

Self-Evaluation Report
Teacher Retirement System of Texas

Presented to the
Sunset Advisory Commission
August 2005

Table of Contents

	Introduction.....	1
I.	Agency Contact Information.....	2
II.	Key Functions and Performance.....	3
III.	History and Major Events.....	27
IV.	Policymaking Structure.....	29
V.	Funding.....	48
VI.	Organization.....	55
VII.	Guide to Agency Programs.....	60
	<i>Core Agency Programs</i>	
	Pension Trust Fund.....	60
	Retirement Benefit Plan.....	60
	Investment Management Program.....	77
	TRS-Care Retiree Health Benefit Program.....	86
	TRS-ActiveCare Public School Employee Health Benefit Program.....	101
	<i>Additional Agency Programs</i>	
	Long-Term Care Insurance Program.....	107
	Local Health Care Comparability Study.....	112
	403(b) Certification Program.....	116
VIII.	Statutory Authority and Recent Legislation.....	121
IX.	Policy Issues.....	134
X.	Other Contacts.....	135
XI.	Additional Information.....	137
	Complaint Data.....	137
	HUB Data.....	140
	EEO Data.....	142
XII.	Agency Comments.....	146
	List of Attachments.....	147

Self-Evaluation Report Teacher Retirement System of Texas

Introduction

In this Self-Evaluation Report, the Teacher Retirement System of Texas (TRS) has provided information in the format requested by the Sunset Advisory Commission.

TRS has certain unique characteristics that distinguish it from other state entities. The System administers a pension trust fund and must operate under fiduciary principles. To comply with fiduciary standards, monies held in trust must be used exclusively for the benefit of TRS members. The state's portion of funding for this program is based on a percentage of the payroll for covered members working in public schools and higher education. Benefit payments to the TRS retirees and/or beneficiaries are funded from multiple revenue sources, including state appropriations, member contributions, and investment income.

The Pension Trust Fund manages the investment of TRS assets totaling more than \$90 billion. TRS investment management costs are appreciably lower than the costs of other similar public funds. The program's earnings for the fund totaled more than \$9 billion in FY 2004.

The System also administers two health benefit trust funds. The active member trust (TRS-ActiveCare) receives no direct state funding. The retiree trust fund (TRS-Care) receives funding based on a percentage of payroll and has received supplemental appropriations.

For most state agencies, Sunset is an assessment by the legislature to determine if there is a need for the agency to continue to exist. TRS is unique in this regard as well, because under TEX. GOV'T CODE § 825.006, the TRS Board of Trustees is subject to review under Chapter 325, but may not be abolished under that chapter (as TRS is established by the Texas Constitution). The TRS sunset provision reads as follows:

SUNSET PROVISION. The Board of Trustees of the Teacher Retirement System of Texas is subject to review under Chapter 325 (Texas Sunset Act), but is not abolished under that chapter. The board shall be reviewed during the period in which state agencies abolished in 2007 are reviewed or, if the retirement system's operating expenses are not subject to the appropriations process on September 1, 1995, the board shall be reviewed during the period in which state agencies abolished in 1997 are reviewed. This section expires September 1, 2007.

We look forward to working with the Sunset Commission during its evaluation of TRS, and we anticipate a very constructive and helpful process.

I. Agency Contact Information

A. Please fill in the following chart.

Teacher Retirement System of Texas Exhibit 1: Agency Contacts				
	Name	Address	Telephone & Fax Numbers	E-mail Address
Agency Head	Ronnie Jung, CPA Executive Director Pattie Featherston, Chief Operating Officer	1000 Red River Street Austin, Texas 78701 (same)	(512) 542-6401 (512) 542-6437 Fax: 542-6585	Ronnie.Jung@trs.state.tx.us Pattie.Featherston@trs.state.tx.us
Agency's Sunset Liaison	Annette Dominguez, Director of Human Resources	1000 Red River Street Austin, Texas 78701	(512) 542-6511 Fax: 542-6571	Annette.Dominguez@trs.state.tx.us

II. Key Functions and Performance

A. Provide an overview of your agency's mission, objectives, and key functions.
--

The **Mission** of TRS:

- to deliver retirement and related benefits authorized by law for members and their beneficiaries; and
- to prudently invest and manage the assets held in trust for members and beneficiaries in an actuarially sound system administered in accordance with applicable fiduciary principles.

The TRS **Philosophy**:

We are dedicated to the professional, accurate, timely, and cost-effective delivery of services and benefits to members and annuitants. We are sensitive, caring, and fair to those we serve and to our co-workers. We take pride in the work we perform and strive to continuously improve. We are open, responsive, and ethical in the conduct of business with members, annuitants, government officials, and the public.

Key Functions

TRS is the public entity that has responsibility for the administration of the retirement benefit program for Texas public education employees, which includes service and disability retirement benefits and death and survivor benefits. Administration of the program requires collection of member and state contributions, investment of the assets of the System, and payment of benefits as provided for by law.

In addition to administration of the retirement benefit program, TRS has been assigned additional responsibilities by the legislature over the years. These additional functions include:

1. Administration of health benefit programs and related responsibilities for TRS retirees (TRS-Care);
2. Administration of health benefit programs and related responsibilities for public school employees (TRS-ActiveCare);
3. Administration of a long-term care insurance program for active and retired public school employees and their eligible family members;
4. Preparation of a biennial comparability study of local health care programs administered by public education entities; and
5. Administration of the statutory provisions requiring certification by companies offering 403(b) qualified investment products to public school employees.

Based on their effect upon covered members and program size, TRS's key programs are the *Pension Trust Fund* (which includes the Retirement Benefit Plan and the Investment Management Program), the *TRS-Care Retiree Health Benefit Program*, and the *TRS-ActiveCare Public School Employee Health Benefit Program*. The additional programs administered by TRS are ancillary in nature; however, they are included in this report as a convenience to reviewers. Brief descriptions of each function follow.

Pension Trust Fund:

Retirement Benefit Plan

The TEX. CONST. art. XVI, § 67 establishes public retirement systems, including the Teacher Retirement System of Texas (TRS). TEX. GOV'T CODE Title 8, Subtitle C, defines the retirement plan features and provides for the administration of the retirement plan trust fund.

The TRS plan is established as a defined benefit plan under the provisions of state law that base retirement benefits on a formula, using years of service credit, final average salary, and a multiplier (currently 2.3%). See TEX. GOV'T CODE § 824.203(a). The plan also specifies the age at which a participant is eligible for service retirement. See TEX. GOV'T CODE § 824.202. Under a defined benefit plan, once the participant has achieved the required years of service credit and age for retirement eligibility, the participant's retirement benefit is determined by reference to the formula set out in the plan; there is no discretion on the part of the plan in determining the benefit. The objective of the TRS pension plan is to assure a lifetime stream of income to public education employees during retirement years, with the intention of replacing a portion of salary earned during working years as correlated to length of service.

Additionally, the TRS plan provides disability retirement benefits for eligible employees no longer able to work, and it pays death benefits to beneficiaries of active and retired participants. These features of the plan provide at least a minimum level of financial support for members and families affected by disability or death.

It is the policy of the state, as expressed in TEX. GOV'T CODE § 825.506, that the TRS plan operate as a qualified retirement plan under federal tax law, 26 U.S.C. §401(a). To maintain plan qualification, TRS must adhere to the applicable requirements of federal tax law for such plans; in exchange, TRS members obtain the benefits of plan qualification, such as deferral of income tax on salary contributions made to the plan (and on interest earned on those contributions) until those amounts are paid out as part of a benefit distribution.

Investment Management Program

The investment management function is integral to the operation of the retirement plan. Under the Texas Constitution and federal tax law applicable to qualified retirement plans, assets are held in trust for the exclusive benefit of plan participants. TRS manages and invests pension trust assets for the benefit of the pension plan participants.

TRS-Care Retiree Health Benefit Program:

TRS-Care is the retiree health benefit program established in 1985 (with an effective date of September 1, 1986) by the 69th Legislature under what is now Chapter 1575, TEX. INS. CODE. It makes available a basic level of health coverage without cost to eligible TRS public school retirees. Eligible retirees and their eligible family members may pay premiums to participate in a plan of more comprehensive benefits and coverage.

