Meeting of the TMRS Advisory Committee on Benefits Design

June 23, 2016

TMRS Advisory Committee

TMRS
Texas Municipal Retirement System

Welcome!

Today's Agenda

1. Welcome and Introduction
2. Review of the Agenda and Schedule for the Interim
3. Presentation and Discussion on TMRS Return to Work Provisions

   BREAK
4. Presentation and Discussion on TMRS COLA and Retroactive Provisions
5. Review of Session
6. Discussion of Agenda for Next Committee Meeting
7. Public Comment
8. Adjourn

Advisory Committee Charge

- Provide input to the Board on the advantages and disadvantages of benefit design issues affecting TMRS cities, members, and retirees as assigned to the Advisory Committee by the Board;
- Provide an additional conduit for communication between the TMRS Board and its members, retirees, city officials and policy makers;
- Maintain communication with statewide professional organizations, including employer and employee groups, and member cities.

Schedule for the Interim Session

June 23, 2016 – Advisory Committee Meeting #1

- Receive education from TMRS Actuary (GRS) and Staff on study issues
- Consider, discuss and develop the advantages and disadvantages of each study issue
- Request additional information as needed

Between Advisory Committee Meetings

- Individually consider and respond to a possible survey from TMRS staff regarding the study issues
- Review and consider materials provided in response to information requests
- Contact TMRS staff with any requests for clarification or further information

August 18, 2016 – Advisory Committee Meeting #2

- Review the results of any surveys or materials provided in response to information requests
- Further consider and discuss study issues
- If possible, strive for consensus regarding the significant advantages and disadvantages of each study issue

Committee Ground Rules for Your Consideration

- Stay engaged, and to the extent possible, turn off mobile devices until breaks
- Participate appropriately - respect your colleagues - balance listening and talking so all viewpoints are heard
- Stay focused on the agenda items and resist temptation to get into other interesting topics until the time is right to do so
- Out of respect for others, refrain from sidebar conversations
- Be succinct with comments so all viewpoints are heard
- Expect the facilitator to guide, focus the comments, keep a fast pace, and interrupt, if necessary

Advisory Committee on Benefit Design Meeting – RTW Options

June 23, 2016

GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries
www.gabrielroeder.com

Return to Work (RTW) Policies

- Managing policies that apply to employees who have retired and then choose to return to work (RTW) for the former employer creates challenges for all public employee retirement systems

Prospective behavior and its impact on long term costs

- The most common RTW scenario involves a member who retires but, after retirement, wishes to return to work for economic or other reasons
- Another common scenario occurs when the member is approached by their former employer to come out of retirement and return to work
- When the decision to retire is made without the intention to return to work, costs to a system may not be significant. Under some scenarios, RTW can even produce liability gains

Prospective behavior and its impact on long term costs

- However, when the RTW provisions are too attractive they can influence members to retire with the intention of returning to work
- Such provisions can change retirement behavior that may produce significant costs to the system
- Systems with lenient RTW provisions may also face political and public criticism

TMRS current provisions

- Currently, if a member retires from one city and then returns to work for that same city:
  - The member's current annuity is suspended until he re-retires (the member forfeits the benefit payments that would have occurred during the suspension); may result in actuarial gain to city
  - A new member account is created to which the member and employer contribute (with interest granted) and the balance is annuitized at the second retirement

GRS

TMRS current provisions

- There is a special provision for members who are separated from their employer for a period of more than 8 years before they return to work. Those members are eligible to receive as a lump sum the accumulation of their suspended benefit payments when they re-retire (without interest)

TMRS current provisions

- When a member returns to work at another TMRS city, the member's annuity is not suspended and they can simultaneously receive their annuity from the previous city and salary from their new city
- A new member account is created to which the member and employer make contributions like any other member (with interest granted) and the balance is annuitized at the second retirement

