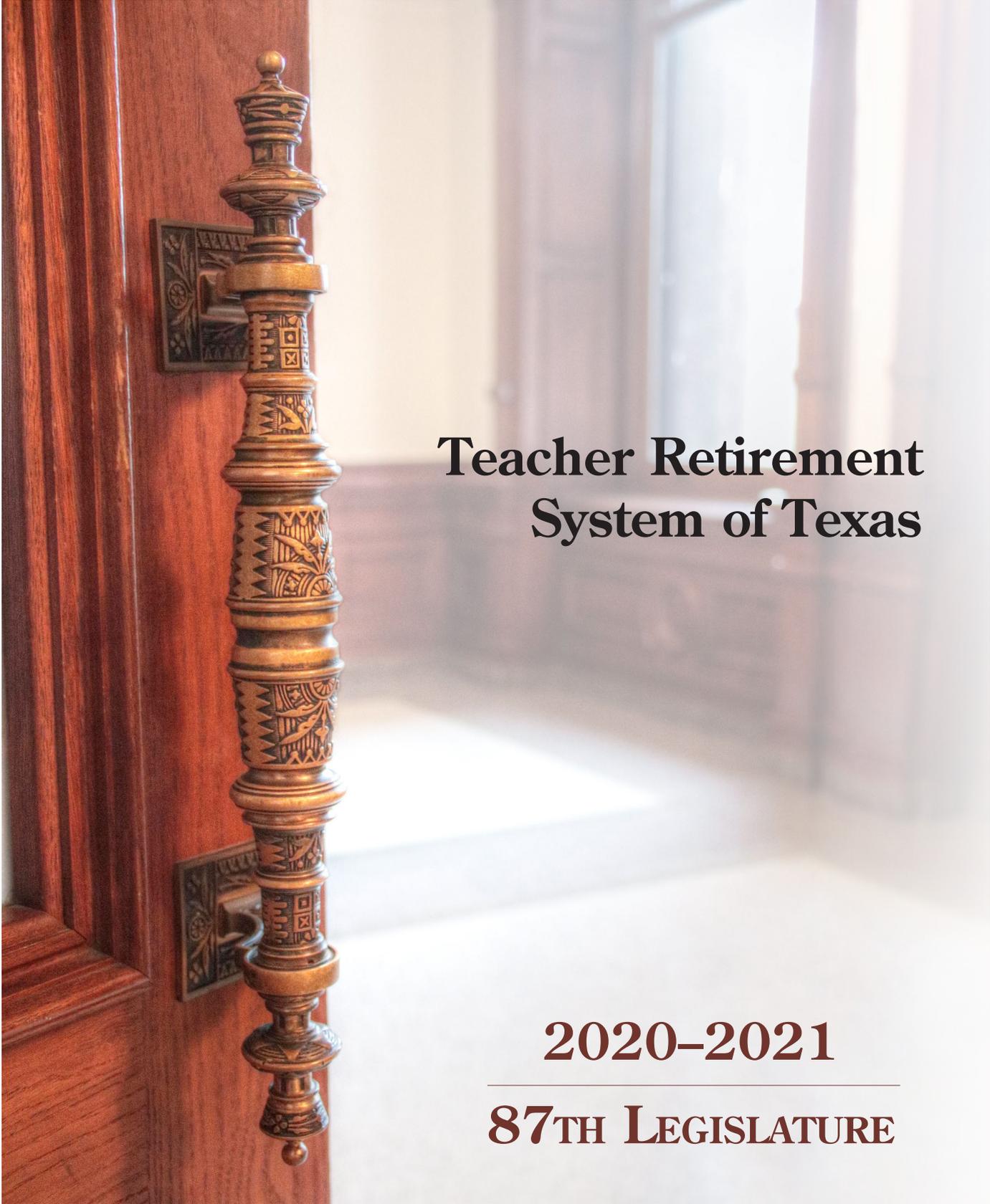


# SUNSET ADVISORY COMMISSION

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STAFF REPORT WITH FINAL RESULTS



Teacher Retirement  
System of Texas

2020–2021

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87TH LEGISLATURE

# SUNSET ADVISORY COMMISSION



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*Executive Director*

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*Cover photo: The Texas Capitol is a marvel of craftsmanship down to the smallest details. Elaborate, custom-designed hardware accentuates the beautifully carved wooden doors. The Sargent and Co. of New Haven, Connecticut created the glass molds especially for the building in the 1880s. The Capitol hardware features incised designs of geometric and stylized floral motifs. This reflects the shift from the Renaissance Revival style of the building's interior architecture to the simpler Aesthetic Movement for its decorative details. Photo credit: Janet Wood*

# TEACHER RETIREMENT SYSTEM OF TEXAS

SUNSET STAFF REPORT WITH FINAL RESULTS  
2020–2021  
87TH LEGISLATURE

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## HOW TO READ SUNSET REPORTS

For each agency that undergoes a Sunset review, the Sunset Advisory Commission publishes three versions of its staff report on the agency. These three versions of the staff report result from the three stages of the Sunset process, explained in more detail at [sunset.texas.gov/how-sunset-works](http://sunset.texas.gov/how-sunset-works). The current version of the Sunset staff report on this agency is noted below and can be found on the Sunset website at [sunset.texas.gov](http://sunset.texas.gov).

### **Sunset Staff Report**

The first version of the report, the Sunset Staff Report, contains Sunset staff's recommendations to the Sunset Commission on the need for, performance of, and improvements to the agency under review.

### **Sunset Staff Report with Commission Decisions**

The second version of the report, the Sunset Staff Report with Commission Decisions, contains the original staff report as well as the commission's decisions on which statutory recommendations to propose to the Legislature and which management recommendations the agency should implement.

### **CURRENT VERSION: Sunset Staff Report with Final Results**

The third and final version of the report, the Sunset Staff Report with Final Results, contains the original staff report, the Sunset Commission's decisions, and the Legislature's final actions on the proposed statutory recommendations.

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# FINAL RESULTS

## House Bill 1585 Lambert (Lucio)

### Summary

The Teacher Retirement System of Texas (TRS) is a trust fund that provides retirement and health benefits to more than 1.6 million members, including active and retired Texas teachers, public education support staff, certain higher education professionals, and their dependents. Unlike most state agencies Sunset reviews, TRS is constitutionally created and not subject to abolishment. The Sunset Commission determined that TRS generally manages its \$157 billion trust fund well, but needs to focus more on its members, including improving communications to ensure members have the support and information needed to be secure in retirement.

House Bill 1585 specifies TRS is subject to Sunset review, but not abolishment, again in 2033. The bill also improves TRS communications to ensure members have the support and information needed to be secure in retirement. House Bill 1585 makes changes to the agency's process for and information about appeals, and restructures employment after retirement benefit limitations to lessen the burden on members. Finally, the bill requires TRS to create an ombudsman position to investigate complaints and identify ways to increase input from members.

The following material summarizes the results of the Sunset review of TRS, including management actions directed to the agency that do not require legislative action.

### ISSUE 1 — Member Communication, Outreach, and Engagement

**Recommendation 1.1, Adopted** — Require TRS to develop a communication and outreach plan to better help members and employers plan for retirement. Also require TRS to respond to appeals at all levels of staff review within the same amount of time that members have to appeal agency decisions. Additionally, require TRS to create communication and engagement materials informing members of the existing option to request an external review of healthcare coverage appeals denied by third-party health plan administrators, and ensure members are aware they may work directly with TRS for assistance in navigating the appeals process.

**Recommendation 1.2, Adopted** — Require TRS to make improved efforts to return contributions to inactive members before funds are forfeit.

As a management action, direct TRS to develop a process to submit inactive member information to the comptroller's office upon request by the comptroller's office.

**Recommendation 1.3, Modified** — Direct TRS to adopt a member engagement policy to increase transparency on key decisions by February 1, 2021, rather than September 1, 2020. In addition, direct TRS to provide an update to the Sunset Commission on the implementation of this recommendation by February 1, 2021, instead of December 1, 2020. Also direct TRS to review the TRS-Care Retirees Advisory Committee and make any changes needed to more effectively receive feedback from retirees on TRS-Care. (Management action – nonstatutory)

As a statutory change, require the TRS Board of Trustees to appoint an ombudsman to monitor the agency's interactions with active and retired members; investigate, escalate, and report to the board on member complaints; and recommend changes to agency operations that would benefit members and increase their input into agency decisions.

## ISSUE 2 — Contract Management and Oversight

**Recommendation 2.1, Adopted** — Direct TRS to fully centralize contracting functions and clarify roles and responsibilities between central contracts department staff and division staff managing contracts. Direct TRS to report its progress on implementing this recommendation to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

**Recommendation 2.2, Adopted** — Direct TRS to enhance its contract monitoring process and report its progress on this recommendation to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

**Recommendation 2.3, Adopted** — Direct TRS to include standard remedies in contracts and consistently apply enforcement tools. Direct TRS to provide an update on the implementation of this recommendation to the Sunset Commission by February 1, 2021, instead of December 1, 2020. (Management action – nonstatutory)

**Recommendation 2.4, Adopted** — Direct TRS to require staff who procure or manage contracts to complete the comptroller's contract training and report to the Sunset Commission on its implementation of this recommendation by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

## ISSUE 3 — Investment Oversight and Transparency

**Recommendation 3.1, Adopted** — Direct TRS to perform a cost-benefit analysis of implementing an enhanced investment accounting system to provide increased oversight of the custodian bank's accounting data and report to the Sunset Commission on the estimated costs and benefits and the agency's recommended approach by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

**Recommendation 3.2, Adopted** — Direct TRS to have its Internal Investment Committee review internal investments and strategies. (Management action – nonstatutory)

**Recommendation 3.3, Adopted** — Direct TRS to include clear, easily understandable information about alternative investments in its Comprehensive Annual Financial Report and report on its status in implementing this recommendation to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

## ISSUE 4 — Governance and Organizational Best Practices

**Recommendation 4.1, Adopted** — Update the standard across-the-board requirement related to board member training.

**Recommendation 4.2, Adopted** — Abolish three, modify two, and consolidate two of TRS' reporting requirements.

As a management action, direct TRS to provide more comprehensive information on TRS-Care healthcare costs to the Legislature and the Texas Department of Insurance in the consolidated TRS-Care report, including out-of-pocket costs for retirees such as co-payments, deductibles, and non-covered services. Also direct TRS to provide information on incentive payments to TRS investment staff in its Comprehensive Annual Financial Report, including the method of calculating incentive pay and the amounts paid.

**Recommendation 4.3, Adopted** — Update TRS' statute to reflect the requirements of the person-first respectful language initiative if the changes would not impact TRS' ability to administer disability retirement benefits. Ultimately, statute was not updated because Texas Legislative Council determined a change could have a negative impact.

**Recommendation 4.4, Adopted** — Direct TRS to develop and maintain a system for receiving and responding to complaints. Direct the agency to adopt this system and report its progress to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

## NEW RECOMMENDATIONS ADDED BY THE SUNSET COMMISSION

**Employment after retirement reductions, Modified** — Specify that TRS members who retire after January 1, 2021, and exceed employment after retirement limitations are subject to a three-strikes system for any violations of the limitations. Require TRS to send a warning the first time a retiree violates employment after retirement limitations. For a subsequent violation, the retiree is subject to a dollar-for-dollar reduction. For any future violations, retirees lose their entire monthly annuity.

**Complaints information update, Adopted** — Update the standard across-the-board requirement related to developing and maintaining a complaints system and making information on complaint procedures available to the public. Specify agencies may not inform parties of the status of complaints if doing so would jeopardize an ongoing investigation.

## Provision Added by the Legislature

**Sunset review** — Specify TRS is subject to Sunset review, but not abolishment, again in 2033.

## Fiscal Implication Summary

Overall, the Sunset Commission's recommendations, including those enacted in House Bill 1585, will not have a fiscal impact to the state because TRS' operating expenses are not appropriated from general revenue. The recommendations could be implemented within TRS' existing resources and should not result in a cost to the pension trust fund.



# SUNSET COMMISSION DECISIONS

## Summary

The following material summarizes the Sunset Commission's decisions on the staff recommendations for the Teacher Retirement System of Texas (TRS), as well as modifications and new recommendations raised during the public hearing.

Unlike most state agencies Sunset reviews, TRS is constitutionally created and not subject to abolishment. The Sunset Commission therefore did not consider the question of the fundamental need for the agency. Instead, the Sunset Commission focused on whether TRS operates efficiently, effectively, and in the best interest of its 1.6 million members. The commission determined that TRS generally manages its \$157 billion trust fund well, but needs to focus more on its members, including improving communications to ensure members have the support and information needed to be secure in retirement. The commission also determined changes are needed to the agency's process for and information about appeals, and that reductions to certain retirees' benefits for exceeding employment after retirement limitations should be restructured to lessen the burden on members. TRS should also create an ombudsman position to investigate complaints and identify ways to increase input from members. Finally, TRS should report additional information about out-of-pocket costs for TRS-Care members and incentive payments to investment staff to increase transparency.

## ISSUE 1

### TRS Needs to Repair Its Relationship With Its Members by Focusing on Their Needs.

**Recommendation 1.1, Adopted as Modified** — Require TRS to develop a communication and outreach plan to better help members and employers plan for retirement. Also require TRS to respond to appeals at all levels of staff review within the same amount of time that members have to appeal agency decisions. Additionally, require TRS to create communication and engagement materials informing members of the existing option to request an external review of healthcare coverage appeals denied by third-party health plan administrators, and ensure members are aware they may work directly with TRS for assistance in navigating the appeals process.

**Recommendation 1.2, Adopted as Modified** — Require TRS to make improved efforts to return contributions to inactive members before funds are forfeit.

As a management action, direct TRS to develop a process to submit inactive member information to the comptroller's office upon request by the comptroller's office.

**Recommendation 1.3, Adopted as Modified** — Direct TRS to adopt a member engagement policy to increase transparency on key decisions by February 1, 2021, rather than September 1, 2020. In addition, direct TRS to provide an update to the Sunset Commission on the implementation of this recommendation by February 1, 2021, instead of December 1, 2020. Also direct TRS to review the TRS-Care Retirees Advisory Committee and make any changes needed to more effectively receive feedback from retirees on TRS-Care. (Management action – nonstatutory)

As a statutory change, require the TRS Board of Trustees to appoint an ombudsman to monitor the agency's interactions with members; investigate, escalate, and report to the board on member complaints; and recommend changes to agency operations that would benefit members and increase their input into agency decisions.