TRS-ActiveCare Public School Employee Health Benefit Program:

TRS-ActiveCare is a program established in 2001 (with an effective date of September 1, 2002) under what is now Chapter 1579, TEX. INS. CODE to provide health benefit for active employees of Texas school districts, open enrollment charter schools, and other eligible participating entities.

Additional Programs:

Long-Term Care Insurance Program

The Long-Term Care Insurance for Public School Employees program administered by TRS was established in 1999 under Chapter 1576, TEX. INS. CODE. TRS is authorized by the statute to provide voluntary long-term care insurance for eligible active and retired public school employees and their eligible family members.

Pass-Through Supplemental Compensation Program

The supplemental compensation is a salary-related program that pays public school employees to assist with payment of health care costs. Current supplemental compensation is authorized through FY 2005 in the amount of \$500 per year for full-time and \$250 for part-time employees, excluding administrators. From 2001 to the present time, this function has been administered by TRS as “pass through” funding from the state to the districts, which then pay the compensation through their employee payrolls. Effective September 1, 2005, the Texas Education Agency (TEA) will administer this function, as provided by Senate Bill 1691, 79th Legislature, Regular Session. Since TEA administers public school employee salary issues and funding to districts, TRS agrees that the function is more appropriately handled by that agency. Because of the imminent transfer of this function to TEA, TRS has not described the program in detail in later sections of this report, although funding related to the program appears in FY 2004-2005 fiscal information.

Minimum Effort Transition Assistance Funding to Districts. Chapter 1581 of the TEX. INS. CODE established minimum effort transition assistance funding to qualifying districts and charter schools to assist them in meeting their required minimum level of contribution toward employee health care. This function was administered by TRS for FY 2003 and 2004. No funding has been appropriated for this purpose after FY 2004.

Social Security Matching. Chapter 1581 of the TEX. INS. CODE established funding to qualifying districts to assist them in paying Social Security matching on the portion of the supplemental compensation funding paid to employees as compensation. TRS administered this funding in FY 2003. No funding has been appropriated for this purpose after FY 2003.

Local Health Care Comparability Study

TEX. EDUC. CODE § 22.004 requires TRS to certify and report to the Legislative Budget Board by September 1 of even-numbered years whether health coverage offered to employees by local school districts is comparable to the basic health coverage provided state employees under the Texas Employees Group Benefits Act. Since 1998, four studies have been completed, with the next report due September 1, 2006. To determine comparability, TRS obtains and analyzes plan information provided by districts that do not participate in TRS-ActiveCare. (TRS-ActiveCare participating districts are automatically certified as comparable.)

403(b) Certification Program

As amended in 2001, TEX. REV. CIV. STAT. ANN. art. 6228a-5 requires TRS to administer a 403(b) certification program as a means of setting minimum standards for companies selling annuity and other investment products to public school employees utilizing salary reduction agreements. Such programs are additional, optional savings/investment programs offered by some employers to their employees. Companies qualified by law that also meet the TRS minimum standards may certify to TRS. The first list of certified companies was published in June 2002.

B. Do each of your key functions continue to serve a clear and ongoing objective? Explain why each of these functions is still needed. What harm would come from no longer performing these functions?

Pension Trust Fund:

Retirement Benefit Plan

Clearly, the core function of TRS is to provide ongoing retirement, death, and disability benefits to Texas public education employees. More than 75 years ago, the teachers of Texas expressed their desire for a statewide retirement system to provide retirement benefits to educators throughout the state. In 1936, the legislature and voters of the State of Texas agreed by proposing and approving a constitutional amendment to establish a retirement system.

As a defined benefit plan, the TRS plan assures a stream of income during retirement years. Additionally, the TRS plan provides disability retirement benefits for eligible employees no longer able to work, and it pays death benefits to beneficiaries of active and retired participants. These features of the plan provide at least some financial support for members and families affected by disability or death. Further, the TRS plan structure supports individual responsibility because it contains a mandatory retirement savings feature. Mandatory participation and

mandatory member contributions of at least 6% of monthly salary require all public education employee members to save for their retirement years.

Today, the administration of the TRS retirement plan supports several priority goals of the State of Texas. As set forth in the most recent TRS strategic plans, TRS activities support the following state goals:

Education – Public Schools. TRS enhances the well-being of those dedicated to serving in public education by providing retirement and related benefits, which serve as a recruitment and retention incentive for Texas public school employees. This directly supports the state's priority goal for education.

Education – Higher Education. TRS directly supports the state's priority goal for education by providing retirement and related benefits, which serve as a recruitment and retention incentive for Texas higher education employees.

Health and Human Services. TRS supports the state's priority goal for health and human services by providing income and health benefits for retired Texas public education employees and their families.

Economic Development. TRS supports the state's priority goal for economic development by contributing to the Texas economy through disbursement of annuity payments. In FY 2004, these payments totaled approximately \$5.7 billion, of which 95% went to Texas residents.

General Government. TRS supports the state's priority goal for general government by operating efficiently, openly, and by focusing on its core competencies. In addition, prudent pension trust fund investment provides a foundation for ensuring that retirement programs and pension funds are actuarially sound and well-managed.

The creation of TRS at a time when the federal Social Security program was being developed still has relevance today to many Texas school districts as employers. The TRS retirement plan was approved in 1936 by an amendment to the Texas Constitution, followed by enabling legislation in 1937. The approval of the amendment to establish a retirement system for Texas public education employees came one year after the federal Social Security Act was signed into law. State and local government employees were excluded from Social Security coverage from 1935 (the date of the original Social Security Act) until 1950, because there was a legal question regarding the Federal government's authority to tax state and local governments.

Beginning in 1951, states were allowed to enter voluntary agreements with the Federal government to provide Social Security coverage to public employees. All states, including Texas, now have such agreements with the Social Security Administration. However, because of the voluntary nature of such agreements, the extent of Social Security coverage varies from state to state. The largest proportion of uncovered state and local government employees work at the local level. The majority of uncovered local government public employees are police, firefighters, and teachers. Medicare coverage, however, now is mandatory for state and local government employees hired (or rehired) after March 31, 1986. Mandatory Social Security and Medicare coverage for state and local government employees who are not members of a public

retirement system and who are not covered under an agreement with the Social Security Administration (known as a Section 218 agreement) became effective July 2, 1991.¹

Currently, the majority of school district employees in Texas are covered by Medicare. However, TRS members employed by most of the school districts are *not* covered by Old-Age, Survivors, and Disability Insurance (OASDI)², known as Social Security. The results of a survey TRS completed in 2002 indicate that only 16 districts contribute to Social Security for all of their employees. The TRS pension plan continues to be the primary or sole retirement benefit for 80% of its overall membership.³

The TRS retirement plan was established and continues to exist in recognition of the desirability of a systematic means of providing retirement income for teachers at the conclusion of careers in public education positions. The initial exclusion of public educators from the federal Social Security program certainly emphasized Texas teachers' need for a plan of their own at the state level in order to achieve some measure of income security during their retirement years.

The existence of the TRS retirement plan allows a large number of Texas school district employees to continue to be exempt from Social Security OASDI coverage. The district employers therefore are not required to make employer contributions to Social Security on behalf of such exempted employees. Under federal law, the TRS retirement plan serves as an acceptable retirement alternative to otherwise mandatory participation in Social Security.

The retirement plan continues to serve a clear and important need for public educators. If this function were no longer performed by the System, each employer would either have to:

- Contribute to Social Security; or
- Establish its own retirement system.

This action would result in significant additional administrative costs, and potentially would provide fewer benefits to the employees. In addition, employees would have to purchase

1 Source: Federal-State Reference Guide, IRS Publication 963, 2002 Revision, p. 1-1.

2 "Social Security" is commonly used to refer to OASDI alone.

3 Public education work not covered by Social Security has other consequences for TRS members, in addition to not receiving OASDI credit for those years of earnings.

