TRS UPDATE

House Ways and Means Education Committee
February 13, 2019
Leura Canary, General Counsel
Retirement Systems of Alabama
PROGRAMS ADMINISTERED BY RSA

- Teachers’ Retirement System
- Employees’ Retirement System
- Judicial Retirement Fund
- Public Education Employees’ Health Insurance Plan
- RSA-1 Deferred Compensation Plan
- Alabama Retired Education Employees’ Health Care Trust
- Public Employees’ Individual Retirement Fund
OTHER FUNDS MANAGED BY RSA

- Alabama Cultural Resources Preservation Trust Fund
- Alabama Firefighters Annuity and Benefit Fund
- Division of Wildlife and Freshwater Fisheries Fund
- Alabama Nongame Wildlife Endowment Trust
- Alabama Underground and Aboveground Storage Tank Trust Fund
- Clerks’ and Registers’ Supernumerary Fund
- Alabama Senior Services Trust Fund
- Alabama Trust Fund
- Alabama Treasury Fund
- Charlotte Thorn Trust Fund
- County Municipal Trust Fund
- Alabama State Employees’ Retired Health Care Trust Fund
- State Docks Pension Plans
# RSA’s Retirement Plans

<table>
<thead>
<tr>
<th>Plan</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Teachers’ Retirement System</td>
<td>- Provides retirement benefits to public education employees.</td>
</tr>
<tr>
<td>Employees’ Retirement System</td>
<td>- Provides retirement benefits to state employees and state police; and</td>
</tr>
<tr>
<td></td>
<td>- Administers retirement benefits for local units that elect to participate.</td>
</tr>
<tr>
<td>Judicial Retirement Fund</td>
<td>- Provides retirement benefits to district attorneys and circuit clerks (elected for the first</td>
</tr>
<tr>
<td></td>
<td>time on or after November 2015) and to justices and judges.</td>
</tr>
</tbody>
</table>
PARTICIPATING EMPLOYERS
as of 9/30/18

TRS
- 13 Universities
- 25 Post-Secondary
- 139 Boards of Education
- 33 State Agencies/Other

ERS State
- State of Alabama

ERS Local
- 297 Cities
- 65 Counties
- 511 Other Public Entities

JRF
- 67 Counties (Probate Judges, Circuit Clerks, and District Attorneys)
- AOC (Justices and Judges)
TRS BOARD OF CONTROL

• TRS Board, 15 members:
  • 3 Ex Officio
    • State Treasurer
    • Finance Director
    • State Superintendent of Education
  • 2 Elected Higher Education Employees
  • 1 Elected Postsecondary Employee
  • 1 Elected School Superintendent
  • 1 Elected School Principal
  • 3 Elected Active Teachers
  • 2 Elected Support Personnel
  • 2 Elected Retired Education Employees
RSA Members and Benefits by System
as of 9/30/17

<table>
<thead>
<tr>
<th></th>
<th>TRS</th>
<th>ERS State</th>
<th>ERS Local</th>
<th>JRF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active &amp; Retired Members</td>
<td>224,085</td>
<td>28,597</td>
<td>52,288</td>
<td>753</td>
</tr>
<tr>
<td>Annual Benefits Paid</td>
<td>$2.1B</td>
<td>$1.1B</td>
<td>$32.8M</td>
<td></td>
</tr>
<tr>
<td>Average Annual Benefit</td>
<td>$22,308</td>
<td>$21,048</td>
<td>$81,708</td>
<td></td>
</tr>
</tbody>
</table>
RSA Active Members by Tier as of 9/30/17

**TRS**
- Tier I: 101,540 (74%)
- Tier II: 35,401 (26%)

**ERS**
- Tier I: 59,390 (70%)
- Tier II: 25,726 (30%)

136,941 Total Active Members
85,116 Total Active Members
## TRS Tier I and Tier II Comparison