## ISSUE 2

### TRS Needs More Effective Contract Management and Oversight.

**Recommendation 2.1, Adopted as Modified** — Direct TRS to fully centralize contracting functions and clarify roles and responsibilities between central contracts department staff and division staff managing contracts. Direct TRS to report its progress on implementing this recommendation to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

**Recommendation 2.2, Adopted as Modified** — Direct TRS to enhance its contract monitoring process and report its progress on this recommendation to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

**Recommendation 2.3, Adopted as Modified** — Direct TRS to include standard remedies in contracts and consistently apply enforcement tools. Direct TRS to provide an update on the implementation of this recommendation to the Sunset Commission by February 1, 2021, instead of December 1, 2020. (Management action – nonstatutory)

**Recommendation 2.4, Adopted as Modified** — Direct TRS to require staff who procure or manage contracts to complete the comptroller's contract training and report to the Sunset Commission on its implementation of this recommendation by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

## ISSUE 3

### As One of the Largest Public Pension Funds in the U.S., TRS Would Benefit From Additional Oversight and Greater Transparency of Its Investment Practices.

**Recommendation 3.1, Adopted as Modified** — Direct TRS to perform a cost-benefit analysis of implementing an enhanced investment accounting system to provide increased oversight of the custodian bank's accounting data and report to the Sunset Commission on the estimated costs and benefits and the agency's recommended approach by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

**Recommendation 3.2, Adopted** — Direct TRS to have its Internal Investment Committee review internal investments and strategies. (Management action – nonstatutory)

**Recommendation 3.3, Adopted as Modified** — Direct TRS to include clear, easily understandable information about alternative investments in its *Comprehensive Annual Financial Report* and report on its status in implementing this recommendation to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

## ISSUE 4

### TRS' Statutes Do Not Reflect Some Standard Elements of Sunset Reviews.

**Recommendation 4.1, Adopted** — Update the standard across-the-board requirement related to board member training.

**Recommendation 4.2, Adopted as Modified** — Abolish three, modify two, and consolidate two of TRS' reporting requirements.

As a management action, direct TRS to provide more comprehensive information on TRS-Care healthcare costs to the Legislature and the Texas Department of Insurance in the consolidated TRS-Care report, including out-of-pocket costs for retirees such as co-payments, deductibles, and non-covered services. Also direct TRS to provide information on incentive payments to TRS investment staff in its *Comprehensive Annual Financial Report*, including the method of calculating incentive pay and the amounts paid.

**Recommendation 4.3, Adopted** — Update TRS' statute to reflect the requirements of the person-first respectful language initiative.

**Recommendation 4.4, Adopted as Modified** — Direct TRS to develop and maintain a system for receiving and responding to complaints. Direct the agency to adopt this system and report its progress to the Sunset Commission by February 1, 2021, rather than December 1, 2020. (Management action – nonstatutory)

## ADOPTED NEW RECOMMENDATIONS

### Employment After Retirement Reductions

Specify that TRS members who retire after January 1, 2011, and exceed employment after retirement limitations are subject to either a dollar-for-dollar reduction in their monthly annuity or forfeiture of their full monthly annuity, whichever is less. The dollar-for-dollar reduction does not apply if a disability retiree exceeds the 90-day limit for a school year, unless other existing exceptions for disability retirees apply.

### Complaints Information Update

Update the standard across-the-board requirement related to developing and maintaining a complaints system and making information on complaint procedures available to the public. Specify agencies may not inform parties of the status of complaints if doing so would jeopardize an ongoing investigation.

## Fiscal Implication Summary

Overall, the Sunset Commission's recommendations would not have a fiscal impact to the state, because TRS' operating expenses are not appropriated from general revenue. Most recommendations could be accomplished within TRS' existing resources and should not result in a significant cost to the pension trust fund.

The recommendation to create an ombudsman position could have a fiscal impact to the pension trust fund if TRS needs to hire an additional employee to serve as ombudsman, which cannot be predicted at this time.

The recommendations to centralize the agency's contracting functions and increase contract monitoring could result in some additional operating expenses. TRS is currently hiring additional contract management staff, and these recommendations would not require expanding that effort.

The recommendation to centrally track and report on complaints could result in a cost to the agency, but the cost would depend on how TRS chooses to implement a complaint tracking system and cannot be estimated at this time.

The new recommendation regarding employment after retirement reductions could have a fiscal impact to the pension trust fund, but the impact would depend on the number of members affected and their annuity amounts, and therefore cannot be estimated.

# SUMMARY OF SUNSET STAFF REPORT

The Sunset review of the Teacher Retirement System of Texas (TRS) took place during a controversial period for the agency, with significant attention surrounding TRS' decision to lease office space for its investment staff in a new, expensive building in downtown Austin. While TRS changed course on this decision in February 2020, the agency's lack of transparency in making the initial decision highlighted growing mistrust from its members and some legislators. This controversy followed a successful legislative session for TRS and its members in 2019, with the Legislature increasing contribution levels and authorizing a one-time supplemental payment for retirees.

Unlike most state agencies Sunset reviews, TRS is constitutionally created and not subject to abolishment. The Sunset review therefore did not consider the question of the fundamental need for the agency, but instead whether TRS operates efficiently, effectively, and in the best interest of its members. TRS' 1.6 million members span a broad range of Texas teachers and other public education staff, who depend on TRS to ensure they can retire securely. While TRS has a critical fiduciary duty to manage the \$157 billion trust fund in the best interest of its members, the agency also has an important responsibility to ensure its members have the support and information needed to be secure in retirement.

TRS has an important responsibility to ensure members have the support needed to be secure in retirement.

TRS' benefit counseling options do not meet members' needs, with limited member-specific information available by phone and unequal access to in-person counseling for members throughout the state, most of whom must travel to Austin for one-on-one retirement sessions. TRS also does not provide enough member-friendly financial planning information to ensure members understand what they need to prepare for retirement, such as the importance of additional savings beyond their TRS pension benefits.

As a state agency with a large and sophisticated investment program, TRS is in a unique and precarious position. TRS' status as a major institutional investor affords the agency significant respect and deference in the investment arena, but the billions TRS manages ultimately belong to the members it serves. With one foot in the high-powered investment world and the other in the more modest public arena, TRS struggles to find the balance between managing the pension fund appropriately while serving its members and conducting itself as a judicious state agency. In addition to needing to focus more on its members, the review also found that, as a large, public investor, TRS needs greater transparency and oversight for its investment functions. Additionally, TRS manages about \$2.5 billion in active contracts, but lacks the centralized structure and contract management tools needed to ensure the agency gets what it pays for. In particular, TRS has struggled to enforce a major contract for an information technology system overhaul, which the agency ultimately terminated during this review, assuming completion of the project itself.

The following material highlights Sunset staff's key recommendations for the Teacher Retirement System of Texas.

## Sunset Staff Issues and Recommendations

### ISSUE 1

#### TRS Needs to Repair Its Relationship With Its Members by Focusing on Their Needs.

TRS has an important fiduciary responsibility to act in the best interest of its 1.6 million members, which includes both ensuring the pension trust fund is sound and also helping members make important retirement decisions. However, TRS has not provided the information and support its members need to be secure in retirement, with overly complex explanations, insufficient retirement information, and inadequate counseling options. Additionally, TRS does not provide employers the resources they need to assist TRS members who often come to them with questions about their benefits. Overall, TRS' recent actions and questionable decisions have made members uncertain of whether TRS is acting in their best interest or its own.

#### Key Recommendations

- Require TRS to develop a communication and outreach plan to better help members and employers plan for retirement.
- Require TRS to make improved efforts to return contributions to inactive members before funds are forfeit.
- Direct TRS to adopt a member engagement policy to increase transparency on key decisions.

### ISSUE 2

#### TRS Needs More Effective Contract Management and Oversight.

To carry out its mission to provide benefits to its members, TRS has nearly \$2.5 billion in active contracts. Sunset staff found several TRS contracting and procurement procedures do not align with best practices, limiting the agency's ability to oversee and manage contracts effectively. While TRS has begun making improvements to its contracting and procurement processes, the agency needs to address a lack of centralization, poor performance monitoring, ineffective use of contract remedies, and insufficient contract training.

#### Key Recommendations

- Direct TRS to fully centralize contracting functions and clarify roles and responsibilities between central contracts department staff and division staff managing contracts.
- Direct TRS to enhance its contract monitoring process and require staff who procure or manage contracts to complete the comptroller's contract training.

- Direct TRS to include standard remedies in contracts and consistently apply enforcement tools.

## ISSUE 3

### As One of the Largest Public Pension Funds in the U.S., TRS Would Benefit From Additional Oversight and Greater Transparency of Its Investment Practices.

TRS manages a trust fund valued at more than \$157 billion and uses investment income to help pay for members' benefits. TRS contracts with a custodian bank to hold fund assets, settle transactions, and perform investment reporting and accounting for the agency. Sunset staff found TRS could reduce risks in its investment accounting by using a fully independent or automated system to better identify accounting inconsistencies. Sunset staff also found the agency lacks a formalized process for reviewing internal investments. Finally, TRS does not provide stakeholder-friendly information about alternative investments in its *Comprehensive Annual Financial Report*.

#### Key Recommendations

- Direct TRS to perform a cost-benefit analysis of implementing an enhanced investment accounting system to provide increased oversight of the custodian bank's accounting data.
- Direct TRS to have its Internal Investment Committee review internal investments and strategies.
- Direct TRS to include clear, easily understandable information about alternative investments in its *Comprehensive Annual Financial Report*.

## ISSUE 4

### TRS' Statutes Do Not Reflect Some Standard Elements of Sunset Reviews.

Among the standard elements considered in a Sunset review are across-the-board recommendations that reflect criteria in the Sunset Act designed to ensure open, responsive, and effective government. TRS' statute does not contain updated requirements for board member training, such as a training manual and discussion of the board's rulemaking authority. While TRS' governing statutes contain standard language requiring the agency to maintain complaint information, TRS has not developed an agencywide process to track and resolve complaints.

#### Key Recommendations

- Update the standard across-the-board requirement related to board member training.
- Direct TRS to develop and maintain an agencywide system for receiving and responding to complaints.

## Fiscal Implication Summary

Overall, the recommendations in this report would not have a fiscal impact to the state because TRS' operating expenses are not appropriated from general revenue. Most recommendations could be

accomplished within TRS' existing resources and should not result in a cost to the pension trust fund. Some recommendations that could have minimal impacts to TRS are discussed below.

**Issue 2** — Centralizing the agency's contracting functions and increasing contract monitoring could result in some additional operating expenses. TRS is currently hiring additional contract management staff, and these recommendations would not require expanding that effort.

**Issue 4** — The recommendation to centrally track and report on complaints could result in a cost to the agency, but the cost would depend on how TRS chooses to implement a complaint tracking system and cannot be estimated at this time.

# TRS AT A GLANCE

Created in 1936, the Teacher Retirement System of Texas (TRS) is a trust fund that provides retirement and health benefits to more than 1.6 million members, including active and retired Texas teachers, public education support staff, certain higher education professionals, and their dependents. TRS' mission is to improve the retirement security of its members by prudently investing and managing the trust fund's assets and delivering benefits to members. To fulfill this mission, TRS carries out the following key activities:

- Administers retirement benefits, such as annuity payments and survivor benefits, to pension plan participants and their beneficiaries.
- Oversees healthcare programs for retired and active members, and a voluntary long-term care insurance program.
- Manages and invests a pension trust fund and two trust funds for health care.

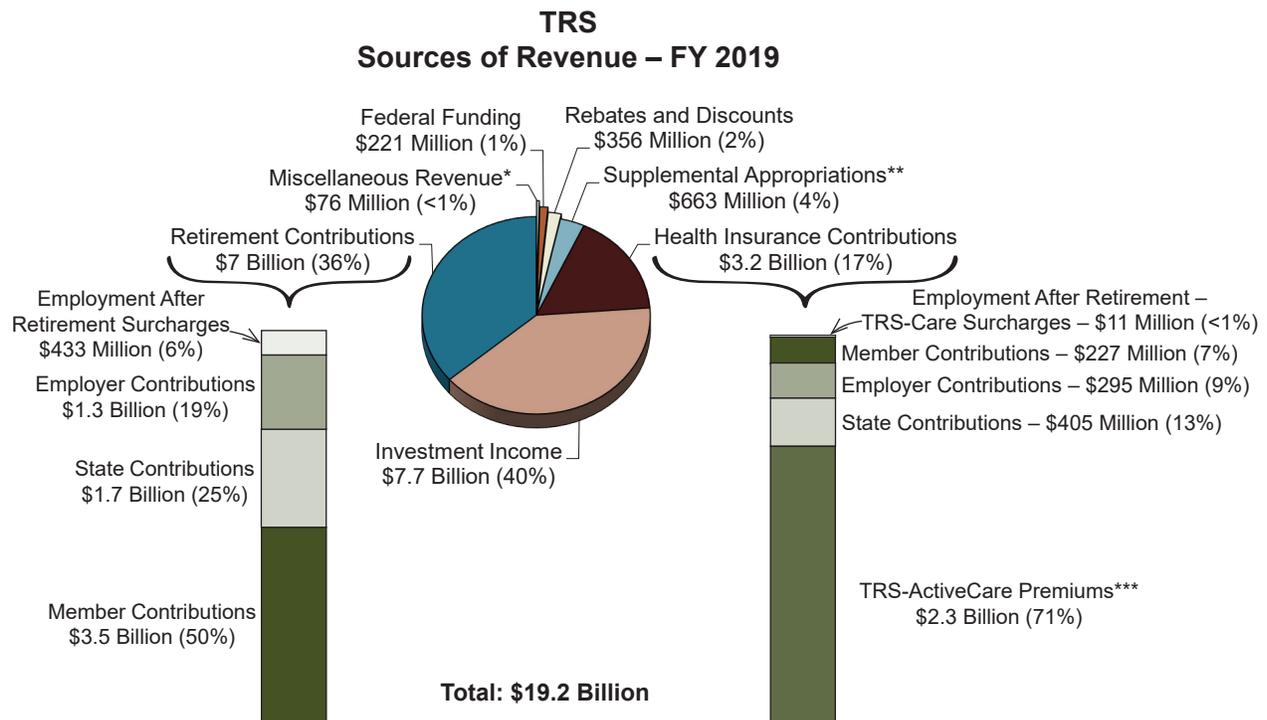
## Key Facts

- **Board of trustees.** The TRS Board of Trustees is comprised of nine members responsible for the general administration and operation of the agency. Statute specifies membership requirements, with the governor directly appointing three trustees and appointing six others nominated by the State Board of Education (SBOE) or TRS members.<sup>1</sup> Trustees serve staggered, six-year terms and must meet various qualifications, detailed in the table, *TRS Board of Trustees*.

