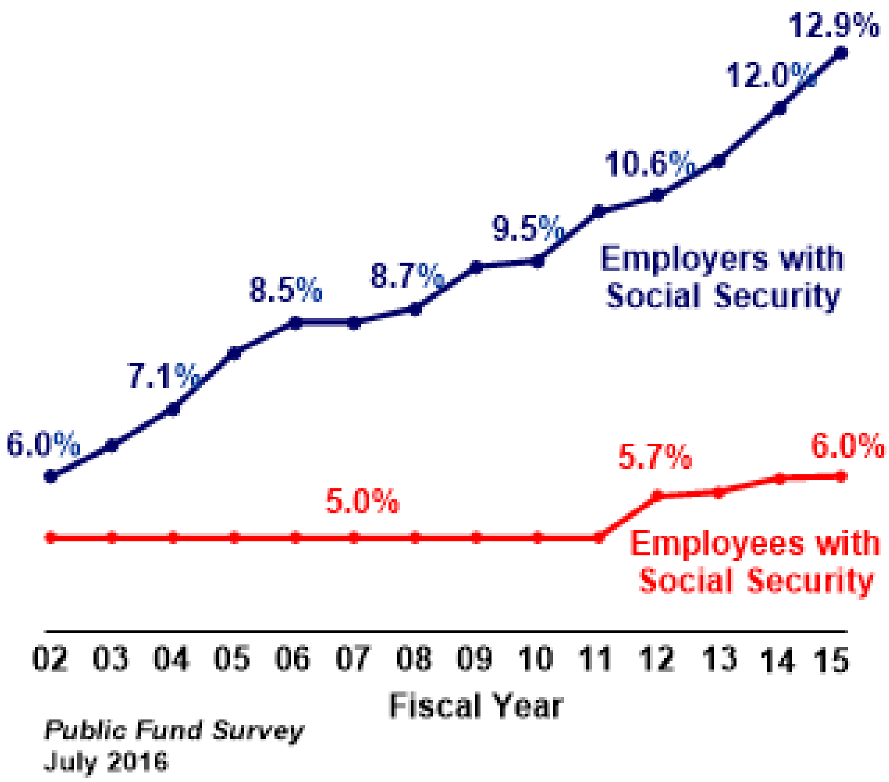
Public sector salary growth is improving but still modest

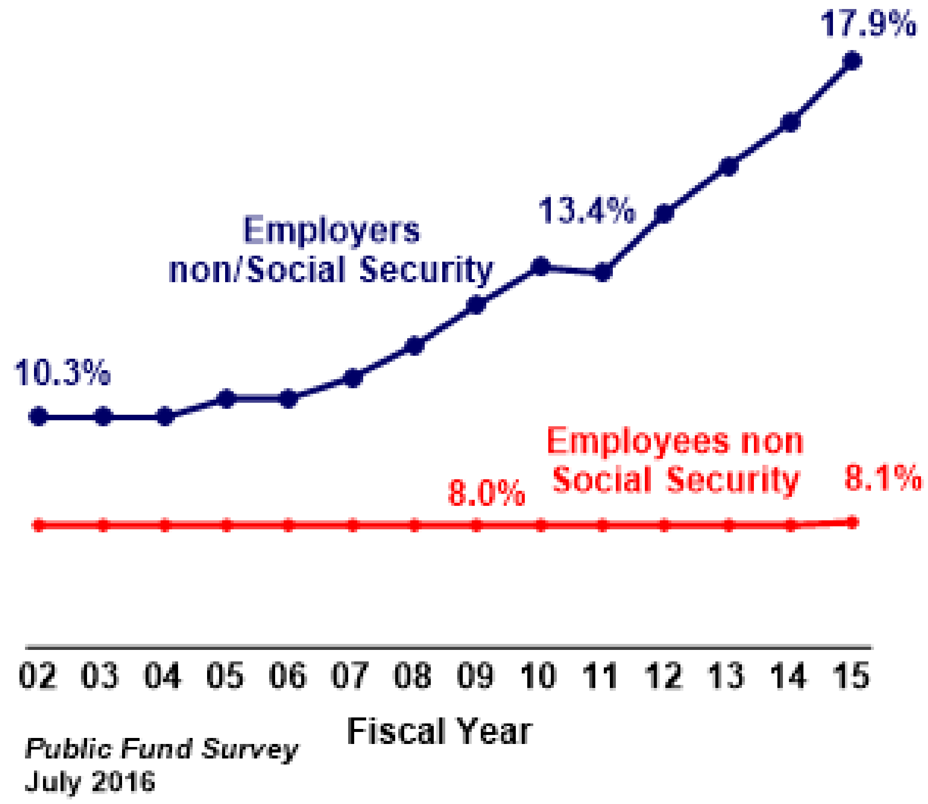
Annualized change in wage and salary costs, private and state & local government, Jan-01 to Mar-17



