Teacher Retirement System of Texas

TRS Update

TASSCUBO Winter Conference

February 4, 2013

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Topics for Discussion

- Status of the TRS Fund
- Interim studies
  - TRS-Care Sustainability
  - Pension Plan Design
- TRS-Active Care
- Upcoming Legislative Session

Trust Fund Status

- With the global economic decline, the TRS pension trust fund had decreased to $70.6 billion, as of February 28, 2009.
- As of August 31, 2012, the fund was valued at $111.4 billion. Currently, the fund is approximately $115 billion.
- FY 2012 Investment return rate was 7.6% compared to 15.5% in FY2011. Over the past 25 years, the return was 8.6% despite a decade of highly volatile markets. The assumed rate is 8.0%.
- As of August 31, 2012, the fund could make benefit payments to 2065 under current funding.
- The next valuation update will be available in March 2013.

Interim Studies

- In 2011, the Texas Legislature directed TRS to conduct studies on the **sustainability of TRS-Care** for retirees and **pension benefit design**.
- For both studies, TRS presented updates at four TRS Board meetings and two town hall meetings. Three of the six meetings offered the public an opportunity to provide input and ask questions, in person and on the web site. All six of the meetings were web cast and archived at www.trs.state.tx.us.
- Full studies are online at: www.trs.state.tx.us

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TRS-Care Study

Funding sources

- The law provides that the state contribute 1.0% of active district payroll. The General Appropriations Act reduced this contribution to 0.5% for FY 2013.
- School districts contribute between 0.25% and 0.75% of active district payroll. The current contribution rate is 0.55%.
- Active school district employees contribute 0.65% of payroll.
- Retirees pay premiums for any plan option other than TRS-Care 1 retiree-only coverage.
- Medicare Part D retiree drug subsidy.
- Investment income.

Assuming that the retirees' share of total costs includes both premiums and out-of-pocket costs, the projected retiree contribution for FY 2012 is 46.5% and the state contribution is 20.5%.

TRS-Care Study

- TRS added Aetna Medicare Advantage option for health care to begin January 1, 2013.
- In 2012 TRS selected Express Scripts for prescription drugs, achieving better pricing beginning September 1, 2012, and is offering a new Medicare Part D option beginning January 1, 2013.
- Assuming 80% participation rate in both plans, the fund is now projected to be solvent through 2014-2015 biennium with a balance of $14.5 million. Currently, Aetna Medicare Advantage participation is under 80%, while Express Scripts Medicare Part D is over 90%.
- However, the **shortfall** for the 2016-2017 biennium is projected to be **approximately $1.2 billion.**

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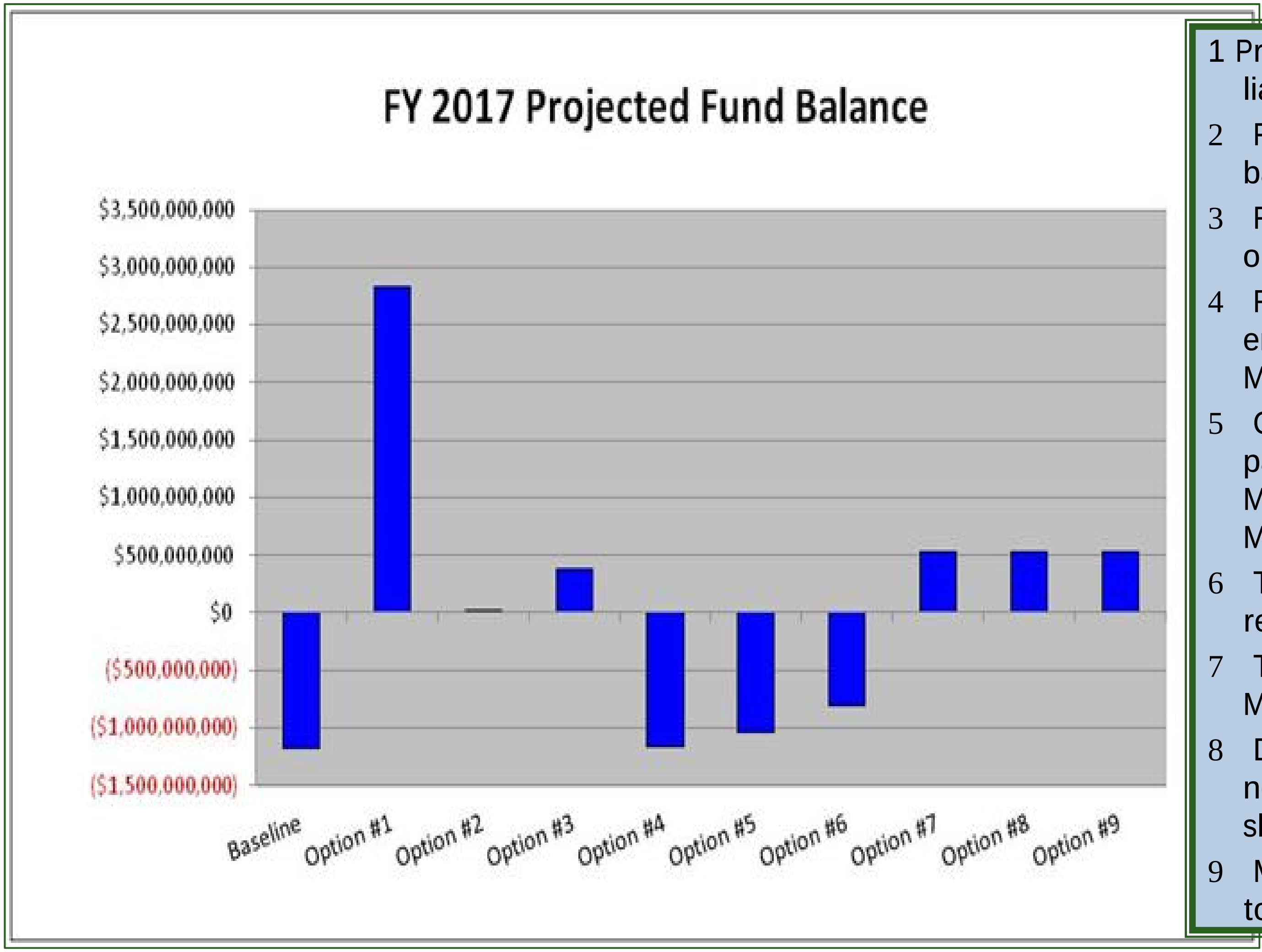
TRS-Care Study