**TRS Board of Trustees**

Name	Qualification	Method of Appointment	Term Expires
Jarvis V. Hollingsworth, Chairman	Financial Expertise	Direct appointment by Governor	2023
Nanette Sissney, Vice Chairwoman	Active TRS Member	Nominated by retired and public school employee TRS members, appointed by Governor	2023
Michael Ball	Active TRS Member	Nominated by public school employee TRS members, appointed by Governor	2025
David Corpus	Financial Expertise	Nominated by SBOE, appointed by Governor	2025
John Elliott	Financial Expertise	Direct appointment by Governor	2021
Greg Gibson, Ed.D.	Active TRS Member	Nominated by public school employee TRS members, appointed by Governor	2021
Christopher Moss	Financial Expertise	Nominated by SBOE, appointed by Governor	2021
James Dick Nance	Retired TRS Member	Nominated by retired TRS members, appointed by Governor	2023
Robert H. Walls, Jr.	Financial Expertise	Direct appointment by Governor	2025

- Funding.** In fiscal year 2019, about half of TRS’ funding came from state, employer, and member contributions, and investment income made up about 40 percent of the funding. In 2019, the Legislature issued a one-time supplemental appropriation and increased contribution rates for the following six fiscal years.<sup>2</sup> The chart, *TRS Sources of Revenue*, provides more detail on the agency’s methods of finance. Appendix A describes the agency’s use of historically underutilized businesses in purchasing goods and services for fiscal years 2017–19.

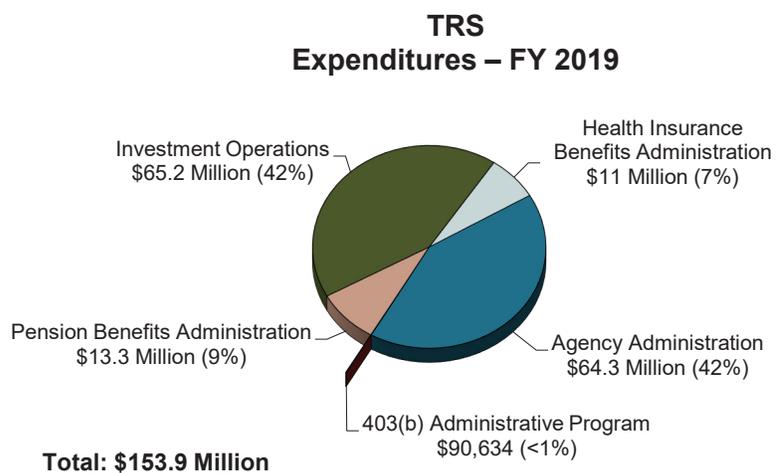


\* Service credit purchases and state contributions for TRS members with salaries above a certain level dictated by federal law.

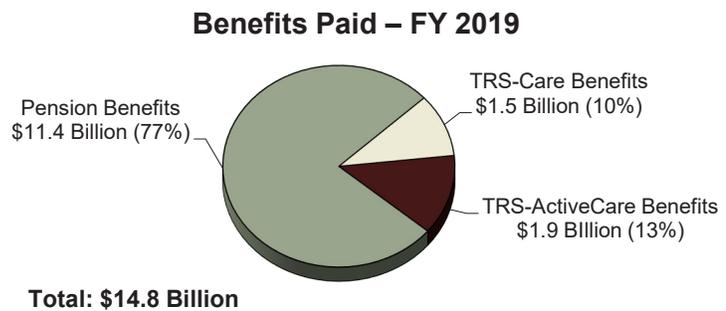
\*\* Includes \$589 million for a one-time supplemental payment to retirees and about \$73 million for TRS-Care.

\*\*\* The state, employers, and TRS members contribute to TRS-ActiveCare through the school finance formulas.

The chart, *TRS Expenditures*, shows the agency’s administration expenditures by program, and the chart on the following page, *Benefits Paid*, shows the amount TRS paid for pension benefits and healthcare claims in fiscal year 2019. All together, TRS spent just over \$15 billion total in fiscal year 2019. Additional revenue, in excess of operating costs and benefits paid, is deposited in the pension trust fund and invested to reduce unfunded liabilities and pay member benefits in future years. Appendix B provides more detailed information on revenues and expenditures for the pension trust fund and the TRS-Care and TRS-ActiveCare funds.



- **Staffing.** In fiscal year 2019, TRS employed 693 staff at two locations in downtown Austin and four investment staff at a foreign subsidiary office in London, England. TRS also contracted for 79 additional staff to assist with a major IT system upgrade. Appendix C compares the agency's workforce composition to the percentage of minorities in the statewide civilian workforce for the past three fiscal years.



- **Membership.** TRS' membership is comprised of employees from public educational institutions, including school districts, open-enrollment charter schools, and education service centers, and certain employees of institutions of higher education.<sup>3</sup> These employees include educators, administrators, and auxiliary staff, such as bus drivers and cafeteria workers. Certain higher education employees, including faculty and administrators, are also members of TRS, but can elect to participate in the Optional Retirement Program instead of TRS at the start of their employment.<sup>4</sup> In fiscal year 2019, TRS had nearly 1.2 million active members and about 434,000 retired members.
- **Retirement benefits.** TRS operates a defined benefit pension plan to guarantee benefits for public education employees upon retirement. Unlike for state employees, where the state of Texas is both the employer and administrator of the retirement system, TRS is only the administrator of the retirement system. TRS enrolls members, collects payroll information from employers, offers benefit counseling, and pays out monthly annuities. In fiscal year 2019, TRS paid a total of \$11.4 billion in annuities to retirees and their beneficiaries.
- **Health insurance benefits.** TRS administers health insurance benefits for its members through three different programs. Public school retirees and dependents who are ineligible for state employee or state higher education health benefits may receive benefits through TRS-Care. In 2001, the Legislature established TRS-ActiveCare to provide health benefits for active employees of participating public education employers, particularly in school districts with fewer than 500 employees.<sup>5</sup> That year, the Legislature also granted larger employers a one-time opportunity to opt in to TRS-ActiveCare coverage.<sup>6</sup> Finally, TRS administers a voluntary long-term care insurance program for eligible members and their families. The table, *TRS Health Insurance Participants*, shows the number of members and employers participating in each TRS health insurance program in fiscal year 2019.

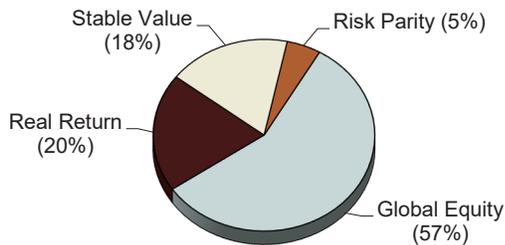
**TRS Health Insurance Participants – FY 2019**

Program	Members	Employers
TRS-Care	225,297	1,224
TRS-ActiveCare	475,739	1,088
Long-Term Care Insurance	7,402	—

- **Investment management.** TRS invests trust fund assets to maximize long-term benefits for members. In fiscal year 2019, TRS managed an investment portfolio valued at about \$157 billion.<sup>7</sup> TRS invests in a diverse set of asset classes, with the majority of funds invested in global equity, as shown in the chart on the following page, *Investment Asset Allocation*. The textbox on the following page, *Investment Asset Classes*, provides examples of each type of asset. In fiscal year 2019, TRS delivered a total investment return of about 5.2 percent. A fiscal year 2019 actuarial valuation of the pension

trust fund found the system to be actuarially sound, with a funding period of 29 years.<sup>8</sup> The funding period describes the estimated time, in years, the pension plan will need to pay off owed benefits and meet future benefit obligations.

**Investment Asset Allocation  
FY 2019**



**Investment Asset Classes**

- **Global Equity** – Stock shares in U.S. and foreign companies, both public and private
- **Real Return** – Investments in real estate, energy, natural resources, or infrastructure
- **Stable Value** – Bonds
- **Risk Parity** – Strategic mix of multiple public asset classes to manage risk

- **Customer service.** To help members navigate pension and health benefit options, TRS distributes brochures, newsletters, online videos, and other materials; hosts presentations and webinars; and provides one-on-one benefit counseling to members and beneficiaries. In fiscal year 2019, TRS handled more than 575,000 customer service calls and about 12,100 office visits, and gave about 120 pension and health benefit presentations.

<sup>1</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 825.002, Texas Government Code.

<sup>2</sup> Chapter 566 (S.B. 12), Acts of the 86th Texas Legislature, Regular Session, 2019. In 2019, the Legislature appropriated \$589 million to TRS to fund a one-time supplemental payment for eligible retirees and \$524 million to cover the increased state contribution rate for fiscal years 2020 and 2021.

<sup>3</sup> Section 822.001, Texas Government Code.

<sup>4</sup> Section 822.002(a)(1), Texas Government Code.

<sup>5</sup> Chapter 1187 (H.B. 3343), Acts of the 77th Texas Legislature, Regular Session, 2001.

<sup>6</sup> Section 1579.152, Texas Insurance Code.

<sup>7</sup> Teacher Retirement System of Texas, *2019 Comprehensive Annual Financial Report*, accessed February 25, 2020, [https://www.trs.texas.gov/TRS%20Documents/cafr\\_2019.pdf](https://www.trs.texas.gov/TRS%20Documents/cafr_2019.pdf), 7.

<sup>8</sup> GRS Retirement Consulting, *Teacher Retirement System of Texas Actuarial Report as of August 31, 2019*, accessed January 28, 2020, [https://www.trs.texas.gov/TRS%20Documents/actuarial\\_valuation\\_pension\\_fund\\_2019.pdf](https://www.trs.texas.gov/TRS%20Documents/actuarial_valuation_pension_fund_2019.pdf).

# ISSUE 1

## TRS Needs to Repair Its Relationship With Its Members by Focusing on Their Needs.

### Background

The Teacher Retirement System of Texas (TRS) administers the state retirement system for Texas teachers, public education support staff, and certain higher education employees. TRS' mission is to improve the retirement security of its members by prudently investing and managing trust assets and delivering benefits that make a positive difference in their lives. As the sixth largest public pension in the United States, managing a fund of more than \$157 billion, TRS has an important legal duty to act in the best interest of its members.<sup>1</sup>

TRS membership is comprised of more than 1.6 million active and retired teachers and other public education staff. These members place a high value on their retirement and health insurance benefits, which also help employers attract and retain quality talent to support education in Texas.<sup>2</sup> The textbox, *Typical TRS Members*, describes the average actively working TRS member and average retired member.

#### Typical TRS Members

##### Active Member

- 44 years old
- 10 years of service in public education
- Annual salary of about \$49,000

##### Retired Member

- 71 years old; most retire at age 60
- 24 years of service in public education
- Average monthly annuity is \$2,096

TRS assists members with their benefits through a call center, one-on-one counseling, benefit presentations, and information provided in emails, print, video, and on the TRS website. TRS also works closely with more than 1,300 employers, including public school districts, charter schools, institutions of higher education, and regional education service centers. These employers must report information to TRS, such as the hours employees worked and wages earned, which TRS uses to calculate retirement eligibility and account balances. These employers are also the first place many members go to for assistance with their TRS benefits, including health insurance enrollment and questions about their retirement.

### Findings

#### **TRS has not provided the information and support members need to adequately ensure they are secure in retirement.**

TRS has a critical fiduciary duty to ensure the TRS pension trust fund is sound and able to pay members' benefits, but the agency also has a fundamental responsibility to ensure its members have the information and support needed to make well-informed, life-changing decisions about their retirement. While TRS manages the pension trust fund well and has achieved mostly strong investment returns, the agency has not provided the same level of service to its members. TRS has identified benefit delivery and communication as areas for improvement in its current strategic plan, but it has yet to deliver on those goals.<sup>3</sup>

TRS manages the pension trust fund well, but has not provided the same level of service to its members.

- **Overly legalistic and complex explanations.** State law requires public retirement systems provide information in clear, plain terms understandable to a typical member.<sup>4</sup> Instead, TRS provides extremely lengthy and legalistic information members and employers struggle to interpret, resulting in frequent confusion. Active members in particular have reported difficulty understanding information provided by TRS, with just 40 percent of active members surveyed by TRS giving a favorable rating on the relevance and user-friendliness of retirement planning information.<sup>5</sup> While some members hire financial advisors or attorneys to guide them through the retirement process, not all TRS members can afford this assistance and must make difficult decisions on their own.

**TRS Benefit Explanations**

- **Employment after retirement:** “Remember, full time means more than one-half time and one-half time is limited to no more than the equivalent of four hours for each workday that month, including any paid leave that you use, or working more than half the number of workdays in that calendar month if you combine work under the substitute and one-half time exceptions in the same calendar month and including any paid leave that you use.”
- **Purchasing leave service credit:** “The cost to purchase credit for state sick and/or personal leave is the actuarial present value at the time of purchase of the increased benefits associated with the additional service credit. Generally, actuarial present value means that you will make payment sufficient to fund the cost of the increased benefits you will receive as a result of purchasing the additional credit.”

The textbox, *TRS Benefit Explanations*, provides two examples of the complicated information TRS provides members.<sup>6</sup> Throughout the Sunset review, TRS members and employers expressed significant frustration with TRS’ complex employment after retirement explanations. This convoluted information can lead to significant consequences for some members, such as retirees who return to work and lose their entire monthly annuity because they misunderstood TRS’ complicated guidance.

- **Missing key retirement information.** While members’ financial decisions are their own responsibility, TRS provides little meaningful assistance to help members understand their needs in retirement. While TRS cannot legally provide financial or legal advice to members, it should provide useful and understandable retirement planning information members need to make their own informed decisions.<sup>7</sup>

Insufficient financial planning information. Many retirement planners refer to the “three-legged stool” of retirement income, which includes a retiree’s pension, Social Security, and personal savings. Retirees need to carefully plan to ensure all three legs of the stool provide enough income to support them in retirement. However, not all three legs of the stool are guaranteed for TRS members, which can come as a surprise. In Texas, individual school districts decide whether to enroll their employees in Social Security, creating a patchwork of coverage. Additionally, federal provisions for state pension recipients may reduce Social Security benefits for eligible members or spouses.<sup>8</sup>

Other retirement systems, including the Employees Retirement System of Texas, California State Teachers’ Retirement System, and State Teachers Retirement System of Ohio emphasize retirement planning is a shared responsibility between members and the system, but TRS puts the burden of navigating the complex retirement system primarily on its members.

TRS puts the burden of navigating the complex retirement system primarily on its members.

Many TRS members report feeling like their relationship with TRS is an arms-length transaction rather than a shared undertaking. For example, in fiscal year 2017, TRS created an online video series on financial awareness topics, but the information is only available as YouTube videos. While this information is helpful, it is not presented in a format members prefer or find as useful as presentations, one-on-one counseling, and brochures, but it is one of the only ways TRS provides information about the financial implications of retirement decisions.

Limited early retirement planning information. TRS does not provide members personalized retirement estimates for the first five years of their career in public education. If those members contemplate career changes, they could be unaware of the long-term retirement benefits of staying a TRS member or the consequences leaving has on their retirement eligibility and potential annuity amount. After five years, members become vested in the system and receive an annual estimate of their retirement date and annuity. In fiscal year 2019, more than 37,000 members withdrew from TRS, including about 33,600 members with less than five years of membership who may not have fully understood the effects of their decision.

