Meeting of the TMRS Advisory Committee on Retirement Matters
April 4, 2014

Opening Remarks

Ms. Julie Oakley welcomed the Advisory Committee members and thanked them for their participation. After brief introductions, the agenda was reviewed. Mr. Dan Wattles reviewed the Advisory Committee's charge from the TMRS Board, including the four topics for the Committee's consideration: (1) modification to the Cost of Living Adjustment (COLA) catch-up provision, (2) fixed rate COLA, (3) employee eligibility threshold, and (4) two-tiered benefits.

Mr. Wattles stated that the TMRS Board designated these topics for study as a result of a February 2014 survey of Advisory Committee members. The Committee was also asked in the survey to identify any additional topics that it wanted to discuss over the next several meetings, to which no additional topics were noted. The minutes of the August 2012 Committee meeting were presented and unanimously approved.

Discussion on National Pension Landscape and Trends in Benefits Changes

Mr. Mark Randall from Gabriel Roeder Smith & Company (GRS) provided a general overview of the major themes impacting public pension plans across the nation. This included a general decrease in states considering defined contribution plans to replace defined benefit plans, the continued decline of funding ratios and increase in contribution rates, and a continued level of antagonism toward public pension plans.

He presented information comparing TMRS investment performance, investment return assumptions and funded ratios to national figures. Mr. Randall discussed the linkage between consistent full funding (payment of the Annual Required Contribution or ARC) of a plan and its funded ratio. In addition, TMRS investments were well-positioned during the 2008 financial crisis. As a result, TMRS was a top investment performer within its peer group during that year.

Mr. Randall explained that the average funded ratio for large public sector plans was 70%. He compared this to the 80% funded ratio threshold cited by the media when conveying the fiscal health of public pension plans. Mr. Randall cautioned the group that the standalone use of such a measure is often misguided. Actuaries use a variety of factors to measure the fiscal health of a given pension plan, and generally tend to be more concerned with the trend of a plan's funded ratio and whether the ARC is being consistently paid. Ms. Oakley explained that the law applicable to TMRS that requires that cities pay the ARC improves the sustainability and stability of the system.

Mr. Randall outlined the major trends occurring in the public pension plan industry, including reducing benefits, increasing employee contributions and creating tiered benefit plans. He noted that all plans are adapting to the new Governmental Accounting Standards Board (GASB) standards. Ms. Oakley noted that even though GASB standards are moving away from reporting the ARC, participating TMRS cities will still be required by law to pay the ARC.

Mr. Randall provided examples of other statewide plans, including those in Texas that have made structural changes within the past five years. He highlighted changes that included the creation of new benefit tiers, reduced COLAs, and adjusted final average salaries used to calculate benefits. He observed that these actions will generally result in a reduced member benefit.

A discussion followed regarding the outcomes created by defined contribution plans versus defined benefit or hybrid plans. The higher administrative and investment costs of defined contribution plans, as well as the shift in investment management responsibility to the member were cited as key differences.

Ms. Leslee Hardy then outlined the new GASB standards, how they differ from prior accounting and reporting requirements, the effective dates of the standards, and the resulting impact to participating employers. Specifically, the new standards require the valuation of COLAs to the extent that they are considered substantively automatic. Ms. Hardy addressed the definition of substantively automatic and the Committee discussed various examples to understand the practical implications.

Ms. Hardy noted that criteria will need to be adopted to determine when a participating city would have to report a COLA. TMRS has not yet finalized the criteria. Ms. Hardy stated that TMRS has an internal GASB committee which will analyze this issue and possibly propose policy to recommend to the Board.

Discussion on COLA Catchup Provision and Other COLA Options

Mr. Wattles summarized the survey results that led to the four topics being studied this interim by the Committee. He observed that the topics have been the subject of legislation over the past three legislative sessions. Mr. David Gavia provided a brief history of the evolution of the TMRS COLA over the years.

Mr. Randall next detailed the mechanics of how the current ad hoc COLA provision works. Using case studies from the TMRS population, he explained the difference in the funding patterns for repeating versus annual ad hoc COLAs, and described how the catchup feature of the TMRS COLA functions. He explained that the catch-up feature is unique to TMRS and noted that most other plans do not have a similar provision. While it helps maintain a retiree's standard of living, he noted that an ideal COLA is one that is pre-funded and not retroactive.

Mr. Joe Angelo asked if TMRS recommends what participating cities should do and how they should proceed with COLAs. Mr. Gavia responded that TMRS does not tell cities whether they should or should not have a COLA provision. He noted that many variables affect whether a city believes a COLA to be appropriate for its employees.

Ms. Hardy outlined the cost impact of the catchup provision through examples, including an ad hoc COLA with a catchup feature, an ad hoc COLA without a catchup feature, and a flat rate COLA. She contrasted those scenarios with examples of the annually repeating COLA, both with and without the catchup provision.