GRS

TMRS RTW Statistics as of 12/31/2015

- RTW rehires all cities: 1,870
- RTW rehires for another city: 1,617
- RTW rehires same city: 253 (in 134 different cities)
  - < 1 year break: 88
  - >= 1 year break: 165
    - Accrued suspended payments
      - Average: $39,664; Total: $6.545 million
      - Range: lowest is $174; highest is $280,895
  - >= 8 year break: 32
    - Accrued suspended payments
      - Average: $36,782; Total: $1.177 million
      - Range: lowest is $1; highest is $222,909

GRS

National RTW Practices

- RTW provisions vary widely across the country
  - From suspended benefit to in-service distribution
  - Some don't suspend but put the member into a DC plan during the second employment
  - Some don't suspend but put caps on how much the member can earn in salary per year; if exceeded, the benefit is suspended
  - If suspended, most do not accumulate and pay out value of forfeited payments at second retirement
  - Most common is a minimum break in service threshold that must be met before annuity and salary can both be received and if minimum threshold not met, benefit suspended

GRS

Why discuss now

- Legislation has been proposed in past sessions to modify RTW provisions
- With the aging population and rising healthcare costs, the number of members who have chosen to retire but want to return will likely increase
- From the employer's perspective, previous employees may be a desired source of workers

Legislative History

- Before 1995, annuities suspended if retiree returned to work at <u>any</u> city.
  - All suspended payments forfeited
  - RTW retirees did not rejoin the system
- In 1995, provisions changed to current status

GRS

Legislative History

- TMRS proposed RTW changes in the 2003, 2005 and 2007 legislative sessions. (none passed)
  - Proposal would have allowed retirees who return to work for the same city they retired from to continue to receive annuity if they had at least a one month break in service
- Also, in 2007, HB 3392 was passed that allows retirees who return to work because of a failed privatization effort to do so without suspension of the annuity
- In 2011, HB 159/SB 812 passed, allowing retirees who have at least an 8-year break in service before returning to work to receive a lump sum equal to their suspended payments
- In 2015, HB 2188 and 3100 filed but did not pass
  - HB 2188 proposed that interest be paid on the suspended payments when a retiree who returns to work re-retires
  - HB 3100, proposed interest be paid and that TMRS recalculate the annuity with any COLA granted during the suspension period

Features to be studied

- Returning to work at the city last retired from
- Length of separation
- Annuity suspension vs. accumulation of suspended payments
- Interest or no-interest
- Lump sum vs. annuitization of new balance (balance since return to work)

