Public Pension Landscape and Trends

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NASRA

Presentation Summary

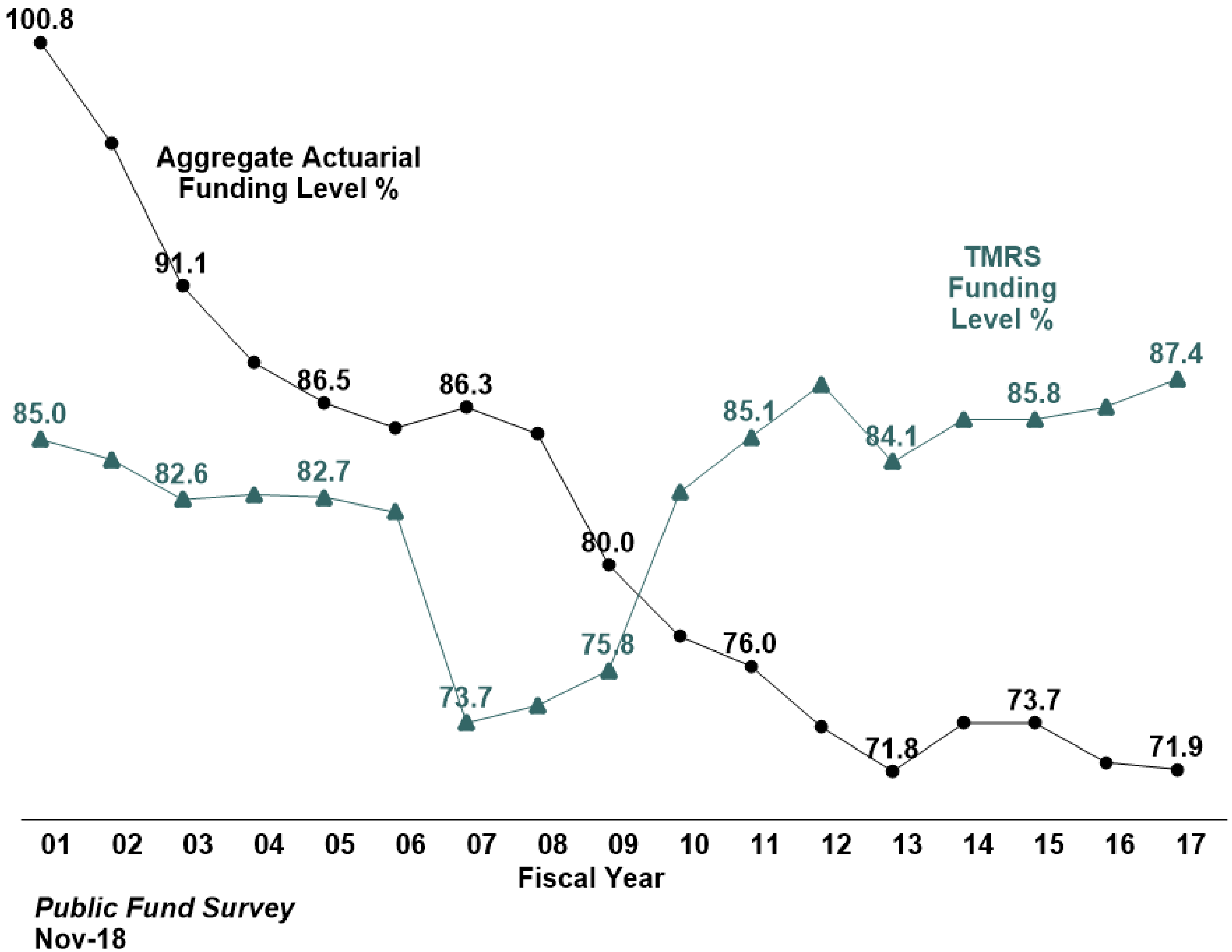
- Broad overview of the public pension community in the US and Texas
- Public pension funding issues and challenges
- Public pension reform and risk sharing
- Risk assessment
- Texas pension legislation, 2019

Public Pensions in Texas

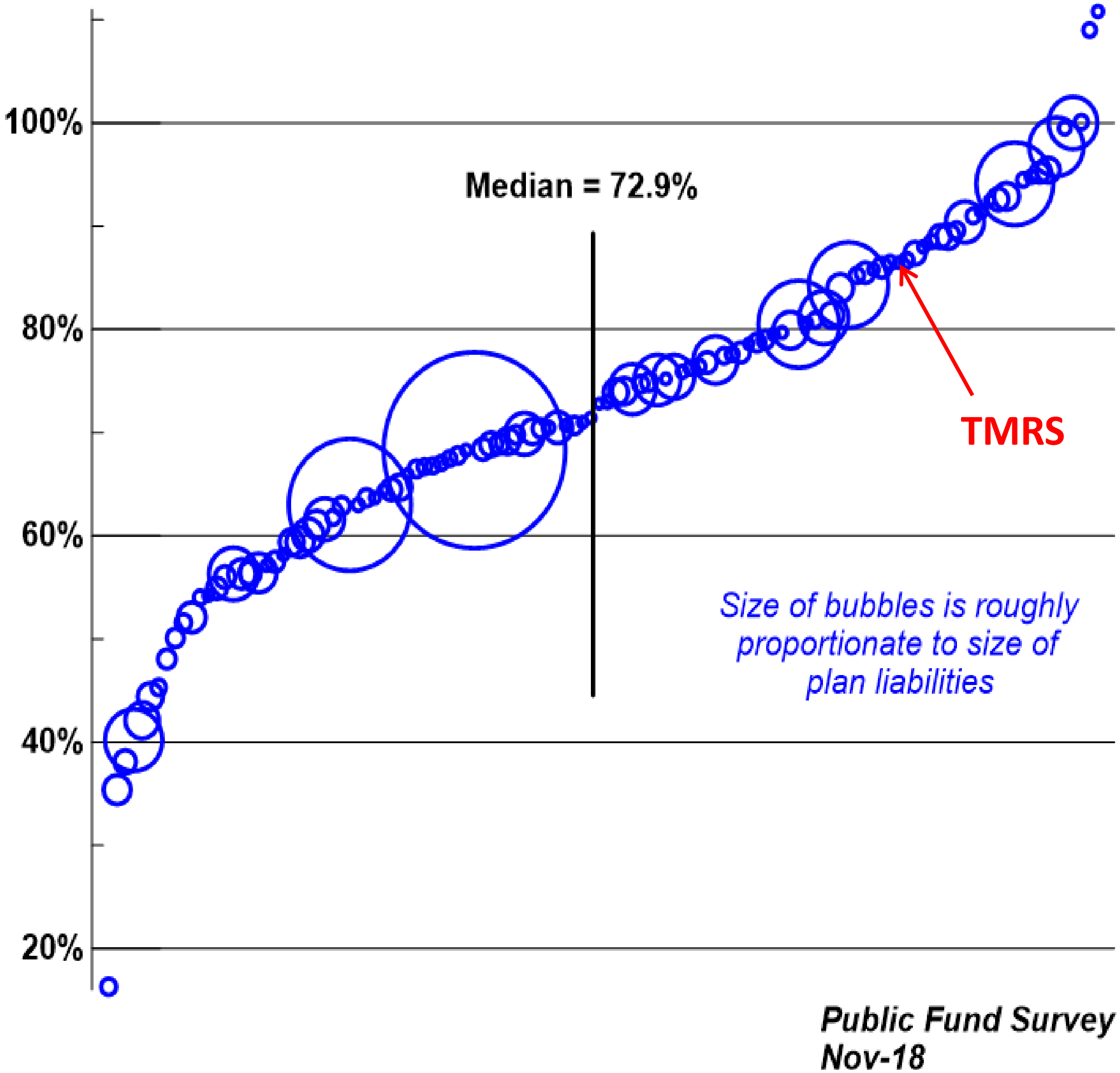
- ~$280 billion in assets
- 1.34 million active (working) participants
- 700,000+ retirees and their survivors receive $17 billion in benefits annually
- Annual contributions = $11.8 billion
  - $5.3 billion from employees
  - $6.5 billion from employers
- Approximately 95 systems in the state
- TRS alone accounts for more than half of the assets and participants
- TRS, ERS, TCDRS, TMRS account for 90+%
- Aggregate funding level = ~78%