The Committee next discussed the perceived advantages and disadvantages of a catchup provision and flat rate COLA. Potential advantages cited for not having a catchup provision included increased affordability, and flexibility of the COLA in terms of it being either on a repeating or ad hoc basis. The disadvantages cited for not having a catch-up provision included that the COLA may not keep pace with the CPI, and it does not restore the retiree's lost purchasing power.

The potential advantages of a flat rate COLA that were identified included that the provision could be a better cost-control mechanism, and that a lower flat rate could be used to curb liability growth. The cited potential disadvantage of a flat rate COLA is that it, too, may not keep pace with the CPI and does not restore the retiree's lost purchasing power.

Mr. Randall next presented the option of offering a window during which time the catchup feature is removed. It was observed that this could be costly and complex for TMRS to administer. In addition, an option to have a one-time removal of the catchup provision was discussed.

Mr. Greg Vick commented that his perception of the one-time option was that it was just delaying the problem for future years and generations. Specifically, he didn't like the concept of limiting the ability of a city council to make decisions for its city. Mr. Greg Shipley stated that he did not like the ability for cities to constantly turn COLAs on and off, particularly when it relates to members who lack access to Social Security, such as those that he represents. Mr. Dean Frigo and Mr. Scott Kerr believed it to potentially be a good compromise. Mr. Michael Dane noted that the sustained approach to a COLA is often a difficult sell to council members.

Mr. Wattles then reviewed information relating to the trends in cities adopting COLAs and the corresponding levels of COLA coverage among TMRS retirees. He cited that while a lower number of cities are adopting COLAs, there has been an actual increase in the absolute number of TMRS retirees covered by COLAs.

The Committee then discussed possible alternatives for the catchup provision. Mr. Frigo shared his perspective on past legislative attempts to modify the catchup provision, noting that the goals were to increase flexibility and local control.

Mr. Gavia reminded the Committee that the Board and staff are not seeking change, but rather are looking for input from the Committee on those areas where potential interest has been shown and where no definitive resolution had yet been attained.

The Committee discussed whether the catchup provision topic was still relevant, given that city contribution rates had stabilized. The one-time option was again cited as a potential for the Committee's consideration. It was acknowledged by the group that within the constructs of this option, if a city wanted to increase, they could do so without the catchup option, but any reduction of the COLA percentage would include the catchup provision.

Ms. Oakley asked whether any additional percentage options should be discussed pertaining to the CPI-based COLA, to which the group agreed that the current percentage options seemed sufficient.

Mr. Tadd Phillips asked to see a breakdown of the cities that had dropped or reduced their COLAs. Mr. Gavia noted that in the past, staff had provided the Committee with a list of which cities have turned off repeating COLAs and any ad hoc COLAs granted since that time. Staff will provide the Committee with updated data on this matter.

Mr. Monty Wynn noted that from his perspective, various cities have differing opinions. Mr. Bryan Langley noted that there seems to be two sides: 1) cities without COLAs who want to begin to offer such a provision, but can't afford to because of the retroactive nature of the COLA, and 2) other cities that have dropped the COLA provision.

Mr. Dane commented that if the catchup provision is creating an obstacle to cities adopting the COLA, it should be addressed and a solution should be sought.

Mr. Dane introduced for discussion the idea of a COLA tier, whereby COLAs could not be reduced for retirees after adoption; it could be changed only for future retirees. Mr. Victor Hernandez responded that such a move would limit elected official's options, and that while he is pro-employee, he is also in favor of flexibility and local control. He continued by stating that the option presented by Mr. Dane seemed limiting. Mr. Gavia also noted that there may be Constitutional issues associated with legislation imposing a requirement that doesn't allow a city to change or repeal future COLAs. Allowing the city an option to differentiate between retirees may be possible, but would have much less impact in terms of rate relief.

Mr. Hernandez inquired as to the notification requirement involved if a city was changing from a repeating COLA to an ad hoc COLA, to which Mr. Gavia explained that past COLA legislation required notice to retirees when a decrease in benefits occurs. The legislation did not pass and there is no current requirement to provide direct notice to retirees of COLA changes.

To conclude the meeting, the Committee was asked to identify additional research that it wanted in advance of the next meeting. Mr. Vick asked for a summary of the menu of options that a TMRS participating city has within its discretion in terms of affecting its contribution rate. The Committee agreed that surveying participating employers who had interest in these issues and conducting a straw poll of Committee members may be beneficial at some point to support the Committee discussions.

Discussion of Agenda for the Next Advisory Committee Meeting

Ms. Oakley announced that the next Advisory Committee meeting will be held on May 15, 2014. The focus will be to further discuss the COLA issue, along with the eligibility threshold and two-tiered plan topics.