

TRS UPDATE

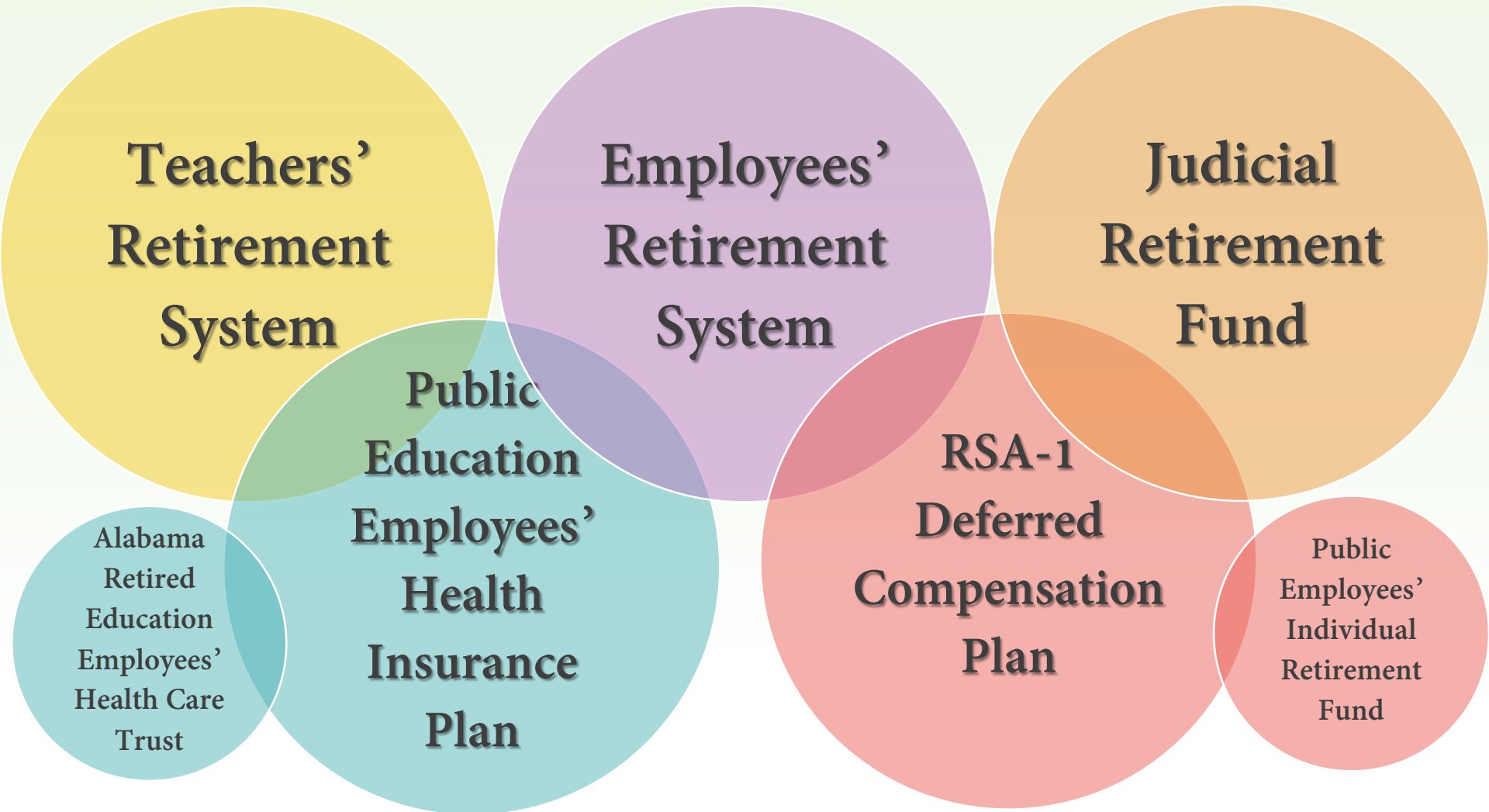
House Ways and Means Education Committee

February 13, 2019

Leura Canary, General Counsel
Retirement Systems of Alabama



PROGRAMS ADMINISTERED BY RSA



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

Teachers' Retirement System

- Provides retirement benefits to public education employees.

Employees' Retirement System

- Provides retirement benefits to state employees and state police; and
- Administers retirement benefits for local units that elect to participate.

Judicial Retirement Fund

- Provides retirement benefits to district attorneys and circuit clerks (elected for the first time on or after November 2015) and to justices and judges.