Unlike TRS, the Employees Retirement System of Texas sends all members an annual retirement statement with three personalized retirement scenarios beginning in their first year of employment, which show a member's projected monthly and lifetime annuity payments and eligibility for health insurance coverage, based on different retirement dates. The annual statement also includes information about members' monthly contributions, Social Security, and supplemental savings. These estimates allow state employees to understand the amount of pension benefits they could receive and additional income they need to plan for in retirement regardless of their years of service. Without this vital information, newer TRS members cannot plan ahead and may not see one of the greatest incentives to stay in public education. While TRS does not have access to information about members' other retirement income or savings outside the trust fund, the agency could provide general information on the importance of building a larger nest egg through additional savings.

- **Inadequate counseling services for members.** TRS struggles to provide adequate phone and in-person counseling to answer members' questions. The 2006 Sunset review of TRS identified similar problems and made recommendations to improve TRS counseling services, and while the agency has implemented some changes, TRS still fails to adequately address demand for improved customer service.<sup>9</sup> For example, as part of the previous Sunset review, the Legislature required TRS to create a benefit counseling policy, but the agency never did so.<sup>10</sup>

Untimely and ineffective phone counseling. Members contact TRS' call center for guidance with general benefit questions, but often fail to get timely answers. In fiscal year 2018, TRS answered just 15 percent of calls within three minutes, far short of its target 80 percent. While TRS'

Many TRS members report their relationship with TRS is an arms-length transaction, not a shared undertaking.

TRS has not adequately addressed customer service issues identified in the 2006 Sunset review.

Some TRS members must travel up to 16 hours to receive retirement counseling in Austin.

performance improved in fiscal year 2019, the agency still has not met its goal. Additionally, when TRS members are able to speak with a call center counselor, TRS policy prevents counselors from providing certain information over the phone, such as a member’s account balance or estimated retirement benefits, significantly limiting the usefulness of the call. While TRS members can use an online retirement benefit calculator to get an estimate, counselors cannot provide this same information by phone. TRS also offers dedicated retirement counseling sessions by phone to members with a retirement estimate, but could not document the number of these sessions.

Limited availability of in-person counseling. Members can obtain more comprehensive counseling in-person, but they must travel to Austin or wait for one of the rare counseling opportunities offered in other parts of the state. In fiscal year 2019, just 5 percent of in-person counseling sessions were conducted outside of Austin. As a result, members from West Texas or the Panhandle must travel up to 16 hours round trip to receive counseling in Austin. While TRS also offers remote counseling sessions by videoconference, this option is unpopular with members. Limited counseling options place the burden on members to get assistance from TRS to plan for retirement. TRS is currently exploring options to open small field offices outside of Austin to provide counseling, but the first would not open until 2021.

**TRS does not provide employers with the resources needed to best serve TRS members.**

Many times, employers, such as school districts and education service centers, are the first line of communication in helping TRS members with their benefits. TRS relies on employers to report employment and other information about active TRS members to them, and to relay information from TRS to active members about their benefits. However, TRS does not provide employers the resources needed to fully understand and explain member benefits.

Many employers report having to hire additional staff to fulfill TRS’ complex reporting requirements.

- **Flawed reporting system.** TRS launched a new employer reporting system in 2017 that has been plagued with numerous problems from the onset. Many employers have reported having to hire additional staff to accommodate enhanced reporting requirements and numerous defects that necessitate manual workarounds before employers can submit payroll information to TRS. Employers also report spending hours each month submitting error resolution emails to TRS to resolve hundreds of errors in payroll reporting. TRS provides a payroll manual and updated lists of defects and workarounds, but employers report this information is lengthy, not user-friendly, and does not provide the tools needed to enter data effectively. Employers told Sunset staff they would prefer step-by-step instructions, training on how to handle different reporting scenarios, and tips on how to troubleshoot typical problems. TRS has created an Employer Advisory Group to share feedback on the system, but employers remain frustrated with the system’s challenges three years after its debut.

- **Limited information and training.** Employers also indicated to Sunset staff they need more information on health and retirement benefits to help better educate members. Employers are frequently approached by members with retirement questions, but do not always have the knowledge or resources needed to respond correctly or effectively. Additionally, TRS' health insurance plans change frequently, and even though employers receive some training from the vendor, they continue to have trouble figuring out and communicating healthcare changes to TRS members. TRS plans to launch a toolkit for school districts with information on health benefits, but has not yet developed this resource. Other retirement systems, including the Employees Retirement System of Texas, offer benefit coordinator portals with information to help employers educate members on their benefits. The textbox, *Examples of Employer Resources*, lists some tools other retirement systems offer for employers that TRS does not.
- **Poor responsiveness.** When employers need help from TRS on reporting issues or assisting members with benefit questions, they do not receive quick responses from TRS staff. Employers generally gave Sunset staff positive feedback on the quality of assistance TRS provides, but noted wait times are excessive, particularly given the tight deadlines TRS imposes on employers for submitting reports. Employers also expressed difficulty communicating questions to TRS by email due to problems with a secure system for online messaging. The challenges employers have experienced with the new reporting system, coupled with slow response times, have led to significant dissatisfaction among employers. The textbox, *Employer Feedback on TRS Assistance*, provides examples of responses TRS received to a recent survey.<sup>11</sup>

### Examples of Employer Resources

- Forum for employers to ask questions, share answers, and interact with system staff
- Advance notification of member communications
- Benefit guides targeted to specific employer types
- Information on employer roles and responsibilities

### Employer Feedback on TRS Assistance

“TRS needs to make itself available to [employers]. That is my biggest complaint. This system is difficult enough to use, and we have to come in and do reporting while the district is closed in order to meet the deadline. When you have a problem and have nobody to call for help, you are out on a limb.”

“We need to go back to the TRS phone line being answered by a person that can assist us. Currently the ONLY person you can talk with is your consultant. We send email upon emails waiting to discuss an issue with our consultant.”

## TRS' recent actions and decisions show a disregard for members' interests.

TRS has lost sight of its stated vision to earn its members' trust every day. To retired members living on an average annuity of about \$2,100 per month and active teachers earning an average of \$49,000 a year, TRS' actions seem to prioritize its own interests over members'. Some TRS members conveyed to Sunset staff that TRS' inadequate customer service, together with the agency's lack of transparency, leaves members feeling TRS is not looking out for their best interests.

- **Unreturned member contributions.** State law requires TRS to return contributions to members who are inactive for more than seven years even if members have not requested this money.<sup>12</sup> However, TRS puts the onus

on members to apply for these funds without making a concerted effort to reach them. TRS is also noncompliant with the statutory requirement to submit inactive members' information to the comptroller's office to be included in the statewide database that allows Texans to identify and access

**Forfeited Member Contributions**

Fiscal Year	Members	Total Dollar Value Forfeited
2015	8,807	\$20,694,744
2016	8,598	\$24,144,025
2017	10,439	\$31,976,811
2018	11,477	\$33,234,473
2019	12,410	\$32,435,421
<b>Total</b>	<b>51,731</b>	<b>\$142,485,474</b>

unclaimed property.<sup>13</sup> Each year, thousands of members' contributions are forfeited to the pension trust fund, and in the last five fiscal years, members unintentionally forfeited more than \$142 million to the fund, as shown in the table, *Forfeited Member Contributions*.

TRS is unable to comply with state law because of a federal requirement for pension plans to allow members to choose whether to roll over contributions into a different retirement account or accept a payout with a tax penalty.<sup>14</sup> However, TRS does not take additional steps to contact missing members as recommended by the federal government, such as by using certified mail,

internet searches, or credit reporting agencies.<sup>15</sup> TRS has a duty to all members, including those who cease working in the Texas public education system and may not be aware of their inactive retirement accounts. Instead of proactively attempting to return these contributions to members, TRS merely sends members a refund application to complete before their account becomes inactive. Members can still apply for a refund after their accounts are forfeited to the pension fund, but may not know this money is available; in fiscal year 2019, just 1,316 members received such a refund. TRS owes its members the same level of dedication when handling members' money as it provides to managing the pension trust fund.

TRS' decision to lease high-dollar office space in a new, premium building in downtown Austin caught members and legislators off guard.

- **Questionable decisions.** TRS' recent decision to lease high-dollar office space in a new, premium building in downtown Austin to house its investment staff caught TRS members, legislators, and other key stakeholders off guard.<sup>16</sup> After considerable pressure on the agency, the TRS board changed course in February 2020, and voted unanimously to instead seek an extension of the agency's existing lease at a less expensive rate and sublet the newer, more costly space. While this change may alleviate members' immediate concerns about TRS' operating costs, the optics and lack of transparency around the initial decision have led to significant skepticism among some members about whether TRS is a good steward of their contributions. These concerns could continue, as TRS is currently exploring options for relocating its agency headquarters and was, but no longer is, considering opening an additional investment office in Singapore.<sup>17</sup>

TRS has a history of poor decision making. In the past, similar decisions by TRS raised concerns about its spending on operations and a lack of transparency and openness. The 1995 Sunset review of TRS found the agency's operating expenses had ballooned and office space was used inefficiently.<sup>18</sup> In an effort to control TRS' spending since that review, the Legislature began appropriating TRS' operating expenses, although the TRS Board of Trustees has the authority to approve the use of additional

pension trust funds to supplement its operations costs. While the next Sunset review of TRS in 2006 found the agency had resolved some of the prior concerns, more recently TRS once again eroded the trust of its members, stakeholders, and the Legislature.<sup>19</sup> After a successful legislative session for teachers and other TRS members in 2019, legislators have indicated TRS' mishandling of the lease agreement could diminish the strides the Legislature made to help ensure the stability of the pension trust fund.<sup>20</sup>

## Sunset Staff Recommendations

### *Change in Statute*

#### **1.1 Require TRS to develop a communication and outreach plan to better help members and employers plan for retirement.**

Under this recommendation, TRS would be required to create a communication and outreach plan to improve the information it provides to members and employers, and ensure materials are user-friendly and easy to understand, as directed by state law. TRS could develop this plan in concert with the agency's existing strategic planning initiatives on communication, and should look to resources for members and employers developed by other retirement systems, such as the Employees Retirement System of Texas. In developing this plan, TRS should:

- Involve members, employers, and other stakeholders in developing the plan, including, but not limited to, surveys of members and employers and input from the Employer Advisory Group.
- Offer additional options for receiving counseling by phone or in-person at different locations outside of Austin.
- Update TRS materials such as the benefits handbook, employment after retirement brochure, and benefits presentation.
- Provide retirement estimates for all members, not just those who have vested.
- Enhance training for employers and create a portal that focuses on assistance with not just reporting, but also on other aspects of employers' work with TRS and members, such as counseling employees about employment after retirement, benefits for retirees, and health insurance enrollment.

TRS would be required to develop the plan by September 1, 2021, and present it to the board for approval at the September 2021 board meeting, with an expected implementation date of December 1, 2021. TRS should review and update the plan every five years. This recommendation would replace the existing statutory requirement for TRS to develop a benefit counseling policy. This recommendation would help ensure members and employers receive the information they need from TRS to make informed retirement decisions.

#### **1.2 Require TRS to make improved efforts to return contributions to inactive members before funds are forfeit.**

This recommendation would modify statute to require TRS take specific steps to contact inactive members to return their contributions, rather than merely sending them an application for a refund. For members inactive for more than seven years, TRS should, at a minimum, use certified mailings and Internet searches to locate members whose contributions have been forfeited to the pension trust fund.

TRS should also develop a policy specifying when the agency should make additional efforts, such as using credit reporting agencies, commercial locating services, or contacting a member's designated beneficiaries. In implementing this recommendation, TRS should determine any additional changes needed to better capture member and beneficiary contact information before members become inactive, and other ways to better communicate with inactive members about their contributions.

As a related management action, TRS would be directed to submit the required report on inactive members to the comptroller's office, including members whose contributions are currently treated as forfeit, and publish a link to the unclaimed property database on the TRS website. This would help ensure the members TRS cannot contact have an ongoing opportunity to claim their contributions. TRS would be required to provide the Sunset Commission an update on the implementation of this recommendation by December 1, 2020.

### ***Management Action***

#### **1.3 Direct TRS to adopt a member engagement policy to increase transparency on key decisions.**

This recommendation would direct TRS to establish a policy to better engage members, particularly when making major changes that could create an appearance of using the pension trust fund to benefit the agency over its members. For example, TRS should ensure members are updated as the agency explores building a new headquarters in Austin and establishing satellite locations, and on the recent change to the agency's facility plan for investment staff working in downtown Austin. In developing a member engagement policy, TRS should consider opportunities to host regular town hall meetings throughout Texas to engage more members on key issues. TRS should develop this plan by September 1, 2020, and provide the Sunset Commission an update on the implementation of this recommendation no later than December 1, 2020.

### **Fiscal Implication**

These recommendations would not have a fiscal impact to the state because TRS' operating expenses are not appropriated from general revenue. The recommendations could be accomplished within TRS' existing resources and should not result in a cost to the pension trust fund.

