

SUBJECT: Revising operations and establishing a Sunset review schedule for ERS

COMMITTEE: Pensions — committee substitute recommended

VOTE: 6 ayes — Flynn, Alonzo, Hefner, Huberty, Paul, J. Rodriguez

0 nays

1 absent — Anchia

WITNESSES: For — (*Registered, but did not testify:* David Sinclair, Game Warden Peace Officers Association; Clay Taylor, Texas Department of Public Safety Officers Association; Katy Reagan, Texas Public Employees Association)

Against — None

On — (*Registered, but did not testify:* Porter Wilson, Employees Retirement System of Texas; Emily Johnson, Sunset Advisory Commission; Brian Guthrie, Teacher Retirement System)

BACKGROUND: The Employees Retirement System of Texas (ERS) was created by a constitutional amendment in 1947. As a constitutionally created agency, ERS is not subject to traditional Sunset provisions and had not been reviewed since the 1992-93 review cycle. The 84th Legislature in 2015 placed ERS under Sunset review after concerns arose about its process in procuring a new vendor for its group benefits program.

Functions. ERS administers the retirement fund, health and optional insurance coverage, and other benefit programs for its members, including state and higher education employees, retirees, and their dependents.

Governing structure. A six-member board of trustees governs the agency. The governor, House speaker, and Texas Supreme Court chief justice each appoint one member and the remaining three are active state employees elected by state employees and retirees. All board members

serve staggered six-year terms.

Funding. ERS is funded through state and member contributions and returns from investments. It also receives some federal funds. The total revenue available to ERS in fiscal year 2015 was \$4.5 billion. ERS benefit payments in fiscal year 2015 totaled \$5.2 billion.

Staffing. In fiscal year 2015 ERS employed 350 staff at its Austin headquarters and 15 contract employees at a call center in Harlingen. The agency also uses outside consultants and investment advisors.

DIGEST:

CSHB 2459 would place the Employees Retirement System of Texas (ERS) under Sunset review while stipulating that the agency would not be abolished. The Sunset review would be set for 2029 and every 12th year after.

It would limit alternative investments and require tracking and reporting of profit-sharing arrangements associated with those investments. The bill would require the agency to implement a process to allow members enrolled in the group benefits program to participate directly in an appeal of an enrollment or claim decision. It would repeal a requirement for a cost-of-living increase for retirees if the retirement fund reaches a certain level.

Alternative investments. The bill would limit the amount of assets that ERS staff could direct to a single "alternative investment," defined as an investment in an asset other than a traditional asset, including a private equity fund, private real estate fund, hedge fund, or infrastructure fund. No more than 1 percent of the fund's total market value as reported in the most recent annual financial report could be invested in an alternative investment without approval from the ERS board.

The bill contains provisions that would allow the board to discuss an alternative investment or potential investment in a closed meeting and vote in an open meeting.

The board would be required to develop a consistent method for

calculating data on "profit share," defined as an amount received by a private professional investment manager either in consideration for achieving certain investment returns or as part of the sharing of investment returns between the manager and investor. This would include a performance fee, incentive fee, and carried interest. The board would be required to report, at a minimum, the aggregate amount of profit shares paid to private investment managers, categorized by asset class, in the agency's comprehensive annual financial report.

Group benefits program. The bill would require the agency to implement a process to allow members enrolled in the group benefits program to participate directly in an appeal of an enrollment or claim decision.

The board would be required to develop and maintain a precedent manual related to agency determinations concerning appeals of enrollment and claims decisions. The manual would be composed of precedent-establishing determinations made initially and on appeal by the board, executive director, or staff. It would be made available to members and staff. The board and staff would not be bound by a decision in the manual.

Cost-of-living adjustment. The bill would repeal Government Code, sec. 814.604, which requires ERS to grant a one-time cost-of-living adjustment to a retiree who has been retired for at least 20 years when the pension fund's unfunded actuarial liabilities do not exceed 30 years by one or more years.

Other provisions. At least once every four years the board would be required to adopt tables related to actuarial assumptions; make an actuarial experience investigation of members' mortality, service, and compensation; and make a valuation of the retirement fund's assets and liabilities.

The bill would change the due date from January to February for the agency's annual report to the governor and legislative leaders. The report would be expanded to include information about group coverage plans,

benefit changes, and recommendations for statutory changes.

The bill would add standard sunset provisions governing board training and use of alternative rulemaking and dispute resolution.

Effective date. The bill would take effect September 1, 2017, and would apply only to contracts between ERS and a private investment manager entered into or renewed after that date.

SUPPORTERS
SAY:

CSHB 2459 would put the Employees Retirement System (ERS) under a 12-year Sunset review cycle, allowing the Legislature to provide oversight of the agency that is responsible for managing the retirement and health benefits for hundreds of thousands of state employees and retirees. Although ERS has taken management actions to address the contracting concerns that prompted this review, the review identified other issues and made recommendations that would be implemented through the bill.

Alternative investments. The bill's requirements related to alternative investments would promote transparency and oversight. Disclosure of fees and profit-sharing arrangements would demonstrate to pension plan members that ERS is getting fair deals with their investment dollars. Tracking and reporting the fees would help ERS better assess the costs of alternative investments compared to other asset classes. This would give staff and the ERS board the data needed to make more informed decisions about the fund's asset allocations.

The requirement for board approval of alternative investments that are more than 1 percent of the fund's value would set a standard that would appropriately fluctuate with the fund and allow ERS to continue diversifying its portfolio.

The bill also would clarify that the board could discuss alternative investment contracts in closed meetings, ensuring that such discussions do not telegraph potential investment decisions before they are made in an open meeting.

Group benefits program. The bill would address concerns raised during the Sunset review that ERS lacks balance in its treatment of members during the agency's insurance appeals process. It would allow more direct interaction with agency staff, allowing members to take a more active role in presenting their case and hearing opposing points. These communications could help agency staff identify and solve issues that lead to insurance appeals and change the agency's tendency to attribute most appeals to member error.

The requirement for ERS to establish a precedent manual would provide useful information for members and ERS staff to compare an issue to previous decisions on insurance plan requirements. The manual would not be binding but would provide guidance on how ERS has considered similar facts.

Cost-of-living adjustment. Although not a part of the ERS Sunset review, the bill would remove a requirement for an automatic cost-of-living adjustment for long-time retirees when the fund reaches actuarial soundness. While cost-of-living adjustments may be beneficial to retirees, they can be detrimental to the actuarial soundness of the plan for future retirees and employees. ERS would retain the legal flexibility to pay a "13th check" to all retirees under certain conditions.

OPPONENTS
SAY:

Alternative investments. Alternative investments currently account for about 25 percent of the retirement fund's investment portfolio and typically have better returns than traditional investments. Disclosure of fees and profit-sharing arrangements with outside fund managers could result in a public backlash and lead to fewer alternative investments and the loss of their potential for higher returns. In addition, fund managers could decide not to contract with ERS due to concerns that their proprietary fee structures would be available to their competitors.

Group benefits program. The precedents manual could create confusion and invite litigation if members believe their issue being appealed should be decided in the same manner as a similar case.

Cost-of-living adjustment. Retired state employees have not received an increase in their pensions since 2002 even as inflation makes their checks less valuable. These longtime retirees deserve an increase when the fund reaches actuarial soundness and the requirement for an automatic increase should not be repealed.

NOTES:

A companion bill, SB 301 by Watson, was approved by the Senate on April 4 and reported favorably by the House Pensions Committee on April 24.