US Bureau of Labor Statistics
Compiled by NASRA

Median Contribution Rates, Social Security–eligible and –ineligible, FY 02 to FY 15





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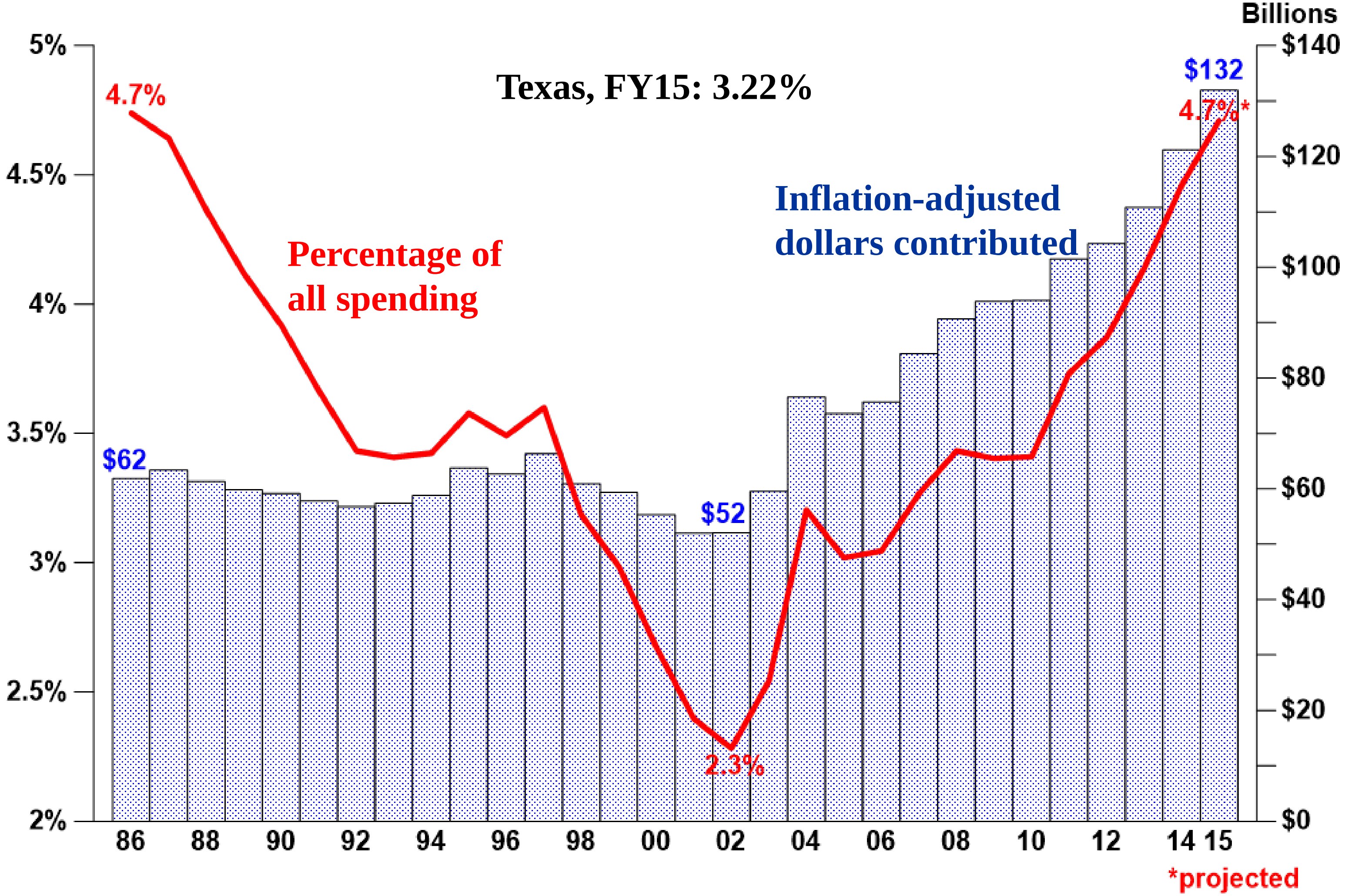
Employer spending on public pensions, 1984 to 2015