The federal Government Pension Offset (GPO) reduces the OASDI spouse's, widow's, or widower's benefit when that person receives a pension from a state or local government for work where the person did not pay Social Security taxes. A recent federal law change has made it more difficult for persons affected by the GPO to obtain an exemption. This change is commonly referred to as having closed the "last day loophole," whereby individuals could work their last day before retirement in a Social Security-covered school district and claim an exemption from the GPO. Now, federal law requires five years' work in a Social Security-covered position before retirement, though a transition provision modifies the requirement for some individuals.

The federal Windfall Elimination Provision (WEP) affects how the amount of a person's retirement or disability benefit from Social Security is calculated if the person receives a Social Security benefit from work covered by OASDI in addition to a pension from work where Social Security taxes were *not* taken out of pay. A modified formula is used to calculate the benefit amount, resulting in a lower Social Security benefit.

disability insurance to replace the disability benefits currently provided for by TRS.

Another important function served by the TRS retirement plan is that it permits TRS members to defer federal income tax on their plan benefits until the time a distribution is made at retirement, death, or separation from service and termination of plan participation. Certain plan provisions are required for TRS to fulfill this function and to otherwise operate as a qualified plan for tax purposes. Further discussion of this issue is provided in Attachment #24.

Investment Management Program

The investment management function continues to serve the objective of generating income to support the administration and payment of benefits to participants, including payment of cost-of-living increases for retirees when investment returns (or returns coupled with other sources of revenue) are sufficient to support them. If the investment function were no longer performed, revenues would decrease and replacement revenue would need to be obtained from the state, members, or employers for payment of benefits already established in law, as well as any new benefit enhancements. Additionally, the failure of a trust fund to perform the investment function with respect to funds under its control would call into question whether the fund's Board is properly fulfilling its fiduciary duties to the participants of the trust.

TRS-Care Retiree Health Benefit Program:

The legislature established TRS-Care in 1985 to provide uniform health care benefits for public school retirees. Enrollment began September 1, 1986. The legislature established this health benefit program for several reasons, including the fact that the majority of public school districts, excluding higher education, did not offer health coverage to retirees. TRS-Care also provides retired public school employees needed health coverage at a statewide level so they can receive health benefit no matter where they live.

The retiree health benefit program is affected by Medicare eligibility for a portion of the participants. Some TRS retirees are not eligible for Medicare Part A (hospital insurance) at age 65 because they were employed in positions not covered by the Medicare tax during their work years. When these non-eligible retirees participate in TRS-Care, the program costs are higher than for TRS-Care participants who enroll in Medicare Part A upon reaching age 65. The number of such retirees will diminish over time due to mandatory Medicare coverage for employees hired after March 31, 1986.

The retiree health benefit program continues to provide a valuable and needed service for TRS retirees. Should this program be eliminated, retirees would have to obtain individual insurance on their own and/or rely only on Medicare when they reach age 65. Many retirees would not be able to afford reasonable insurance and they would be forced to use other public programs or not receive adequate services. Costs would significantly increase for those retirees able to afford services.

TRS-ActiveCare Public School Employee Health Benefit Program:

The legislature established TRS-ActiveCare in 2001 (with an effective date of September 1, 2002) as a mechanism to pool resources to form a stronger health plan for active

public school employees. The need was indicated because health plan costs varied from school to school, rural schools faced limited access and rising costs, and schools that paid little or none of the coverage costs found it difficult to attract and retain qualified employees.⁴ The enabling legislation established a uniform group coverage program for public school employees with funds from state, district, and employee contributions.

Although TRS-ActiveCare was established fairly recently, the fact that school districts continue to voluntarily join the plan is evidence that there is a need for the program to continue. If this program were to be discontinued, individual districts would have to assume responsibility for administering their own individual health care plans. This situation would create additional administrative costs for these districts and could leave members with limited access to health care plans.

Additional Programs:

Long-Term Care Insurance Program

This program provides voluntary long-term care insurance for eligible active and retired public school employees (and their eligible family members). It was established to assure that such coverage remains available at group rates to public school employees. If the program were discontinued, not all public school employers would be able to make such coverage available; and for those employers that could provide coverage, the cost would likely increase.

Local Health Care Comparability Study

This study is conducted in even-numbered fiscal years to determine whether the basic health coverage provided by local school districts is comparable to that provided to state employees, as required by state law. Since 1998, four studies have been completed, with the next report due September 1, 2006.

Before TRS-ActiveCare was established, TRS obtained and analyzed plan information from all districts. TRS-ActiveCare is required by law to offer a plan comparable to that provided to state employees. Therefore, starting with the 2004 study, TRS-ActiveCare participating districts are automatically certified as comparable.

During the 79th Legislature, Regular Session, TRS's charge to conduct the study was continued. If the function were not performed, information about whether school districts that do not participate in TRS-ActiveCare are in compliance with the comparability law would not be available to TRS members or the legislature.

403(b) Certification Program

The 403(b) company certification requirements administered by TRS were established to provide minimum standards for the financial stability of the companies selling annuity and other investment products to public school employees, uniform disclosure of annuity product terms,

⁴ Bill Analysis, HB 3343, 77th Legislature.

and limits on fees charged in connection with annuity products and mutual fund investments. By maintaining a list of certified companies on its Internet Web site, TRS indicates which companies have certified compliance with the financial requirements and fee limitations. Only companies that certify to TRS may receive payments through employee salary reduction agreements.

This function was assigned to TRS in 2001 by legislation designed to protect public school employees from being charged excessive fees for their optional savings investments. This program continues to serve the objective of having uniform minimum standards, fee restrictions, and disclosure requirements for all companies offering products to Texas public school employees when purchased through employer payroll deduction. If this function were eliminated, any company could sell 403(b) products to public school employees. In the past, the lack of certification permitted companies to market products with unreasonable fees to TRS members.

C. What evidence can your agency provide to show your overall effectiveness and efficiency in meeting your objectives?

TRS has a long tradition of excellence and commitment to service to its membership. The organization's staff takes pride in consistently delivering high quality services to plan participants at a very efficient cost.

Effectiveness:

Perhaps the best measure of the overall effectiveness of TRS programs and services is the 2004 result of the biennial *Member Satisfaction Survey*, conducted for TRS by the Survey Research Center of the University of North Texas. In its conclusions, the survey report states:

*The findings from the TRS 2004 Member Satisfaction Survey can be used as an indication of member perceptions of TRS among its two key customer groups of retired members and active members... **The 2004 Member Satisfaction Survey shows quite favorable ratings among both customer groups.** Overall, 97.0 percent of the retired members and 93.3 percent of the active members reported that they were either satisfied or very satisfied with TRS' member services.*

Regarding health care issues...Ninety-one percent of [TRS-Care] respondents were very satisfied/satisfied overall with TRS-Care services. For those respondents participating in the TRS-ActiveCare Program...91 percent...were satisfied with TRS-ActiveCare services.

In addition to member satisfaction ratings, TRS performance regularly meets or exceeds significant performance targets. Some examples include:

- Monthly annuities are paid each month on time.
- New retirees receive their first check as soon as they are legally entitled to it.
- Investment returns regularly exceed benchmarks established by the Board on a one-,

three-, five- and ten-year time frame. The ten-year returns also exceed the actuarial assumed rate of 8%.

- Both health benefit plans provide participants with access to quality medical attention throughout the state.

Specific program detail regarding effectiveness is provided in *Section VII, Guide to Agency Programs* of this report.

Efficiency:

Based on work done by Cost Effectiveness Measurement (CEM)⁵, TRS administrative pension costs are among the lowest in the nation, and are less than one-half the same costs among the System's peer groups (based on membership size). TRS serves twice as many members per System employee as its peer-group systems do.

TRS manages investments at a cost of less than two basis points, which is significantly lower than the management costs of the System's peer group, and a fraction of what the costs would be if the System used external managers.

In the health care arena, TRS eliminates the private-sector profit margin by self-insuring. TRS also partners with private sector health care companies and uses their networks to take advantage of larger group discounts. TRS uses competitive bidding to obtain the best prices possible for medical and pharmaceutical coverage, and claim payments are made in a timely manner (as required by contract).

