

SUBJECT: Revising provisions for municipal employee retirement systems

COMMITTEE: Pensions, Investments & Financial Services — favorable, without amendment

VOTE: 8 ayes — Capriglione, Lambert, Bhojani, Bryant, Frazier, Plesa, VanDeaver, Vo

0 nays

1 absent — Leo-Wilson

SENATE VOTE: On final passage (April 12) — 31 - 0

WITNESSES: None (*considered in a formal meeting on April 20*)

BACKGROUND: Concerns have been raised that the City of Austin Employees’ Retirement System amortization period of 34 years places it outside the Pension Review board’s funding guidelines. Some have suggested that a comprehensive framework should be established to ensure the long-term financial stability of the system.

DIGEST: SB 1444 would revise provisions of Vernon’s Texas Civil Statutes regarding the municipal retirement system for employees in a city with a population between 760,000 and 860,000.

Definitions. The bill would define certain terms, including:

- “city legacy contribution amount” as a predetermined payment amount for each calendar year expressed in dollars in accordance with a payment schedule amortizing the legacy liability for 2022 that was included in the initial risk sharing valuation study;
- “corridor” as the range of employer contribution rates that were equal to or greater than the minimum employer contribution rate and equal to or less than the maximum employer contribution rate;
- “corridor margin” as five percentage points;

- “corridor midpoint” as the projected employer contribution rate specified for each calendar year for 30 years as provided by the initial risk sharing valuation study, rounded to the nearest hundredths decimal place; and
- “legacy liability” as the unfunded actuarial accrued liability determined as of December 31, 2022, and adjusted for each subsequent calendar year under certain amounts established by the bill.

Administration. The bill would revise provisions on the administration of a municipal retirement system.

Retirement board member criteria. The bill would revise the criteria for members of the retirement board of a municipal retirement system. For membership places three through five, consisting of three qualified voters of the city, the bill would include the condition that such board members had experience in the field of securities investment, pensions administration, pension law, or governmental finance. Membership place six would be filled by the director of finance of the municipality or the director’s designee. Places seven through nine would be comprised by three, rather than four, active-contributory members elected by the active-contributory members of the board.

Retirement board member terms. The bill would remove the requirement for staggered terms for board members seven through nine of the board, and would establish that board member seven’s term would begin January 1, 2024, and that the terms for eight and nine would begin January 1 of the following even-numbered year.

The bill would not affect the term of a retirement board member appointed or elected under current law who was serving on the board on the effective date of the bill.

When the terms of the board members serving in places six and seven of the board expired, the resulting vacancy in place six would be filled by the municipality’s director of finance or the director’s designee, and the

resulting vacancy in place seven would be filled by election of the active-contributory members.

Retirement system trust fund. The bill would remove the authorization for the retirement board to increase the benefits and allowances the board paid from the retirement system trust fund.

Actuarial investigation. At least once every five years, rather than from time to time, the actuary designated by the retirement board would be required to make an actuarial investigation of the mortality, service, and compensation experience of members, retired members, surviving spouses, and beneficiaries of the retirement system and make a valuation of the assets and liabilities of the funds of the system.

Experience study and determining actuarial assumptions. The bill would require the retirement board to, at least once every five years, cause the retirement system's actuary to conduct an experience study to review the actuarial assumptions and methods adopted by the board for the purposes of determining the actuarial liabilities and actuarially determined contribution rates of the system. The system would be required to notify the board's city at the beginning of an upcoming study. In connection with such a study, the city could conduct a separate experience study using an actuary chosen by the city, have the city's actuary review the experience study of the system's actuary, or accept the experience study of the system's actuary.

If the city conducted a separate study using the city's actuary, the city would be required to complete the study by the 91st day after the date the retirement system notified the city of the system's intent to conduct a study. If the city elected to have the city's actuary review that system's study, the city would be required to complete the review by the 31st day after the date the preliminary results of the study were presented to the retirement board. If the city chose to have the city's own study performed or to have the city's actuary review the system's study, the system's and city's actuaries would determine what the hypothetical employer contribution rate would be using the proposed actuarial assumptions from

the studies and data from the most recent actuarial valuation. If the difference between the hypothetical employer contribution rates determined by the system's and city's actuaries was:

- less than or equal to two percent of pensionable payroll, no further action would be needed and the retirement board would use the study performed by the system's actuary in determining assumptions; or
- greater than two percent of pensionable payroll, the actuaries would have 20 days to reconcile the difference in assumptions or methods causing the differences.

If, as a result of the reconciliation efforts, the difference between the employer contribution rates determined by the actuaries was reduced to less than or equal to two percentage points, no further action would be needed and the board would use the system's experience study. If, after the 20th business day, the actuaries were not able to reconcile the difference in the hypothetical employer contribution rates, the bill would require that a third-party actuary be retained to opine on the differences in the assumptions and methods used by the other actuaries.