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- <sup>1</sup> Teacher Retirement System of Texas, *2019 Comprehensive Annual Financial Report*, accessed February 25, 2020, [https://www.trs.texas.gov/TRS%20Documents/cafr\\_2019.pdf](https://www.trs.texas.gov/TRS%20Documents/cafr_2019.pdf), 7. All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 825.101, Texas Government Code.
- <sup>2</sup> National Institute on Retirement Security, *State and Local Employee Views on Their Jobs, Pay and Benefits*, accessed November 12, 2019, [https://www.nirsonline.org/wp-content/uploads/2019/11/NIRS\\_OR\\_PublicEmployee2019\\_FINAL-1.pdf](https://www.nirsonline.org/wp-content/uploads/2019/11/NIRS_OR_PublicEmployee2019_FINAL-1.pdf).
- <sup>3</sup> Teacher Retirement System of Texas, *Strategic Plan FY 2019–FY 2023*, accessed March 4, 2020, [https://www.trs.texas.gov/TRS%20Documents/strategic\\_plan\\_2019\\_2023.pdf](https://www.trs.texas.gov/TRS%20Documents/strategic_plan_2019_2023.pdf).
- <sup>4</sup> Section 802.106(g), Texas Government Code.
- <sup>5</sup> Texas A&M University Public Policy Research Institute, *Teacher Retirement System of Texas 2019 Member Satisfaction Survey*, accessed February 19, 2020, [https://www.trs.texas.gov/TRS%20Documents/member\\_satisfaction\\_survey\\_2019.pdf](https://www.trs.texas.gov/TRS%20Documents/member_satisfaction_survey_2019.pdf), 39.
- <sup>6</sup> Teacher Retirement System of Texas, *EAR: Employment After Retirement* (January 2017), [https://www.trs.texas.gov/TRS%20Documents/employment\\_after\\_retirement.pdf](https://www.trs.texas.gov/TRS%20Documents/employment_after_retirement.pdf), 19; Teacher Retirement System of Texas, *TRS Benefits Handbook* (January 2018), [https://www.trs.texas.gov/TRS%20Documents/benefits\\_handbook.pdf](https://www.trs.texas.gov/TRS%20Documents/benefits_handbook.pdf), 20.
- <sup>7</sup> Section 825.601, Texas Government Code.
- <sup>8</sup> 42 U.S.C. Section 415(a)(7); 20 C.F.R. Section 404.408a.
- <sup>9</sup> Sunset Advisory Commission, *Teacher Retirement System of Texas Staff Report April 2006*, <https://www.sunset.texas.gov/public/uploads/files/reports/Teacher%20Retirement%20System%20Staff%20Report%202007%2080%20Leg.pdf>, 11–16.
- <sup>10</sup> Section 825.601, Texas Government Code.
- <sup>11</sup> Texas A&M University Public Policy Research Institute, *Teacher Retirement System of Texas 2019 Reporting Entity Partner Satisfaction Survey*, accessed February 20, 2020, [https://www.trs.texas.gov/TRS%20Documents/re\\_partner\\_satisfaction\\_survey.pdf](https://www.trs.texas.gov/TRS%20Documents/re_partner_satisfaction_survey.pdf), 5, 15.
- <sup>12</sup> Section 825.502, Texas Government Code.
- <sup>13</sup> Section 821.010, Texas Government Code.
- <sup>14</sup> 26 U.S.C. Section 401(a)(31); Section 825.509, Texas Government Code.
- <sup>15</sup> Internal Revenue Service, *Internal Revenue Bulletin: 2019–19*, May 6, 2019, accessed March 16, 2020, [https://www.irs.gov/irb/2019-19\\_IRB](https://www.irs.gov/irb/2019-19_IRB).
- <sup>16</sup> Texas Senate Finance Committee, 86th Session Interim Hearing, February 25, 2020; Texas House Pensions, Investments, and Financial Services Committee, 86th Session Interim Hearing, March 9, 2020; Anthony Cave, “Teacher Retirement System of Texas to Spend at Least \$326K a Month in Rent,” *KXAN*, January 17, 2020, <https://www.kxan.com/news/education/teacher-retirement-system-of-texas-to-spend-at-least-326k-a-month-in-rent/>; Bob Sechler, “Retired Teachers ‘Shocked’ by TRS Rent,” *Austin American-Statesman*, January 28, 2020, <https://www.statesman.com/business/20200128/retired-teachers-group-director-says-members-shocked-by-trs-rent>.
- <sup>17</sup> TRS has publicly discussed opening an additional foreign office in Singapore since 2018, most recently at the September 2019 TRS Board of Trustees meeting. In March 2020, TRS leadership indicated to Sunset staff the agency would not be moving forward with opening this office.
- <sup>18</sup> Sunset Advisory Commission, *Staff Report on the Teacher Retirement System of Texas (1994)*, <https://www.sunset.texas.gov/public/uploads/files/reports/Teacher%20Retirement%20System%20staff%20report%201995%2074%20leg.pdf>.
- <sup>19</sup> Sunset Advisory Commission, *Teacher Retirement System of Texas Staff Report (April 2006)*.
- <sup>20</sup> Bob Sechler, “Lawmakers skewer TRS over Indeed Tower lease plan,” *Austin American-Statesman*, February 25, 2020, <https://www.statesman.com/business/20200225/lawmakers-skewer-trs-over-indeed-tower-lease-plan>.



## ISSUE 2

# TRS Needs More Effective Contract Management and Oversight.

### Background

To carry out its mission to provide retirement and health benefits to its members, the Teacher Retirement System of Texas (TRS) spends a significant amount on contracts for health benefits, investment services, information technology (IT), and other goods and services. Currently, TRS has nearly \$2.5 billion in active contracts, including about \$1.9 billion for health benefits; \$236 million for investment services and consultants; and \$98 million for IT.

TRS relies on a central contracts department that recently increased to 17 staff to assist other divisions with procurement and coordinate agency contracting processes. Each division plans for procurement, evaluates responses, and manages contracts in coordination with the central contracts department. In fiscal year 2018, TRS conducted an internal audit that identified weaknesses in the agency's contracting process, including a failure to follow agency procurement policies and to ensure all contracts were coordinated with the central contracts department. TRS has begun addressing these issues, including hiring a consultant to help the agency develop a plan to improve its procurement processes and working to improve training and communication, IT applications, and administrative functions related to contracting.

While the Legislature has historically exempted TRS from many state contracting requirements, in fiscal year 2019, the Legislature repealed some of these statutory exemptions and extended new state contracting requirements to TRS through Senate Bill 65.<sup>1</sup> The textbox, *Changes to TRS Contracting*, summarizes some of TRS' new contracting requirements. TRS is currently implementing risk assessment and vendor performance reporting processes to comply with the statutory changes.

#### Changes to TRS Contracting

- The state's Contract Advisory Team may monitor TRS contracts over \$5 million.
- TRS must evaluate and report vendor performance to the comptroller at least once a year for contracts over \$5 million.
- TRS must document decisions whether to include liquidated damages in new contracts.
- Vendors may not transfer the rights of a services contract to a third party without TRS approval.

### Finding

**Several TRS contracting and procurement procedures do not align with best practices, limiting the agency's ability to oversee and manage contracts effectively.**

When evaluating an agency's contracting operations, Sunset uses the general framework established in the *State of Texas Procurement and Contract Management Guide*, as well as documented standards and best practices compiled by Sunset staff.<sup>2</sup> While TRS has begun making improvements to its contracting and procurement processes, the agency needs to ensure its improvements address the following issues.

TRS' decentralized structure results in inconsistent contract oversight.

- **Lack of centralization.** Agencies should have strong, centralized contracting coordination to promote accountability and consistency. While TRS has begun to clearly define roles and responsibilities for its central contracts department, the agency's decentralized structure still results in inconsistent contract oversight agencywide. Each division generally manages its own contracts, with optional involvement from the central contracts department, meaning divisions do not consistently benefit from the central contracts department's expertise. In addition, the agency may not have a complete picture of all its contracting activities because of the lack of oversight from the central contracts department over the contracting functions performed by division staff. TRS has considered embedding a dedicated contract administrator within each division to help each division manage and monitor contracts and provide more centralized oversight, but it has not yet implemented this idea. TRS is also developing its own procurement and contract management manual that would include more detailed policies, define roles and responsibilities, and ensure compliance with the agency's new contracting requirements, but this guide is still in the draft phase. Without a more centralized process, the agency cannot ensure consistently managed contracts.

TRS tries to resolve contract issues informally and does not fully document problems and resolutions.

- **Poor performance monitoring.** Agencies should carefully monitor contractor performance to ensure successful outcomes. TRS lacks a consistent process for monitoring performance agencywide, with each TRS division independently monitoring contractor performance. Divisions rely on relationship management, seeking to resolve contract issues informally with vendors, and do not keep comprehensive records documenting problems and their resolutions. When Sunset staff asked TRS for copies of all its contract monitoring logs, the agency was only able to produce four logs for all of its contracts, and those few logs lacked complete documentation of status updates, performance problems, and monitoring efforts. As a result, TRS may be unable to make the most informed decision to renew a contract with a vendor who may have an undocumented history of poor performance. Undocumented corrective actions may also lead to inconsistent and potentially unfair treatment of vendors. TRS is developing a checklist to evaluate vendor performance after the contract term ends and at the time of renewal as required by state law. However, these checklists do not include specific details on each vendor's successes and shortcomings, or lessons learned to apply in the next procurement. Documenting these details would help with internal contract monitoring and future solicitations. Additionally, contract managers may not have enough information to effectively evaluate vendor performance because TRS does not require divisions to document problems or resolutions that arise with vendors during the contract term.

- **Ineffective use of contract remedies.** Agencies should have a range of sanctions or remedies available for noncompliance with contract terms, and should ensure consistent application of those sanctions and remedies when problems arise. Most TRS contracts do not include clearly defined

remedies. For example, while TRS' health plan administrator contracts include standard remedies like performance guarantees and liquidated damages, the majority of TRS contracts do not contain similar terms. TRS recently created a schedule of remedies, but these remedies are currently only included in a small percentage of agency contracts, and some standard remedies, such as liquidated damages and corrective action plans, are missing from the schedule. In addition, TRS seldom uses formal remedies to address contractor performance issues, even when those terms are included in contracts, having issued just one corrective action plan in the last three fiscal years. Without a policy to ensure all contracts have appropriate remedies, and without consistent application of those remedies, significant poor performance may go unaddressed.

In one of the most prominent recent examples of poor contract enforcement, TRS experienced dozens of issues with its large contract for a new IT system and amended the contract 45 times. The textbox, *TRS IT Contract Issues*, provides more explanation of the problems. When TRS terminated the contract in February 2020, it was significantly over budget and behind schedule. TRS ultimately paid \$20,000 more than the initial contract value, years after the originally expected completion date, and phase two of the contract was not completed. The vendor delivered phase one of the contract, but the product had significant defects that required additional ongoing work by TRS staff. Although TRS included liquidated damages in the contract, it did not use them and ultimately held the vendor free of any fault for its poor performance.

- **Insufficient contract training.** State law requires contract managers to receive training provided by the comptroller's office. Although TRS' central contracts department staff have all completed the required training, many staff managing contracts within the various divisions have not, even though contracting may comprise a significant portion of their work. In the last year, TRS developed an internal training for contract managers, but this training is optional. The comptroller's training provides important information on monitoring and enforcing contracts, complying with requirements in the *State Contract Management Guide*, documenting contracting decisions, planning for problems, and evaluating performance.<sup>3</sup> Requiring staff who manage contracts to complete this course and TRS' internal training would better ensure compliance with state law and allow TRS to manage contracts more effectively.

### TRS IT Contract Issues

- TRS terminated the contract in February 2020, when it was over time by 50 percent.
- Phase one of the project has been riddled with issues, with TRS working to address numerous defects each month.
- TRS assumed two major project components due to vendor performance limitations and plans to hire staff from the vendor to complete the project.
- The vendor split into new entities three times during the contract, and most key project personnel no longer work for the vendor.

Many TRS staff managing contracts have not completed the required contract management training.

## Sunset Staff Recommendations

### *Management Action*

#### **2.1 Direct TRS to fully centralize contracting functions and clarify roles and responsibilities between central contracts department staff and division staff managing contracts.**

This recommendation would ensure central oversight for all agency contracting activities, with the central contracts department providing enhanced oversight of division staff responsible for procuring and managing contracts. TRS should clearly define the role of the central contracts department, establishing the respective responsibilities of the central contracting department and division staff in all contracting. At a minimum, the central contracts department should:

- Finalize and publish the agency's procurement and contract management guide, including clearly defined roles for staff procuring and managing contracts and agencywide policies and procedures to comply with state procurement and contracting law.
- Track contracting training and certification status for all TRS staff who procure or manage contracts.
- Assist division staff in developing appropriate standard contract terms, including remedies.
- Coordinate with all agency divisions to ensure consistent contract monitoring techniques.

To better provide centralized oversight, TRS could hire additional contract administrators to provide specialized assistance to each division based on the type of contracts the divisions use. TRS should report its progress on implementing this recommendation to the Sunset Commission by December 1, 2020. This recommendation would help ensure TRS complies with state law, including recent legislative changes, and would allow for more central oversight of contractor performance issues.

#### **2.2 Direct TRS to enhance its contract monitoring process.**

This recommendation would direct TRS to improve its contract monitoring to better document vendor performance and ensure compliance with contract terms. As part of this recommendation, TRS should, at a minimum:

- Establish a standardized contract monitoring process with oversight by the central contracts department.
- Develop contract monitoring tools to ensure consistent documentation of vendor performance agencywide.
- Implement a policy to regularly evaluate contractor performance during and after the life of the contract.
- Require divisions to collect vendor performance data and review that data before procuring any new contracts.

TRS should report its progress on this recommendation to the Sunset Commission by December 1, 2020. This recommendation would ensure the agency quickly identifies and resolves problems, and maintains documentation of vendor performance for future solicitations.

### **2.3 Direct TRS to include standard remedies in contracts and consistently apply enforcement tools.**

Under this recommendation, TRS would adopt standard remedies to include in all of its contracts, such as specified liquidated damages, corrective action plans, and performance discounts. TRS would also be directed to develop a policy to ensure contract managers consistently apply remedies as needed. The central contracts department should develop a remedy tracking tool to be implemented agencywide and monitor division actions to provide greater oversight of contract problems. TRS should provide an update on the implementation of this recommendation to the Sunset Commission by December 1, 2020. Requiring and applying consistent contract remedies would help ensure TRS and contract vendors are held responsible.

### **2.4 Direct TRS to require staff who procure or manage contracts to complete the comptroller's contract training.**

This recommendation would direct TRS to ensure all staff who procure or manage contracts as a significant portion of their job, regardless of title, complete the comptroller's contract management training. TRS should also consider providing internal contract training to other staff with meaningful work related to contracting or interaction with contract vendors. TRS should report to the Sunset Commission on its implementation of this recommendation by December 1, 2020. This recommendation would ensure staff have the necessary knowledge to follow state contracting law and internal policies.

## **Fiscal Implication**

These recommendations would not have a fiscal impact to the state because TRS' operating expenses are not appropriated from general revenue. While centralizing the agency's contracting functions and increasing contract monitoring could result in some additional operating expenses, TRS is currently hiring additional contract management staff, and these recommendations would not require expanding that effort. Improving contract management and oversight would allow the agency to better identify and resolve potentially costly discrepancies in contracts and be a better steward of its funds for members.

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<sup>1</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 825.103, Texas Government Code; Chapter 953 (S.B. 65), Acts of the 86th Texas Legislature, Regular Session, 2019.

<sup>2</sup> Texas Comptroller of Public Accounts, *State of Texas Procurement and Contract Management Guide*, accessed March 5, 2020, <https://comptroller.texas.gov/purchasing/docs/96-1809.pdf>.

<sup>3</sup> Section 656.052(b), Texas Government Code.



## ISSUE 3

# As One of the Largest Public Pension Funds in the U.S., TRS Would Benefit From Additional Oversight and Greater Transparency of Its Investment Practices.

### Background

The Teacher Retirement System of Texas (TRS) invests member and state contributions and uses the investment income to help pay for members' retirement benefits. The TRS Board of Trustees sets the agency's investment policies by balancing the desired rate of return with a prudent level of risk and determining the mix of assets in which to invest the fund. In fiscal year 2019, the portfolio was valued at more than \$157 billion and had a one-year rate of return of 5.2 percent.<sup>1</sup> The table, *TRS Investment Returns*, summarizes TRS' past rates of return and benchmarks against which the agency measures its performance.