<table>
<thead>
<tr>
<th></th>
<th>Tier I</th>
<th>Tier II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Date of Employment</strong></td>
<td>Prior to January 1, 2013</td>
<td>On or after January 1, 2013</td>
</tr>
<tr>
<td><strong>Member Contribution Rate</strong></td>
<td>7.5%</td>
<td>6.0%</td>
</tr>
<tr>
<td><strong>Retirement Eligibility</strong></td>
<td>25 years of service at any age</td>
<td>• No 25-year or 30-year retirement</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• At least 10 years of service at age 62</td>
</tr>
<tr>
<td><strong>Retirement Factor</strong></td>
<td>2.0125%</td>
<td>1.650%</td>
</tr>
<tr>
<td><strong>Disability Retirement</strong></td>
<td>No Change</td>
<td>New disability standard</td>
</tr>
</tbody>
</table>
## RSA Tier I and Tier II Comparison

<table>
<thead>
<tr>
<th></th>
<th>Tier I</th>
<th>Tier II</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Average Final Salary</strong></td>
<td>Average of the highest three years of the last ten years</td>
<td>Average of the highest five years of the last ten years</td>
</tr>
<tr>
<td><strong>Benefit Cap</strong></td>
<td>None</td>
<td>80% of Average Final Salary (Approx. 48 yrs &amp; 6 mos to get to cap)</td>
</tr>
<tr>
<td><strong>Retirement Contributions on Overtime Pay</strong></td>
<td>Earnable Compensation cannot exceed 120% of base pay</td>
<td>Earnable Compensation cannot exceed 125% of base pay</td>
</tr>
<tr>
<td><strong>Sick Leave Conversion</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>
## Proposed Changes to TRS Tier II

<table>
<thead>
<tr>
<th></th>
<th>Tier II</th>
<th>Proposed Tier III</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefit Multiplier</td>
<td>1.65%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Retirement Eligibility</td>
<td>62/10</td>
<td>62/10 or 30 years</td>
</tr>
<tr>
<td>Sick Leave Conversion</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Member Rate</td>
<td>6.00%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Est. Increase in Employer Rate for Unfunded Liability</td>
<td>n/a</td>
<td>0.07%</td>
</tr>
<tr>
<td>Est. Increase in Tier II Employer Normal Rate</td>
<td>n/a</td>
<td>0.64%</td>
</tr>
<tr>
<td>Est. Increase in TRS Employer Contributions for FY20</td>
<td>n/a</td>
<td>$16.7M</td>
</tr>
<tr>
<td>Est. Increase in TRS Employer Contributions from ETF for FY20</td>
<td>n/a</td>
<td>$9.8M</td>
</tr>
</tbody>
</table>
RSA FUNDS as of 9/30/17

<table>
<thead>
<tr>
<th>Fund</th>
<th>Fair Market Value</th>
<th>Actuarial Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRS</td>
<td>24.5B</td>
<td>23.9B</td>
</tr>
<tr>
<td>ERS State</td>
<td>5.3B</td>
<td>5.1B</td>
</tr>
<tr>
<td>ERS Local</td>
<td>6.8B</td>
<td>6.6B</td>
</tr>
<tr>
<td>JRF</td>
<td>293M</td>
<td>300M</td>
</tr>
</tbody>
</table>
## EMPLOYEE CONTRIBUTION RATES

<table>
<thead>
<tr>
<th></th>
<th>Tier 1</th>
<th>Tier 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRS and ERS State Employees</td>
<td>7.5%</td>
<td>6.0%</td>
</tr>
<tr>
<td>ERS State Police</td>
<td>10.0%</td>
<td>10.0%/7.0%</td>
</tr>
<tr>
<td>ERS Firefighters, Law Enforcement &amp; Corrections</td>
<td>8.5%</td>
<td>7.0%</td>
</tr>
<tr>
<td>ERS Local</td>
<td>5% or 7.5%*</td>
<td>6.0%</td>
</tr>
<tr>
<td>JRF</td>
<td>8.5%</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

* Dependent upon whether local units adopted higher contribution rate as set forth in Act 2011-676.
THE EMPLOYER CONTRIBUTION

• The employer contribution is an employee benefit and is statutorily-required to help fund retirement benefits for RSA members.