Source: US Census Bureau, compiled by NASRA

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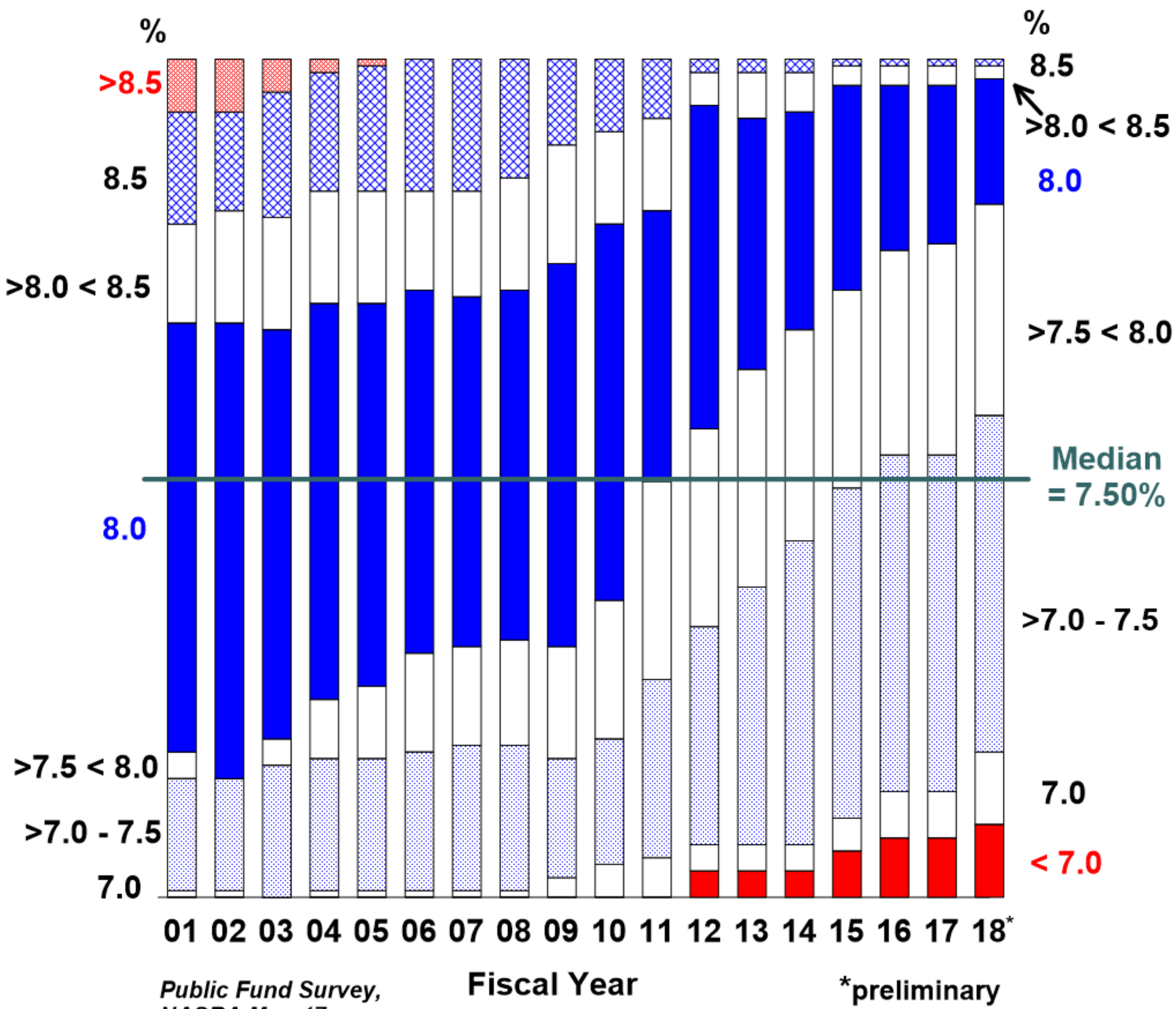