Supporting Evidence:

TRS regularly conducts internal audits, external audits, benchmarking studies, and other objective measurements of its efficiency and effectiveness, including:

- Results of the independent *2004 Member Satisfaction Survey*, conducted by the Survey Research Center of the University of North Texas (Attachment #18).
- Quarterly reports from independent entities on TRS investment performance (Attachment #23).
- TRS was a 2001 Recipient of the Governor's *Texas Star Award*.
- Quarterly and annual performance measure data reported to the Board and the Legislative Budget Board.
- Independent report from CEM, *Cost Effectiveness Measures for Defined Benefit Administration* (Attachment #10).
- Quarterly performance information from outside vendors on the health benefit programs (annual reports supplied as Attachments #31 and #32).
- Comparisons with other groups on health care costs.
- Comparisons with other public pension funds on diverse programs, policies, and procedures.

⁵ *Cost Effectiveness Measures for Defined Benefit Administration*, provided as Attachment #10.

D. Does your agency's enabling law continue to correctly reflect your mission, objectives, and approach to performing your functions? Have you recommended changes to the Legislature in the past to improve your agency's operations? If so, explain. Were the changes adopted?

Yes. The original mission of TRS is described in the provisions of the TEX. CONST. art. XVI, § 67, and Title 8, Subtitle C, TEX. GOV'T CODE. These laws established the administration of retirement and related death and disability benefits for public school employees as the mission of TRS, along with investment of System assets in support of the retirement program. Over time, additional statutory responsibilities have been added, including the administration of retiree and active member health benefit programs and administration of the 403(b) certification program. Responsibilities such as administration of long-term care insurance and the health coverage comparability study also have been added as components of TRS's involvement in health program administration for eligible public education employees and retirees. These responsibilities are set forth in other Texas statutes, such as the Insurance Code and Revised Civil Statutes.

During the 79th Legislature, Regular Session, TRS was asked to identify provisions of enabling law for the pension and health benefit programs that could be modified or clarified to provide opportunities or remove obstacles in the administration of TRS's responsibilities. TRS identified possible clarification of several statutory provisions to better describe the fiduciary nature of TRS's responsibilities and to expressly recognize the TRS Board of Trustees' need for operational flexibility consistent with their fiduciary duties. The clarifications are reflected in Senate Bill 1691, which was enacted into law.

E. Do any of your agency's functions overlap or duplicate those of another state or federal agency? Explain if, and why, each of your key functions is most appropriately placed within your agency. How do you ensure against duplication with other related agencies?

Pension Trust Fund:

Retirement Benefit Plan

The TRS pension plan functions are comparable to those of the Employees Retirement System of Texas (ERS), which serves state employees. However, the pension administration (and investment functions) serving public education employees are placed with TRS because of state constitutional requirements and because of the characteristics of the population served. TRS investment and pension administration functions are constitutionally mandated and must be administered by a Board of Trustees. (See TEX. CONST. art. XVI, § 67.) The constitutional provisions suggest that separate plans and boards were envisioned for the retirement system serving public education employees and the system serving state employees.

Certain distinctions between the covered populations support maintaining separate retirement systems. For example, public education employees typically work on a semester or school-year basis rather than a continuous 12-month plan year, as is common for state employees. As a

result, the method of crediting service in the two systems is different. In another example, school employees often have out-of-state teaching service or take developmental (e.g., sabbatical) leave, and these circumstances may be less common with state employees. The TRS plan allows the purchase of service credit for these situations, while the ERS plan does not.

TRS ensures against duplication with ERS by serving only the population eligible for membership in TRS and by customizing its services to meet the needs of public education employees and reporting entities (school districts, open enrollment charter schools, and higher education).

Investment Management Program

The TRS investment function is constitutionally mandated and is performed by the TRS Board of Trustees and internal investment staff. However, there are other entities capable of performing the investment function, if state law were to provide for delegation of the function. Further discussion is provided in Section VII, questions H and I.

TRS-Care Retiree Health Benefit Program, TRS-ActiveCare Public School Employee Health Benefit Program, and Long-Term Care Insurance Program:

ERS also manages health benefit and insurance programs and could conceivably perform these functions for active or retired public education employees. It may be worthy of study to determine whether the state would benefit from establishing a separate entity to administer all its health benefit programs, to better foster the necessary expertise both among staff and the governing body. Further discussion is provided in Section VII, questions H and I.

Additional Programs:

Local Health Care Comparability Study

No other entity presently performs this function, although either TEA or TDI could perform the study.

403(b) Certification Program

There is no state or federal agency providing a certification function closely comparable to that available under the TRS 403(b) certification program. However, the Texas Department of Insurance (TDI) and the State Securities Board (SSB) regulate or register certain companies, agents, brokers, or advisors involved in the offering of 403(b) investment products. Additionally, the Texas Education Agency (TEA) has established relationships with school districts and could administer some aspects of the 403(b) certification function. Also, the Internal Revenue Service regulates compliance with Section 403(b) of the Internal Revenue Code; thus, employers who offer these plans must do so in compliance with federal regulations.

ERS offers a 457 plan and 401(k) plan to state employees, and certain aspects of these plans are comparable to the 403(b) plans available through school district payroll reduction. ERS has an established process for selecting companies that will be allowed to receive the investment

dollars that state employees voluntarily commit to these plans. Additionally, the Texas Higher Education Coordinating Board performs a somewhat similar function in the administration of the Optional Retirement Program (ORP). Higher education institutions may apply vendor requirements for companies offering investments to those participating in ORP. Finally, under Chapter 609, TEX. GOV'T CODE, school districts are authorized to establish vendor qualifications for 457 plans in which school district employees may participate.'

TRS does not duplicate these efforts because the 403(b) plans were not subject to any state standards or criteria prior to the initiation of the current program administered by TRS.

<p>F. In general, how do other states carry out similar functions?</p>

Pension Trust Fund:

Retirement Benefit Plan

Teacher retirement, death, and disability benefits are provided through qualified defined benefit pension plans in many other states. Most states have established a separate retirement system for teachers, as Texas has; however, some states have combined retirement systems that include both teachers and other public employees. Plan design and administration may vary in several respects, including membership eligibility, state and member contributions, benefit formula, service credit and benefit accrual, retirement eligibility, payment options at retirement, and other features. For example, in some states, the Board of Trustees may determine the level of contributions and the benefits provided. However, governmental defined benefit pension plans in all states must operate under the same federal tax code requirements as TRS to maintain their qualified status. Additional information on comparisons between TRS and other large public pension funds is available from studies published by such national pension organizations as the Public Pension Coordinating Council (PPCC), the National Council on Teacher Retirement (NCTR), the National Association of State Retirement Administrators (NASRA), and other organizations. Extracts or copies of several pertinent studies are provided as Attachment #33.

The federal tax code permits other forms of retirement plans to be administered for public employees, such as 457, 403(b), 401(k), or other 401(a) plans. Some states use these other forms of retirement plans as alternative or supplemental plans for public education employees. Certain tax code provisions would limit the availability of some of these plans, such as the prohibition against the establishment of new 401(k) plans by governmental employers.

Investment Management Program

With respect to investment management, it is common for state teacher retirement or other public employee plans to be authorized to delegate their investment management authority to external investment managers. An "external manager" is a person or firm that makes investment portfolio decisions and executes transactions independently, subject to the overall restrictions agreed upon by contract between the fiduciary for the fund (that is, the Board of Trustees) and the external manager. Some systems with such authority may choose to manage investments

internally or use a combination of internal and external management. Currently, Texas law has been interpreted as not permitting delegation of investment management authority to external investment managers. See Tex. Atty Gen. Op. No. JC-0043 (1999). Therefore, unlike many other public retirement systems, the investment portfolio of TRS remains managed exclusively by internal professional investment staff according to the Investment Policy Statement established by the TRS Board of Trustees.

Pension funds that use external managers experience much higher investment costs than TRS. By using in-house professional investment staff, TRS manages the trust fund at a cost of less than .02% of plan assets per year (less than two basis points or “bps”) while achieving investment policy objectives. Funds that use outside money managers have investment costs many times greater, typically 10-20 basis points. TRS is one of the largest funds that internally manages all investments, enhancing trust fund value over time through substantial management cost savings. Outsourcing this function could eliminate the substantial cost savings from which the trust fund has traditionally benefited.