Length of separation

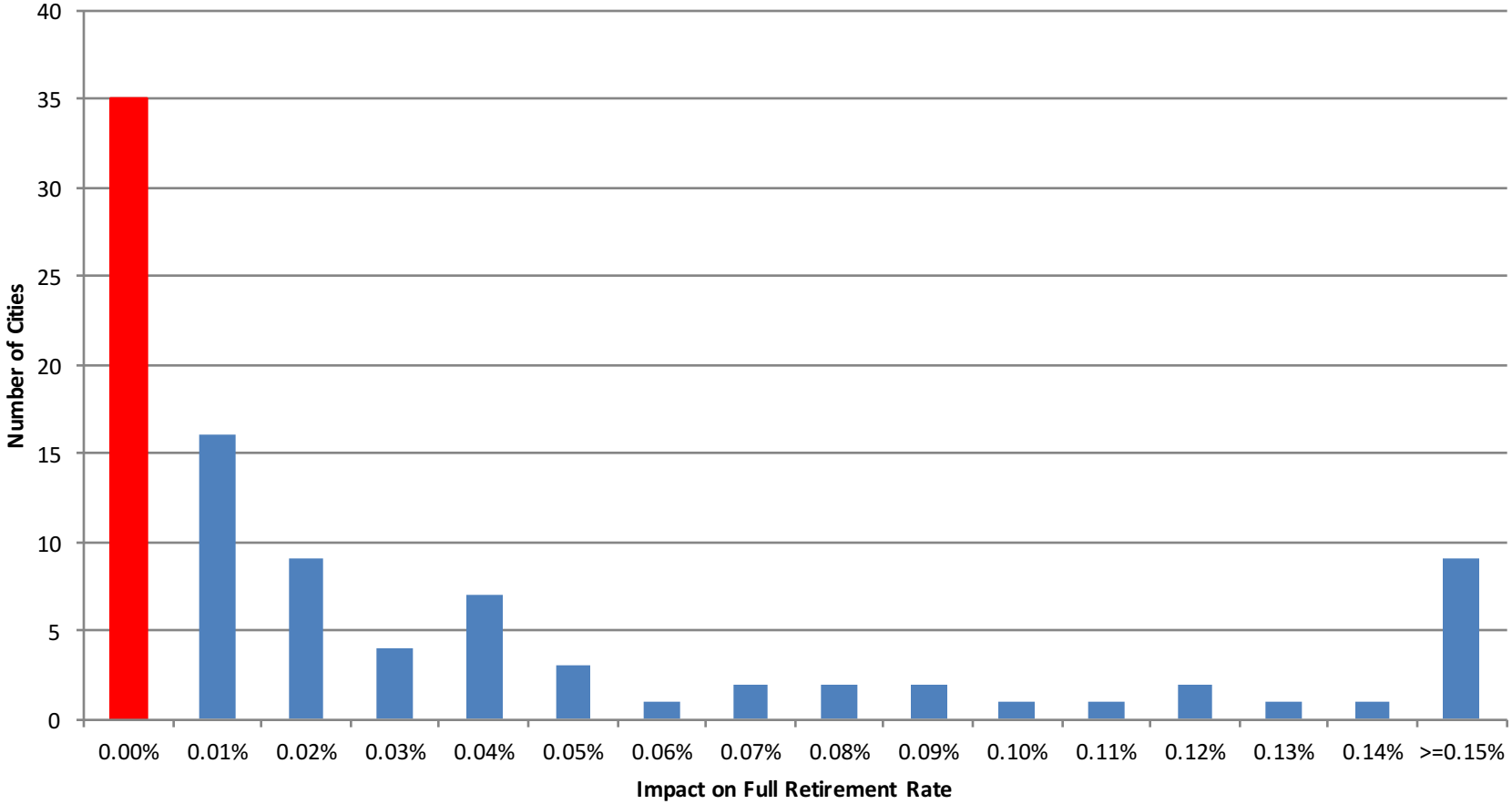
- There are IRS requirements addressing a "bona fide" break in service and no pre-arrangement for re-hire
- While there are no specified definitions, general opinions are that at least a 6-month separation is needed, with 1 year being safer
- The 1 year requirement is less likely to cause a change in behavior than a shorter requirement
  - Makes it harder for an employer to guarantee position
- We have estimated that if new provisions were enacted that increased retirement behavior by 20%, the average increase in employer rates would be from 0.03% to 0.13%

Who should new provisions apply to?

- Just future retirees?
  - Low to no cost, loss of future actuarial gain
- Current retirees who have yet to return to work?
  - Low to no cost, loss of future actuarial gain
- Retirees who have returned to work but have not re-retired?
  - Provide prospective only or include retro payments?
  - On a prospective basis: low cost, loss of future actuarial gain
  - Providing retrospective payments will have a cost, with a wide distribution based on the utilization at the given city
    - Cities may have previously benefited from actuarial gains
- If retrospective payments are provided, what about the retirees who have previously returned to work but have already subsequently retired?

GRS

Information on cost of suspended payments for cities with eligible rehires



Only includes those cities which currently have a rehired retiree who had been retired for at least one year prior to being rehired.

Note: Some cities may have benefited from actuarial gains due to annuity suspensions.

