Summary
TMRS Advisory Committee
December 1, 2011

National Landscape – presentation by Mark Randall, GRS, with comments by Nancy Williams, David Gavia, and others

Public retirement systems are under scrutiny. Government employers at all levels are making changes to their employee pension plans to reduce costs or increase funding. At the state level, the following table summarizes recent changes:

Type of Benefit Change	Number of States
Increased Employee Contributions	16
Increased Vesting Requirements	7
Increased Age/Service Requirements for Normal Retirement	15
Extended Period for Final Average Salary	6
Reduced Post-Retirement COLAs	10
Reduced Benefit Multipliers	4
Two Part Hybrid Plans	8

COLAs are expensive to fund and are often a target for immediate change – either eliminating them or reducing the COLA amount. At some public retirement systems, new hires must now wait longer to retire. In 2012, some state legislatures are considering two tier benefit structures for future employees.

Despite some rebound in the financial markets, many systems continue to experience a steady decline in their funded status. Fewer states are making their actuarially required contributions.

Generally, state governments are more likely to examine changing plans from defined benefit arrangements to defined contribution plans, while local governments are making benefit reductions or requiring contribution increases by members.

Upcoming changes to the Governmental Accounting Standards Board (GASB) standards for public pension accounting, will further complicate discussion about public employee defined benefit plans.

Around the country, a few cities have declared bankruptcy or gone into receivership. Some of the strain on those cities arises from their employee pension requirements. The key to maintaining a healthy DB plan is funding discipline (all TMRS cities are required to pay their Actuarially Required Contribution (ARC)).

In Rhode Island, the state legislature passed a law putting claims of a bankrupt city's creditors ahead of pension obligations. The legislature took this action to prop up the state's credit rating for bond issuances but it has a severely negative potential impact on public employees.

TMRS Benefit Options for Discussion During the Interim

Additional Cost of Living Adjustment (COLA) Options

TMRS currently provides cities the option to adopt COLAs at three levels, 30%, 50%, or 70% of the annual change in the Consumer Price Index (CPI). Cities may adopt COLAs on either an ad hoc or annually repeating basis. For COLA purposes, TMRS calculates the percentage of change in the CPI from the December before the date the member retired through the December that is 13 months prior to the effective date of the increase. This "look back" or "catch up" feature can make the cost of adopting a COLA very high if a city has never granted one or has gone years without granting one. It can also result in a retiree who has been receiving COLAs at the 70% rate not receiving a COLA for several years if the employing city drops its COLA rate to 50% or 30%. Cities that drop annually repeating COLAs or that lower their COLA percentage will find it progressively more expensive to resume the benefit or increase the rate the longer they wait. These features of the current TMRS COLA options have led some TMRS employers and others to seek additional statutory COLA options in the last two sessions of the Texas Legislature.

Some of the options for new COLA features that were discussed by Committee members and TMRS staff included:

- Removing the "catch-up" feature and allowing cities to grant flat rate COLAs not tied to the change in CPI
- Allowing employees to make contributions of 1% or 2% more to fund COLAs – either matched or unmatched by cities. Actuarial work is needed to determine what level of COLAs additional contributions might buy.
- Allowing employees to select a COLA as part of the option selection at retirement – the base benefit would be reduced accordingly
- Creating a COLA tied to the annual rate of return on TMRS investments
- Creating a COLA "bank" that could be credited in good times and debited in bad times – that could be used to fund COLAs
- Providing a "window" of one or more years in which cities that had turned off or never enacted a COLA could adopt one without invoking the "catch-up" provision

Comments from committee members included:

- As more cities turn off COLAs, the demand for flexibility will increase
- The current TMRS COLA provisions can make it extremely costly for a city that has never had a COLA to adopt a COLA provision
- Annually repeating COLAs help reduce the probability of changes in city government policy over time
- Employee associations want a way to guarantee that COLAs will be protected, especially if employees make additional contributions
- Some cities might be willing to contribute more if employee contributions were raised, but some would not
- COLAs are more of an issue for employees of those cities that do not participate in Social Security (In a recent survey, TMRS found that approximately 82% of cities and approximately 82% of members are covered by Social Security.)

COLAs received the most interest as a topic for potential study though no consensus on approach was apparent.

Gain-sharing Options

Through 2006, TMRS trustees made an annual decision whether to allocate extra interest to member accounts and credited member accounts with percentages higher than 5%. For many years, when bond yields and inflation were high, TMRS annual interest credits exceeded 10%. In those years TMRS also paid retirees "extra checks," though none has been paid since 2006. Under the TMRS Act, member accounts are guaranteed 5% annual interest, but the Board still has the option to pay interest greater than 5% and to provide an additional check to retirees.