TRS-Care Retiree Health Benefit Program:

There is no established practice concerning whether and how other states carry out similar health benefit functions. Some states do not provide any health care to public school employees; others provide it through the same agency that provides other state employee benefits; and others offer health coverage only to retirees. The following is a brief review of how six other states approach health care for public school employees:

California: The California State Teachers Retirement System (CalSTRS) does not offer health coverage for public school employees; rather, that coverage is offered by the California Public Employees Retirement System (CalPERS) to all state employees and retirees, as well as employees and retirees of school systems that contract with CalPERS.

New York: The New York State Health Insurance Program (NYSHIP) provides health care for employees and retirees of participating school districts. Retirement benefits for both state and public school employees are provided by the New York State and Local Retirement System.

New Mexico: The New Mexico Retiree Health Care Authority offers health benefits to retired state employees, including public school employees. Three separate agencies provide active state employees health benefits: The New Mexico Public School Insurance Authority and the Albuquerque Public Schools provide health benefits to active public school employees, and the State of New Mexico, Risk Management Division, provides health benefits to active state employees. The retirement system is a separate state agency, the New Mexico Public Employee Retirement System.

Oklahoma: The Oklahoma State and Educational Employee Group Insurance Board and the Employees Benefits Council provide health benefits to active and retired state employees, including public school employees. The retirement system is a separate state agency, the Oklahoma Public Employees Retirement System.

Ohio: The State Teachers Retirement System of Ohio offers health benefits to public school retirees only.

South Carolina: The South Carolina Budget and Control Board offers the Employee Insurance Program, which provides health benefits to all state employees and retirees, including public school employees.

TRS-ActiveCare Public School Employee Health Benefit Program:

We are not aware of any established practice concerning whether and how other states carry out similar health benefit functions. (See discussion of this issue above under TRS-Care.)

Additional Programs:

Long-Term Care Insurance Program

We are not aware of any established practice concerning whether and how other states provide similar group insurance options.

Local Health Care Comparability Study

We are not aware of another entity performing this service.

403(b) Certification Program

In Texas, as in other states, individual public education employers establish 403(b) plans through salary reduction agreements with their employees. These plans are specific to the individual employers. Most states have no central oversight of how public school employers control marketing access by companies to employees, or of the qualification of companies that will be allowed to receive employee contributions through the salary reduction agreements. Each employer may decide how many company vendors it wishes to deal with and what qualifications those vendors must meet.

In California, a centralized system exists for the registration of vendors who are permitted to market to the employees and who can then receive contributions through salary reduction agreements between the employers and employees. Assembly Bill 2506 enacted in 2002 requires the Teachers' Retirement Board of the California State Teachers' Retirement System (CalSTRS) to establish a registration process for vendors seeking to offer retirement investment products to employees of all local school districts, community college districts, and county offices or education. Registered vendors are permitted to offer only registered 403(b) products as funding vehicles for 403(b) plans. CalSTRS is required to maintain an impartial investment information bank via an Internet Web site about the investment products and an objective comparison of vendors and types of products. All registered vendors share the administrative costs of the program equally. School employees may select only from registered 403(b) products.

G. What key obstacles impair your agency's ability to achieve its objectives?

Financial market conditions can dramatically affect the actuarial condition of the pension fund. Annual returns in financial markets began to fall in 2000, following several years of above-average returns. A similar pattern occurred for returns on TRS pension assets. Consequently, TRS's unfunded pension liabilities have grown significantly compared to the years when the financial markets were producing extraordinarily high returns. Recent investment earnings have returned to a level higher than the assumed 8 percent return. Nevertheless, the level of returns, along with the current level of state and member contributions, are not sufficient to support all liabilities in an actuarially sound manner at their current pace of accrual.

The impact of the decrease in market returns was exacerbated by benefit improvements made during the late 1990s. Due to the market downturn, the improvements have proven too expensive to support with investment earnings alone. Additional member, state, or employer contributions are needed to restore the System to an actuarially acceptable level of funding. Alternatively, the pace of accrual of actuarial liabilities may need to be addressed through changes in retirement eligibility, the patterns of retirement, or the level of benefits accrued. It should be noted that both TRS contribution rates and liabilities are determined by the legislature through plan design decisions (such as eligibility criteria and benefit levels).

Despite these challenges, TRS continues to achieve its objective of paying the pension plan benefits set out by statute in a timely manner to each person entitled to receive those benefits. In the short-term, benefit payments will not be affected. In the long-term, solutions must be found to improve the actuarial condition of the fund.

In addition, communication issues are a continuing challenge for an organization of TRS's complexity and membership size. The issues tend to be two-fold: First, the issues confronting TRS are complex and not always well understood by the System's stakeholders; and, second, communication with the System's membership can be constrained by the scale involved in contacting the System's entire membership.

In the health benefit arena, the TRS-Care program is significantly affected by rising health care costs, especially for participants not yet eligible for Medicare. Prescription drug costs, in particular, have risen significantly for both Medicare-eligible and those who are not yet eligible, placing cost burdens on the program. Retirement plan features (such as expanded return-to-work provisions and subsidized early age retirement options) may have encouraged some members to retire earlier than they would have in the absence of these features; their relatively young average retirement age creates a wider gap in years between their TRS retirement age and their Medicare eligibility age. When a public school member retires, health benefit plan costs typically shift from the local employer to the statewide TRS-Care plan. Since funding for TRS-Care is tied to payroll growth, rather than growth in the number of retirees or medical trends, TRS will have to continually request funding for the program.

To address rising health care costs and younger retirement ages, TRS alternatives are to:

- Reduce the program benefits,
- Shift more costs to the participants through increases in premiums, co-payments and deductibles, or
- Seek additional external funding for the program.

Finally, TRS encounters obstacles in balancing the requirement to manage trust assets in accordance with fiduciary principles with the trend toward centralization of functions and certain decision-making in the state government environment. Fiduciary principles require loyalty to the trust beneficiaries, and use of trust funds for the exclusive benefit of trust beneficiaries. These principles often may conflict with the state government trend toward delegating decision-making and fiscal control to one agency on behalf of all state government agencies or entities.

H. Discuss any changes that could impact your agency's key functions in the future (e.g., changes in federal law or outstanding court cases).

Pension Trust Fund:

Retirement Benefit Plan

Retirement plans have been in the press and public eye in recent years due to some high-profile examples of under-funded plans in both the public and private sector. Some under-funding situations resulted from less favorable financial market conditions beginning in 2000, while others may have had other causes. Additionally, bankruptcies in some industries, such as the airline industry, have focused attention on the effect of bankruptcy on pension plan participants.

This publicity about retirement plans and their funding problems has sparked debate about the pros and cons of defined benefit retirement plans versus defined contribution retirement plans, such as 401(k) plans. Two prominent examples are the Social Security personal accounts discussion and the initiative of the Governor of California to convert that state's governmental defined benefit plans to defined contribution plans. In California, the effort has been postponed for further study of the participant advantages offered by defined benefit plans that would be lost in a transition to a defined contribution structure. Additionally, questions have been raised about whether the state would actually experience significant cost savings in both the short- and long-term from such a transition.

In Texas, the defined benefit versus defined contribution issue has not reached the same level of prominence as in the State of California. Although the TRS pension fund is actuarially under-funded at the current time, the funding percentage for accrued actuarial liabilities is still quite high (91.8%), placing TRS among the top public retirement plans. To date, the Texas legislature has opted to address TRS's funding situation by making gradual changes to the retirement eligibility requirements and benefit calculation features (as expressed in Senate Bill 1691, 79th Legislature, Regular Session). These changes will slow the rate of accrual of liabilities, thus gradually improving the actuarial condition of the pension fund. However, the funding period is expected to remain "infinite" for years, even with recent changes. It should also be noted that

state contribution rates to TRS remain below the median for major public employee pension funds.⁶

TRS anticipates that, depending on market conditions and retirement trends, additional changes may be considered by the legislature to restore TRS to an actuarially sound condition. Another factor creating pressure on the legislature to consider further changes is that TRS retirees depend on legislative action for any cost-of-living increases to their benefits, because the statutory plan provisions do not include a built-in or automatic cost-of-living adjustment (“COLA”) feature. During more favorable market conditions, investment earnings were available to fund *ad hoc* COLAs for retirees. However, the last *ad hoc* increase was enacted during the 77th Legislature in 2001. Before a new benefit increase may be enacted, the System’s funding must meet the standards in TEX. GOV’T CODE § 821.006, which essentially provide for an amortization period for the unfunded actuarial liabilities of the System of no more than 30 years. The legislature also is constrained by TEX. CONST. art. XVI, § 67(a)(1), requiring financing of benefits to be based on sound actuarial principles. To support an *ad hoc* increase, the actuarial condition of the fund will need to improve through contribution increases, higher market returns, or benefit changes—or a combination of these.

