

SUBJECT: Teacher Retirement System revisions

COMMITTEE: Pensions and Investments — committee substitute recommended

VOTE: 7 ayes — Telford, Johnson, Haggerty, McCall, Rangel, Willis
0 nays
2 absent — Berlanga, Wilson

SENATE VOTE: On final passage, March 7 — voice vote

WITNESSES: For — Mike Lehr, Retired Teachers Association; Michael L. Davidson; Elaine Nail, Texas Counseling Association; Lonnie Hollingsworth, Texas Classroom Teachers Association; Myrtice N. Larson, Texas Retired Teachers Association.

Against — Anna Nahovitza

On — John Moore, David Holland, Ken Levine, Texas Sunset Commission; Rita Horwitz, Pension Review Board; Lennijo Blair; Mike Barron and Randy Mercer, Teacher Retirement System; Frank Camp, Dana Williams, Teacher Retirement System Board of Trustees; Mike McLamore, Association of Professional Educators; Pam Thomas, Texas Federation of Teachers; Don Rogers, Teacher Retirement System Working Group.

BACKGROUND: The Texas Teacher Retirement System, the nation's fourth largest retirement system, was created under constitutional authorization granted by voters in 1936. TRS provides retirement and death benefits for employees of public school districts, including teachers, administrators and support staff and employees of institutions of higher education. (College and university faculty members and some administrators may choose to belong to the Optional Retirement Program, a defined contribution retirement program, instead of TRS.) TRS now has more than 606,000 active members, 128,000 retirees and 9,700 surviving beneficiaries.

TRS in 1994 had more than 420 employees and an annual budget of more than \$27 million, which was not subject to the legislative appropriations

process. The system is subject to periodic review by the Sunset Advisory Commission, and recently underwent such a review, but is not subject to being abolished by the Legislature under the Sunset Act.

TRS board of trustees. TRS is governed by a nine-member board of trustees who serve six-year staggered terms and are responsible for administering the system and investing the fund's assets. Seven of the trustees are appointed by the governor. Three may not be TRS members or retirees, and two of the three must have financial expertise. The governor also appoints two public school employees, one retiree and one employee of a public institution of higher education, who are nominated and elected by their peers. The remaining two members are appointed by the State Board of Education.

Administration. TRS is administered by an executive director appointed by the board of trustees. The board also hires an actuary

Contributions. TRS assets are valued at nearly \$39 billion. The state contribution to TRS in 1991-993 is 7.31 percent of payroll, and the employee contribution is 6.4 percent of salary. Combined state and members contributions accounted for 31.4 percent of the \$6.1 billion in revenues received by TRS in fiscal 1994. The Constitution requires member contributions to be above 6 percent and the state contribution to be between 6 and 10 percent. The law requires the TRS funding period, the time it would take to pay off current and future benefit obligations, not to exceed 31 years.

Investments. The board invests the fund according to the "prudent person rule," and has the fiduciary responsibility to manage the fund's assets as trustees would manage their own money. In fiscal 1994 the \$38.9 billion TRS fund was invested 53 percent in stocks, 39.4 percent in bonds, 4.3 percent in real estate, about 2.5 percent in cash and less than 1 percent in the Texas Growth Fund, which promotes economic development in Texas. The fund is not permitted to invest directly in real estate, but does own properties due to foreclosure.

TRS investments are made in-house based on board of trustee guidelines. The trustees also employ outside professional investment consultants and

real estate advisors to assist the staff in managing the TRS portfolio. Over the past 10 years, TRS investments have earned an average of 13.3 percent a year, and over the last five years, 9.7 percent.

Retirement and death benefits. The TRS is a defined-benefit program that provides retirement benefits based on salary and length of service. The Constitution requires the Legislature to guarantee funding to meet TRS commitments. TRS members become vested, that is, entitled to receive retirement benefits, after five years of service. Generally members are allowed to purchase service credit in TRS for up to 10 years of out-of-state teaching service and five years of military service.