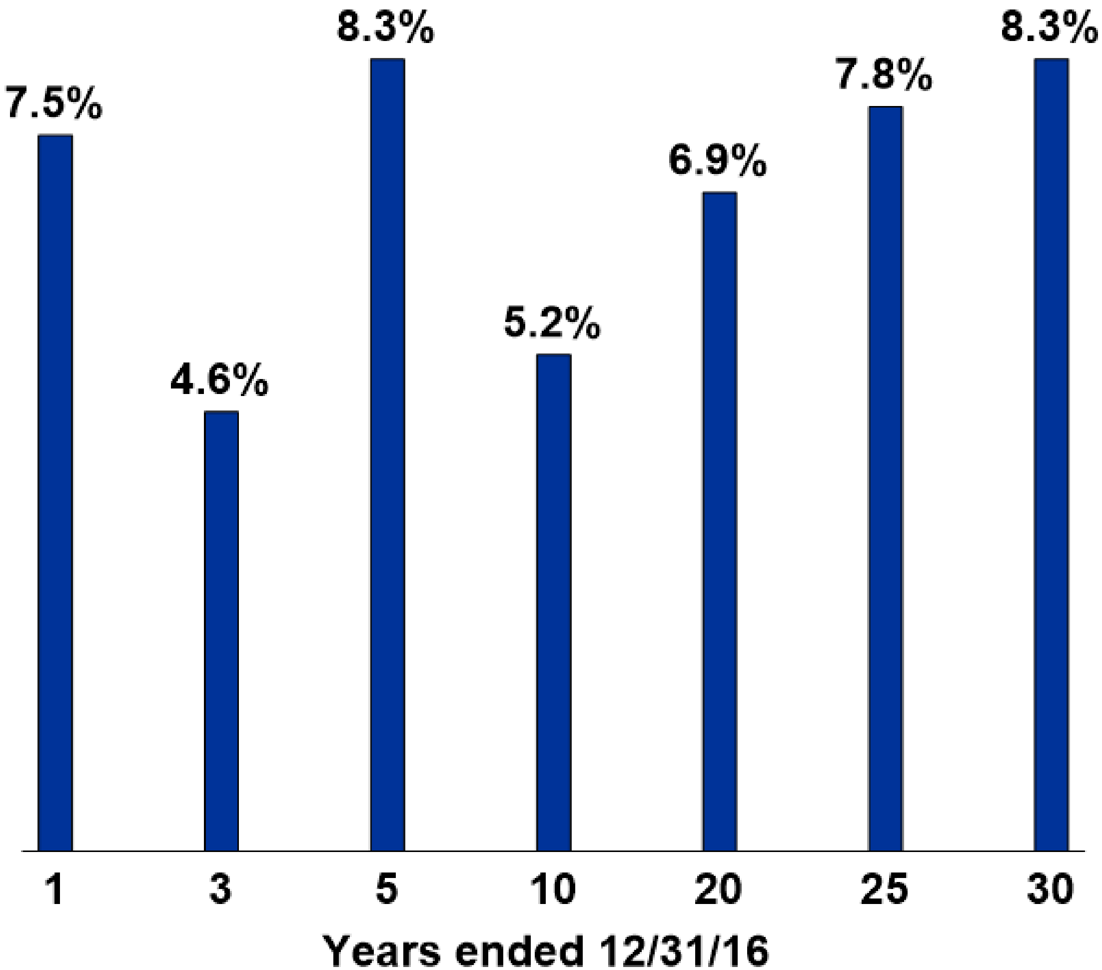
Change in distribution of investment return assumptions, FY 01 to present