GRS

Basic Considerations

- Consider no RTW change for members who return less than 1 year after retirement
- In all scenarios, recommend no change to the current treatment for new accruals
  - Member contributes into a new account
  - Employer provides a match
  - Earns interest just as any other member
  - Any USC calculation is only based the new employment period
  - Balance is annuitized at second retirement based on age at second retirement. Any option is available.
  - No change to original annuity, except for perhaps COLAs granted during the reemployment

GRS

Options for Original Annuity during re-employment

- Option 1: No Change at all in RTW provisions
- Option 2: Treat RTW retirees at previous city after a 1-year break in service just like a member who returns to a different city
  - No suspension, continue to receive annuity
  - By far the least administrative burden compared to current policy
  - Puts previous employer in same position as another employer

GRS

Options

- Option 3: Decrease the 8 year requirement to 1 year
  - Annuity is suspended, but accumulated suspended payments are paid to the retiree at the subsequent retirement without interest
  - The second least administrative burden compared to current policy
  - Attempts to make the member whole compared to value before second employment
  - Ensures that a member who retires and returns to work does not receive an enhanced benefit compared to the member who never retired

Options

- Variants of Option 3: Decrease the 8 year requirement to 1 year
  - Could provide interest on suspended payments
    - Interest provides even greater incentive to return to work
    - Could lead to more pronounced impact on retirement behavior with potential significant costs
    - Creates a program that looks very similar to a DROP
  - Could annuitize accumulated balance (with or without interest) of suspended payments
    - Annuitized based on age at second retirement using same option as the original annuity
    - Added to the original annuity
    - Member would ultimately receive total of:
      - Original Annuity (at original option, with COLAs)
      - Annuity of Suspended Payments (at original option based on current age)
      - Annuity for new employment (any option based on current age)

GRS

Example

- Under Option 1 – No change in RTW provisions
- Member retires at age 55 with a $40,000 annual benefit ($3,333 per month)
- Returns to work at age 56 and works for 5 years, retiring a second time at age 61
  - Receives $422 per month in additional annuity based on second 5 year employment
- Based on current provisions, the $3,333 would recommence at the second retirement with any COLAs granted during the suspension period
- In all scenarios, the member receives their salary from their employer

Example

- Under Option 2 (no suspension), the member would receive their annuity and their salary during the re-employment period and then have the $422 added to their annuity at the second retirement
- Under Option 3 (suspension but accumulation of missed payments), there are the following alternatives at second retirement (plus the $422 increased annuity)

	Lump Sum	Increased Monthly Annuity
Without interest	$200,000	$1,212
With 5% interest	$226,551	$1,373

Under the "with interest " scenario, the member would receive $3,333 plus $422 plus $1,373 = $5,128 monthly

GRS

Break

Advisory Committee on Benefit Design Meeting – COLA Options

June 23, 2016

GRS
Gabriel Roeder Smith & Company
Consultants & Actuaries
www.gabrielroeder.com

TMRS COLA Overview

- Structure
  - First adopted in 1975
    - Fixed rate; specified percentage
    - Could only be adopted once every 4 years
  - As currently structured, in place since 1981
    - Changed to CPI-based
    - "Retroactive" feature added
  - Proposed changes
    - Legislation has been filed every session since 2009 to modify the COLA
    - Remove "Retro" provision
    - Use "fixed rate" COLA structure as option

TMRS COLA Coverage

- Trends – TMRS Cities
  - Overall
    - The number of cities participating in TMRS has increased from 827 in 2008 to 866 in 2016
  - Cities Adopting COLAs
    - In 2008, 495 of 827 (60%) cities adopted COLAs
    - In 2016, 471 of 866 (54%) cities adopted COLAs
  - Repeating COLAs
    - In 2008, 486 of the 495 (98%) cities adopted repeating COLAs; 467 were 70% repeating COLAs
    - In 2016, 460 of the 471 (98%) cities adopted repeating COLAs; 402 were 70% repeating COLAs
  - Ad Hoc COLAs
    - In 2008, 9 cities adopted Ad Hoc COLAs; this increased each year (except for 2010) peaking at 20 in 2013
    - The number of cities adopting Ad Hoc COLAs has declined each year since 2013, to 16 in 2014, 14 in 2015 and to 11 in 2016