State law changes to TRS benefits can affect key functions at TRS in several ways. First, plan changes may increase the complexity of plan administration, requiring new programming, publications, processing requirements, counseling, and other services. Second, communicating the changes to the membership in a timely and clear manner is challenging, due to short implementation periods often prescribed for the changes, as well as the complexity of some changes. Third, as financial market forces and state funding limitations restrain or reverse the momentum toward benefit improvements over the last decades, education of the membership regarding how to best utilize their TRS benefits in retirement planning becomes increasingly important. Fourth, the TRS plan at times must absorb the impact of other public policy changes or decisions, such as the state’s desire to keep experienced teachers in classrooms by allowing them to work after retirement or a district’s financial inability to grant large pay increases, sometimes resulting in the district’s encouragement of retirement and then re-hiring of the retiree as a means to enable that employee to receive what amounts to a large boost in income through receipt of both salary and retirement benefits.

Public policy issues such as these have ripple effects through the TRS plan, changing retirement patterns and the rate of accrual of actuarial liabilities. TRS retirement patterns also affect other programs, such as the TRS-Care retiree health program, with earlier retirement placing greater burdens on that program. As state and local public education funding issues become increasingly difficult, TRS must monitor the proposed solutions for both direct and indirect effects on the soundness of the TRS plan, so that TRS can continue to fulfill its mission of paying retirement benefits as specified by law.

Finally, if the state decided to explore other significantly different retirement plan forms instead of making gradual changes to the defined benefit plan features, TRS functions could be

⁶ Based on data from the National Association of State Retirement Administrators *Public Fund Survey Summary of Findings FY 2003*.

significantly affected. The actual effects would depend on how the changes would be structured. First, any transitional costs and administrative issues, including plan qualification issues, would need to be addressed. Second, any member choices would need to be developed and implemented, and benefits of existing members would need to be protected to the extent necessary under plan qualification requirements. Third, short- or long-term costs to the existing defined benefit plan would need to be assessed and addressed in order to maintain a sound actuarial status for the plan and its participants. Because of the complexity of undertaking new plan forms, TRS would anticipate extensive involvement in the study of any new plan forms proposed for its membership.

In addition to potential state law changes, the following possible changes in federal law could impact various aspects of the TRS retirement plan:

- Social Security law changes are proposed in each session of Congress. Possible legislation includes mandatory participation by governmental employees; modification to the Government Pension Offset (GPO) and Windfall Elimination Provisions (WEP); and restrictions on use of Social Security numbers or other provisions addressing privacy issues. Additionally, the proposals for personal accounts within Social Security, coupled with California initiatives to convert public defined benefit plans to defined contribution plans, have broadened public debate about the costs and benefits of defined benefit retirement plans in today's environment.
- Legislation is proposed from time to time to establish federal oversight of state or local public retirement plans.⁷ Such federal oversight would involve major changes for TRS because currently no federal oversight exists (other than through plan qualification requirements of the federal tax code). Private retirement plans are subject to federal oversight through the Employee Retirement Income Security Act of 1974 (ERISA), a comprehensive federal law designed to protect the rights of plan participants. However, governmental plans are exempt from Titles I and IV of ERISA and subject to state laws and oversight.
- Initiatives to overhaul complex federal tax code provisions and simplify different kinds of retirement plans and retirement saving vehicles could affect TRS.
- Recently the staff of the Congressional Joint Committee on Taxation recommended the repeal of public employer "pick-up" of member contributions under Section 414(h)(2) of the IRC. The recommendation is generating concern among public pension plans. The proposal would have a significant impact on TRS members and employers if enacted into law, since it would end the tax-deferred nature of employee contributions and instead would cause salary used for member contributions to be taxable when paid by the employer.

Additionally, TRS monitors litigation affecting retirement benefit and investment issues for potential impact on TRS, such as:

- Age Discrimination—Litigation continues in the pension plan arena on age

⁷ Such bills are often referred to as "PERISA" (Public Employee Retirement Income Security Act) or "PEPPRA" (Public Employee Pension Plan reporting and Accountability Act) bills.

discrimination issues, particularly in the conversion of a conventional defined benefit plan to a cash balance defined benefit plan, with the conversion performed in an allegedly age-discriminatory manner. *Cooper v. IBM*, 274 F. Suppl. 2d 1010 (S.D. Ill., 2003) is one of the most followed cases. Though not directly applicable to TRS, TRS monitors developments in court rulings in order to determine whether any TRS plan features or plan changes are vulnerable to challenge.

Investment Management Program

Economic Terrorism—Public retirement systems are monitoring state and federal legislative interest in proposals that would restrict investments in companies with ties to nations or organizations deemed to be terrorist in nature. Public systems are concerned that, in the absence of a federal government list of such companies, there would be insufficient information on which to base such a determination.

Health Benefit Programs:

For the purposes of this section, TRS-Care and TRS-ActiveCare issues are addressed jointly.

Health benefit programs like TRS-Care and TRS-ActiveCare continue to be affected by rising health care costs. Additionally, TRS-Care (the program for public school retirees) is significantly affected by retirement patterns of the TRS membership and by the federal Medicare program. Since Medicare pays some medical expenses for its participants, the extent of Medicare reimbursement and the eligibility requirements for Medicare both affect TRS-Care. Since Medicare eligibility generally is based on reaching age 65, TRS retirees who retire at an earlier age and who are eligible for TRS-Care generally will participate in the TRS-Care program for a number of years before becoming Medicare eligible. The earlier members retire and enroll in TRS-Care, the longer the number of years that the state program must be the sole provider of health benefits for this population. Any benefit improvements or other forces that cause TRS members to retire at a younger age will have a flow-through effect on TRS-Care.

Another Medicare eligibility consideration is that not all TRS-Care participants will be eligible for Medicare Part A (hospitalization), even upon reaching age 65. Some Texas public school employees were hired at a time when Medicare coverage was not mandatory; upon retirement, TRS-Care may be the only coverage for these retirees for their lifetime. However, since Medicare coverage became mandatory for employees hired after March 31, 1986, this will be a diminishing issue for TRS-Care.

In addition to these general concerns, TRS-administered health benefit plans may be affected by the following federal or state developments:

- **Proposed Equal Employment Opportunity Commission (EEOC) rules concerning retiree health benefits and age discrimination.** In response to an opinion by the United States Court of Appeals for the Third Circuit, the EEOC published rules that permit employers to take into account the existence of Medicare or comparable state health

benefit programs when providing health benefits without violating the Age Discrimination in Employment Act (ADEA). The court held that employers could not consider either Medicare or comparable state health benefit programs when determining whether they were providing equal health benefits to those below age 65 and those 65 and older. This caused many employers to cease offering retiree health benefits because having to provide the same benefits for those with and without Medicare was expensive. The EEOC rules craft a narrow exception to the ADEA for only this type of coordination.

However, the rules are not yet final because AARP and other advocacy groups objected to the rules, claiming that they will have the opposite effect to the one intended: that employers will stop providing retiree health benefits because they can now rely on Medicare and States to provide those health benefits. If the new rules go into effect, they would clarify the interaction between Medicare and TRS-Care. Recently, a federal district court held that the regulations were beyond the authority of EEOC to adopt under the Age Discrimination in Employment Act. The court enjoined the EEOC from publishing or otherwise implementing the regulation. See *AARP v. EEOC*, E.D. Pa., No. 05-CV-509, 3/30/05. EEOC plans to appeal the ruling to the U.S. Court of Appeals for the Third Circuit.