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

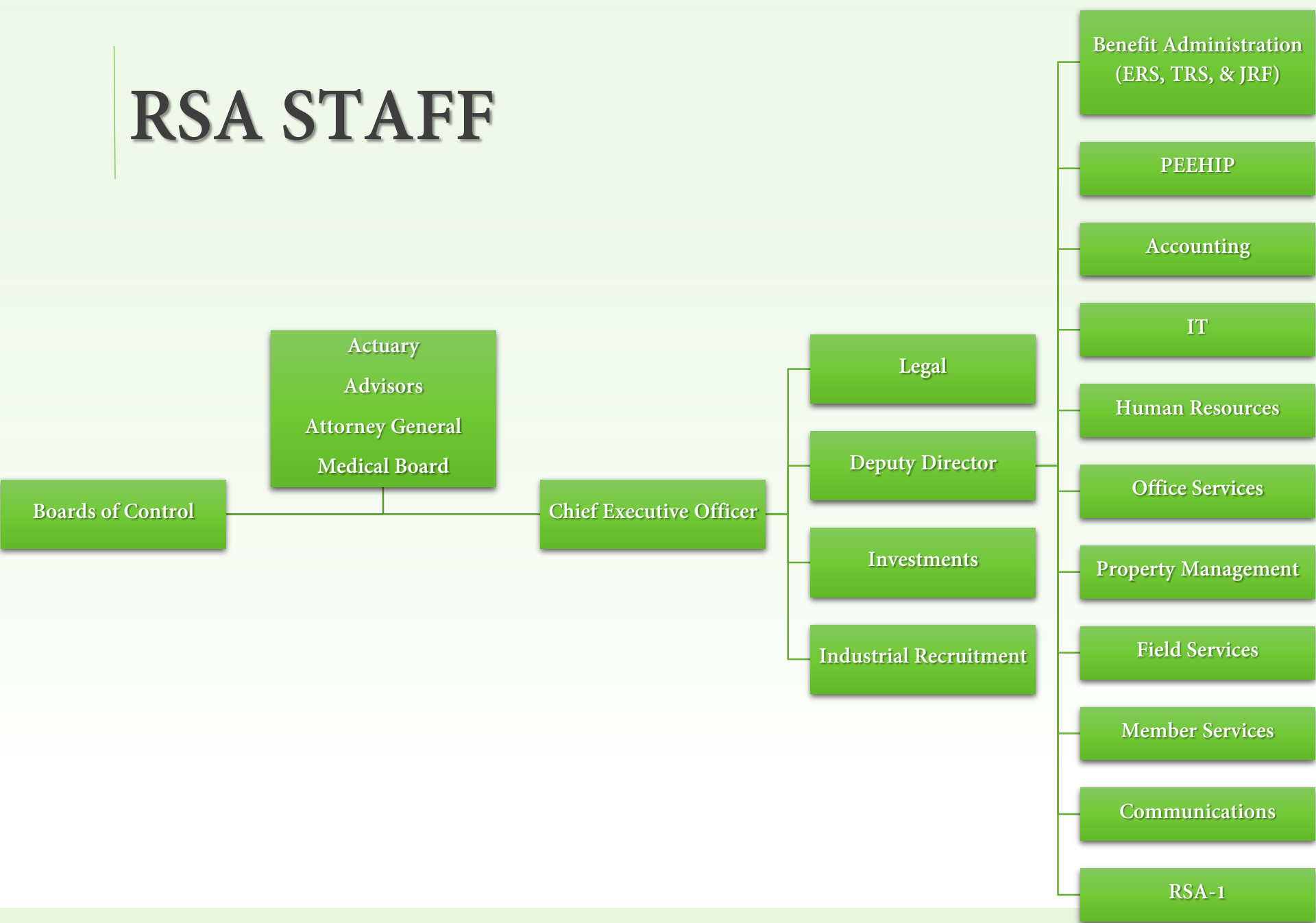
67 Counties
(Probate
Judges, Circuit
Clerks, and
District
Attorneys)