U.S. Census Bureau, Pension Review Board, Public Fund Survey

Change in Aggregate Public Pension and TMRS Funding Levels, FY 01 to FY 17



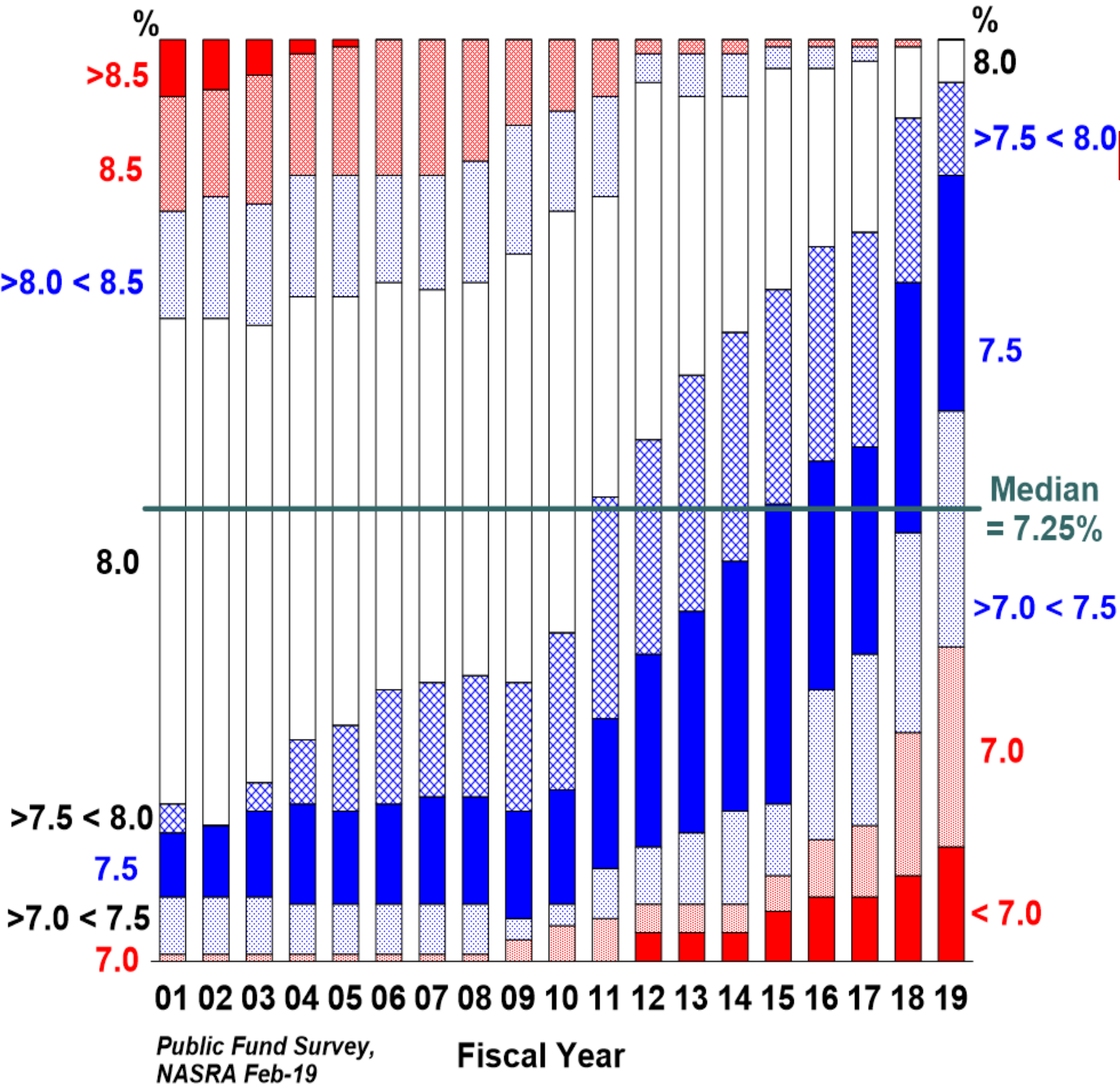
Distribution of Public Pension Funding Levels, FY 17