- **The Medicare Prescription Drug, Improvement and Modernization Act of 2003.** This new federal law includes a prescription drug benefit for seniors, which becomes effective in 2006. This benefit is known as Medicare Part D. The provisions are numerous and complex. TRS continues to monitor any guidelines issued to clarify how this law interacts with programs that TRS administers, such as TRS-Care. In June 2005, the TRS Board of Trustees authorized the staff to take the steps necessary to receive the subsidy available to TRS-Care under Medicare Part D, with savings estimated at over \$100 million for the 2006-2007 biennium.
- **State litigation.** TRS is involved in a lawsuit in district court in Travis County, Texas, originally brought by two hospitals, challenging the constitutionality of two laws passed during the 78th Legislature, Regular Session. The style of the case is *Mother Frances Hospital Regional Health Care Center, et al. v. The State of Texas, et al. and East Texas Medical Center and Longview Regional Medical Center, Intervenors*, No. GN 303352, in the 250th Judicial District Court of Travis County, Texas. The challenged statutes prohibit TRS-Care or TRS-ActiveCare from excluding from its provider network any general hospital located in a county in the Texas-Louisiana Border Region with a certain population so long as the hospital agrees to the same terms and conditions as other providers.

If the Court determines that the statutes are constitutional because they have statewide application, the fiscal impact to both health benefit programs will be substantial because they will have to contract with any willing general hospital in the state. This will result in lesser volume going to hospitals already in the network, and the volume was the basis for the deeper discounts that the third-party administrators obtained. Additionally, no such network exists in the state, meaning that TRS will have to find a third-party administrator that is willing to build a custom network for TRS. Such an effort will

presumably be expensive for the plans. As both plans are self-funded, any increase in costs will have to be borne by the program's funding sources, which include participants, the State, and the school districts.

Additional Programs:

Long-Term Care Insurance Program

None applicable.

Local Health Care Comparability Study

None applicable.

403(b) Certification Program

IRS recently released proposed new 403(b) regulations that have generated interest in the education community and tax-sheltered annuity industry. Public comment has been taken on the proposal, but the regulations have not yet been finalized. Until they are finalized, TRS cannot determine the extent to which proposed changes may affect the 403(b) certification program.

I. What are your agency's biggest opportunities for improvement in the future?

Communication: The administration of a large pension fund is a complex business, which is not always well understood by the System's stakeholders. In addition, communication can be constrained by the scale involved in contacting the System's entire membership. As a result, significant opportunity rests with the agency's continuing efforts to:

- Provide basic education about issues facing any large pension fund.
- Enhance its communication strategies to better serve all stakeholders.
- Enhance its methods of obtaining member input into decision-making.

Funding: Funding issues are a part of the reality for all public pension funds today, and are likely to continue into the foreseeable future. While most funding decisions that affect the System rest with the state legislature, the organization can positively affect outcomes by continuing to:

- Enhance communication about funding needs and possible strategies.
- Consistently evaluate investment strategy to ensure returns are optimal.
- Manage the benefit package for health care programs within available revenue, while helping to inform policy-makers about challenges caused by the disparity between the program structures and funding structure of TRS-administered health benefit programs.

Member Services: TRS is known for the quality and responsiveness of its customer service, and is strongly committed to continuing this tradition. To do so, the System must effectively address the challenges of increasing volume due to demographic trends. Specific areas of opportunity include:

- Continuously explore new ways to improve services to members.
- Increase member access through development of additional Web-based self-service applications.

- Provide more information and educational tools to members for better financial planning.

J. In the following chart, provide information regarding your agency's key performance measures included in your appropriations bill pattern, including outcome, input, efficiency, and explanatory measures.

Teacher Retirement System of Texas			
Exhibit 2: Key Performance Measures—Fiscal Year 2004			
Key Performance Measures	FY 2004 Target	FY 2004 Actual Performance	FY 2004 % of Annual Target
<i>Outcome Measures:</i>			
<i>TRS Annual Operating Expense Per Active and Retired Members (excluding investment expenses)</i> Definition: This measure is intended to show the annual cost (excluding investment expenses) per member (active and retired) to operate the TRS pension fund.	\$27.00	\$22.89	84.8% ⁸
<i>Percent of TRS-Care Participants Satisfied with Services</i> Definition: This measure is intended to indicate the level of satisfactions with TRS-Care services among participants.	70.00%	90.80%	129.71% ⁹
<i>Output or Efficiency Measures:</i>			
<i>Number of TRS Benefit Applications Processed</i> Definition: Using data from TRS information systems, all applicable transactions are searched to determine the percentage that comply with performance targets.	66,000	75,249	114.01% ¹⁰
<i>Dollar Amount of Participating</i>	\$187,080,000	\$348,914,238	186.51% ¹¹

8 Explanation of +/-5% Variance: The FY 2004 budget request included funding for 13 new positions and an increase in professional services related to investments management. A hiring freeze implemented in FY 2003 created vacancies in existing positions, delaying TRS's ability to fill new positions (average actual FTEs for FY 2004 was 412, 11 positions under the FTE cap for FY 2003). Due to market conditions, investment in alternative asset classes was lower than anticipated, thus the need for the related professional services was also reduced.

9 Explanation of +/-5% Variance: Due to solvency issues with the TRS-Care Program at the time the FY 2004 target was set, it was anticipated that participants could experience a significant increase in premiums and/or reduction in benefits. Legislation was subsequently enacted that increased funding from active members, the state, and school districts, offsetting the need to raise premiums to an even higher level had this funding not been provided. Based on TRS's concerted efforts to improve the quality of service delivery, satisfaction ratings continue to remain high.

10 Explanation of +/-5% Variance: Cumulative annual applications processed (75,249) exceeded the annual target (66,000) by 14.01%. TRS does not control the number of applications received, and all applications received are processed. Indications are that increased retirement volume was due to changes in the Social Security Government Pension Offset (GPO) law and in state laws related to retiree health benefit eligibility.

11 Explanation of +/-5% Variance: Cumulative annual savings (\$348,914,238) exceeded the annual target (\$187,080,000) by 86.51%. Savings from the hospital, pharmacy, and physician network have increased due to continued aggressive pricing of these services, which results in reduction of cost to the plan. Additional savings have been realized by the restructuring of

Key Performance Measures	FY 2004 Target	FY 2004 Actual Performance	FY 2004 % of Annual Target
<p>Network Savings Definition: This amount is an estimate reported by the program's benefit health consultant. This measure indicates the savings estimated from reasonable and customary charges through the discounted network participating fees.</p>			
<p>Percent of TRS Retirees Who Received Their First Annuity Within 31 Days of Their Effective Retirement Date Definition: Using data from TRS information systems, all applicable transactions are searched to determine the percentage that comply with performance targets.</p>	98.00%	99.03%	101.05%
<p>Average Customer Hold Time for Calls Received on Toll-Free Number (In Minutes) Definition: This measure provides the average time (in minutes) it takes for a telephone call received through the toll-free telephone line to be answered by a TRS benefits counselor after the call is released from the automated telephone system.</p>	3.00	5.82	194.00% ¹²
<p>Percent of Claims Adjudicated within 14 Days of Receipt Definition: This measure is intended to reflect the efficiency of claims settlement.</p>	93.00%	94.09%	101.17%

prescription drug benefits and the TRS-coordinated care network, which includes the majority of areas in Texas and all out-of-Texas (in the USA) having network services provided by Aetna's network.

12 Explanation of +/-5% Variance: Increased hold time reflected the volatile environment created by numerous legislative issues related to retiree health benefit eligibility and changes in the Social Security Government Pension Offset law. There was much anxiety among members concerning the change in federal law, causing a record number of retirements in FY 2004 (28,000+, with 38% processed in June and July) as the members attempted to meet a June 30th deadline. These issues are complex and required lengthier call durations. Other drivers for increased call volume were questions concerning increases in retiree health care premiums and the complete redesign of the retiree health care plans effective September 1, 2004.