The third-party actuary would be required to be chosen by the city from a list of three actuarial firms provided by the retirement system. If the third-party actuary was retained, that actuary's finding would be required to be presented to the retirement board with the experience study conducted by the system's actuary and, if applicable, the city's actuary. If the board adopted actuarial assumptions or methods contrary to the third-party actuary's findings, the system would provide a formal letter describing the rationale for the board's action to the governing body and the State Pension Review Board. If the board adopted actuarial assumptions or methods contrary to the third-party actuary's findings the system's actuary and executive director would be required to be made available at the request of these entities to present in person the rationale for the board's action.

If the retirement board proposed a change to actuarial assumptions or

methods that were not in connection with an experience study, the retirement system and the city would be required to follow the same process prescribed by the bill with respect to an experience study in connection with the proposed change.

Trust fund interest rate revision. The interest rate assumed to have been earned by the fund for any period would be equal to the actuarial assumed rate of return in effect on the date of purchase, rather than being equal to the interest rate credited for that period to the accumulated deposits of members divided by 0.75.

Creditable service. The bill would revise provisions regarding the creditable service of a retirement system member.

Record verification. The bill would require the retirement board to:

- verify the records for creditable service claims filed by the members of the retirement system; and
- establish time frames during which a member would be required to act to ensure that the purchase of creditable service or the conversion of sick leave to creditable service coincided with the member's retirement.

Establishing creditable service. In order to establish creditable service, the bill would remove the requirement for a retirement system member to contribute a lump-sum payment equal to 25 percent of the estimated cost of the retirement benefits the member would be entitled to receive. Instead, the bill would require the member to contribute at retirement a lump-sum payment equal to the full actuarial cost of the additional creditable service, as determined by the retirement board acting on the advice of the actuary.

Purchasing noncontributory creditable service. The bill would authorize a retirement system member to purchase at retirement, rather than at any time before a member's actual retirement date, noncontributory creditable service equal in amount to a certain period.

Regarding the conversion of accrued sick leave to creditable service, the member, rather than the employer and the member, would be required to make the equivalent amount of retirement contributions that would have been made had the sick hours been exercised and used as sick leave hours. The bill would require that the employer's cost for sick leave conversions be funded through the contribution rates.

The bill would allow a member to purchase nonqualified permissive creditable service only at retirement.

Cost of living adjustments and additional payments. Before a cost of living adjustment or additional payment to retirees, beneficiaries, or other payees could be provided:

- the retirement system's actuary would be required to certify in writing that it was demonstrable that the fund had and likely would continue to have the ability to pay such an amount after all other obligations of the fund had been paid;
- the retirement board would be required to approve the adjustment or additional payment;
- the governing body would be required to approve the adjustment or additional payment; and
- the relevant statute would be required to be amended to provide for the adjustment or additional payment.

The bill would prohibit the precluding of an increase in benefits by amendment to statute, including by amendment in accordance with the above provisions that was made possible by forfeitures or for any other reason. The bill would remove the authorization for an action of the retirement board to increase such benefits. The bill would remove the requirement for the actuary to recommend an adjustment or additional payment to the retirement board.

Contributions and financing. SB 1444 would revise provisions regarding contributions to municipal retirement systems and the methods

of financing such systems.

Member contributions. The bill would require each active-contributory member, under certain circumstances, to make deposits to the retirement system at a rate equal to, beginning with the first pay period of 2024, 9 percent, rather than 8 percent, of the member's base pay, exclusive of overtime, incentive, or terminal pay. A member would make deposits to the system at a rate equal to, beginning with the first pay period of 2025, 10 percent of the member's base pay exclusive of overtime, incentive, or terminal pay. The bill also would require a member, as necessary, to make deposits at a rate equal to the otherwise prescribed member contribution rate, rather than making deposits at a higher contribution rate approved by a majority vote of regular full-time employee members.

If a regular full-time employee worked at least 75 percent of a normal 40-hour work week but less than the full 40 hours, the employee would make deposits as though working a normal 40-hour week even though the rate of contribution could exceed the member contribution prescribed by the bill, rather than exceeding 8 percent of the employee's actual compensation, pay, or salary. This revision also would apply to additional employer contributions made under these conditions. The contribution rate of active-contributory member, rather than that of a regular full-time employee, could be increased by a majority vote of all such members voting at an election to consider an increase in contribution to a rate above 10 percent, rather than 8 percent, or a higher rate than the rate that was in effect at the time of the election.

Employer contributions. Beginning with the first pay period of 2024, and before the first pay period of 2025, the employer would contribute an amount equal to the sum of:

- the employer contribution rate, as determined in the initial risk sharing valuation as of December 31, 2022, multiplied by the pensionable payroll for the applicable pay period; and
- 1/26 of the city's legacy contribution amount for 2024, as determined and adjusted in the initial risk sharing valuation study.

Beginning with the first pay period of 2025, and for each subsequent year, the employer would contribute an amount equal to the sum of:

- the employer's contribution rate for the applicable year, as determined in a subsequent risk sharing valuation study, multiplied by the pensionable payroll for the applicable pay period; and
- 1/26 of the city's legacy contribution amount for the applicable year, as determined and adjusted in the initial risk sharing valuation study.