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 STAFF

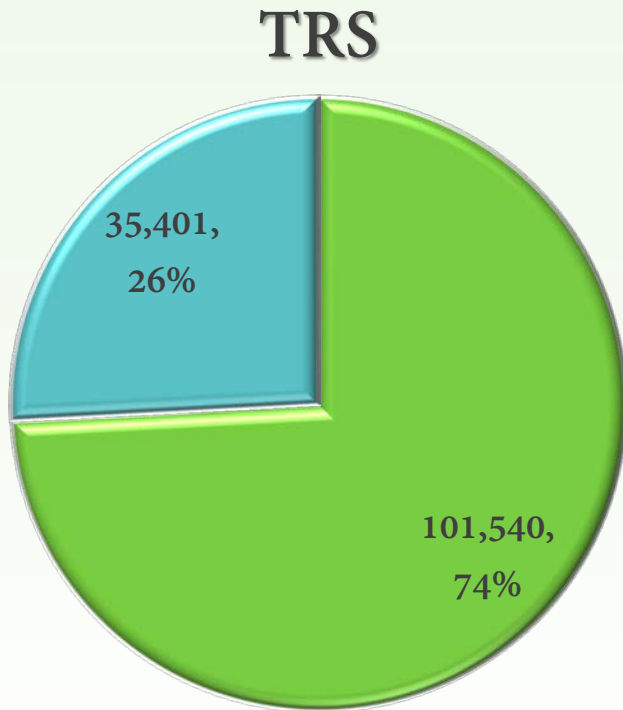


RSA Members and Benefits by System

as of 9/30/17

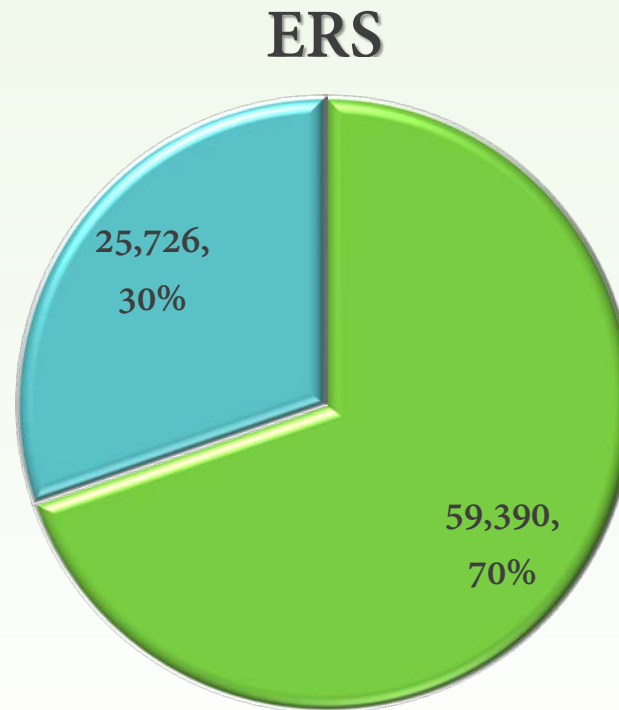
	TRS	ERS State	ERS Local	JRF
Active & Retired Members	224,085	28,597	52,288	753
Annual Benefits Paid	\$2.1B	\$1.1B		\$32.8M
Average Annual Benefit	\$22,308	\$21,048		\$81,708

RSA Active Members by Tier as of 9/30/17



■ Tier I ■ Tier II

136,941 Total Active Members



■ Tier I ■ Tier II

85,116 Total Active Members

TRS Tier I and Tier II Comparison

	Tier I	Tier II
Date of Employment	Prior to January 1, 2013	On or after January 1, 2013
Member Contribution Rate	7.5%	6.0%
Retirement Eligibility	25 years of service at any age	<ul style="list-style-type: none"> • No 25-year or 30-year retirement • At least 10 years of service at age 62
Retirement Factor	2.0125%	1.650%
Disability Retirement	No Change	New disability standard

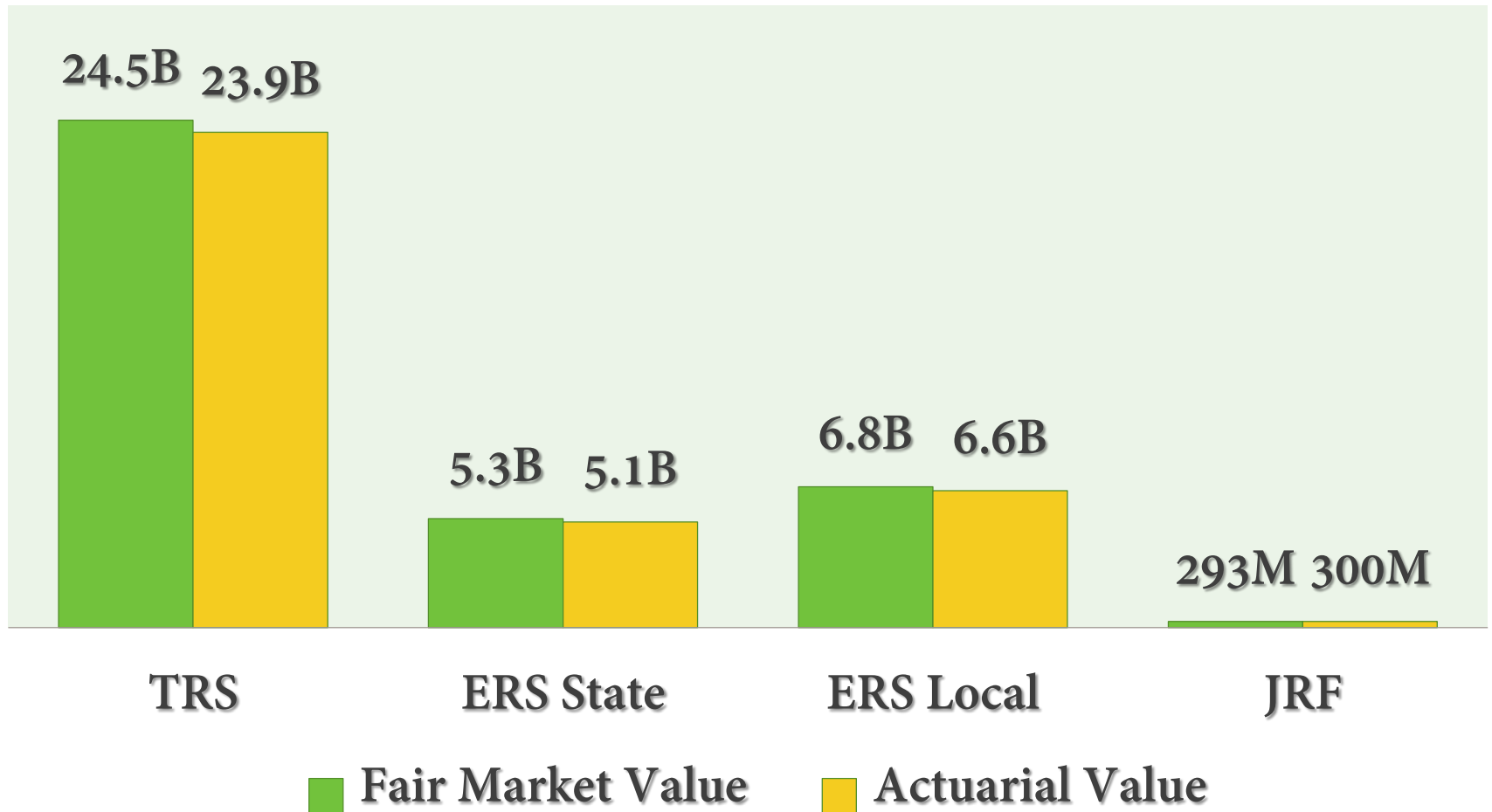
RSA Tier I and Tier II Comparison

	Tier I	Tier II
Average Final Salary	Average of the highest three years of the last ten years	Average of the highest five years of the last ten years
Benefit Cap	None	80% of Average Final Salary <i>(Approx. 48 yrs & 6 mos to get to cap)</i>
Retirement Contributions on Overtime Pay	Earnable Compensation cannot exceed 120% of base pay	Earnable Compensation cannot exceed 125% of base pay
Sick Leave Conversion	Yes	No