Headwinds Facing Public Pension Plans

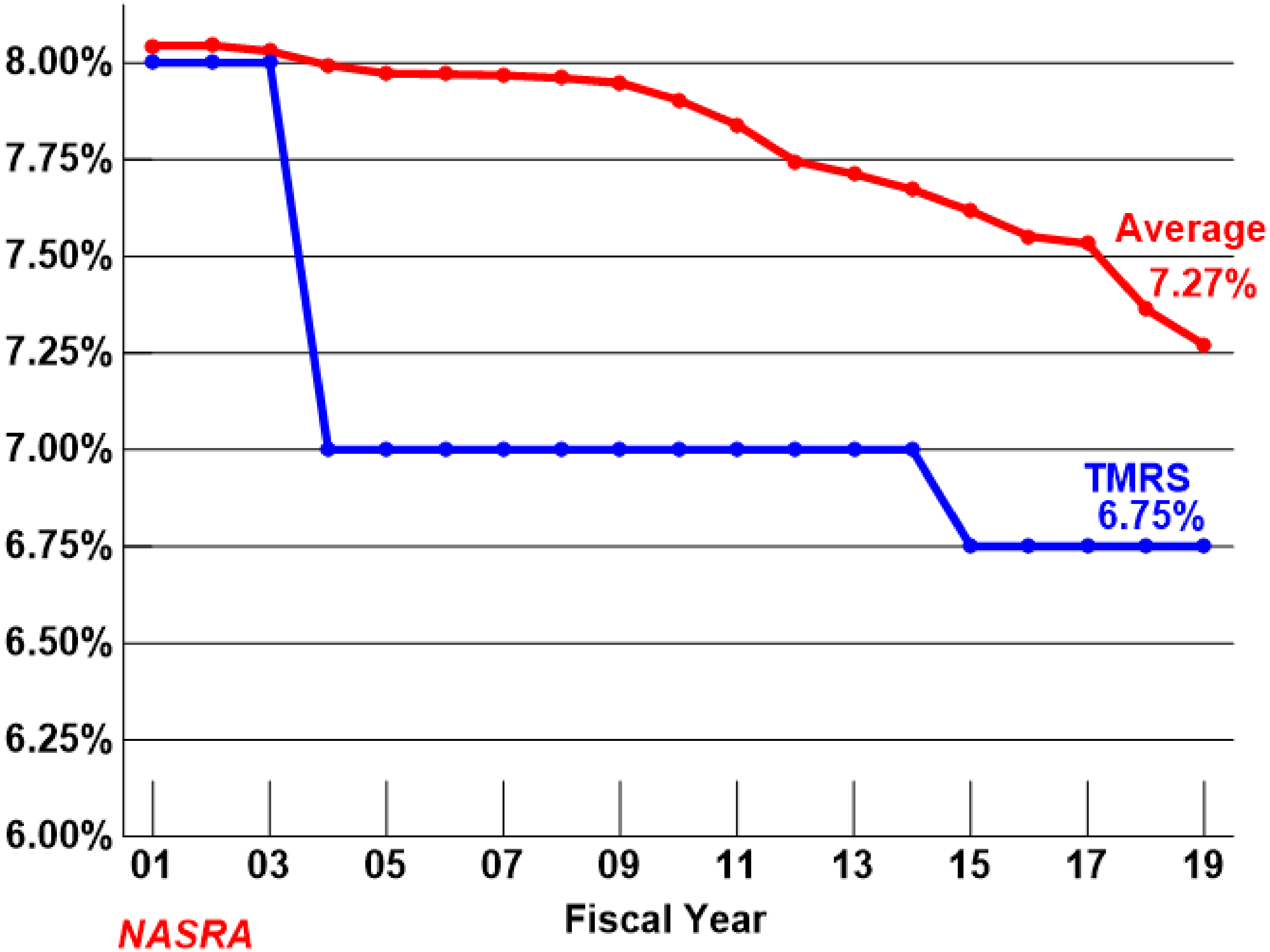
- Higher costs resulting from
  - Declining investment return assumptions
  - Slow payroll growth, which is a result of
    - Sluggish hiring and
    - Tepid salary growth
  - Updated mortality assumptions to reflect longer life expectations
- Increasing plan maturity