• The contribution is paid on a monthly basis by RSA participating employers based on an employer contribution rate that is set by RSA’s actuaries as a percentage of payroll.
EMPLOYER CONTRIBUTION RATE

• The employer contribution rate is calculated using investment returns from 3 fiscal years prior. For example, the FY20 rate is based upon the FY17 investment returns.

• The Legislature approves the rate for TRS, JRF, and ERS State but does not appropriate money directly to RSA (except for a line item appropriation to JRF for probate judges).

• Each ERS local unit has a unique employer contribution rate that is calculated specifically for that unit and is paid by that unit.
EMPLOYER CONTRIBUTION RATE: Components

- The employer contribution rate includes the following components:
  - The normal cost to fund benefits accrued during the valuation year;
  - The cost attributable to pay the amortized unfunded actuarial accrued liability;
  - The cost to fund administrative expenses;
  - The cost to fund pre-retirement death benefits (TRS and ERS only); and
  - The cost to fund the term life insurance benefit (TRS only).
## FY18-FY20 TRS EMPLOYER CONTRIBUTION RATES

<table>
<thead>
<tr>
<th></th>
<th>FY18</th>
<th>FY19 (Current)</th>
<th>FY20 (Requested)</th>
<th>Increase (Decrease) from FY19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tier 1</strong></td>
<td>12.24%</td>
<td>12.41%</td>
<td>12.43%</td>
<td>0.02%</td>
</tr>
<tr>
<td><strong>Tier 2</strong></td>
<td>11.01%</td>
<td>11.35%</td>
<td>11.34%</td>
<td>(0.01%)</td>
</tr>
<tr>
<td><strong>Total Employer Cost</strong></td>
<td>$798.7M</td>
<td>$830.1M</td>
<td>$829.1M</td>
<td>($1M)</td>
</tr>
<tr>
<td><strong>Est. Amt. from ETF</strong></td>
<td>$470.7M</td>
<td>$489.2M</td>
<td>$488.6</td>
<td>($0.6M)</td>
</tr>
</tbody>
</table>

* Based upon estimates from the EBO using FY16 data, approximately 58.93% of the total employer cost comes from the ETF; the remainder is paid by TRS participating employers from other funds (9.59% Federal, 20.95% Tuition, 0.64% Non-Government, and 9.88% Local).
EMPLOYER CONTRIBUTION RATE:

**Employer Contribution Funding Sources**

- **State Agency** Appropriation from the General Fund
- **K12, Postsecondary, or University** Appropriation from the Education Trust Fund
- **State Earmarked Funds Received by State Agencies**
- **Federal Funds Received by State Agencies**
- **Local Funds from Local Units**
- **Federal and Local Funds Received by K12**
- **Federal Funds Received by Universities and Postsecondary**
- **Tuition Received by Universities and Postsecondary**
- **Private Monies Received by Association Employers**
# RSA HISTORICAL INVESTMENT RATES OF RETURN (as of FY18)

<table>
<thead>
<tr>
<th></th>
<th>1 Yr</th>
<th>3 Yr</th>
<th>5 Yr</th>
<th>10 Yr</th>
<th>15 Yr</th>
<th>20 Yr</th>
<th>25 Yr</th>
<th>30 Yr</th>
<th>35 Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>ERS</td>
<td>9.29%</td>
<td>10.78%</td>
<td>9.00%</td>
<td>7.58%</td>
<td>6.97%</td>
<td>6.29%</td>
<td>7.23%</td>
<td>8.14%</td>
<td>8.66%</td>
</tr>
<tr>
<td>TRS</td>
<td>9.42%</td>
<td>10.53%</td>
<td>8.88%</td>
<td>7.77%</td>
<td>7.15%</td>
<td>6.48%</td>
<td>7.37%</td>
<td>8.25%</td>
<td>8.77%</td>
</tr>
</tbody>
</table>
INVESTING EFFICIENTLY

• RSA’s investment expenses are among the lowest in the country for major public pension funds.