1 Pre-fund the long-term liability
2 Fund on a pay-as-you-go basis for the biennium
3 Retiree pays full cost for optional coverage
4 Require Medicare eligible enrollees to purchase Medicare Part B
5 Opt out consequence for participants eligible for the Medicare Advantage and Medicare Part D plans
6 Tighten eligibility requirements
7 TRS-Care 1 only for non-Medicare retirees
8 Defined contribution for non-Medicare retirees to shop in the private market
9 Move non-Medicare retirees to TRS-ActiveCare

Some options can be combined to increase the financial impact.

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TRS-Care Study

Options 1 & 2 increase funding to TRS-Care and align the funding to medical costs.

Option 3 affects all retirees. Retiree pays full cost for optional coverage.

Options 4 & 5 affect Medicare retirees**.**

Options 6 - 9 affect non-Medicare retirees.

TRS-Care Study

Options likely to be considered.

Option 4: Require participants to purchase Medicare Part B.

The standard Part B premium is $99.90 per month for 2012. This will have a very small impact on TRS-Care.

Option 9: TRS-ActiveCare for non-Medicare Retirees.

Projections indicate that TRS-ActiveCare premiums would need an overall increase of 5% in FY 2014.

Non-Medicare retirees, which make up 34% of the TRS retiree population, cost almost 6 X more than Medicare-eligible retirees.

Pension Benefit Design Study

The pension benefit design study charge directed TRS to examine the actuarial and fiscal impacts of:

- changing the benefit factors of the current plan, which includes changes in retirement eligibility and the final average salary and benefit multiplier provisions of the current plan; and
- moving to an alternative plan design, such as a cash balance plan or defined benefit-defined contribution hybrid plan.

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Significant Factors

- TRS contribution rates are among the lowest in the nation.
- Two significant periods are 1980-1995, during which the state contribution rate ranged from 7.1% to 8.5%, and 1996-2007, during which the state contributed the constitutional minimum of 6.0%.
- Over the past 25 years, the TRS pension plan has earned a return of approximately 8.6% despite a decade of highly volatile markets. TRS assumed return rate is 8.0%.
- The Texas Constitution requires that the state and members regularly contribute to TRS, and neither have taken a "funding holiday."