Public Fund Survey, NASRA May-17

Median annualized public pension fund investment returns for selected periods ended 12/31/16



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Public pensions in Texas

- ~$250 billion in assets
- ~1.48 million active (working) participants
- 650k retirees and their survivors receive $14.4 billion annually in benefits
- Annual contributions = $9.65 billion
  - $5.7 billion from employers; $4.0 billion from employees
  - Of all state and local government spending in Texas, 3.22 percent is spent on public pensions
- Of 92 public retirement systems, the largest four (TRS, ERS, TCDRS, TMRS) account for 88 percent of assets and members
- Aggregate funding level = 80%

US Census Bureau, Public Fund Survey, Texas Pension Review Board

Municipal Pensions in Texas, Outside TMRS

- Larger cities in Texas sponsor their own pension plans
  - Houston, Dallas, San Antonio (for fire and police), Ft. Worth, Austin, El Paso, and Galveston
  - 16 plans
- Governance of these plans varies widely
- Authority over key elements of plan design and financing is distributed among the pension board, city council, local voters, and legislature
- Almost every plan governance arrangement is unique
- Governance arrangements for certain cities are under scrutiny

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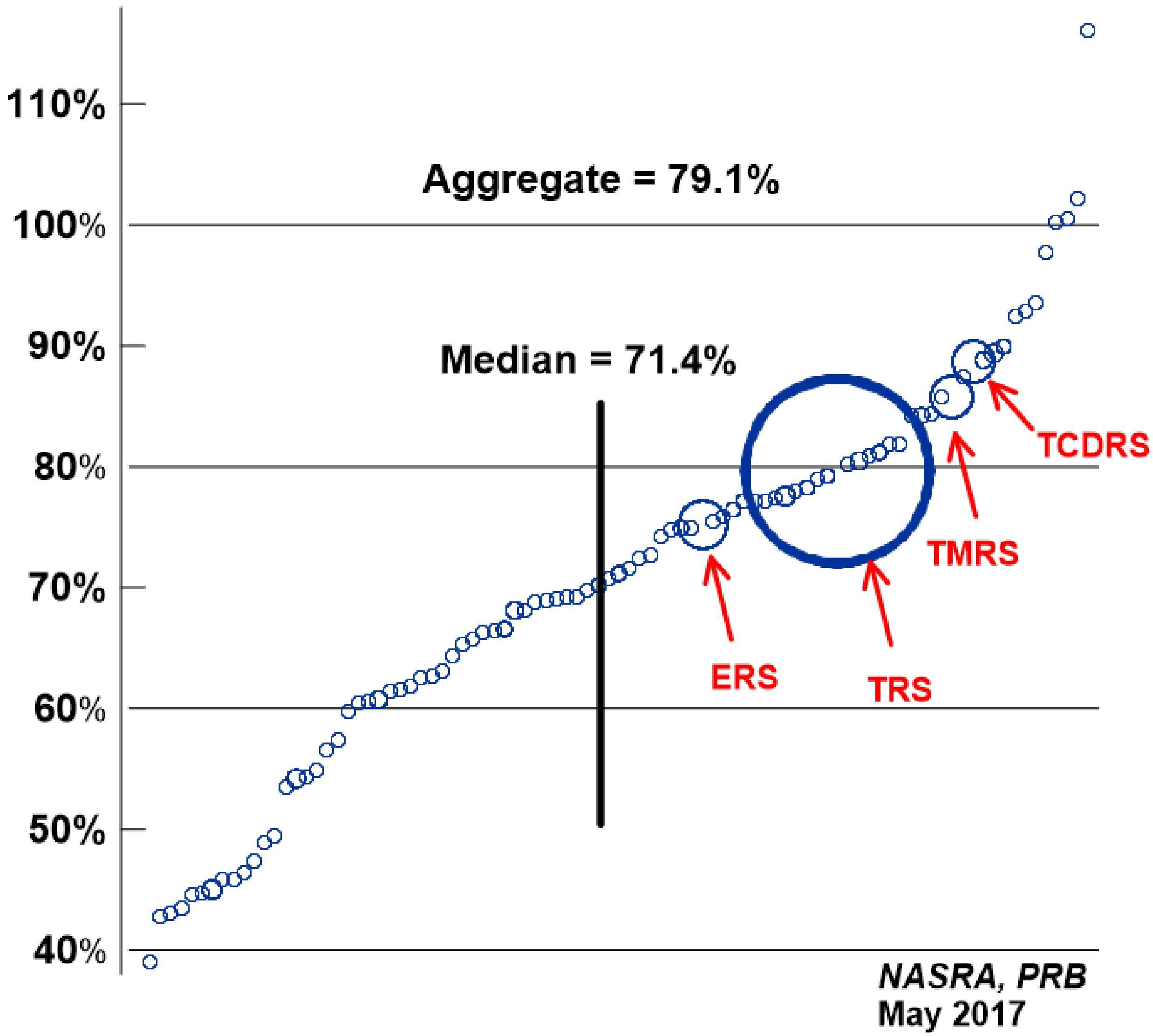
Public pension funding levels in Texas, FY 15