The 73rd Legislature allowed members of both TRS and the Employees Retirement System (ERS) who have service credit in both systems to combine service credits under one system at the time of retirement.

Members of TRS are eligible for full standard retirement benefits if they retire at age 65 with five or more years of service; at 60 with 20 or more years of service or at 55 with 30 years of service. The standard retirement benefit is 2 percent of the highest three-year average salary times the number of years of service. For example, at person retiring with 20 years service whose average last three years of salary was \$30,000 would received a standard annual annuity of \$12,000. Retirees may choose to receive benefits under five plans ranging from full monthly benefits that stop when the retiree dies to reduced monthly benefits with survivor benefits.

TRS Care Fund. The Legislature created the Texas Public School Retired Employees Group Insurance Program (TRS-Care) in 1985 to provide health insurance for retirees. Most public school districts do not offer health insurance coverage for retirees and few public school employees are eligible for Medicare. To be eligible for TRS-Care, retirees must have 10 or more years of service and not be eligible for other public health insurance. The program is funded by a state contribution of 0.5 percent of total salaries of public school employees, a public school employee contribution of 0.25 percent of each employee's salary, payments from retirees and earnings on investments.

Active Member Insurance Fund. This fund consists of a \$10 fee charged to TRS active members and is to provide money to start a health insurance program for school district employees if approved by the Legislature. At the end of fiscal 1994 the fund contained \$4.9 million.

DIGEST:

CSSB 9 would require appropriation of operating funds to the TRS and require the system to undergo sunset review again in 1999. Should TRS not come under the appropriations process, sunset review would occur in 1997. The bill would make a number of changes to TRS including increasing benefits for TRS retirees, changing the way members of the board of trustees are appointed, revising governance and administration of the system, establishing a health insurance program for active members, as well as other technical changes.

Board of trustees. The bill would require that the governor appoint two members of the board of trustees from a list of nominees submitted by the State Board of Education instead of the state board directly appointing the two members. These members would have to have direct investment and business experience. In addition, the bill would require that three of the governor's direct appointees be experienced in business and investments, instead of just two members. It would require the chair of the board of trustees to be appointed by and serve at the pleasure of the governor instead of having the chair elected by the board. It would require board members to undergo a training program on the TRS and state laws regarding open government and ethics.

Funding and operations. The bill would require the Legislature to appropriate funds for the administration of TRS and would give the board authority to spend amounts beyond that appropriated in order to meet its fiduciary responsibilities. In addition, the bill would make operating, reporting and administrative changes, including:

- prohibiting TRS employees from advocating an increase in benefits or in any way attempting to influence the Legislature, and allowing these prohibitions to be grounds for employee dismissal;

- prohibiting any TRS assets to be used to advocate or influence the outcome of an election or a legislative measure, but not preventing any trustee or employee from providing information upon request to anyone;
- requiring that TRS verify the accuracy of information disseminated in publications regarding benefits and the TRS trust fund with the State Pension Review Board;
- requiring the Legislative Audit Committee to choose an independent auditor to evaluate the system's investment practices and performance to be paid for by the TRS;
- requiring TRS to comply with state space allocation standards;
- requiring TRS to file an annual financial report with legislative committees and the Legislative Budget Office;
- eliminating the collection of membership fees to fund the administration of the retirement system and requiring that TRS operating expenses be appropriated by the Legislature;
- requiring the TRS to comply with State Purchasing and General Services Act regarding historically underutilized businesses;

Benefits. The bill would increase benefits for TRS retirees beginning September 1, 1995. Retirees would have their benefits increase through one of the following options:

- an ad hoc increase to the current benefit based upon 33.3 percent of the difference between the retiree's annuity and what it would have been had the annuity kept up with inflation;
- a recalculation of benefits based on the current retirement formula (three highest years salary times 2 percent multiplier) plus ad hoc increases and a 33.3 percent inflation ad hoc increase; or
- a minimum benefit calculated on the minimum starting teacher salary as set in the Education Code (\$20,400);