**TRS Investment Returns**

	FY 2019	3 Years	5 Years	10 Years
TRS	5.2%	8.6%	6.5%	9.2%
Benchmark	5.6%	8.0%	6.2%	8.5%

Over the last two decades, TRS has shifted its investment strategy from traditional investments, like internally managed stocks and bonds, to more alternative investments, such as private equity, hedge funds, energy, natural resources, infrastructure, and real estate. Alternative investments can be internally managed, but TRS often uses external managers for these investments.

In 2018, TRS started hiring more in-house investment staff to reduce external management costs. Senior internal investment staff serve on TRS' Internal Investment Committee, which is charged with approving potential investments with external investment managers and informally reviewing internal investment strategies. TRS' investment policy requires the board to approve initial external investments above 0.5 percent of the trust's value, or \$785 million in fiscal year 2019, but the policy does not require the board to approve any new internal investment strategies.<sup>2</sup>

### Findings

#### TRS could reduce risks in its investment accounting system.

TRS lacks an automated accounting system for its investments and its current accounting process is not fully independent of the custodian bank. Without these, TRS may be unable to identify accounting inconsistencies between itself, its custodian bank, and its external investment managers. Like other pension systems, TRS contracts with a custodian bank to hold fund assets, settle transactions, and perform investment reporting and some accounting for the agency. TRS reconciles the custodian bank's records using separate transactional records for most investments, but must use a manual process to do so. Further, for a portion of the fund totaling billions of dollars held only by the custodian bank, TRS does not have separate records for reconciliation, which basically equates to a billion-dollar company verifying its credit card purchases using only the credit card statement but not individual receipts or

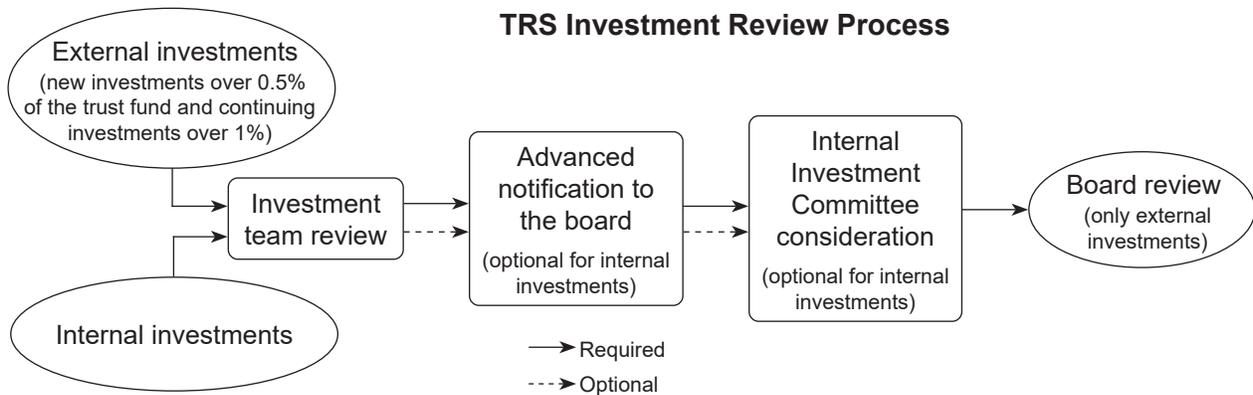
TRS lacks processes that could help catch accounting inconsistencies.

TRS could benefit from an automated or parallel investment accounting system.

records of these transactions. Given both the high volume and significant dollar amount of TRS’ investment transactions, the agency could benefit from an automated or parallel investment accounting system to increase the accuracy and efficiency of the reconciliation process. An automated accounting system would allow TRS to reconcile transactions as they happen rather than relying on spreadsheets, while a parallel accounting system would give TRS its own set of accounting records with which to check the custodian bank’s accuracy. The Employees Retirement System of Texas uses a parallel accounting system to check the accounting of its custodian bank, and the California State Teachers’ Retirement System has an automated reconciliation process. By relying solely on the custodian bank’s records and using a mostly manual reconciliation process, TRS may not be able to identify and correct all errors or discrepancies that could add up to substantial amounts over time.

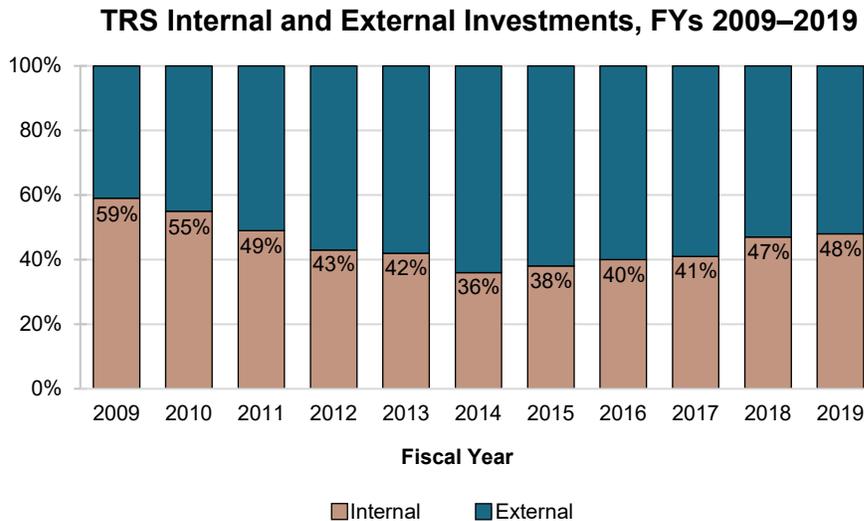
**TRS does not formally review internal investments.**

Internal investments generally involve lower risk and lower dollar amounts compared to external investments, but consistent and thorough oversight is still important. TRS uses the Internal Investment Committee to review new internally managed investment strategies, such as stock portfolios, but this process is informal and not explicitly required by TRS’ investment policy statement. The chart, *TRS Investment Review Process*, shows the review process for internal and external investments.



At least every two years, the TRS Board of Trustees adopts an investment policy statement that sets out how much of the trust fund will be invested in any asset type; the division of authority between investment staff and the board in reviewing investments; risk management policies; and other guidelines for how TRS will manage the fund.<sup>3</sup> While the investment policy statement requires the board to review and approve some externally managed investments, it does not require this for any internally managed investments.<sup>4</sup> TRS’ existing requirement for the Internal Investment Committee to report to the board on external investments above certain amounts with new and existing managers allows the board to review, question, and potentially halt these investments. While the Internal Investment Committee also reviews TRS’ internal investments, this

is not a formal requirement with a defined process for board review. Without a formal review and reporting duty for internal investments, portfolios worth hundreds of millions of dollars are subject to an informal process. As shown in the chart, *TRS Internal and External Investments*, TRS is shifting toward managing more investments in-house, which warrants greater board oversight.



### **TRS lacks stakeholder- and member-friendly investment reporting on alternative investments.**

TRS provides detailed investment information in the agency’s *Comprehensive Annual Financial Report*, but could improve transparency by more clearly explaining its alternative investments. Alternative investments tend to be riskier and more complex than traditional investments, and stakeholders and the Legislature rely on clear investment reporting in the *Comprehensive Annual Financial Report* to understand changes in TRS’ investment strategy. TRS has increased its alternative investments from 20 percent of the fund in fiscal year 2009 to 46 percent in fiscal year 2019. While the annual report includes a pie chart detailing how much of the fund TRS allocates to four broad classes of investments, which typically include alternative investments, the chart fails to demonstrate how TRS’ investment strategy has shifted to allocate almost half of the fund in alternative investments.<sup>5</sup> TRS also provides a short definition of alternative investments in the annual report, but TRS could improve the clarity of its reporting by also providing a chart showing the percentage of the fund allocated to alternative investments.

TRS invested 46 percent of the pension fund in alternative investments in fiscal year 2019.

Other state pension funds, such as the Employees Retirement System of Texas, the Pennsylvania Public School Employees’ Retirement System, and the California State Teachers’ Retirement System, report the percentage of the fund invested in alternative investments as an easily understandable graphic.<sup>6</sup> The Pew Charitable Trusts recommends clear disclosure of the percentage of funds dedicated to alternative assets as a best practice to increase transparency, especially as state pensions increase use of alternative investments.<sup>7</sup>

## Sunset Staff Recommendations

### *Management Action*

#### **3.1 Direct TRS to perform a cost-benefit analysis of implementing an enhanced investment accounting system to provide increased oversight of the custodian bank's accounting data.**

Under this recommendation, TRS would evaluate the costs and benefits of improving its investment accounting through either a parallel records accounting system or an automated reconciliation process. This cost-benefit analysis should include implementation costs such as staffing and software needs. As part of the evaluation, TRS should consider the use of a parallel accounting system, automated reconciliation tools, and detailed transactional data to enhance reporting and oversight, and reduce the agency's reliance on manual systems that increase the risk of error. TRS should report to the Sunset Commission on the estimated costs and benefits of these systems and the agency's recommended approach by December 1, 2020. To ensure coordinated oversight, both investment operations and investment accounting staff should have access to the system's records. Implementing a parallel or improved accounting system would allow the agency to automate reconciliations, improve reporting, and increase data analysis.

#### **3.2 Direct TRS to have its Internal Investment Committee review internal investments and strategies.**

This recommendation would direct TRS to update its investment policy statement to require the Internal Investment Committee review all new internally managed investments above a certain threshold to be adopted by the board, similar to that for external investments. This recommendation also would allow individual board members to request the full board consider an internal investment strategy scheduled for Internal Investment Committee review. The board should add the policy to its investment policy statement during the next scheduled update. This recommendation would ensure the board has more oversight over TRS' billions of dollars in internally managed investments.

#### **3.3 Direct TRS to include clear, easily understandable information about alternative investments in its *Comprehensive Annual Financial Report*.**

Under this recommendation, TRS would clearly indicate in its *Comprehensive Annual Financial Report* the percentage of the trust fund held in alternative investments for the past one, three, five, and 10 years. This information could be provided as a graphical representation such as a pie chart or bar graph, but should give TRS members and other stakeholders a better understanding of TRS' alternative investments. TRS should report on its status in implementing this recommendation to the Sunset Commission by December 1, 2020. Reporting this information in the *Comprehensive Annual Financial Report* would improve transparency, helping TRS members, the Legislature, and the public better understand how TRS manages its assets.

## Fiscal Implication

These recommendations would not have a fiscal impact to the state because TRS' operating expenses are not appropriated from general revenue.

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- <sup>1</sup> Teacher Retirement System of Texas, *2019 Comprehensive Annual Financial Report*, accessed February 20, 2020, [https://www.trs.texas.gov/TRS%20Documents/cafr\\_2019.pdf](https://www.trs.texas.gov/TRS%20Documents/cafr_2019.pdf), 7.
- <sup>2</sup> Teacher Retirement System of Texas, *Investment Policy Statement*, accessed February 19, 2020, [https://www.trs.texas.gov/TRS%20Documents/investment\\_policy\\_statement.pdf](https://www.trs.texas.gov/TRS%20Documents/investment_policy_statement.pdf), 32.
- <sup>3</sup> Ibid.
- <sup>4</sup> The Internal Investment Committee reports to the board on proposed investments above 0.5 percent of the fund for investments with new external managers and above 1 percent for additional investments with current external managers.
- <sup>5</sup> Teacher Retirement System of Texas, *2019 Comprehensive Annual Financial Report*, 106.
- <sup>6</sup> Employees Retirement System of Texas, *2019 Comprehensive Annual Financial Report*, accessed February 11, 2020, <https://www.ers.texas.gov/About-ERS/Reports-and-Studies/Reports-on-Overall-ERS-Operations-and-Financial-Management/2019-CAFR.pdf>, 28; California State Teachers' Retirement System, *2019 Comprehensive Annual Financial Report*, accessed February 11, 2020, <https://www.calstrs.com/sites/main/files/file-attachments/cafr2019.pdf?1577482122>, 36; Pennsylvania Public School Employees' Retirement System, *Comprehensive Annual Financial Report Fiscal Years Ended June 30, 2019 & 2018*, accessed February 11, 2020, <https://www.pasers.pa.gov/FPP/Publications/General/Documents/PSEERS%20FY2019%20CAFR-Website.pdf>, 94–95.
- <sup>7</sup> Pew Charitable Trusts, *Making State Pension Investments More Transparent*, accessed February 12, 2020, [https://www.pewtrusts.org/-/media/assets/2016/02/making\\_state\\_pension\\_investments\\_more\\_transparent.pdf](https://www.pewtrusts.org/-/media/assets/2016/02/making_state_pension_investments_more_transparent.pdf).



## ISSUE 4

# TRS' Statutes Do Not Reflect Some Standard Elements of Sunset Reviews.

### Background

Over the years, Sunset reviews have included a number of standard elements from direction traditionally provided by the Sunset Commission, from statutory requirements added by the Legislature to the criteria for review in the Sunset Act, or from general law provisions imposed on state agencies. This review identified changes needed to conform the Teacher Retirement System of Texas' (TRS) statutes to standard Sunset language generally applied to all state agencies, address the need for the agency's required reports, and update statute to reflect the state's person-first respectful language initiative.

- **Sunset across-the-board provisions (ATBs).** The Sunset Commission has developed a set of standard recommendations that it applies to all state agencies reviewed unless an overwhelming reason exists not to do so. These ATBs reflect an effort by the Legislature to place policy directives on agencies to prevent problems from occurring, instead of reacting to problems after the fact. ATBs are statutory administrative policies adopted by the Sunset Commission that contain "good government" standards for state agencies. The ATBs reflect review criteria contained in the Sunset Act designed to ensure open, responsive, and effective government.
- **Reporting requirements.** The Sunset Act establishes a process for the Sunset Commission to consider if reporting requirements of agencies under review need to be continued or abolished.<sup>1</sup> The Sunset Commission has interpreted these provisions as applying to reports that are specific to the agency and not general reporting requirements that extend well beyond the scope of the agency under review. Reporting requirements with deadlines or that have expiration dates are not included, nor are routine notifications or notices, or posting requirements.
- **Person-first respectful language.** Statute requires Sunset to consider and recommend, as appropriate, statutory revisions in accordance with the person-first respectful language outlined in general law.<sup>2</sup> The stated intent of the law is to try to affect society's attitudes toward people with disabilities by changing the way the language refers to them. Sunset only changes language that occurs in chapters of law that are opened by the Sunset Commission's recommendations.