TMRS COLA Coverage

- Trends – TMRS Annuitants
  - Overall
    - The number of annuitants increased from 34,830 in 2008 to 56,790 in 2016, a 63% increase
  - Annuitants Covered by COLAs
    - In 2008, 32,781 of 34,830 (94%) annuitants received COLAs
    - In 2016, 45,705 of 56,790 (80%) annuitants received COLAs
  - Repeating COLA Coverage
    - In 2008, 32,006 of the 32,781 (98%) annuitants receiving COLAs were in cities with repeating COLAs
    - In 2016, 37,901 of the 45,705 (83%) annuitants receiving COLAs were in cities with repeating COLAs
  - Ad Hoc COLA Coverage
    - In 2008, 775 annuitants benefited from an Ad Hoc COLA; by 2014, this number had risen to 9,828
    - By 2016, the number of annuitants benefiting from Ad Hoc COLAs had decreased to 7,804

Current COLA Options

- 30%, 50% or 70% of CPI-U
- Repeating COLAs are advance funded over each active employee's working career
- Ad-hoc COLAs are funded when granted over 15 years with level dollar amortization

Short Term Analysis

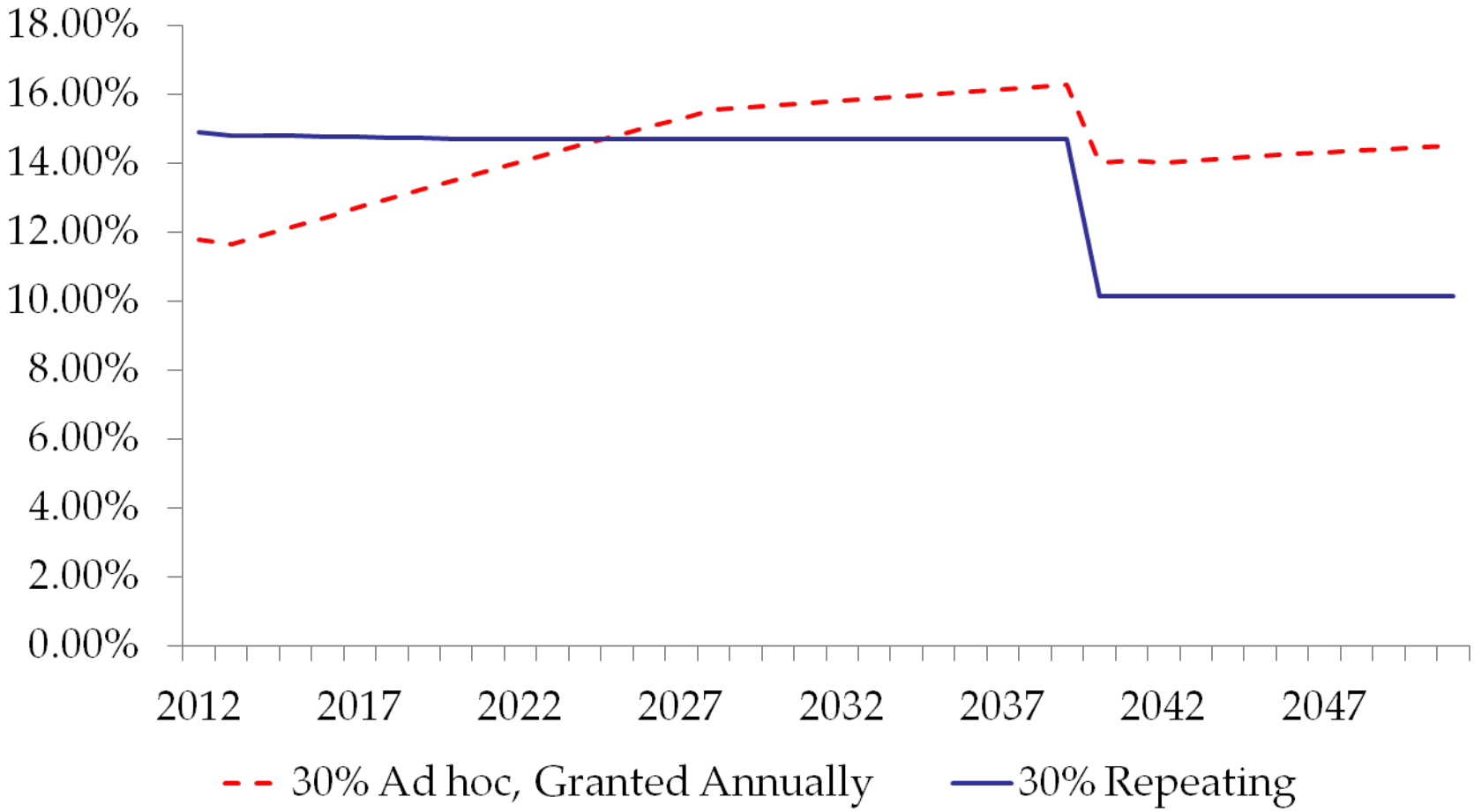
- Ad hoc rates lower in short run, but costs increase with each adoption; repeating rates are stable, but higher initially
- After 10 years, rate for a plan granting ad hocs is similar to the repeating rate and will continue to increase thereafter
- New UAAL is created every time an ad hoc is granted, overall UAAL decreases over time for repeating
- Funded ratio improves over time with repeating, may decline or stay level with ad hocs
- GASB requires consistent ad hoc adoptions to be reflected as repeating in financial statements