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Pension Benefit Design Study

Features to Control Plan Liabilities	
Present	▪ TRS has never enacted an automatic cost-of-living adjustment (COLA). No permanent COLA since 2001.
2011	▪ Purchase of most types of service credit requires payment of actuarial cost
2005, 2011	▪ Controlling salary "spiking"
2005	▪ Retirement age: For members joining after 8-31-07, member must be at least age 60 and meet the rule of 80 to retire without actuarial reductions.
2005	▪ Final average salary (FAS): For most members, retirement benefits now are calculated using a 5 year FAS instead of a 3 year FAS.
2005	▪ Service credit purchases: Members may no longer purchase up to 3 years of service credit ("air time") to reach retirement eligibility earlier or increase benefit amount.
2005	▪ Eligibility for a partial lump sum increased to a Rule of 90.
2005	▪ Enacted the nation's toughest laws regarding return-to-work after retirement. Public education employers who hire retirees must pay TRS pension and health care surcharges.

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Pension Benefit Design Study

Finding 1: While the TRS Pension Fund can pay benefits through 2065, the state needs to begin addressing the unfunded liability. Delays will only increase costs.

Finding 2: The value of the TRS retirement benefit is 36% less than the average benefits of members of peer systems.

The main reason: TRS retirees do not have Social Security or COLAs.

Finding 3: The TRS defined benefit plan provides current benefits at a lower cost than alternative plans.

Other alternative plan structures are from 12% to 138% more expensive than the current plan (not including the cost to pay off any unfunded liability) to provide the same level of benefits.

Pension Benefit Design Study

Finding 4: The majority of TRS members will do significantly worse investing on their own in a plan with a defined contribution component.

- Based on modeling, for members in a plan with a defined contribution component, the spread of returns would likely be very wide.
- An estimated 2/3's of the members would earn returns below 60% of the current defined benefit, while over 90% would accrue less than their estimated current annuity.
- Only about 8% of the members would accrue an annuity that exceeds the current defined benefit plan.
- The estimated underperformance is due to lower investment returns from a shorter investment period, access to fewer classes, less disciplined investment approaches, and potentially higher fees.

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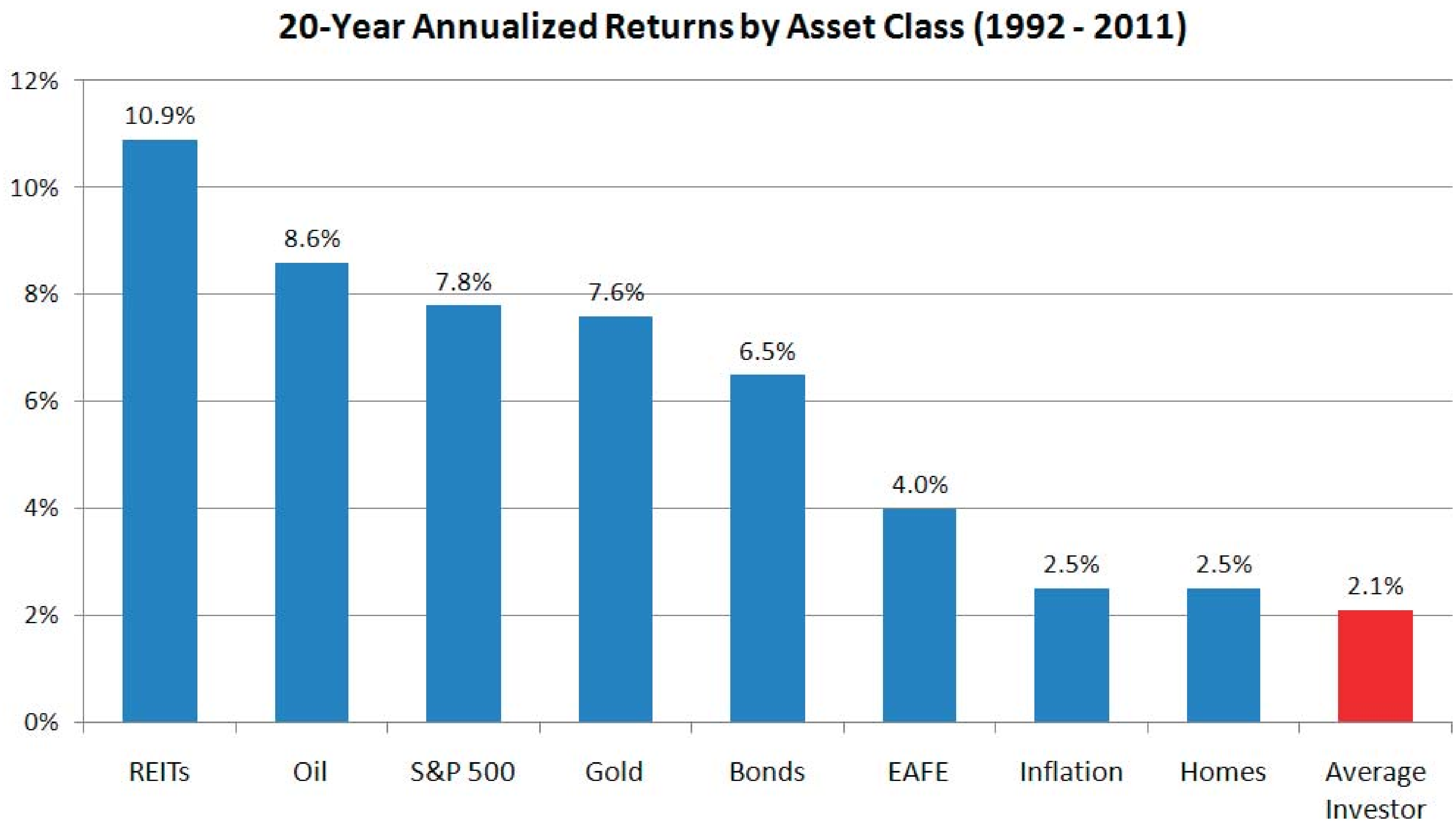
Pension Benefit Design Study