### Findings

#### TRS' statute does not reflect standard language typically applied across the board during Sunset reviews.

- **Board member training.** TRS' statute contains standard language requiring board members to receive training and information necessary for them to properly discharge their duties. While new board members receive robust training, statute does not contain newer requirements for all topics the training must cover, such as a discussion of the scope of, and limitations on, the board's rulemaking authority. Statute also does not require that the agency create a training manual for all board members or specify that board members must attest to receiving and reviewing the training manual annually.

TRs does not have an agencywide complaints tracking system.

- **Complaint information.** While TRS’ governing laws contain standard language requiring TRS to maintain complete information on complaints, the agency has not developed an agencywide process to track and resolve complaints. TRS has separate complaint processes depending on the way in which a complaint is submitted, particularly for complaints received through TRS’ pension and health benefits customer service teams. While TRS is in the process of developing a comprehensive complaint tracking system, the agency’s current, distinct processes do not allow for systematic tracking of complaints agencywide, nor does TRS always monitor the time needed to resolve a complaint. Maintaining a centralized complaint tracking system would help improve management of agency operations, ensure TRS addresses problems in a timely fashion, and reduce the risk of unaddressed complaints from members and others.

**TRs has several reporting requirements that need to be eliminated, modified, or consolidated.**

Appendix D lists the 11 reports state law requires TRS to produce, three of which Sunset staff found were no longer needed, two that should be modified, two that should be consolidated, and four that continue to be needed.

TRs should continue reporting on certain employers with late retirement contributions.

- **Late employer payment certification reports.** Statute creates several requirements for TRS to report on employers who are late in paying various contributions to the retirement system, one of which is no longer needed, and one that needs to be modified.
  - *Employees earning above statutory minimum salary.* Annual report to the commissioner of education certifying the name of each employer failing to pay contributions for employees earning more than the statutory minimum salary, and the unpaid payment amounts. Since 2004, TRS has used the comptroller’s warrant hold process to identify and collect late payments from these employers, so this certification report is no longer needed.
  - *New employees (first 90 days).* Annual report to the commissioner of education and State Auditor’s Office certifying the name of each employer failing to pay contributions for the first 90 days worked by new employees, and the unpaid payment amounts. TRS no longer needs to certify school districts, charter schools, and education service centers because TRS uses the comptroller’s warrant hold process to identify and collect late payments from these employers. However, the warrant process is not available for higher education institutions, so TRS needs to continue reporting on these employers.
- **Investment practices and performance reports.** Statute currently requires TRS to prepare two reports detailing investment practices and performance.<sup>3</sup> In 2019, the Legislature passed a bill creating a new, comprehensive investment reporting requirement for public retirement systems, replacing the two existing requirements that should be eliminated.<sup>4</sup>

- **TRS-ActiveCare drug formulary report.** Statute requires TRS to prepare a semiannual report showing cost savings from prior authorizations of select categories of prescription drugs that drive costs, such as cholesterol-lowering and antidepressant medications.<sup>5</sup> The Legislature created this reporting requirement in 2003, but today, other drugs may incur higher costs too. Modifying this requirement to allow TRS to annually report cost savings information on other types of drugs would provide a more comprehensive report on TRS' efforts to reduce costs using prior authorizations.
- **TRS-Care reports.** Statute currently requires TRS to prepare two separate reports on TRS-Care, a biennial report to the Legislature on TRS-Care financing, benefits, and projected costs of coverage, and an annual report to the Texas Department of Insurance on TRS-Care coverage, benefits, and services provided.<sup>6</sup> To increase efficiency, these reports could be consolidated into one annual report providing all of the required information to both recipients.

**The agency's statute does not use appropriate language when referring to persons with disabilities.**

The governing statute for TRS contains a term that is not consistent with the person-first respectful language initiative. The agency's Sunset bill should revise the statute to use person-first respectful language when appropriate.

## Sunset Staff Recommendations

### *Change in Statute*

#### **4.1 Update the standard across-the-board requirement related to board member training.**

This recommendation would require TRS to develop a training manual that each board member attests to receiving and reviewing annually, and require existing board member training to include information about the scope of, and limitations on, the board's rulemaking authority. The training should provide clarity that the Legislature sets policy, and agency boards and commissions have rulemaking authority necessary to implement legislative policy.

#### **4.2 Abolish three, modify two, and consolidate two of TRS' reporting requirements.**

This recommendation would make several changes to TRS' existing reporting requirements, as discussed below:

- Remove the two requirements for TRS to report on investment practices and investment performance, which were replaced with a single reporting requirement in recent legislation.
- Remove the requirement for TRS to report information on late employer payments for employees earning above the statutory minimum salary.
- Modify the statutory requirement for late employer payments on new employees to require TRS to only report on higher education employers.

- Modify the TRS-ActiveCare drug formulary reporting requirement to allow TRS to include information on cost savings for other drugs in addition to those currently listed in statute. TRS would determine additional classes of prescription drugs for which prior authorization and cost savings information is useful, such as the highest cost drugs or those that are not always medically necessary. The report would also be prepared annually, rather than semiannually, to increase efficiency while still providing this useful information regularly.
- Consolidate the TRS-Care and TRS-Care Operation and Administration reporting requirements to increase efficiency by requiring TRS to report on the program to both the Legislature and the Department of Insurance annually.

TRS' four remaining reporting requirements provide useful information and would be continued.

#### **4.3 Update TRS' statute to reflect the requirements of the person-first respectful language initiative.**

This recommendation would direct the Texas Legislative Council to revise TRS' statute to conform to the person-first respectful language requirements found in Chapter 392, Texas Government Code, as long as these changes do not impact TRS' ability to administer disability retirement benefits.

#### ***Management Action***

#### **4.4 Direct TRS to develop and maintain a system for receiving and responding to complaints.**

This recommendation would require TRS to fully implement the statutory directive to maintain complete information on complaints by centrally tracking and analyzing complaint information to identify trends and issues, including time needed to resolve complaints. TRS should adopt a centralized complaint system and report the agency's progress to the Sunset Commission by December 1, 2020.

### **Fiscal Implication**

These recommendations would not have a fiscal impact to the state because TRS' operating expenses are not appropriated from general revenue. The agency could incur a cost associated with Recommendation 4.4, but the cost would depend on how TRS chooses to implement a complaint tracking system and cannot be estimated at this time.

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<sup>1</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Sections 325.0075, 325.011(13), and 325.012(a)(4), Texas Government Code.

<sup>2</sup> Section 325.0123, Texas Government Code.

<sup>3</sup> Section 825.512, Texas Government Code.

<sup>4</sup> Chapter 578 (S.B. 322), Acts of the 86th Texas Legislature, Regular Session, 2019; Section 802.109, Texas Government Code.

<sup>5</sup> Section 1579.106, Texas Insurance Code.

<sup>6</sup> Sections 1575.452 and 1575.453, Texas Insurance Code.

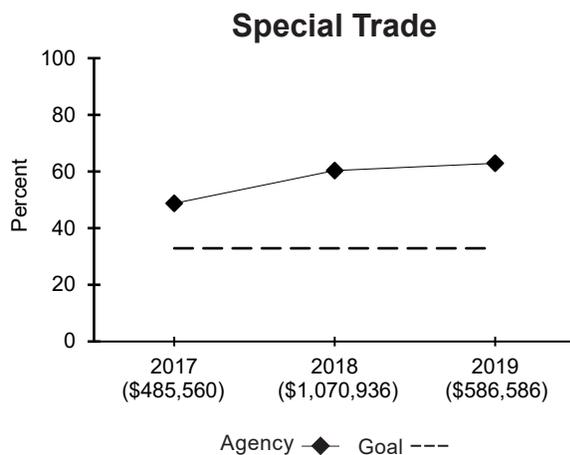
# APPENDIX A

## Historically Underutilized Businesses Statistics, FYs 2017–2019

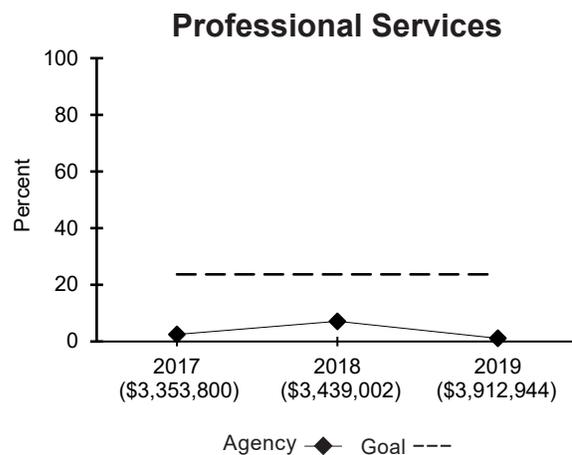
The Legislature has encouraged state agencies to increase their use of historically underutilized businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies’ compliance with laws and rules regarding HUB use in its reviews.<sup>1</sup>

The following material shows trend information for the Teacher Retirement System of Texas’ (TRS) use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in statute.<sup>2</sup> In the charts, the dashed lines represent the goal for HUB purchasing in each category, as established by the comptroller’s office. The diamond lines represent the percentage of agency spending with HUBs in each purchasing category from fiscal years 2017 to 2019. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category.

TRS failed to meet the statewide goal for HUB spending in the professional services category each year from fiscal years 2017–19, but exceeded goals for HUB spending in the special trade category. The agency did not have any spending in the heavy construction or building construction categories.

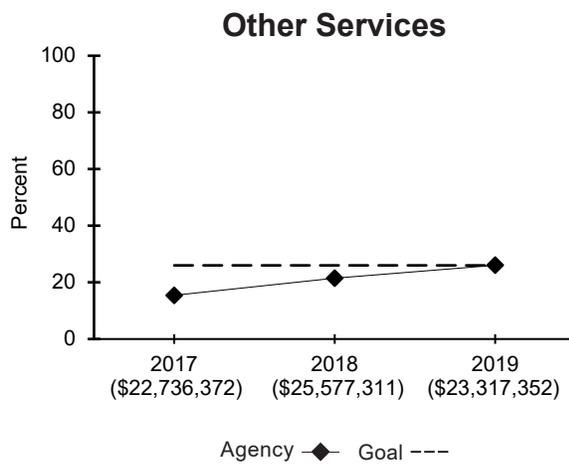


TRS exceeded the statewide goal for HUB spending in the special trade category in each of the last three fiscal years.

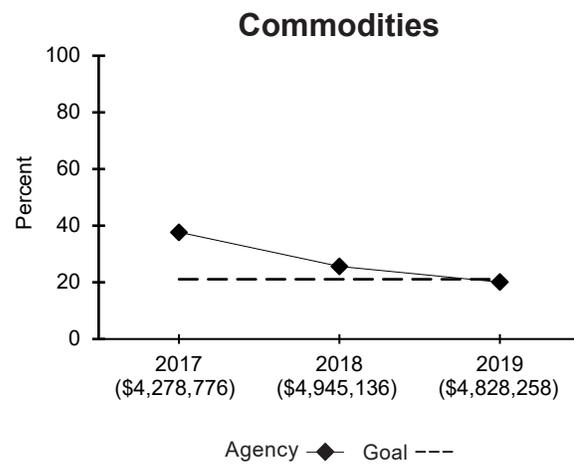


TRS failed to meet the statewide goal for HUB spending in professional services in each of the last three fiscal years.

## Appendix A



TRS did not meet the statewide goal for HUB spending in the other services category in fiscal years 2017 and 2018, but met the goal in fiscal year 2019.



TRS generally met or exceeded the statewide goal for HUB spending in commodities in fiscal years 2017 and 2018 but fell slightly below the statewide goal in fiscal year 2019.

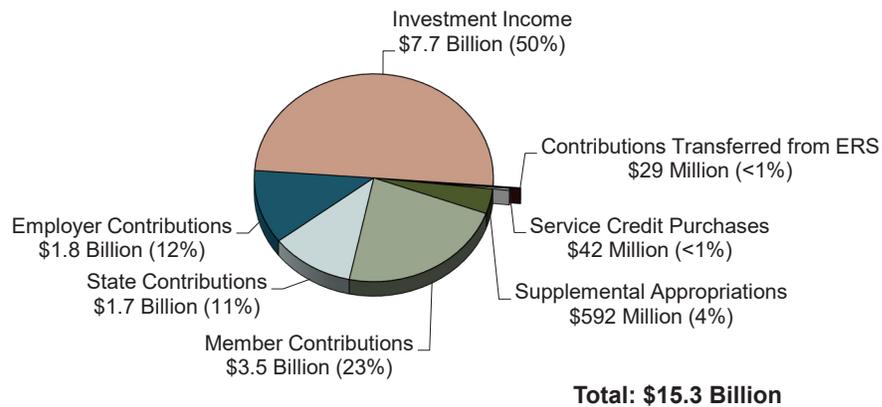
<sup>1</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 325.011(9)(B), Texas Government Code.

<sup>2</sup> Chapter 2161, Texas Government Code.