Change in Distribution of Investment Return Assumptions, FY 01 to present

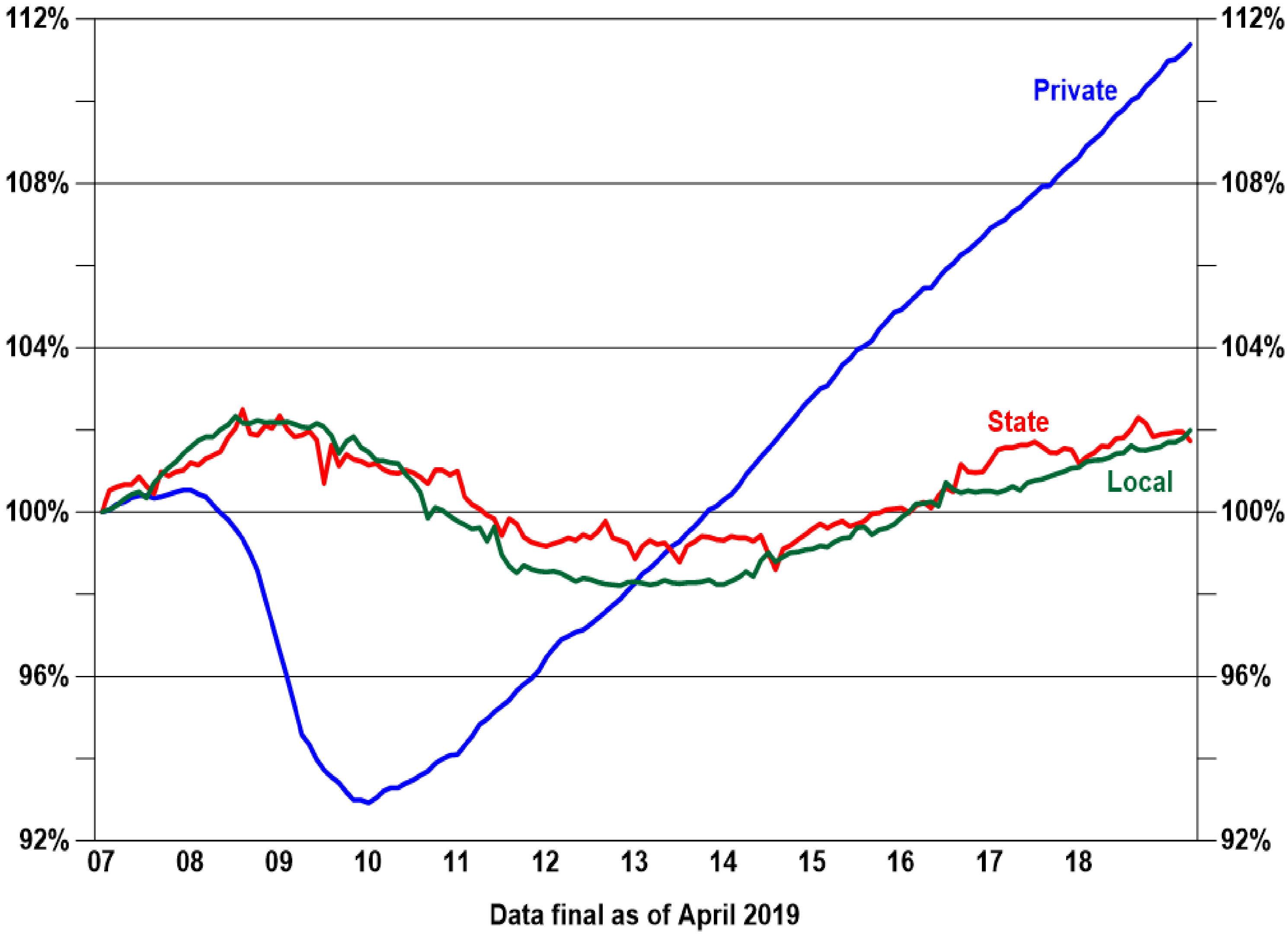


TMRS = 6.75%

Change in Average Public Pension Plan and TMRS Investment Return Assumptions, FY 01 to present