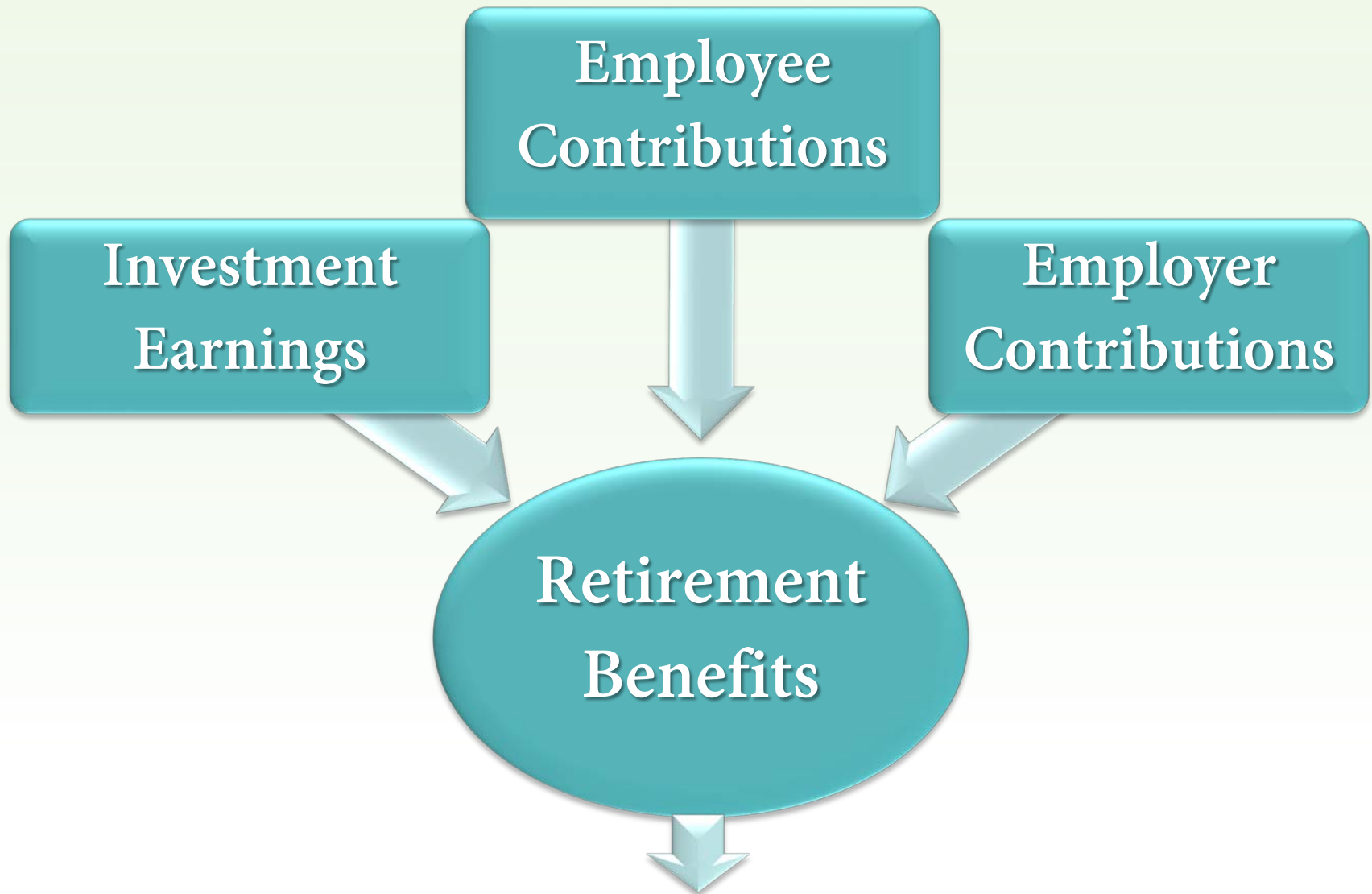
PROPOSED CHANGES TO TRS TIER II

	Tier II	Proposed Tier III
Benefit Multiplier	1.65%	2.00%
Retirement Eligibility	62/10	62/10 or 30 years
Sick Leave Conversion	No	Yes
Member Rate	6.00%	7.5%
Est. Increase in Employer Rate for Unfunded Liability	n/a	0.07%
Est. Increase in Tier II Employer Normal Rate	n/a	0.64%
Est. Increase in TRS Employer Contributions for FY20	n/a	\$16.7M
Est. Increase in TRS Employer Contributions from ETF for FY20	n/a	\$9.8M