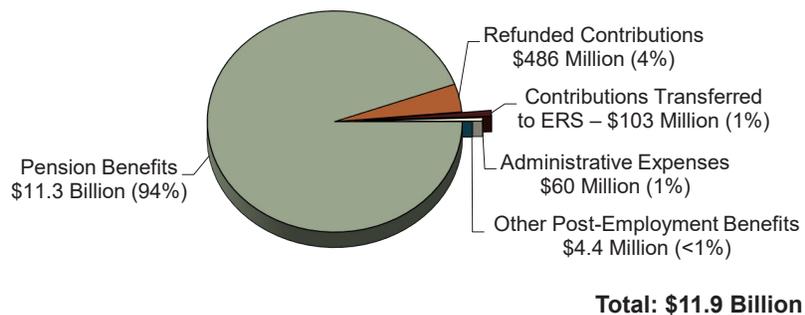
# APPENDIX B

## TRS Revenue and Expenditures by Fund – FY 2019

### Pension Trust Fund Revenue

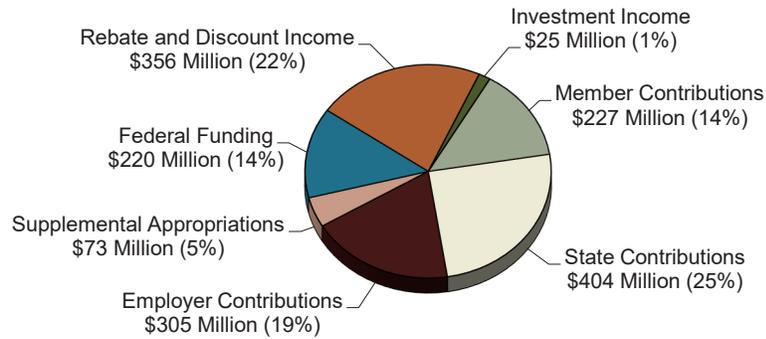


### Pension Trust Fund Expenditures



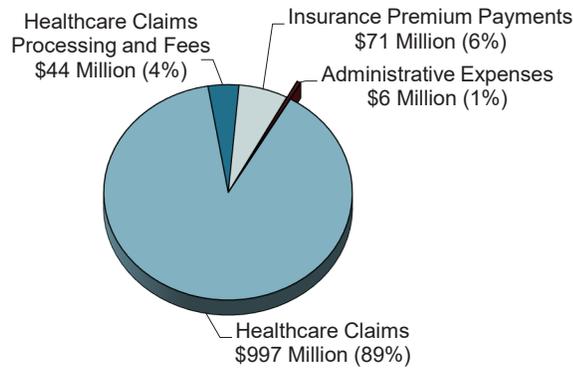
## Appendix B

### TRS-Care Revenue



**Total: \$1.6 Billion**

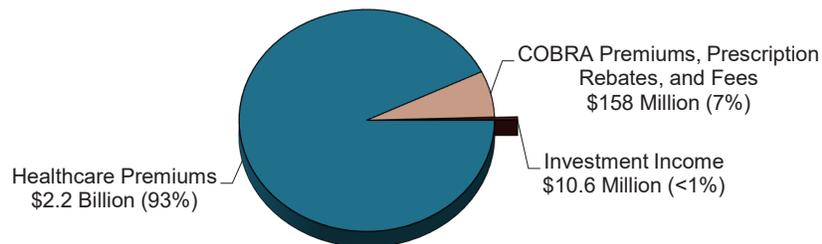
### TRS-Care Expenditures



**Total: \$1.1 Billion**

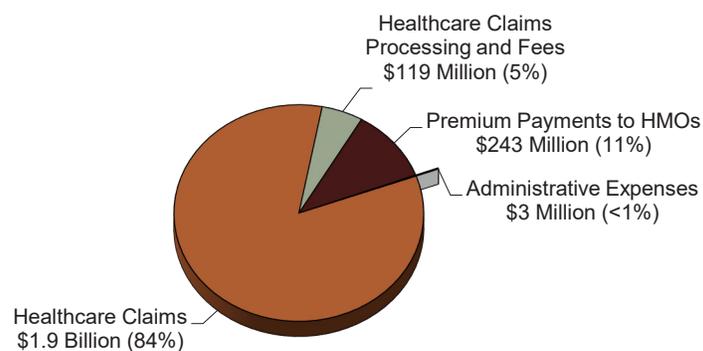
## Appendix B

### TRS-ActiveCare Revenue



**Total: \$2.3 Billion**

### TRS-ActiveCare Expenditures



**Total: \$2.2 Billion**

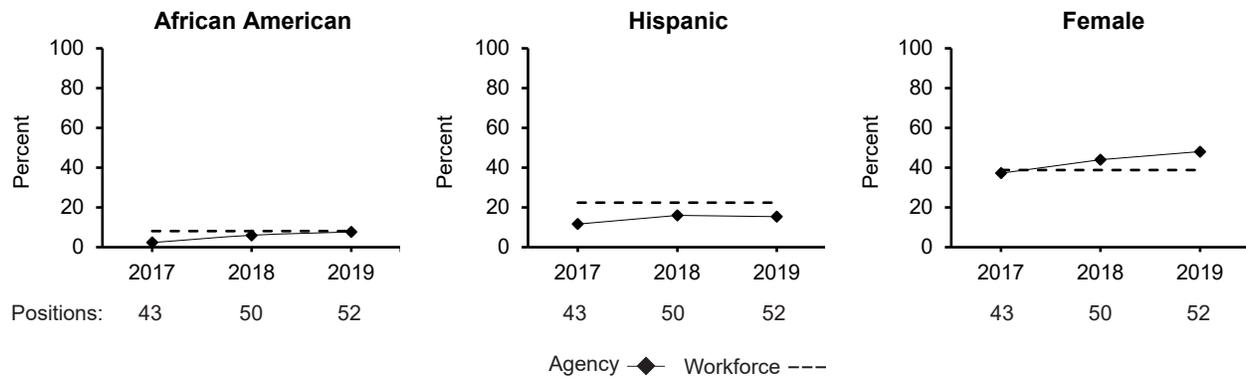


# APPENDIX C

## Equal Employment Opportunity Statistics, FYs 2017–2019

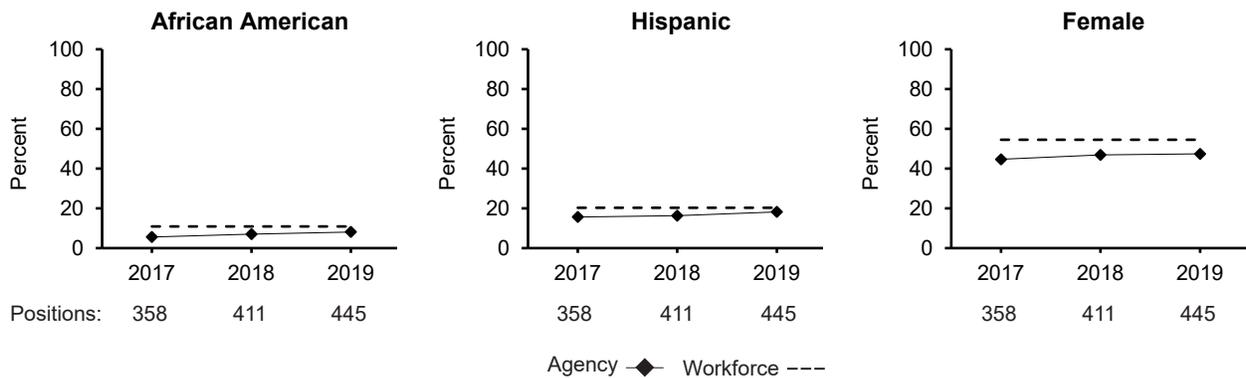
In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the Teacher Retirement System of Texas (TRS).<sup>1</sup> The agency maintains and reports this information under guidelines established by the Texas Workforce Commission.<sup>2</sup> In the charts, the dashed lines represent the percentages of the statewide civilian workforce for African Americans, Hispanics, and females in each job category.<sup>3</sup> These percentages provide a yardstick for measuring agencies’ performance in employing persons in each of these groups. The diamond lines represent the agency’s actual employment percentages in each job category from fiscal years 2017–19. Generally, TRS struggled to meet state civilian workforce percentages for the last three fiscal years, though the agency has shown some improvement in certain categories, such as administration and administrative support. The technical category had too few employees to conduct a meaningful comparison to the overall civilian workforce.

### Administration



The agency fell slightly below the civilian workforce percentages in the last three fiscal years for Hispanic and African American employees. The agency met or exceeded the civilian workforce percentages for females over the same time period.

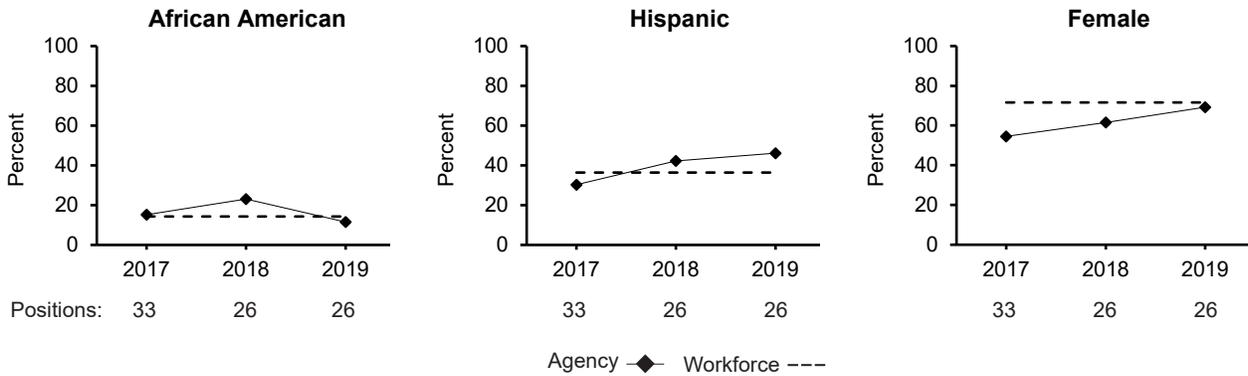
### Professional



The agency fell slightly below the civilian workforce percentages for African Americans, Hispanics, and females in the last three fiscal years, but has improved its performance over that time period.

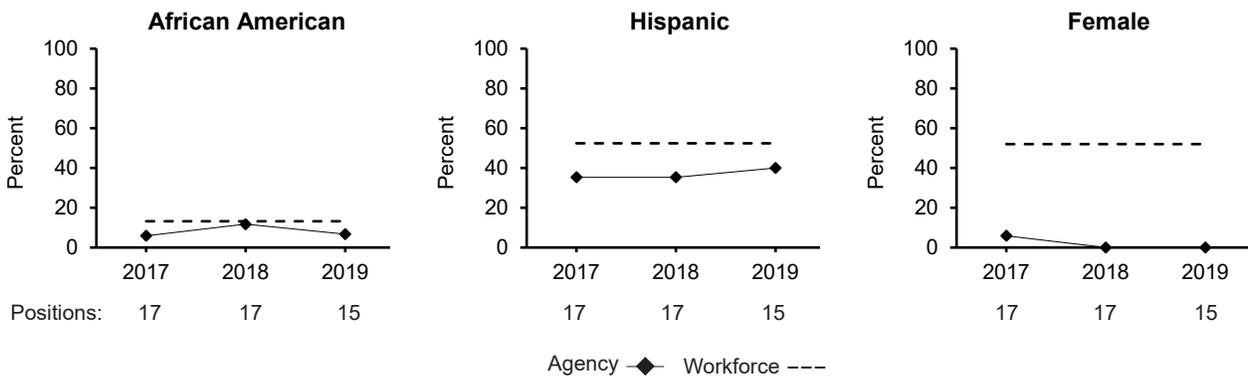
## Appendix C

### Administrative Support



The agency exceeded the civilian workforce percentages for Hispanic employees in fiscal years 2018 and 2019. The agency exceeded the percentages for African Americans in fiscal years 2017 and 2018, but fell slightly below in fiscal year 2019. The agency fell below the civilian workforce percentages for females in each of the last three fiscal years, but has improved its performance.

### Service/Maintenance



The agency fell below the civilian workforce percentages for African American and Hispanic employees, and significantly below for female employees, in each of the last three fiscal years.

<sup>1</sup> All citations to Texas statutes are as they appear on <http://www.statutes.legis.texas.gov/>. Section 325.011(9)(A), Texas Government Code.  
<sup>2</sup> Section 21.501, Texas Labor Code.  
<sup>3</sup> Based on the most recent statewide civilian workforce percentages published by the Texas Workforce Commission.

# APPENDIX D

## Teacher Retirement System of Texas Reporting Requirements

Report Title	Legal Authority	Description	Recipient	Sunset Evaluation
1. Comprehensive Annual Financial Report	Section 825.108, Texas Government Code	Requires TRS to annually report on financial transactions, total assets, investment returns, and funds received and disbursed.	Governor, Lieutenant Governor, Speaker of the House, Comptroller of Public Accounts, Legislative Audit Committee, State Pension Review Board, Legislative Budget Board, Legislative Reference Library	Continue
2. Investment Practices Report	Section 825.512(c), Texas Government Code	Requires a biennial independent evaluation of TRS' investment practices and performance.	Legislative Audit Committee	Abolish – See Recommendation 4.2
3. Investment Performance Report	Section 825.512(e), Texas Government Code	Requires TRS to annually report on investment performance, including a list of all investment commissions and fees paid.	Governor, Lieutenant Governor, Speaker of the House, Legislative Audit Committee, Legislative Budget Board, State Pension Review Board, appropriation and oversight committees	Abolish – See Recommendation 4.2
4. Delinquent Reimbursements	Section 825.407(e), Texas Government Code	Requires TRS to annually report on delinquent contribution reimbursements from academic teaching institutions.	Comptroller of Public Accounts	Continue
5. Late Employer Payment Certification – New Employees	Section 825.4041(f), Texas Government Code	Requires TRS to annually certify the name of each employer failing to pay contributions for the first 90 days worked by new employees, and amounts of unpaid payments.	Commissioner of Education, State Auditor	Modify – See Recommendation 4.2
6. Late Employer Payment Certification – Compensation Above Statutory Minimum	Section 825.405(e), Texas Government Code	Requires TRS to annually certify the name of each employer failing to pay contributions for employees earning more than the statutory minimum salary, and amounts of unpaid payments.	Commissioner of Education	Abolish – See Recommendation 4.2
7. Public Junior Colleges Unpaid Contributions	Section 825.4071(e), Texas Government Code	Requires TRS to annually report on public junior colleges and districts that have not paid required contributions.	Comptroller of Public Accounts	Continue
8. TRS-Care	Section 1575.452, Texas Insurance Code	Requires TRS to report annually on coverage, benefits, and services provided under TRS-Care.	Texas Department of Insurance	Consolidate – See Recommendation 4.2

## *Appendix D*

<b>Report Title</b>	<b>Legal Authority</b>	<b>Description</b>	<b>Recipient</b>	<b>Sunset Evaluation</b>
9. TRS-Care Operation and Administration	Section 1575.453, Texas Insurance Code	Requires TRS to report biennially on TRS-Care financing, benefits, and projected cost of coverage.	Legislature	Consolidate – See Recommendation 4.2
10. TRS-ActiveCare Drug Formulary Report	Section 1579.106, Texas Insurance Code	Requires TRS to report semiannually on cost savings achieved through prior authorizations of select prescription drugs.	Comptroller of Public Accounts, Legislative Budget Board	Modify – See Recommendation 4.2
11. Unclaimed Property Report	Section 821.010, Texas Government Code	Requires TRS to report the name, address, social security number, and date of birth of each member or beneficiary in the retirement system to the comptroller every five years.	Comptroller of Public Accounts	Continue – See Recommendation 1.2

# APPENDIX E

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## Staff Review Activities

During the review of the Teacher Retirement System of Texas (TRS), Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended board meetings; met with staff from key legislative offices; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research.

In addition, Sunset staff also performed the following activities unique to this agency.

- Attended TRS presentations on retirement and healthcare benefits.
- Attended TRS summits for school districts on health insurance trends.
- Attended a TRS Medical Board meeting.
- Attended an Internal Investment Committee meeting.
- Attended TRS training for contract managers.
- Observed and interviewed TRS benefit counselors.
- Attended multiple TRS Employer Advisory Group meetings.
- Received a demonstration of TRS' information technology systems for employer reporting and member self-service.
- Attended a briefing on the actuarial valuation of the pension trust fund.
- Toured TRS headquarters and investment management office space.
- Surveyed employees of school districts, open-enrollment charter schools, institutions of higher education, and education service centers, as well as retirees and other TRS members, employers, and stakeholders.



# Sunset Staff Review of the *Teacher Retirement System of Texas*

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