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Texas Pension Legislative Issues

- The primary focus of TRS legislation this session pertains to retiree health care benefits
- The Legislature is also seeking to address pension funding problems in Dallas and Houston

Houston Pension Proposal

- Reduce benefits for all three systems including changing benefit eligibility, accrual rates, DROP provisions, and COLAs, to reduce current liabilities and to better manage liabilities in the future;
- Change assumptions including lowering the investment return assumption to 7% for all three retirement systems;
- Issue $1B in pension obligation bonds to deliver the proceeds to HMEPS ($250M) and HPOPS ($750M);
- Make full annual contributions to each system;
- Change amortization method from open to closed 30-year; and
- Use of a corridor mechanism to set the City’s contribution boundaries for controlling costs and sharing risk in the future.

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Houston Pension Legislation (SB 2190)

- Original proposal, plus:
- Actuarial, audit, and investing review and reporting requirements
- Required voter approval to issue the POBs, and prohibition on issuance of future POBs to cover contributions;
- Allow the systems to rescind, prospectively, any or all benefit changes made effective under the bill, or allow HPOPS and HMEPS to reestablish the deadline of the delivery of the POB proceeds, if the City fails to deliver the POBs before March 31, 2018;
- Allow the systems' boards and the City to enter into a written agreement to offer an alternative retirement plan or plans, including a cash balance retirement plan, if both parties consider it appropriate;
- Require the boards to close the existing plan to new hires and establish a separate cash balance plan for new hires if:
  - For HFRRF and HPOPS, if the plan's ratio of assets to liabilities falls below 65% at any time after June 30, 2021, and
  - For HMEPS, if the plan's ratio of assets to liabilities falls below 60% at any time after June 30, 2027; and

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Current Dallas Legislation

- ***Shared sacrifice; all stakeholders give something***
- Higher employee contributions: from 8.5% to 13.5%
- Higher employer contributions: from 27.5% to 34.5%, plus $11 million annually for at least two years
- More years of service and higher age required to retire; lower multiplier
- DROP: Annuitization in lieu of lump sums; closed to new hires; limit on length of time in DROP status; no more DROP COLA; no interest in active DROP status; reduced DROP interest credit for retired members
- New board composition
- Board is authorized to make plan design adjustments
- Board is authorized to make clawbacks if funding period exceeds 35 years