Gain-sharing was initially discussed during the 2007-2009 biennium, before and during the passage of HB 360. The current actuarial assumption states that city accounts will earn 7% annual interest, and the discussion over gain-sharing focuses on "extra" interest above this rate.

Gain-sharing could be considered either at the System level or at the city level. Options at the city level will require legislation.

If TMRS earns more than 7%, some think the cities should not receive more than the actuarially assumed rate, but 7% is a long-term rate and, in some years, TMRS is likely to earn less than 7%. Gain-sharing is not free even if the System earns 9% and assumes 7%. Money must be held back and available for times when earnings are less than 7%. For this to be a "zero sum game" there must be risk sharing with both debits and credits.

If earnings exceed 7%, some questioned why the overage is credited to the cities, as was done last year.

The point was made that employees already share the risk because, when city finances are stressed, employees and retirees may experience benefit reductions.

One suggestion would be to allow gain-sharing to be triggered by a city's funding level rising above a certain percentage or when a city's contribution rate dropped below a certain point.

Staff and the TMRS actuary will explore types of gain-sharing used in other systems.

There was group interest in continued discussion of this concept.

Higher Employee Contributions to Maintain or Reinstate Benefits

Additional member contributions to maintain existing benefits is a concept more difficult to incorporate into TMRS' plan than into a standard DB plan. Without other changes, due to TMRS' cash balance nature, additional employee contributions would also increase employer contribution requirements. If the idea is to

have employees make additional, unmatched deposits to TMRS, vehicles such as 457 plans already exist that accomplish similar goals.

If city options exist whereby employees could increase contributions to fund a specific benefit, such as an annually repeating COLA, some feel strongly that a guarantee should be built in. The concern was also expressed, if a mechanism exists for benefit costs to be shifted to employees, such cost shifting may occur.

Another concern was that requiring all employees in a city to make the same level of additional contributions could have a negative impact on lower salaried employees.

For future discussions, any potential tax implications that could arise from members making additional contributions should be analyzed.

There was group interest in continuing discussions of this concept.

Two Tier Plans

Due to legal issues around the reduction or discontinuance of benefits for existing employees, some states and cities have enacted 2nd tier or 3rd tiers of lower benefits for new hires to save money.

In TMRS this is not necessary since the cities have flexibility in controlling costs by making prospective changes in COLAs and the matching ratio for all employees and retirees, not just new employees.

Cost savings with a 2nd tier plan are relatively slow to be realized compared to changes made to COLAs or the matching ratio that are currently available to TMRS cities.

Several committee members spoke against tiered plans and saw personnel issues arising from inequality in benefits. The potential effect on employee recruitment was also mentioned.

Relatively low interest exists for future study of tiered plans, except as noted below with regard to retirement eligibility.

Increasing the Hourly Threshold for Participation in TMRS

In the last legislative session, one city pursued higher thresholds for participation in TMRS from 1,000 hours/year to 1,500 hours/year. The bill had some support but not enough to pass out of committee.

From an informal survey conducted during the session, TMRS learned that, in some cities, very few employees fall into the category between 1,000 to 1,500 hours. Most cities make a conscious decision to work within TMRS limits.

There was a concern that if employers had flexibility with increased hours to participate in TMRS, they may increase hours for some part time people without paying for retirement benefits.

If employees are not covered by TMRS they must be covered by Social Security or a replacement plan.

The idea of aligning the hours for coverage in healthcare plans and coverage in TMRS came up (for example 30 hours per week) but did not seem to be of immediate interest to the Committee. From an HR perspective, uniformity in eligibility might simplify who is entitled to benefits and who is not.

Some expressed that some employees, especially part-timers, would like to get out of TMRS coverage and not have to contribute part of their pay to a retirement plan.

Relatively little interest exists for future study of this topic.

Increase Vesting for New Hires

This is essentially a "mini two-tier plan" and is somewhat of a trend outside Texas.

Currently, employees vest in TMRS after 5 or 10 years of service. Most cities, and all new cities, use 5 years.

The cost saving associated with increasing the vesting period is not significant. Even in 5-year vesting cities, many employees who terminate with between 5 and 10 years of service already take a refund of their contributions rather than stay until retirement. With refunds, the funded status improves because the employer loses the liability for a retirement benefit while retaining the funds formerly contributed by the employer.

There was little interest in changing vesting provisions, except as they affect retirement eligibility – see below.