• RSA’s investment expenses for FY13, FY14, FY15, FY16, and FY17 have averaged only 3.0 basis points (or 0.0003 of its assets) per year compared to an average expense of 47 basis points (or 0.0047 of assets) according to NASRA.

• If RSA spent the average amount in FY17, it would spend $162M per year in investment expenses, compared to the $12M actually spent.
**TRS INCOME SOURCES FOR FY18**

- **Employee Contributions:**
  - $488,503,000

- **Employer Contributions**:  
  - $802,598,000

- **Investment Income:**
  - $2,264,234,000

- **Total Income:**
  - $3,555,335,000

*This includes contributions from all sources for TRS and excludes transfers from ERS and PEEHIP.*
FY2018 TRS EMPLOYER CONTRIBUTIONS AS A % OF EDUCATION APPROPRIATIONS

- TRS Employer Contributions: 5.26%
- Total Education Appropriations: 94.74%
ADDRESSING THE UNFUNDED LIABILITY: RSA BOARD POLICY CHANGES

• Lowered the assumed rate of return from 8% to 7.70%:
  • Results in a one-time increase to the unfunded liability and an increase to the normal cost
  • Will lessen the impact of another market downturn

• Transitioning to a closed amortization period:
  • Increases the unfunded liability portion of the employer contribution
  • Prevents the unfunded liability from growing unchecked and ensures that, over time, it is paid off over a thirty-year horizon
ADDRESSING THE UNFUNDED LIABILITY: LEGISLATIVE ACTION

• Enacted reforms to shift employer costs and reduce benefits for new employees
  • This has made the employer contribution more affordable for the state.

• Continued to ensure that the full employer cost is paid
  • This is the number one indicator of a healthy pension plan.

• Ensured that no unfunded retiree COLAs have been enacted since 2007
  • This has kept the unfunded liability from growing more.
MOVING IN THE RIGHT DIRECTION

• The funded ratio has stabilized.

• TRS is ahead of 2012 estimates regarding funding:
  • 9 years ahead of schedule with $1 billion less in unfunded liability than originally estimated.

• Since 2009, TRS assets have increased by 34.3% (from $17.1B to $25.9B).

• During this time, TRS earned $17.3B in investment income, while paying out $17.4B in retirement benefits.
ASSET ALLOCATIONS AS OF SEPTEMBER 30, 2017

TRS
- Domestic Equity: 51.7%
- International Equity: 14.8%
- Alternatives (incl. Real Estate): 13.6%
- Private Placements: 10.4%
- Fixed Income (excl. Private Placements): 6.0%
- Cash Accounts: 3.5%

ERS
- Domestic Equity: 51.6%
- Alternatives (incl. Real Estate): 16.3%
- International Equity: 12.3%
- Private Placements: 10.3%
- Fixed Income (excl. Private Placements): 6.0%
- Cash Accounts: 3.5%
RSA REAL ESTATE: COMPARED TO TOTAL PORTFOLIO

- 90.22% Residential Developments
- 5.07% Other Investments
- 1.98% Railcar Plant
- 1.17% RTJ Golf Trail
- 0.80% AL Hotels
- 0.57% AL Office Buildings
- 0.19% 55 Water Street
RSA GOVERNANCE

- Alabama Law
- RSA
- Professional Standards
- Board Policies
- Federal Law
RSA GOVERNANCE: Alabama Law

• CONSTITUTIONAL PROVISIONS:
  • The assets, proceeds, and income of RSA are solely for the exclusive use of providing benefits and refunds to its members and for administrative expenses. “All of the assets, proceeds or income of [RSA] . . . Shall be held, invested as authorized by law, or disbursed as in trust for the exclusive purposes of providing for such benefits, refunds and administrative expenses under the management of the boards of control of [RSA].” Ala. Const. Art. V, § 138.03.

• RSA GOVERNING STATUTES:
  • Sets the terms of the ERS and TRS retirement plans, including the benefits levels, governance, investment processes, and funding. Ala. Code § 36-27-1 et seq.; Ala. Code § 16-25-1 et seq.