The bill would require that future benefit increases be determined by the Legislature based upon the performance of the trust fund and would make other benefit changes including:

- allowing members to retire at age 50 with 30 years service.;
- increasing the ceiling on the lump-sum death benefit option from \$60,000 to \$80,000;
- providing an additional survivor benefit that would pay the survivor three-fourths of a reduced annuity for life;
- raising the minimum monthly disability payment from \$50 a month to \$150 a month;

Health insurance. The bill would authorize the TRS trustees to offer TRS-Care 3 to school districts to cover active employees to be funded by contributions from school districts and participating employees. It would require the Legislative Audit Committee to select a firm to evaluate the funding of TRS-Care 3 for active and retired members, which would be paid for by TRS.

The bill would take effect September 1, 1995, except the provisions regarding appointment of members of the board of trustees, which would take effect August 31, 1995.

**SUPPORTERS
SAY:**

CSSB 9 would implement recommendations of the Sunset Advisory Commission and would increase state oversight and accountability of the TRS. Although the board of trustees has fiduciary responsibility to manage the fund assets for the members, the Legislature has the ultimate responsibility for the fund and to provide benefits.

The bill would increase legislative oversight of the budget process and reduce TRS administrative expenditures, which have been excessive compared to other agencies. Since fiscal 1989 TRS operating expenses have increased 83.5 percent. The bill would provide that the Legislature, through the general appropriations act, would control TRS operating funds and that TRS would be required to participate in the state's strategic budget

planning process like other agencies. If the TRS trustees determined that legislative appropriations are not sufficient to operate the system, they would be allowed to use members' funds for additional expenses. The agency would be required to report these additional expenditures to the Legislature.

The bill would increase retirement benefits for all retirees. It would allow retirees who retired before the dramatic teacher salary increases of the 1970s and 1980s to catch up and would give all current retirees 33 percent of the purchasing power lost to inflation. While retirement benefit increases have been consistent, many pensions are below what is needed for an adequate standard of living. For most teachers the TRS pension benefit is their sole source of income since they do not receive social security benefits. The minimum benefit increases provided by this would bring 6,000 retired teachers above the poverty level. The benefit increase would increase the amortization period from 3.6 to 12.1 years far below the statutory limit of 31 years, and would increase the unfunded actuarial accrued liability by \$1.2 billion.

The bill would expand the TRS health insurance program to active members, which is needed because many local school districts' health plans are not comprehensive and may not meet state standards. These changes would not affect TRS-Care for retirees. The bill would require a study be done to evaluate and fund a comprehensive health program for retirees and active employees.

The bill would require that TRS's investment practices and performance be evaluated by an independent firm. An independent audit of the TRS has never been done. Although the fund has had good investment returns in the past, recently its investment returns have been below expectations. The fund earned less than 2 percent in fiscal year 1994 — well below its projected rate of 8 percent. While a few years of poor investment performance is not a threat to the fund, it could reduce the Legislature's ability to provide benefit increases and could require the Legislature to increase contributions to meet existing benefit requirements.

The changes in the composition of the board that require five members to have direct investment and business experience would result in greater

financial expertise. The board has fiduciary responsibilities to manage the fund assets for the benefit of the members and requiring a majority of the board members to be experts in finance would ensure greater scrutiny of staff investment recommendations and understanding of complex investment issues. Currently, only two members are required to have investment experience. A change in the investment rate of one one-hundredth of 1 percent can result in a gain or loss of \$3.8 million. The fourth largest pension fund in the nation, with assets valued at more than \$38 billion, must have trustees who understand actuarial assumptions and investment strategies.

The bill would prohibit trustees and employees of TRS from lobbying, which is not part of their duties to administer or invest the fund. Some TRS trustees and staff have continually attempted to influence legislation in spite of objections from legislators.

Requiring TRS to comply with state standards for the use of building space would provide additional revenue for the benefit of its members. The agency uses twice as much space as it needs. A large amount of its office building space is used for exercise rooms, a greenhouse, conference rooms, libraries and break rooms. The additional 66,200 square feet is generally a result of poor space management. Leasing this space could earn up to \$1.72 million per biennium.