Increase Retirement Eligibility for New Hires

Increasing retirement eligibility provisions produces greater contribution reductions than changing vesting. Currently in TMRS, retirement eligibility is by city option: either after 20 years' service or 25 years' service, or at age 60 with 5 or 10 years' service. Once years of service have been reduced from 25 to 20 or from 10 to 5, they cannot subsequently be increased by a city. The age 60 requirement cannot be increased by a city.

The average age of an employee at retirement in TMRS is approximately 57.

Retirement eligibility is both a perception issue and a cost issue. Social Security and many other pension systems are increasing the requirements for retirement eligibility.

Age and service requirements need further study. If cities could change this for their entire workforce, not just for new hires, it would have a significant effect on city contributions. There may be legal issues in applying this change across the entire workforce.

Police and fire have unique issues with this. They have less mobility and they want some kind of incentive to stay longer.

The group expressed an interest in continuing to study potential changes in retirement eligibility.

Return to Work

In TMRS, when a member retires from a city and come back to work to at that same city, the member's annuity is suspended and any suspended payments are forfeited. However, if a member retires from one city and returns to work at a different city, the returning retiree's annuity is not suspended. Bills have been introduced in past sessions of the Texas Legislature to enable return-to-work at the same city without suspension of benefits, but have generally not been successful.

In the 2011 session, legislation passed that allows a retiree to return to the same city after an eight-year separation. The annuity of an affected retiree would still be suspended during the time the retiree works at the city. However, when the person re-retires, he or she will receive a lump-sum payment equal to the amount of the payments that were suspended during their re-employment.

Retiring and then returning to work for a government employer is sometimes seen by the public and legislatures as "double dipping" and is portrayed negatively in the press as bad public policy. This issue is affected by perception and policy considerations rather than by actuarial cost.

Discussion points regarding return-to-work included:

- Some cities are interested in this feature from a staffing point of view because they are losing talented, retired employees to neighboring cities.
- Federal tax laws prevent employees from retiring and coming back immediately to work because there has been no true break in service (a bona fide separation) .
- At Texas ERS, if employees return to work in 90 days, the law requires the employer to pay into the system although the employee does not rejoin the system and earn new benefits.
- For TMRS, city location is a factor. In areas of low population, or isolated areas, the opportunity to return to work may be more valuable for employers.
- In some Texas systems, DROP programs are perceived as part of the problem and seen the same way—double dipping. TMRS' Partial Lump Sum Distribution does not create the same concern.
- A change in return to work laws may not be well received by the Legislature or public.
- Police and fire do not have as many lower level or part-time positions where return to work makes sense. However some cities have a part time police program and people like it.
- There is concern that a return to work provision or bill would be perceived as a benefit increase, and the political climate would be unfavorable for such a proposal.

There was overall little interest in the group studying return-to-work issues at this time.

Others Ideas for Legislation

The idea of enlarging the TMRS Board was brought up but received little interest.

Political Discussion

One Committee member, participating by phone, expressed an interest in the group taking an active role in the growing debate over public employee retirement systems in Texas.

The Greater Houston Partnership and its related organization Texans for Public Pension Reform have proposed a number of changes, possibly including a Constitutional prohibition against DB plans for public employees. An opposing group, Texans for a Secure Retirement, has begun actively countering the arguments of the Public Pension Reform representatives. Other groups, including the Texas Conservative Coalition, have been or are expected to become involved in the debate, and there is an expectation that the Texas Legislature will be examining these issues in 2013.

It is important for TMRS to continuously show how it is different from the city funds in Texas that are underfunded. TMRS should create an educational piece for new legislators who are not well-versed on different pension plans but who only hear the story from the media or from interest groups. The likely number of new legislators in the 2013 session will be a challenge for TMRS to overcome in getting legislation passed.

Prioritizing Issues

Topics presented to the Committee appear to be prioritized in this order:

Strong interest:
Alternative COLA proposals, including guarantees for employees

Moderate to strong interest:
Additional employee contributions to secure COLAs or other benefits
Gain-sharing
Changes in retirement eligibility provisions

Low interest:
Two-tier plans (except retirement eligibility)
Changes in vesting requirements (except as they affect retirement eligibility)
Changes in hours required to participate in TMRS
Return to work
Expanding the TMRS Board

Timeline and Meeting Schedule

Some liked the schedule of 9 AM to 1 or 2 PM for meetings but others thought the timeframe was too short. With more detailed discussions on certain issues in the future, the meeting times might need to be from 9 AM to 4 PM or later. A topic like COLAs might take up more than one meeting.

Some member expressed the wish that scheduling and the providing of materials to the Committee could be done further in advance.

The TMRS Board will discuss a schedule at its February meeting.

Participants

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