

SUBJECT: Prudent person standard for investing local fire fighter retirement funds

COMMITTEE: Pensions and Investments — favorable, without amendment

VOTE: 9 ayes — Telford, Woolley, Berlanga, Goolsby, Rangel, Sadler, Serna, Tillery, Williams

0 nays

WITNESSES: For — Ken Bailey, Texas State Association of Firefighters; Patrick Hlavaty and R.F. Sullivan, State Firemen's and Firemarshall's Association of Texas; Alva Littlejohn, Lubbock Firefighters' Retirement Fund; Robert May, Texas Local Firefighters' Retirement Funds; Bill Shanklin, Georgetown Fire Department; Herbert M. Williams, Jr., Conroe Firefighters Relief and Retirement Fund; Robert Epley

Against — None

On — Helen Campbell, Firefighters Pension Commission; Rita Horwitz, Pension Review Board

BACKGROUND : The Texas Local Fire Fighters Retirement Act allows local fire fighters to participate in an insurance and pension fund. By law, the fund may invest only in certain instruments, including bonds, mortgage securities, and shares in savings and loans or banks. The act requires that trustees use the judgment and care that would be exercised by a person or ordinary prudence, discretion and intelligence in making investment decisions.

DIGEST: HB 735 would eliminate the list of investment vehicles that can be used by local fire fighter retirement funds.

HB 735 would take take immediate effect if finally approved by a two-thirds record vote of the membership of each house.

SUPPORTERS SAY: HB 735 would allow more efficient management of the local fire fighters' retirement systems by eliminating the requirement that funds invest only in certain instruments and allowing fund trustees to fully exercise the sound, well-established prudent person investment standard already provided in the

law. HB 735 would give the boards of trustees who oversee the funds the same investment latitude granted other state funds, such as the Employee Retirement and Teacher Retirement Systems and the Permanent University Fund, which have similar long-term investment cycles.

Eliminating the laundry list of permissible investments would provide the investment flexibility that today's market demands but still maintain the strict fiduciary responsibility for the trustees investing the pension fund. The boards who will make the investments are composed of the mayors, financial directors, firefighters, and other citizens who have no incentive to endanger the pension funds of their local fire fighters and already invest in a fiscally conservative manner.

The prudent person standard is an appropriate investment criterion for retirement funds of this type. All but four state pension funds are invested using the prudent person standard, the industry standard for this type of investment. The prudent person standard is actually a more secure investment standard than a laundry list of allowable investments because it requires that investments be made according to higher standards of diligence and discretion.

In fact, portfolios with restricted investment options often lack the flexibility needed to keep up with the best investment options, resulting in a higher risk factor. Currently, fund administrators must make repeat trips to the Legislature to adjust the list to keep up with changing markets; it would make better sense to apply a more flexible, yet sound and safe, investment standard.

Subjecting local fire fighters' pension funds to the investment restrictions in the state Public Funds Investments Act would be inappropriate. Entities subject to the Public Funds Investment Act must have a written investment policy and are subject to certain reporting mandates and cannot invest in certain types of "derivative" securities. In enacting this statute in 1995, the Legislature specifically exempted pension funds from these requirements because their investment needs require greater flexibility than is allowed under the act's restrictive list of permissible investments.

OPPONENTS
SAY:

HB 735 would expose investments by local fire fighters' pension funds to too great a risk. A list of permissible investments is needed to ensure that investments made by the local fire fighters' pension funds are properly conservative and low risk. Allowing the funds, some of which amount to as much as \$80 million, to invest under nothing more than the prudent person standard could result in a less balanced and secure portfolios, putting local fire fighter retirement funds potentially at greater risk.

The citizen trustees who manage local fire fighter retirement funds in 37 mid-sized Texas cities may be well meaning, but the fact remains that their decisions, not their intentions, are what control whether the funds remain solvent to provide benefits to plan participants.

The fiduciary responsibility of fund trustees cannot prevent them from making serious mistakes. They could be sued only *after* endangering or losing the local fire fighters' retirement funds. Retaining a specified list of safe investments is the best way to prevent even the possibility of such a calamity.

OTHER
OPPONENTS
SAY:

The local fire fighters' retirement funds could be better invested with increased investment flexibility, but utmost caution should be used in determining what investment authority is appropriate for the funds. The Senate has amended SB 325, the companion to this bill, to require that a knowledgeable state agency, such as the State Auditor's Office, study the funds' structure and investment needs to determine what type of investment authority is appropriate. An intermediate level of investment flexibility, such as that provided by the Public Funds Investment Act, might be more appropriate for these funds.

NOTES:

On March 24, the House passed HB 803, providing for a prudent person investment standard for a similar fund, the volunteer fire fighters' pension fund.

The Senate on February 25 passed SB 325 by Armbrister, the companion to HB 35, by 30-0 after adopting an amendment by Sen. Ogden to require the state auditor to conduct a study to determine if the local fire fighters' retirement system should be covered under the Public Funds Investment Act or a similar statute. SB 325 was reported favorably by the House Pensions and Investments Committee on April 1, making it eligible to be considered in lieu of HB 735. The committee adopted an amendment to remove the Ogden amendment from SB 325.