• FIDUCIARY DUTIES:
  • RSA Board members have “a fiduciary duty to hold and invest [RSA] assets in trust for its members” and “to administer the [ERS] and the [TRS] solely in the interest of the members of the [ERS] and the [TRS].” Knutson v. Bronner, 721 So.2d 678,681 (Ala. 1998); Ex parte Bronner, 171 So.3d 614,625 (Ala. 2014).
RSA GOVERNANCE: **Federal Law**

- **SECURITIES EXCHANGE COMMISSION:**
  - Various reporting requirements that apply to securities trading

- **INTERNAL REVENUE CODE:**
  - Must meet the requirements of IRC section 401(a) to retain qualified plan status which provides special tax considerations

- The Employee Retirement Income Security Act (ERISA) **does not apply** to RSA.
RSA GOVERNANCE: Board Policies

• ERS AND TRS INVESTMENT POLICIES:
  • Set forth the policies by which the ERS and TRS funds’ investments will be managed, including goals and objectives, investment philosophy, target asset allocations, rebalancing policies, eligible asset categories, risk controls and procedures, and performance measurement

• ERS AND TRS FUNDING POLICIES:
  • Reflect the Boards’ long-term strategy for stability in funding the plans and state the overall funding objectives for ERS and TRS, the benchmarks used to measure progress in achieving those goals, and the actuarial methods and assumptions that will be used to develop the benchmarks
RSA GOVERNANCE: Professional Standards

• GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STATEMENTS:
  • Set by the Governmental Accounting Standards Board
  • Govern the financial statements produced by RSA

• GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP):
  • Set by the Governmental Accounting Standards Board
  • Govern the accounting methods employed by RSA

• ACTUARIAL STANDARDS OF PRACTICE (ASOP):
  • Set by the Actuarial Standards Board
  • Govern the work performed by RSA’s actuaries, Cavanaugh Macdonald
RSA ACCOUNTABILITY

• INDEPENDENT AUDITS:
  • Independent financial audits by national certified public accounting firm Carr, Riggs, and Ingram of TRS’s and ERS’s Annual Financial Statements in accordance with GAAP and GASB
  • Independent legal compliance audit by Alabama Examiners of Public Accounts
  • SOC 1, Type 2 audit on effectiveness of controls by national certified public accounting firm A-lign

• VALUATIONS/APPRAISALS:
  • Third-party custodian (State Street) investment returns calculations and portfolio allocation comparisons in compliance with the Global Fund Accounting and Custody System and CFA Institute’s GIPS standards
  • Independent valuations of private placements by Houlihan Lokey applying market, income, and asset-based valuation methodologies as applicable
  • Independent valuations of real estate by national appraisal firm Pearson, Inc., in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP)
  • Peer reviews of actuarial methodology and experience study in compliance with ASOPs
RSA TRANSPARENCY

• OPEN MEETINGS ACT:
  • Applies to all board and committee meetings

• PUBLIC RECORDS ACT:
  • Applies to all board minutes, agendas, and documents, State Street reports, comprehensive listings of investments, benefit documents (with some restrictions for the privacy of members), etc.

• ACCESSIBLE ON WEBSITE
  • Comprehensive Annual Financial Report, GASB Reports, and Financial Statements
  • Annual Actuarial Valuations and Five-Year Experience Studies
  • Annual Report and RSA Advisors
  • Investment Policies
  • Investment Returns and Asset Allocations
  • Benefit Handbooks
RSA-1: A Deferred Compensation Plan

- RSA-1 is an Internal Revenue Code Section 457 deferred compensation plan for all public employees.

- No employer contributions are made.

- Per Ala. Code § 36-27A-7, no administrative fees are charged to members. Instead, the administrative costs are paid from the expense funds of TRS and ERS.

- As of 9/30/2018, RSA-1 held $2.116B in fair market value assets.

- Invested by RSA’s professional investment staff – 3 options:
  - Cash Equivalent
  - Bond Index Fund
  - Stock Index Fund
QUESTIONS?

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