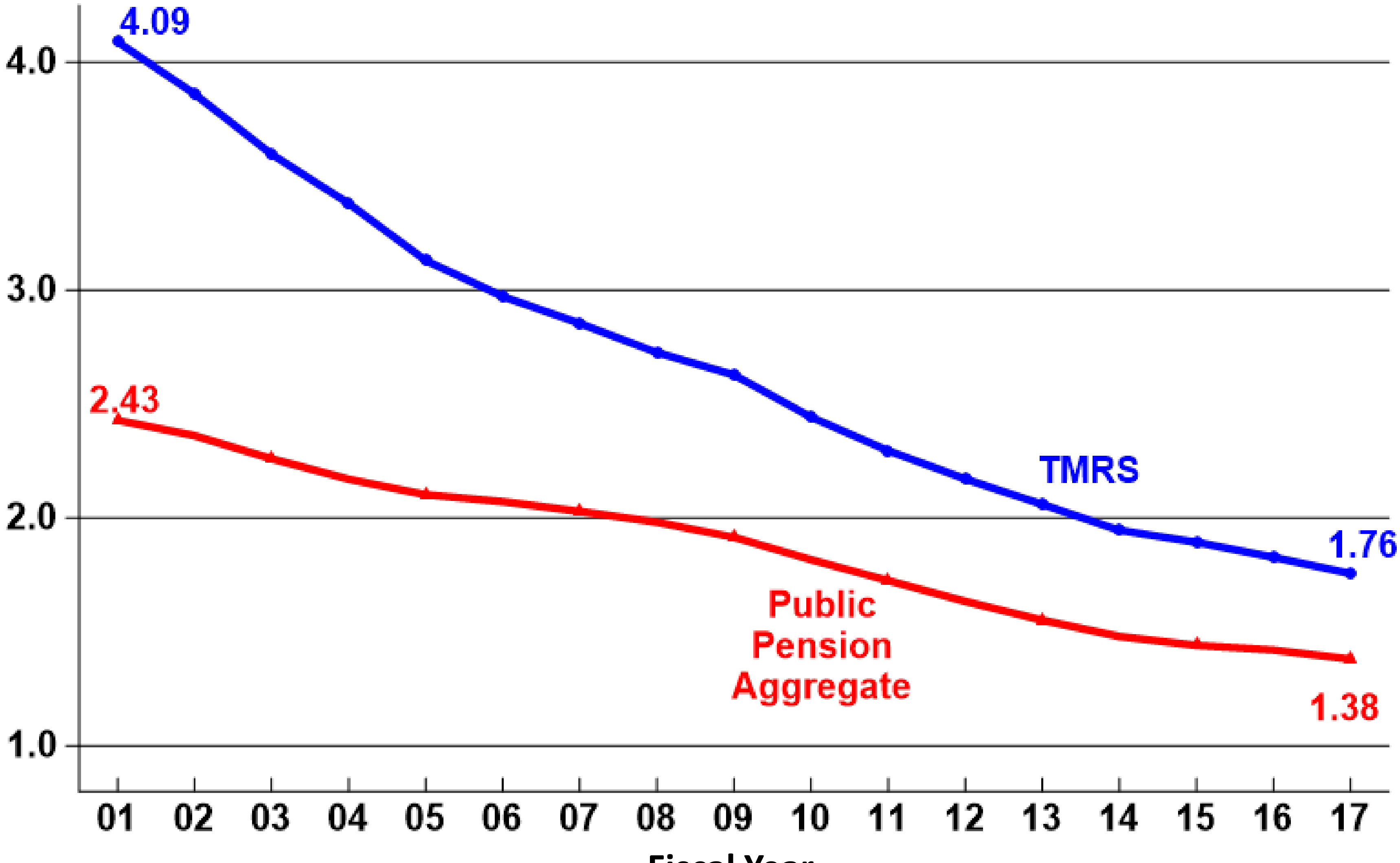


Relative Change in Private and State and Local Employment, 07-19

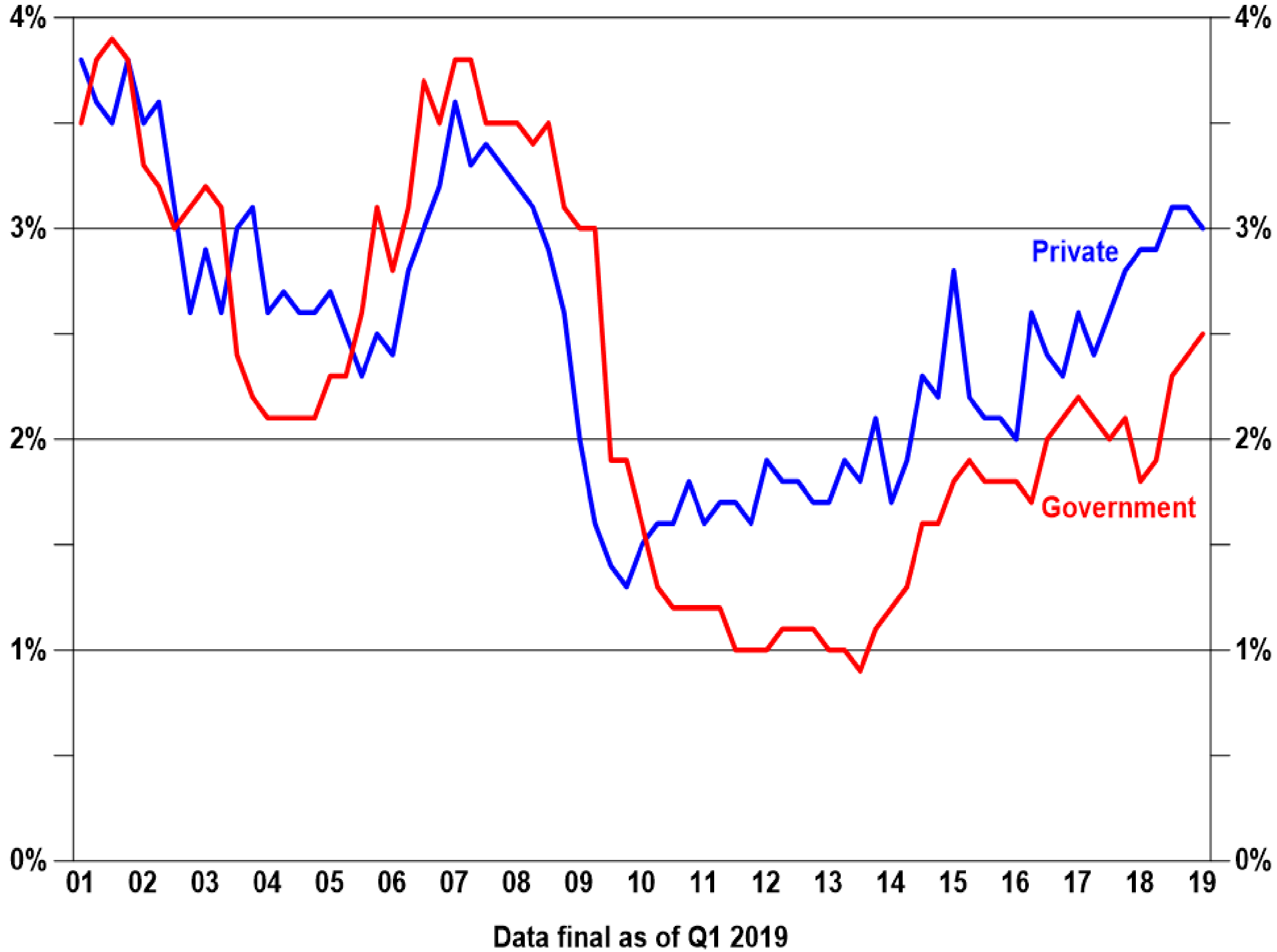


U.S. Bureau of Labor Statistics

Number of Active Members per Annuitant, FY 01 to FY 17

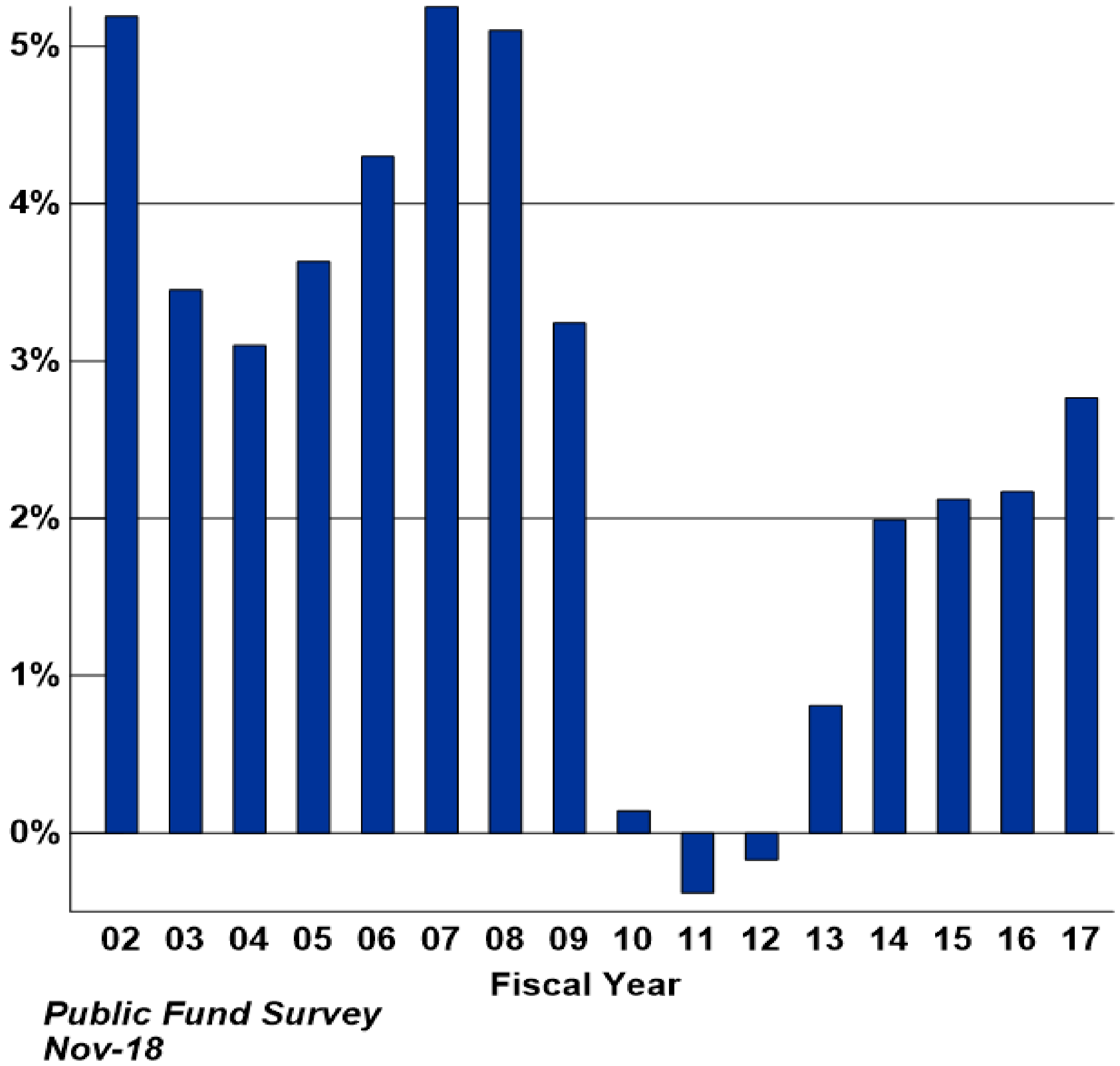


Annualized Quarterly Change in Wage and Salary Costs for Private and State and Local Workers, 01-19