Long Term Analysis

- In the long run, cumulative contributions for ad hoc COLAs exceed those for repeating COLAs
- Investment earnings accumulated through advance funding accounts for difference in long term costs

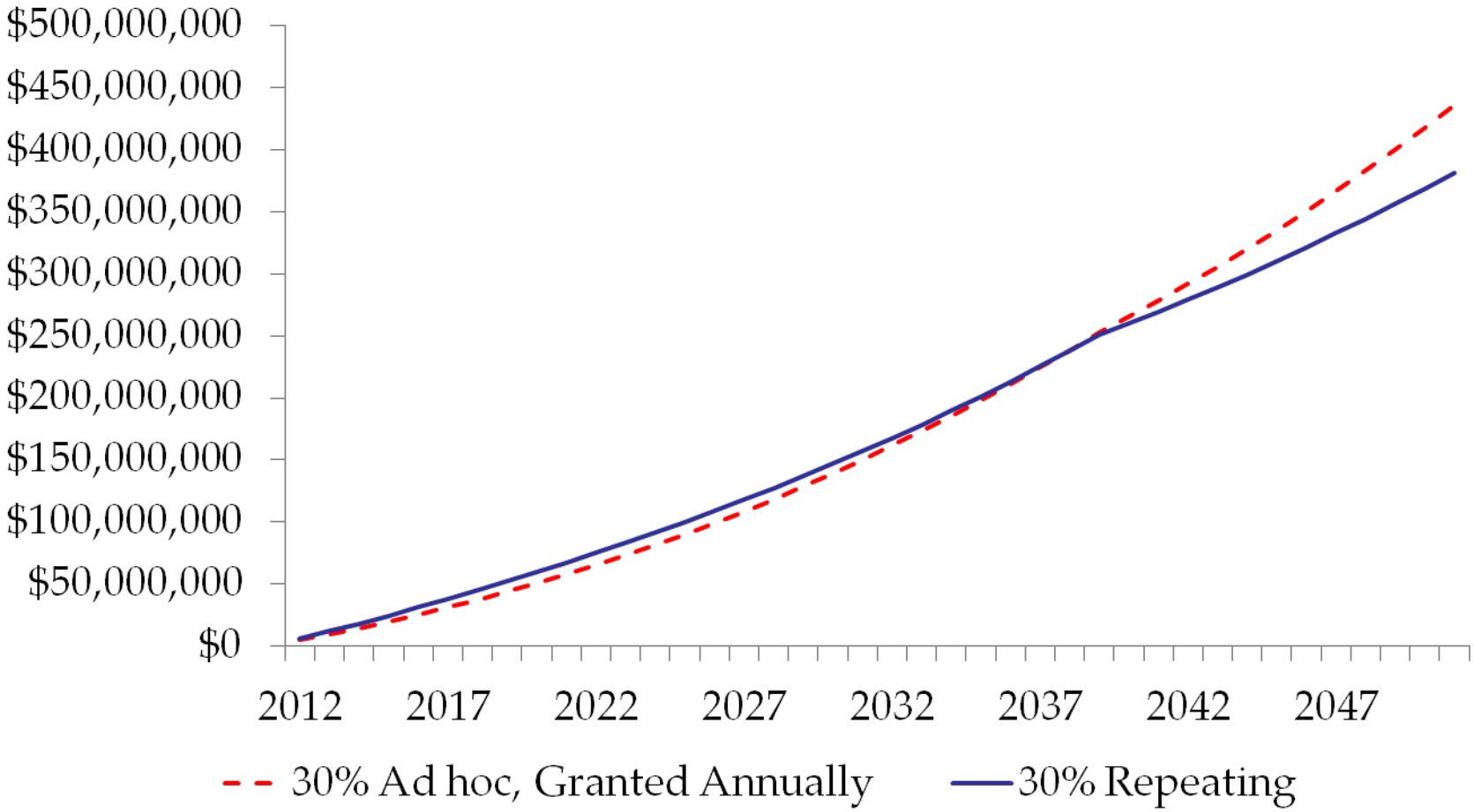
GRS

Projected Contribution Pattern



GRS

Total Cumulative Contributions



GRS

COLAs are Retroactive

- Increases are calculated as if COLA had always been in effect since date of retirement
  - Typically referred to as "catch up" provision
- Initial COLA or an increase in CPI percent results in large benefit increases for the year adopted; longer retired, higher the increase
- Reduction in CPI percent results in lower or no increase until cumulative increase at lower percent exceeds current benefit; longer retired, longer until another increase will be granted
- Two alternatives have been proposed that would eliminate the retroactive or catch up feature:
  - Current CPI based COLA without retroactive feature
  - Flat rate COLA of a specified percentage increase

Pros and Cons of a Non-Retro COLA compared to current policy

- Pros:
  - The total benefit increase will likely be smaller and thus the cost to the employer will be less. May make it more affordable for employers
  - Depending on the design, the employer may be able to better control the cost of COLAs
  - A lower COLA can be utilized to dampen growth of plan liabilities when returns are low
  - Provides an additional option for cities (retro or no retro)

- Cons:
  - May not keep pace with inflation if not tied to CPI
  - If there has been a period of no COLAs, a non-retro COLA does not restore lost purchasing power evenly across retirees
  - Adds administrative complexity

- For Cities that have repeating benefits and do not change the percentage, there is no difference between retro or non-retro

GRS

Comparison of Current CPI-based COLA and Flat Rate without Retroactive Feature

- CPI Based
  - Uses current COLA structure, which employers understand
  - Simple and less costly to administer, given current system
  - Aligns COLA increases with the CPI, which helps retain retiree purchasing power
- Flat Rate
  - Provides more flexibility to employers
  - May not keep pace with inflation if not tied to CPI
  - Adds administrative complexity
  - Has to be carefully crafted to stay consistent with IRS regulations

GRS

Ad hoc Comparative Analysis 1 – COLA last adopted January 2010

	Baseline * (No COLA)	70% CPI Ad hoc with Catch-up (6.67%)	70% CPI Ad hoc without Catch-up (0.51%)	Flat 2.5% Ad hoc
UAAL	$60,062,834	$72,868,402	$61,104,951	$65,161,254
Funded Ratio	86.3%	83.9%	86.1%	85.3%
ER Current Service %	7.23%	7.23%	7.23%	7.23%
Prior Service %	5.17%	6.81%	5.30%	5.82%
Full Rate	12.40%	14.04%	12.53%	13.05%
Estimated Contribution	$10,399,826	$11,775,287	$10,508,856	$10,944,978
Annual Cost to Provide COLA		$1,375,461	$109,030	$545,152
Projected CY2017 Benefit Payments	$20,946,533	$22,343,091	$21,053,570	$21,470,196
Increase Due to COLA		$1,396,558	$107,037	$523,663