RSA FUNDS as of 9/30/17



FUNDING RSA RETIREMENT BENEFITS



EMPLOYEE CONTRIBUTION RATES

	Tier 1	Tier 2
TRS and ERS State Employees	7.5%	6.0%
ERS State Police	10.0%	10.0%/7.0%
ERS Firefighters, Law Enforcement & Corrections	8.5%	7.0%
ERS Local	5% or 7.5%*	6.0%
JRF	8.5%	8.5%

* 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

	FY18	FY19 (Current)	FY20 (Requested)	Increase (Decrease) from FY19
Tier 1	12.24%	12.41%	12.43%	0.02%
Tier 2	11.01%	11.35%	11.34%	(0.01%)
Total Employer Cost	\$798.7M	\$830.1M	\$829.1M	(\$1M)
Est. Amt. from ETF*	\$470.7M	\$489.2M	\$488.6	(\$0.6M)

* 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)

	1 Yr	3 Yr	5 Yr	10 Yr	15 Yr	20 Yr	25 Yr	30 Yr	35 Yr
ERS	9.29%	10.78%	9.00%	7.58%	6.97%	6.29%	7.23%	8.14%	8.66%
TRS	9.42%	10.53%	8.88%	7.77%	7.15%	6.48%	7.37%	8.25%	8.77%

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.

INVESTMENT STAFF

Director of Investments
Marc Green, MBA, CFA

Chief Economist
Lance Lachney, MBA, CFA

Cash Management/Operations
Catherine Ray

Director of Equities
Allan Carr, MBA, CFA
Banks and Diversified Financials

Confidential Executive Assistant
Allison DeBoard

Director of Private Placements
Hunter Harrell, MBA, JD, CFA

Director of Fixed Income
Julie Barranco, MBA, CFA

Asst. Directors of Equities
Steve Lambdin, MBA, CFA
Transportation, Commercial Services, and Aerospace Defense
and
Hunter Bronson, MS, CFA
Telecom and Consumer Staples

Private Placements Analyst
Rachel Daniels, MAcc, CPA

Fixed Income Analyst/Portfolio Manager
Nick Prillaman, MS, CFA

Equity Analyst
Michael McNair, MBA, CFA
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Equity Analyst/Portfolio Manager
Kevin Gamble, MBA, CFA
Technology

Senior Equity Analyst/Portfolio Manager
Adam Rogers, MA, CFA
Consumer Discretionary

Equity Analyst
Josh Husted, MBA

Equity Analyst/Portfolio Manager
Bobby Long, MBA, CFA
Energy and REITS

Equity Analyst
Katie Richard, JD

TRS INCOME SOURCES FOR FY18

Employee Contributions:

\$488,503,000

Employer Contributions*:

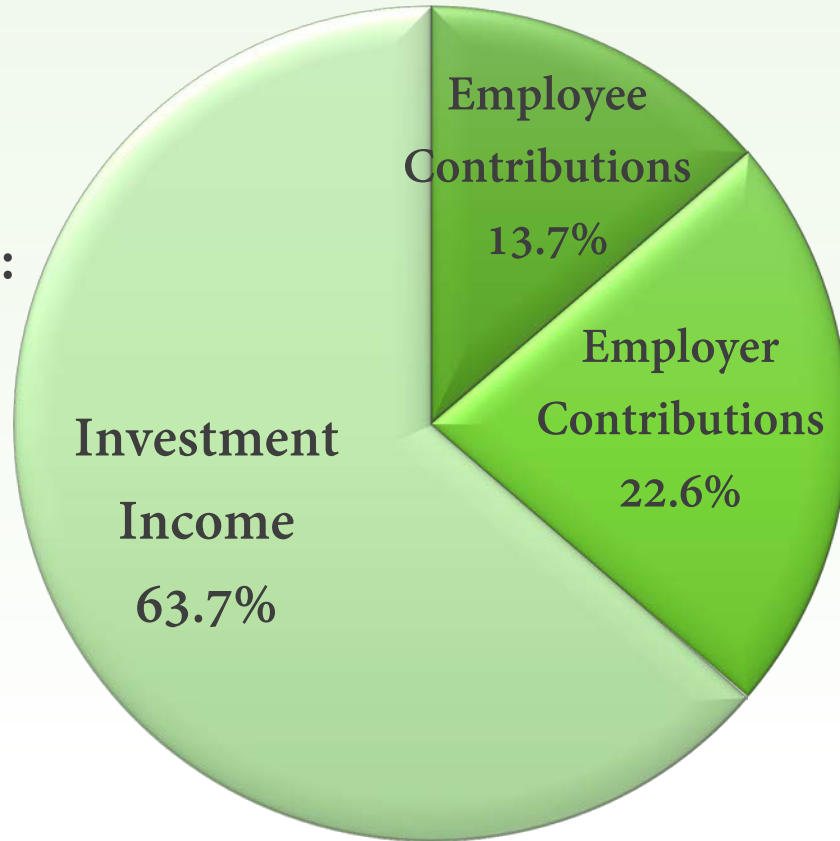
\$802,598,000

Investment Income:

\$2,264,234,000

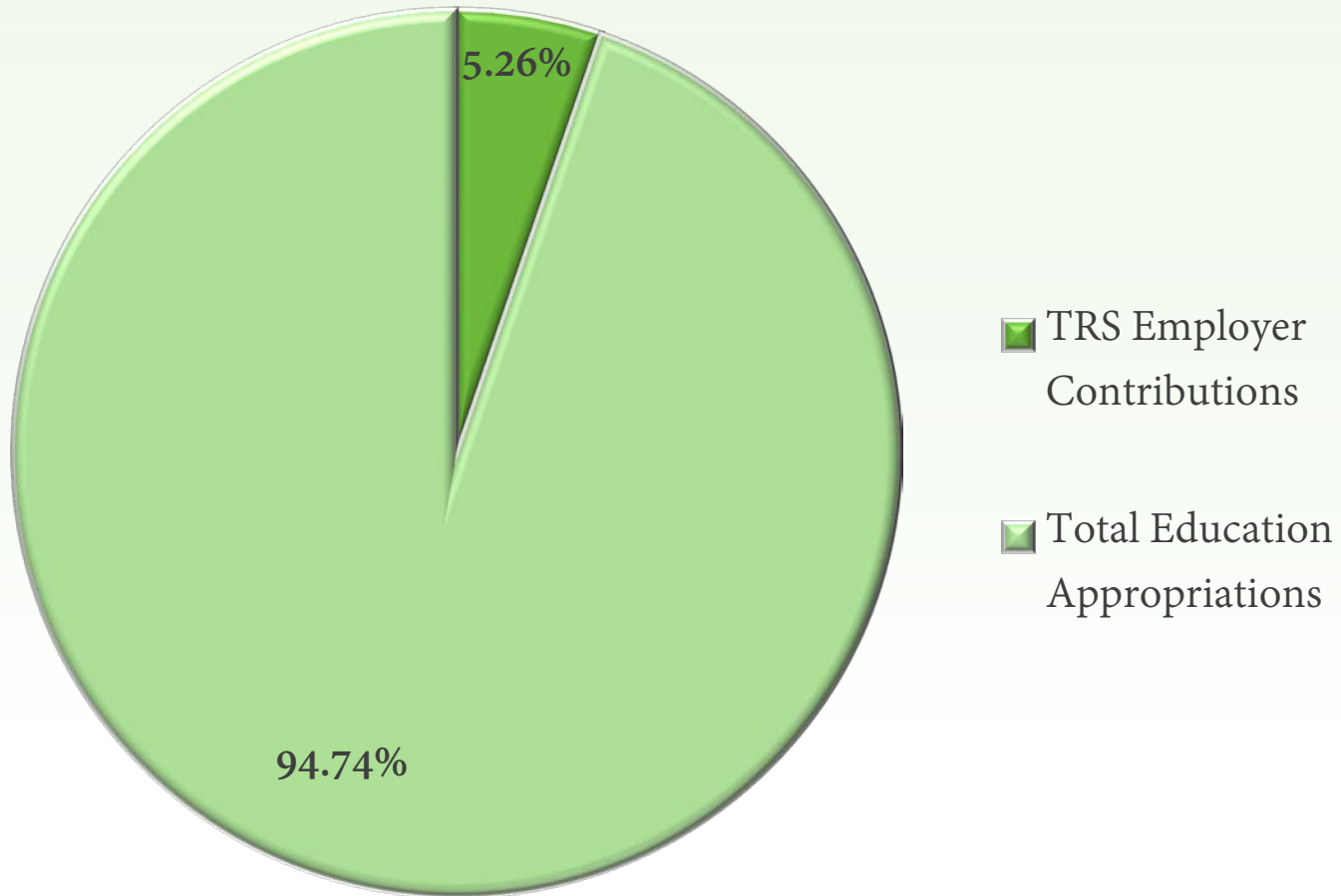
Total Income:

\$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



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

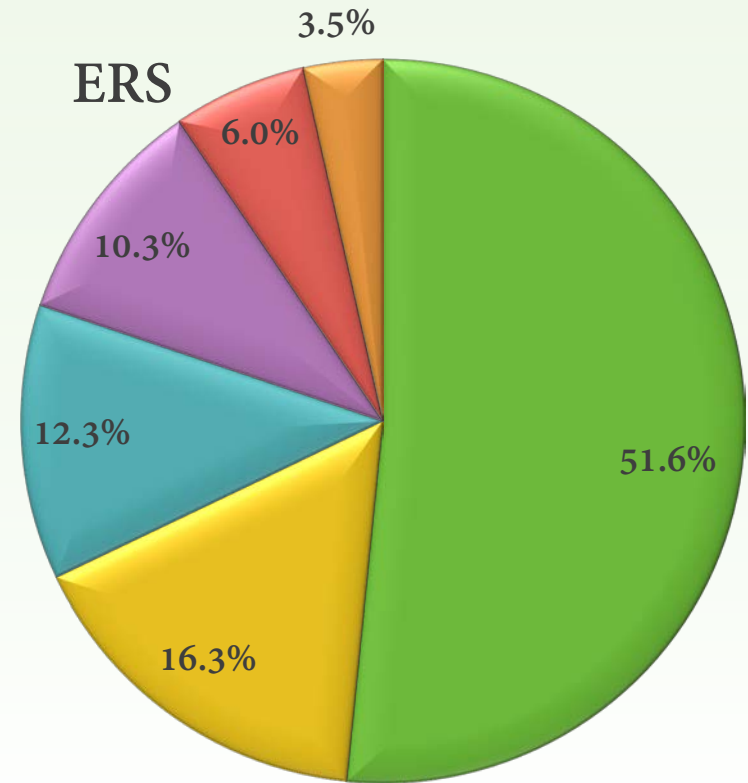
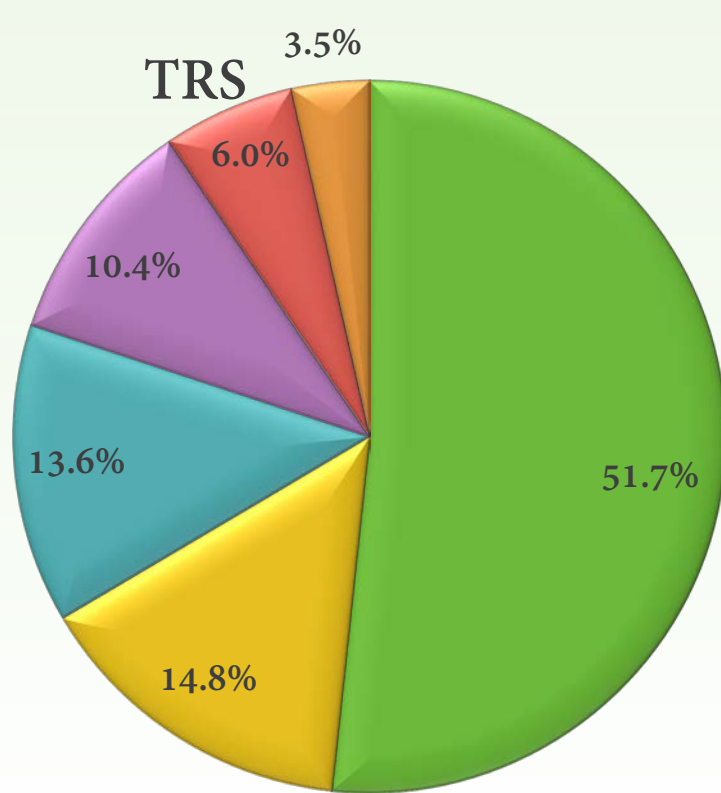
ADDRESSING THE UNFUNDED LIABILITY: *LEGISLATIVE ACTION*

- 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.

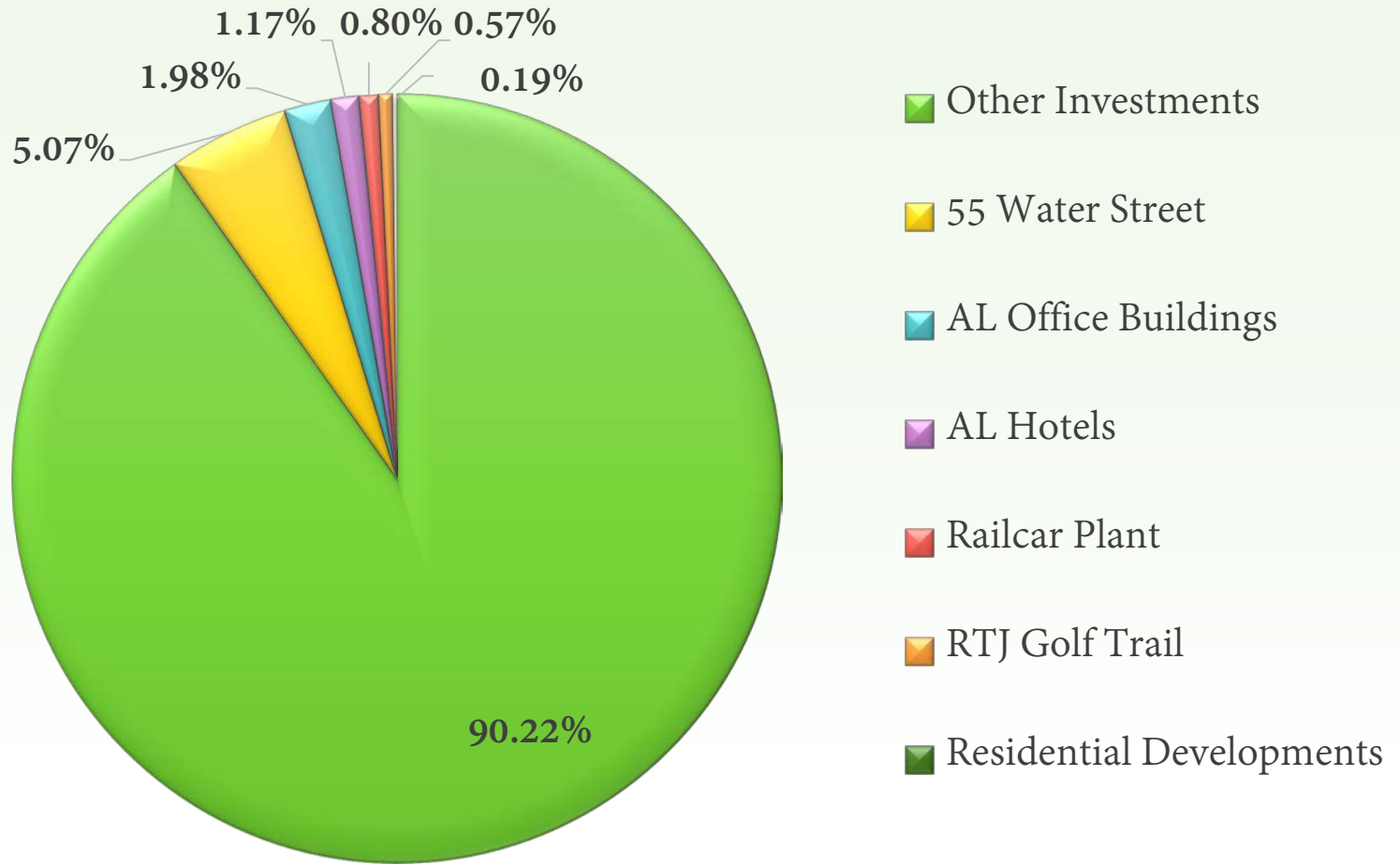
ASSET ALLOCATIONS AS OF SEPTEMBER 30, 2017