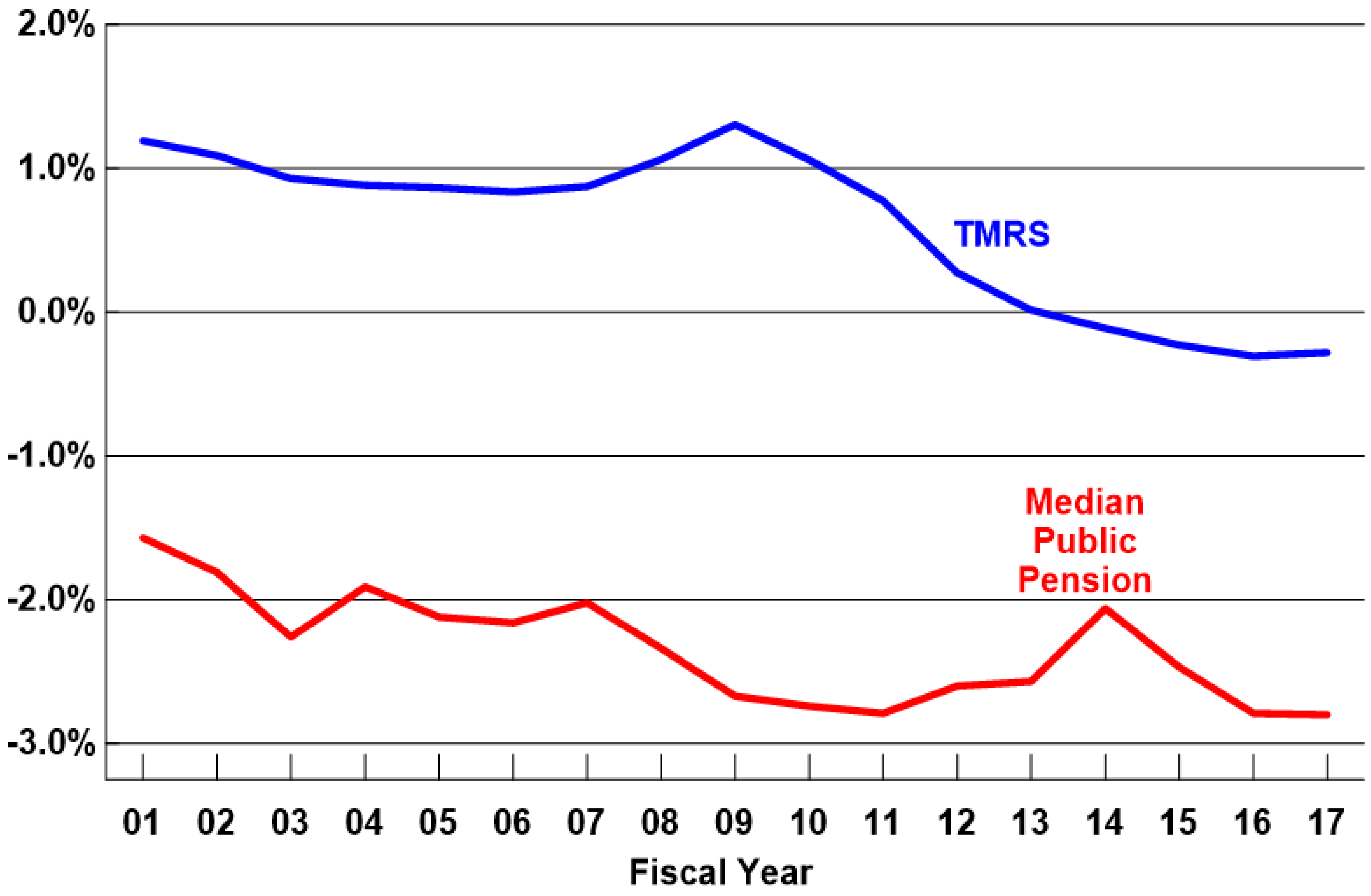


U.S. Bureau of Labor Statistics

Median Annual Change in Payrolls
FY 02 to FY 17



External Cash Flow, Median Public Pension and TMRS, FY 01 to FY 17



Tailwinds Supporting Public Pension Plans

- Stabilizing investment returns ?
- Stronger employer efforts to pay contributions
- More aggressive liability amortization strategies
  - More closed amortization periods
  - Shorter amortization periods
- Lower benefit levels = lower long term costs
- Stronger hiring and salary growth

Where Will Public Pension Funding Conditions Go From Here?

- Many plans continue to struggle with key actuarial challenges
  - Lower investment return assumptions still to be incorporated
  - Sub-par investment returns, particularly in 2015 and 2016, yet to be fully incorporated
  - Rates of public sector hiring and salary growth remain below historic norms
  - Some employers are still not contributing the full ADC
- The size of the challenge varies widely
  - Some plans have relatively small UALs and affordable costs
  - Other plans have UALs that are quite large and burdensome

2010 to present:
The Era of Public Pension Reform

- Since the 2008-09 market decline and recession, states and other public pension plan sponsors have implemented an unprecedented series of reforms to their pension plans
- Unprecedented both in the number of states where reforms were made and in their magnitude
- A major theme of reforms has been the establishment of risk-sharing plan design features
- Also, lower benefit levels and higher employee contributions
- More dedicated funding sources