The bill would remove the requirement for each employer to contribute amounts equal to 8 percent of the compensation, pay, or salary of each active-contributory member and each inactive-contributory member employed by the employer, exclusive of overtime, incentive, or terminal pay, or a higher contribution rate agreed by the employer.

If the employer elected to change the employer's payroll period to a period other than a biweekly payroll period, the fractional amounts of the employer's legacy contribution would be required to be adjusted such that the employer's calendar year contribution equaled the contribution required under the above provisions.

Initial risk sharing valuation study. The bill would require the retirement system's actuary to prepare an initial risk sharing valuation study as of December 31, 2022. The initial risk sharing valuation study would be required to:

- be prepared in accordance with the requirement for subsequent risk sharing valuation studies under the bill;
- be based on the actuarial assumptions that were used by the system's actuary in the valuation completed for 2022;
- project the corridor midpoint for the next 30 years beginning with 2024;
- include a schedule of city legacy contribution amounts for 30 years beginning with 2024; and

- include certain employer contributions.

The schedule of city legacy amount contribution amounts would be required to be determined such that the total annual city legacy contribution amount for the first two years resulted in a phase-in of the anticipated increase in the employer's contribution rate from 2023 to the rate equal to the sum of the estimated contribution rate for 2024 determined as if there was no phase-in of the increase to the city legacy contribution amount. The phase-in would be required to reflect approximately one-half of the increase each year over the two-year phase-in period.

The estimated employer contribution rate for 2024 would be required to be based on the projected pensionable payroll, as determined under the required initial risk sharing valuation study, assuming a payroll growth rate adopted by the retirement board.

Subsequent risk sharing valuation studies. For each year beginning with 2024, the retirement system would have to cause the system's actuary to prepare a risk sharing valuation study. Each risk sharing valuation study would be required to:

- be dated as of the last day of the year for which the study was required to be prepared;
- calculate the unfunded actuarial accrued liability of the system as of the last day of applicable year, including any associated liability layer;
- calculate the estimated employer contribution rate for the following year;
- determine the employer contribution rate and the member contribution rate for the following year, taking into account any required adjustments, as applicable; and
- be based on the assumptions and methods adopted by the retirement board, if applicable, and be consistent with actuarial standards of practice and certain principles.

The bill would allow the city to contribute an amount in addition to the scheduled city legacy contribution amounts to reduce the number or amount of scheduled future city legacy contribution payments. If the city contributed an additional amount, the retirement system's actuary would be required to create a new schedule of city legacy contribution amounts that reflected payment of the additional contribution.

The city and the retirement board could agree on a written transition plan for resetting the corridor midpoint, member contribution rates, or employer contribution rates if at any time the funded ratio of the system was equal to or greater than 100 percent or for any year after the payoff year of the legacy liability.

The retirement board would be authorized, by rule, to adopt certain actuarial principles provided the principles were consistent with actuarial standards of practice, were approved by the retirement system's actuary, and did not operate to change the city legacy contribution amount.

Adjustments to employer contribution rate. Beginning in 2024 and for each subsequent year, if the estimated employer contribution rate was lower than the corridor midpoint, the employer contribution rate for the applicable year would be the corridor midpoint if the funded ratio was less than 90 percent or the estimated employer contribution rate if the funded ratio was 90 percent or greater. The employer contribution rate could not be lower than the minimum employer contribution rate. If the funded ratio was equal to or greater than 100 percent all existing liability layers would be considered fully amortized and paid and the city legacy contribution amount could not longer be included in the employer contribution.

For 2024 and each subsequent year, if the estimated employer contribution rate was equal to or greater than the corridor midpoint and less than or equal to the maximum employer contribution rate for the corresponding calendar year, the employer contribution rate would be the estimated employer rate. If estimated employer contribution rate was equal to or greater than the corridor midpoint and greater than the maximum employer contribution rate for the corresponding year, the

employer contribution rate would be the maximum employer contribution rate.

Adjustment to member contribution rate. If the estimated employer contribution rate was ever greater than the corridor maximum, the member contribution rate would increase by an amount equal to the difference between the estimated employer contribution rate and the maximum employer contribution rate. The member contribution rate could not be increased by more than two percentage points. If the estimated employer contribution rate was more than two percentage points above the maximum employer contribution rate, the city and the retirement board would be required to enter into discussions to determine additional funding solutions.

Repeals. SB 1444 would repeal certain sections of Vernon's Texas Civil Statutes art. 6243n regarding service retirement and withdrawal benefits, including provisions allowing the retirement board to authorize certain cost of living adjustment payments or lump-sum additional benefit payments.

The bill would make conforming changes throughout.

The bill would apply to a person who applied to reinstate membership service on or after the bill's effective date as well as a person who retired on or after the bill's effective date.

The bill would take effect September 1, 2023.

NOTES:

According to the Legislative Budget Board, the bill would make significant changes to the financing structure of the City of Austin Employees' Retirement System. It would increase employee contributions, establish a payment schedule to eliminate the legacy liability, and add an actuarially determined contribution for the employer. The city contributions for fiscal 2024 would increase by \$12.3 million.