The bill would require TRS to increase the use of businesses owned by women and minorities. TRS use of HUBs lags behind that of other agencies, and this provision would encourage compliance.

**OPPONENTS
SAY:**

This bill would infringe on the fiduciary responsibility of the TRS board of trustees. The management and governance of the agency should rest with the trustees, and certain provisions of CSSB 9, such as putting the agency under the appropriations process, prohibiting any employee of the agency from discussing benefit increases upon threat of dismissal and requiring the State Pension Review Board to review all TRS publications for accuracy regarding benefits and the trust fund, would impair the ability of the trustees and agency to properly perform its duties to the membership. Furthermore, it is inherent that the board of trustees are advocates for the members of the system, yet the bill would greatly restrict them in this duty.

The Legislature does not have the fiduciary responsibility for the membership of TRS, but the interest of the state as a whole, which could result in a potential conflict-of-interest when determining state contributions to the system. The trustees have a different mission than the Legislature, and the Legislature should not be meddling in the day-to-day operations of the TRS. The bill increases oversight of the TRS to the extent that trustees might feel constrained in performing their fiduciary duties.

Although the benefit increases are good, the minimum annuity proposed by the bill could appear to redefine the pension system's mission to one that is based on the ultimate retirement benefits of the retiree, rather than the historical role of the pension defined in statute as one based upon service rendered and salary paid.

The TRS does not need another firm to audit the investment performance and actuarial soundness of the fund. TRS has contracted with a firm to provide investment performance audits. It has had an investment consulting firm on contract since 1980 to advise the trustees on investing, and it contracts with an actuarial firm to measure the results of investment performance on the actuarial soundness of the system.

There is no question that more members of the board of trustees should have business and investment experience. However, there is no compelling reason to have the governor appoint the two trustees now appointed by the State Board of Education. The members of the State Board of Education are elected and accountable to the public and have a direct vested interest in education issues and teachers. This provision would mean that the governor would ultimately appoint all the board members.

The Texas Constitution makes the TRS board of trustees responsible for administering the retirement system. Requiring the agency to be under the appropriations process could infringe on the fiduciary responsibility of the board and is not necessary in any case. Although TRS administrative expenditures have risen in the past five years, they are not unreasonable. Although the agency is not under the appropriations process, it is subject to the performance reporting requirements of the Legislative Budget Board

and submitted its budget to the LBB for review and comment. The state auditor issues an opinion of all TRS financial statements.

The TRS building is part of the TRS trust and should be under the control of the trustees. Courts of other states have found that control of public trust fund assets, expenditures and contracts by state entities other than the trustees are inconsistent with trust principles. The board of trustees agrees with the sunset recommendation for a space utilization study on the TRS building. Also, the TRS building is tax-exempt, and the trust may have to pay property taxes on the property if it leased space in the building and received rental income.

TRS has made a good faith effort to contract with HUB firms; however, purchases of goods and services must meet fiduciary requirements of reasonableness of cost and appropriateness, and cannot be removed from the ultimate discretion of the board.

NOTES:

The Senate-passed version of SB 9 would set the TRS sunset date as 2007 instead of 1999 and would have the lieutenant governor, not the governor, appoint the two board members currently appointed by the State Board of Education. In addition, the Senate version would require one of the three gubernatorial appointees to be selected from a list of nominees submitted the speaker of the House. CSSB 9 includes the following provisions not contained in the Senate-passed version:

- allowing a member to retire with 30 years of service at age 50;
- raising the monthly minimum benefit for disability retirees from \$50 to \$150; and
- increasing the cap on lump-sum death benefit option from \$60,000 to \$80,000.

The fiscal note for CSSB 9 estimates the annual budget of the TRS at \$26,125,000 a year. Both House and Senate versions of the general appropriations act contain funding for system administration, which would come from the TRS trust fund.