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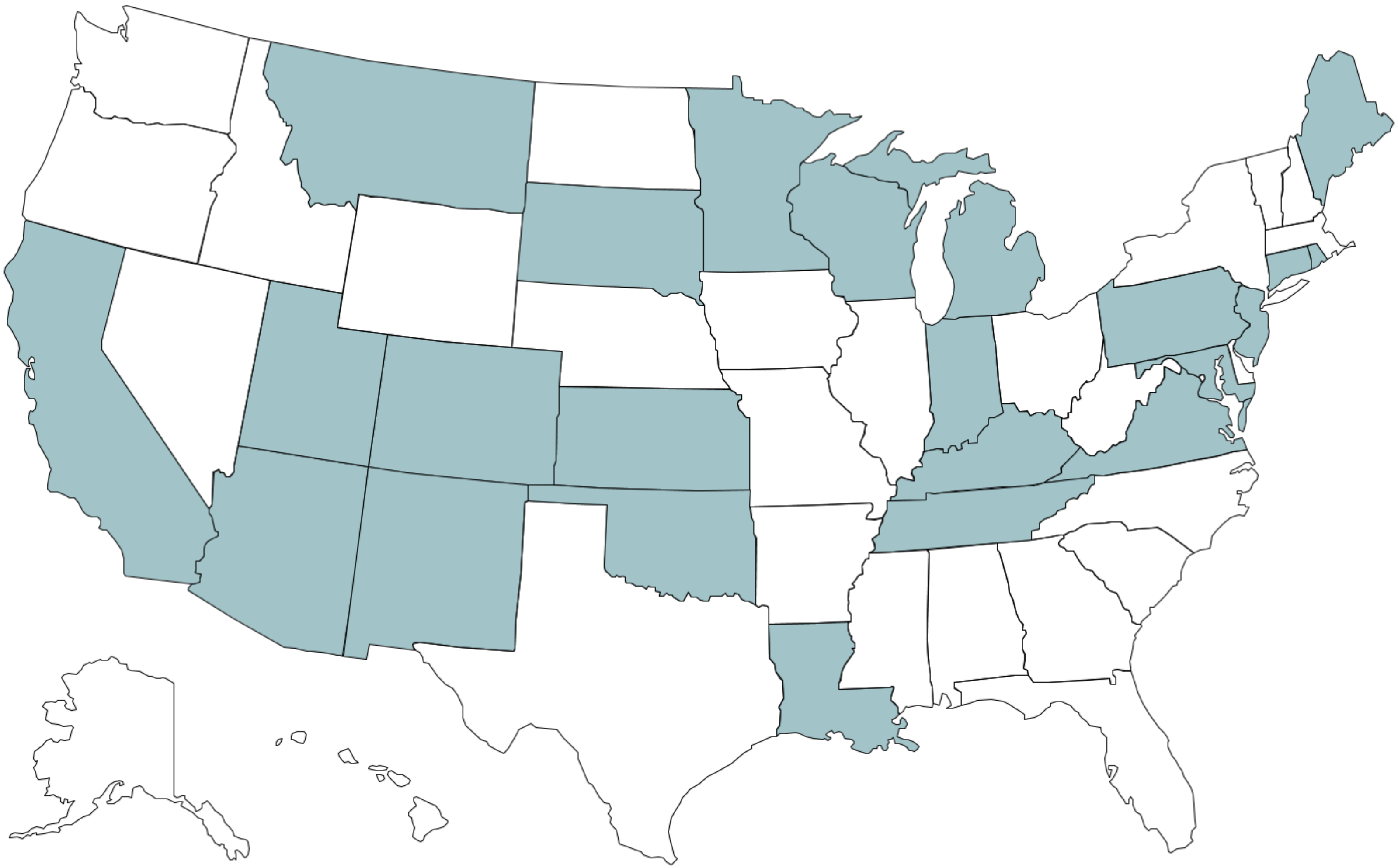
In-depth: Risk Sharing in Public Retirement Plans

States Adding Shared-Risk Plan Designs Since 2000



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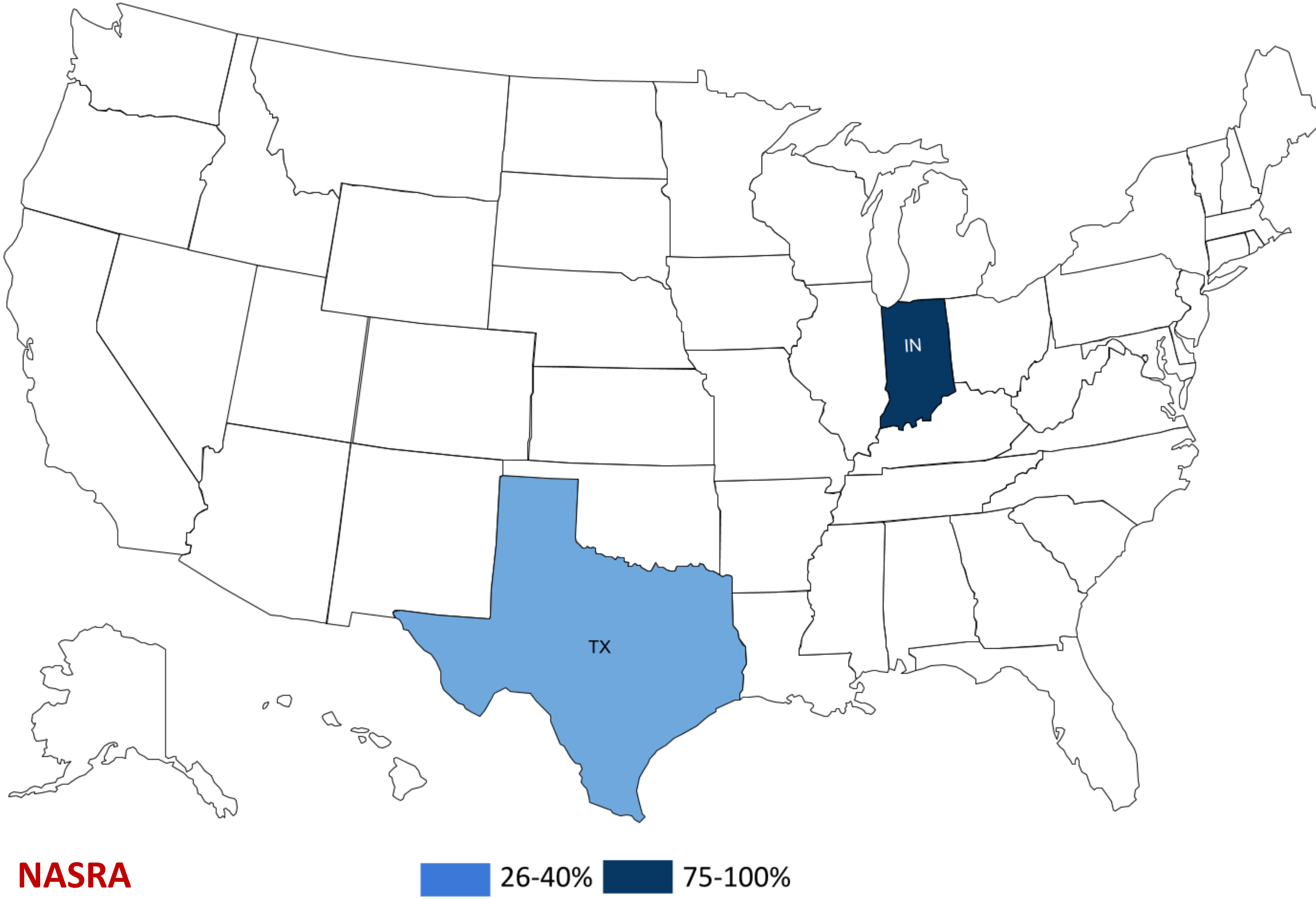
Examples of Risk-Sharing