* City last adopted a COLA on January 1, 2010

GRS

Repeating Comparative Analysis 1– COLA last adopted January 2010

	Baseline * (No COLA)	70% CPI** Repeating with Catch-up (6.67%)	70% CPI** Repeating without Catch-up (0.51%)	Flat 2.50% Repeating COLA
UAAL	$60,062,834	$146,419,293	$132,699,102	$167,458,448
Funded Ratio	86.3%	72.1%	74.1%	69.3%
ER Current Service %	7.23%	9.34%	9.34%	10.24%
Prior Service %	5.17%	11.68%	10.64%	13.27%
Full Rate	12.40%	21.02%	19.98%	23.51%
Estimated Contribution	$10,399,826	$17,629,382	$16,757,138	$19,717,734
Annual Cost to Provide COLA		$7,229,556	$6,357,312	$9,317,908
Projected CY2017 Benefit Payments	$20,946,533	$22,343,091	$21,053,570	$21,470,196
Increase Due to COLA		$1,396,558	$107,037	$523,663

* City last adopted a COLA on January 1, 2010

**Assumes CPI will increase 2.5% annually

GRS

Ad hoc Comparative Analysis 2– COLA never adopted

	Baseline * (No COLA)	70% CPI Ad hoc with Catch-up (10.32%)	70% CPI Ad hoc without Catch-up (0.51%)	Flat 2.5% Ad hoc
UAAL	$21,413,900	$27,155,999	$21,767,835	$23,145,480
Funded Ratio	91.0%	88.8%	90.9%	90.3%
ER Current Service %	4.90%	4.90%	4.90%	4.90%
Prior Service %	3.00%	3.88%	3.05%	3.27%
Full Rate	7.90%	8.78%	7.95%	8.17%
Estimated Contribution	$5,545,153	$6,162,841	$5,580,249	$5,734,671
Annual Cost to Provide COLA		$617,688	$35,096	$189,518
Projected CY2017 Benefit Payments	$6,601,287	$7,282,614	$6,635,019	$6,766,319
Increase Due to COLA		$681,327	$33,732	$165,032

* City has never adopted a COLA

GRS

Repeating Comparative Analysis 2 – COLA never adopted

	Baseline * (No COLA)	70% CPI ** Repeating with Catch-up (10.32%)	70% CPI** Repeating without Catch-up (0.51%)	Flat 2.50% Repeating COLA
UAAL	$21,413,900	$69,574,123	$63,328,054	$82,437,140
Funded Ratio	91.0%	75.7%	77.3%	72.4%
ER Current Service %	4.90%	6.60%	6.60%	7.32%
Prior Service %	3.00%	7.33%	6.77%	8.49%
Full Rate	7.90%	13.93%	13.37%	15.81%
Estimated Contribution	$5,545,153	$9,777,720	$9,384,646	$11,097,326
Annual Cost to Provide COLA		$4,232,567	$3,839,493	$5,552,173
Projected CY2017 Benefit Payments	$6,601,287	$7,282,614	$6,635,019	$6,766,319
Increase Due to COLA		$681,327	$33,732	$165,032

* City has never adopted a COLA

**Assumes CPI will increase 2.5% annually

GRS

Review of the Session

Next Steps

- Preview of agenda for August meeting (August 18, 2016)
- Between now and the August meeting, expect to hear from TMRS Staff regarding:
  - A possible survey on the study issues
  - A summary of today's meeting for your review and distribution to your respective stakeholder groups
  - Information relating to follow up requests from today, if necessary
- Should you be unclear about anything discussed today or have follow up questions, please contact TMRS staff

- Thank You For Your Time!

Adjournment