Source: J.P. Morgan Guide to the Markets, Q3 2012.

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Pension Benefit Design Study

- In a defined contribution plan, poor investment choices or not enough savings will likely cause the employee to have to continue working past normal retirement age.
- Market timing is important – in which economic cycle are the investment returns adequate.
- Members who retire with inadequate retirement savings in a defined contribution plan could have difficulty with retirement self-sufficiency and have to rely on public services.
- These potential outcomes shift some of the longevity and poverty risk back to the employer and taxpayers.

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Pension Benefit Design Study

Finding 5: Alternative plan structures carry differing levels of risk for the state and TRS members.

- While alternative plan structures, as modeled, are more expensive than the current plan to provide a comparable level of benefit, they can shift risk away from the state and to the members who become responsible for managing their own investments for the remainder of their lives.
- Other risks are how to manage the unfunded liability of the old defined benefit plan, the regular transition of workers into retirement at a manageable pace, and diminished retirement income could increase use of social services.

Pension Benefit Design Study

Finding 6: Other states changing structures have lowered benefits to realize savings. Those benefits were reduced by an average of 30% as part of moving to an alternative plan.

Finding 7: Moving new hires to an alternative plan will not eliminate existing plan liabilities.

- TRS' unfunded liability represents benefits earned by current participants; therefore, the state cannot eliminate the unfunded liability by closing the plan to new hires.
- If the state were to close the current plan to new hires, then the plan's liquidity needs will increase as the plan matures, and the liability is expected to grow by an estimated **$11.7 billion** due to lower investment returns from a less effective asset allocation.

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Pension Benefit Design Study

Finding 8: Approximately 95% of TRS public school members do not participate in Social Security, leaving the TRS benefit as their only lifetime annuity.

- Non-participation in Social Security saves Texas public school employers an estimated $1.5 billion annually.
- The level of benefit offered governs mandatory Social Security participation. Therefore, if benefits were reduced enough, the state could find itself in a situation where it must contribute to a pension plan, as required by the Texas Constitution, and the school districts and members must each contribute 6.2% to Social Security.

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TRS-ActiveCare

- TRS-ActiveCare was created in 2001 and is funded by:
  - State contribution $ 75 per month
  - School district contribution $150 per month (minimum)
  - Employees Premiums
- The state contribution has remained the same since 2001 and is funded to the districts through the school finance formula.
- Premium increases
  - Since 2002, there have been six rate increases--- approximately 5% in 2003-2004, 7.5 % in 2007-2008, 4.5% in 2009-2010, 7% in 2010-2011, 9.5% in 2011-12, and effective 9/1/12, increases are 4%, 6%, and 9% for ActiveCare 1, 2, 3.

Upcoming Legislative Session

- Many Changes
  - New House Pensions Committee and Chair
  - New Chair of House Public Education
  - New Senate Finance Chairman Tommy Williams
  - New Senate Education Chairman Dan Patrick
- Key issues
  - Budget
  - School Finance
  - Water
  - Transportation

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Upcoming Legislative Session

HB 1 / SB 1 Appropriations Bill

- For the pension trust fund, the filed bill has a state contribution rate of 6.4% each year and assumes payroll growth of 0% per year for public education and 2% per year for higher education.
- An exceptional item requests that the contribution rate be increased to 6.9% for FY 2014 and 7.4% for FY 2015 and is consistent with recommendations made by the TRS actuary in the past three biennia. Each 1.0% increase costs approximately $250 million per year in general revenue.
- For retiree health insurance (TRS-Care), the filed bill has a state contribution rate of 1.0% for the biennium.