- Hybrid retirement plans
  - DB-DC
  - Cash balance
- Contingent or limited cost-of-living adjustments
- Flexible employee contribution rates
- Adjustable benefit levels

Statewide Hybrid Plans, and Percentage of Public Employees Participating, 1995



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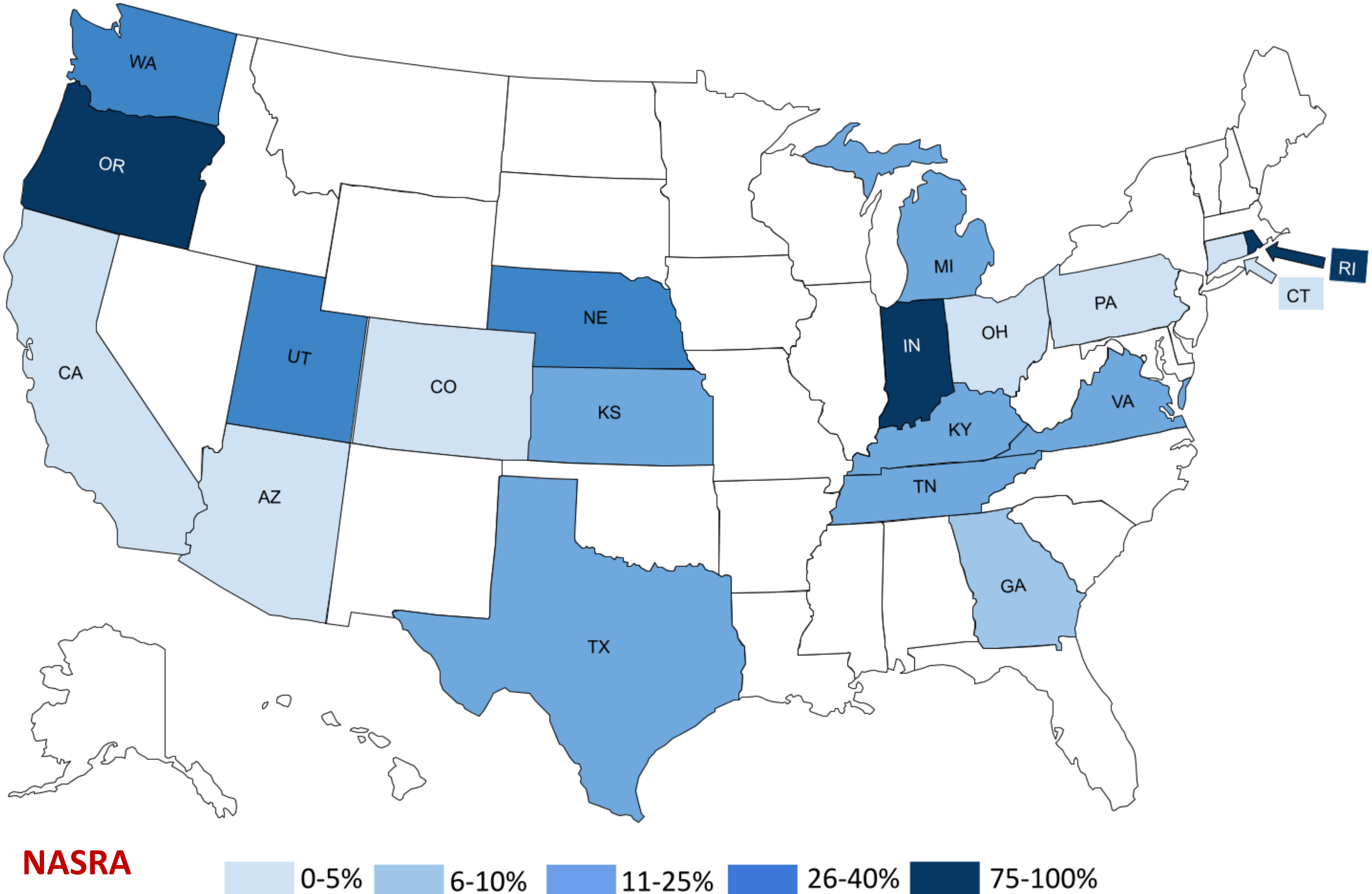
Statewide Hybrid Plans, and Percentage of Public Employees Participating, 2017



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Flexible Employee Contribution Rates

- Employees and employers split the cost of the retirement benefit at the Arizona State Retirement System and the Nevada PERS
- Most new hires in California since 1/1/13 are required to pay at least one-half of the normal cost of the plan
- Iowa statute requires employees participating in the PERS to pay 40 percent of the cost of the plan
- Public employees in Utah must pay the cost of their pension plan above 10 percent
- There are other examples

Flexible Benefit Levels

- Retirement benefits for public employees in New Brunswick (Canada) and Houston, Texas are tied to their plans' actuarial and investment experience
- The New Brunswick plan design features "base" and ancillary benefits. Base benefits are nearly certain to be paid; ancillary benefits may adjust during an employee's working career depending on investment and actuarial experience

Flexible Benefit Levels

- The Houston plans feature a contribution rate corridor arrangement. A rise or fall in the employer contribution rate of five percent triggers changes, including a change in:
  - actuarial methods and assumptions
  - employee contributions
  - COLA
  - normal retirement age

Another Public Pension Trend: Risk Assessment

- Following federal requirements that large banks conduct periodic stress tests, calls are growing for public pensions to undergo risk assessments
- Most larger plans already conduct periodic risk assessments in some form, such as through an asset-liability study
- ASOP 51 requires all actuarial valuations and related analyses to include a risk assessment
- A stress test is a form of risk assessment that measures the effect on the plan of various projected—particularly adverse—investment and actuarial events
- Sensitivity testing—another form of risk assessment—examines the effect on the plan of different actuarial assumptions and methods

Texas Pension Legislation, 2019

- Investment Performance Evaluation (SB 322)
  - Requires public retirement systems to report information about the system’s investments to the Pension Review Board, including fees and commissions, asset managers, investment practices and performance, etc.
- Funding Policy (SB 2224)
  - Requires every public retirement system in the state to publish a funding policy

Thank you

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