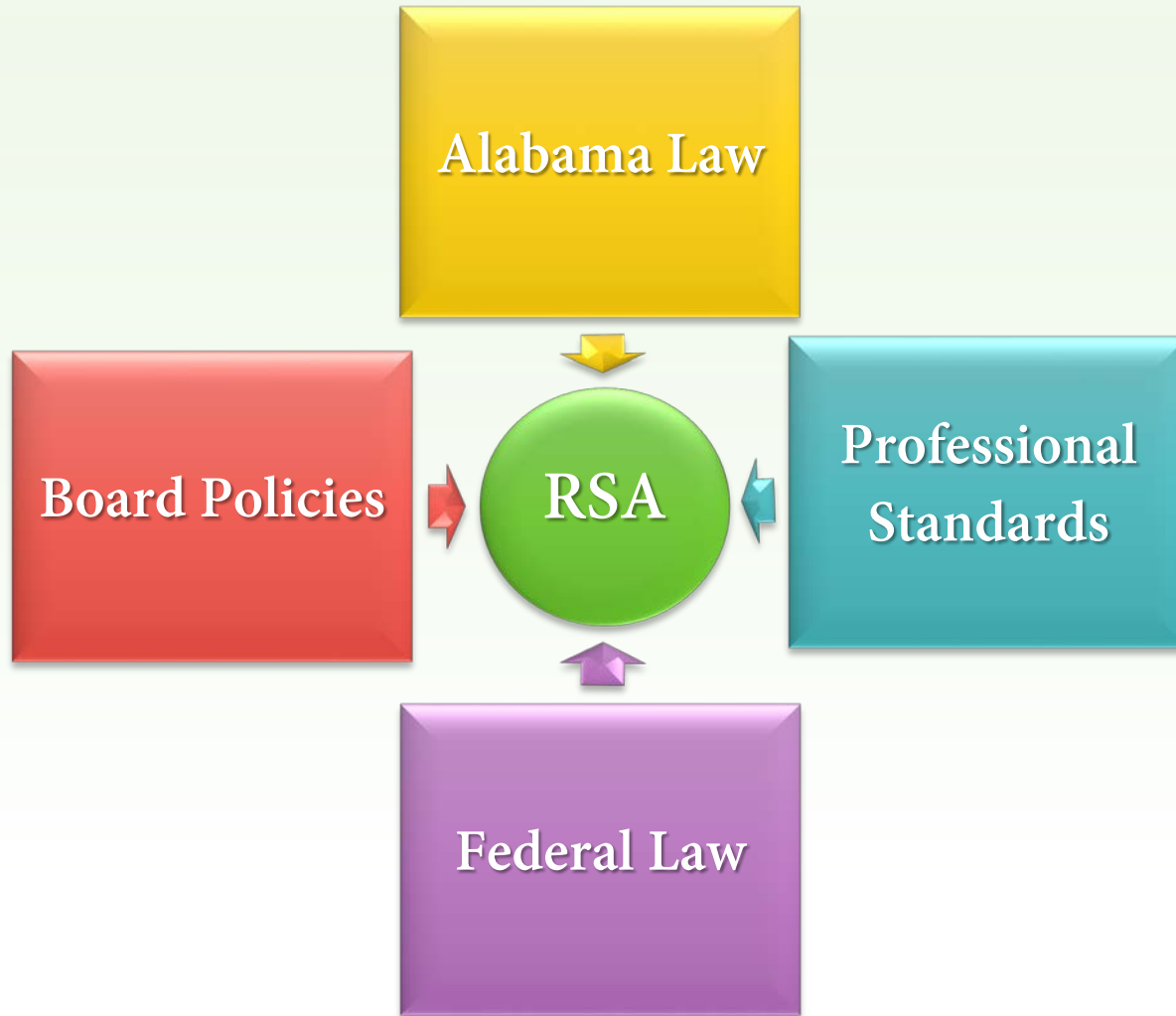
- Domestic Equity
- International Equity
- Private Placements

- Alternatives (incl. Real Estate)
- Fixed Income (excl. Private Placements)
- Cash Accounts

RSA REAL ESTATE: COMPARED TO TOTAL PORTFOLIO



RSA GOVERNANCE



RSA GOVERNANCE: *Alabama Law*

- CONSTITUTIONAL PROVISIONS:

- Pensions are unilateral contracts protected by the Contracts Clause. Ala. Const. Art. I, § 22; *Bd. of Trs. of the Policemen's & Firemen's Ret. Fund v. Cary*, 373 So.2d 841, 842 (Ala. 1979).
- 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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