III. History and Major Events

- 1936 The Teacher Retirement System of Texas (TRS) was created by an amendment to the Texas Constitution to provide a service retirement program for teachers and administrators of the public school systems of Texas, including the Texas Education Agency and institutions of higher education.
- 1937 Enabling legislation for a teacher retirement plan and administration of the System was signed into law by the 45th Legislature.
- 1949 TRS retirement plan membership was expanded to include all employees of public education institutions, including cafeteria workers and bus drivers.
- 1967 The legislature established the Optional Retirement Program (ORP) as an alternative to TRS designed to offer public higher education faculty more portable retirement programs through individual annuities.
- 1970 TRS obtained a determination from the U.S. Internal Revenue Service (IRS) that the TRS pension plan is “qualified” under Section 401(a) of the federal tax code. Plan qualification offers certain tax advantages to the member and plan, and imposes certain responsibilities.
- 1985 The 69th Legislature established TRS-Care, a health benefit program for public school retirees. Most school districts did not extend health insurance coverage upon an employee’s retirement. TRS was given statutory responsibility to administer this new program.
- 1987 The TRS pension plan was amended to take advantage of the federal tax code “pick up” provision for governmental plans. As amended, the TRS plan provides that compensation earned by TRS members after December 31, 1987 is treated as “picked up” by employers, thus allowing income tax on the member contributions plus interest to be deferred until the time of distribution.
- 1989 New state law required Texas public retirement systems, including TRS, to make direct payment of the portion of retirement benefits awarded by a court under a Qualified Domestic Relations Order (QDRO) to former spouses of members and other eligible non-participants.
- 1993 State law was amended to establish a new credit transfer program for members of TRS and the Employees Retirement System (ERS), thus improving portability between these two systems.
- 1995 Following Sunset Reviews in 1993 and 1995, the 74th Legislature passed significant legislation affecting TRS, including:
- Legislation clarifying that the purpose of the retirement system is “to invest and protect the funds of the retirement system and to deliver benefits provided by statute, not to advocate or influence legislative action or inaction or to advocate for higher benefits.”
 - Legislation restructuring the TRS Board of Trustees, which included changing direct appointees of the State Board of Education to gubernatorial appointees selected from a list of candidates submitted by the State Board of Education.
 - Legislation altering the funding of the TRS operating budget from pension trust funds to General Revenue funds. General Revenue funding was appropriated for two biennia, but has not been provided since FY 1999.
- 1999 Legislation was enacted authorizing TRS to administer an optional long-term care insurance program for eligible active members and retirees (and certain family members).
- The TRS administrative budget for the pension fund no longer received appropriated funds as of the FY 2000-2001 biennium. The funding source was shifted back to the pension trust fund by the General Appropriations Act, even though the statute was unchanged.
- 2001 Legislation was enacted to:
- Create TRS-ActiveCare, a statewide health benefit program for employees of school districts, open enrollment charter schools, regional education service centers, and other educational districts whose employees are members of TRS.

- Create a TRS-administered certification program for companies offering 403(b) investment products to Texas public school employees through payroll deduction.
 - Establish the supplemental compensation program to “pass through” \$1,000 of state funding annually for each eligible public school employee to support health benefit program participation. TRS was designated to administer the payment pass-through.
- 2002 TRS-ActiveCare was implemented with smaller districts being required to participate. Since that time, additional districts have opted to participate in TRS-ActiveCare, which now provides health benefit coverage to about 247,000 TRS members and their family members.
- 2003 The supplemental compensation program provisions were amended and replaced by a new Health Reimbursement Arrangement (“HRA”) program to be administered by TRS. However, it was determined by state leadership that the HRA program had not been funded and the supplemental compensation was to remain in place. Due to the determination regarding lack of funding, the TRS Board of Trustees discontinued efforts to put HRAs in place. Other significant legislative changes included a new 90-day waiting period for TRS membership during the biennium, changes to TRS-Care eligibility, and reduction of the supplemental compensation amount from \$1,000 to \$500 annually.
- 2005 The 79th Legislature passed significant legislation affecting TRS including:
- SB 1691, a TRS “omnibus” bill covering administration, retirement benefits, and TRS-Care. This bill also transferred administration of the supplemental compensation program to the Texas Education Agency. Additionally, it requires public education employers to pay the equivalent of the state contribution during the first 90 days of a new employee’s service. Also, it significantly amended “return to work” laws to require a public education employer that hires a TRS retiree to pay the equivalent of the state and member contribution rate applied to the retiree’s salary, and to pay the difference between the retiree’s contribution for TRS-Care coverage and the actual cost of the coverage.
 - SB 121, a bill identifying information relating to private equity portfolios that is considered public information, and designating the remainder as confidential.

In addition to the program responsibilities outlined above, a number of retirement benefit enhancements were made over the years. There have also been a number of changes in the System’s investment authority. These changes are discussed in more detail in Section VII, *Guide to Agency Programs*.

IV. Policymaking Structure

A. Complete the following chart providing information on your policymaking body members.

Teacher Retirement System of Texas Exhibit 3: Policymaking Body			
Member Name	Term/ Appointment Dates/ Appointed by Governor	Statutory Qualification Requirements (See TEX. GOV'T CODE § 825.002)	City
Jarvis V. Hollingsworth, Chair	Six-year term (2001-2007); Appointed on August 13, 2002; Direct appointment by the Governor	1. Demonstrated financial expertise; 2. Worked in private business or industry; 3. Broad investment experience, preferably in investment of pension funds; 4. Not a member or annuitant of the retirement system; 5. Trustee and spouse not disqualified under § 825.0032, Government Code; 6. Reside within Texas; 7. Constitutional oath of office	Missouri City, Texas
Mary Alice Baker, Ph.D., ViceChair	Six-year term (1999-2005); Appointed on October 20, 1999; Appointed by the Governor from three higher education active member candidates nominated by employees of institutions of higher education	1. One of the top three higher education active member candidates nominated by employees of institutions of higher education; 2. Current employee in the group represented; 3. Not disqualified under § 825.0032, Government Code; 4. Reside within Texas; 5. Constitutional oath of office	Beaumont, Texas
Terence (Terry) Ellis	Six-year term (1999-2005); Appointed on October 20, 1999; Direct appointment by the Governor	1. Demonstrated financial expertise; 2. Worked in private business or industry; 3. Broad investment experience, preferably in investment of pension funds; 4. Not a member or annuitant of the retirement system; 5. Trustee and spouse not disqualified under § 825.0032, Government Code; 6. Reside within Texas; 7. Constitutional oath of office	New Ulm, Texas
James W. (Jim) Fonteno, Jr.	Six-year term (2001-2007); Appointed on January 30, 2003; Appointed by the Governor from a list prepared by the State Board of Education	1. Demonstrated financial expertise; 2. Worked in private business or industry; 3. Broad investment experience, preferably in investment of pension funds; 4. Not an annuitant of the retirement system; 5. Trustee and spouse not disqualified under § 825.0032, Government Code; 6. Reside within Texas; 7. Constitutional oath of office	Houston, Texas
John Graham, Jr.	Six-year term (2003-2009); Appointed on	1. Demonstrated financial expertise; 2. Worked in private business or	Fredericksburg, Texas

Teacher Retirement System of Texas Exhibit 3: Policymaking Body			
Member Name	Term/ Appointment Dates/ Appointed by Governor	Statutory Qualification Requirements (See TEX. GOV'T CODE § 825.002)	City
	September 3, 2003; Appointed by the Governor from a list prepared by the State Board of Education	industry; 3. Broad investment experience, preferably in investment of pension funds; 4. Not an annuitant of the retirement system; 5. Trustee and spouse not disqualified under § 825.0032, Government Code; 6. Reside within Texas; 7. Constitutional oath of office	
John Mark Henry, Ed.D.	Six-year term (2003- 2009); Appointed on September 4, 2003; Appointed by the Governor from three public school districts active member candidates nominated by employees of public school districts	1. One of the top three active member candidates nominated by employees of public school districts; 2. Current employee in the group represented; 3. Not disqualified under § 825.0032, Government Code; 4. Reside within Texas; 5. Constitutional oath of office	Galena Park, Texas
Greg Poole, Ed.D.	Six-year term (2001- 2007); Appointed on October 24, 2002; Appointed by the Governor from three public-school-district active member candidates nominated by employees of public school districts	1. One of the top three active member candidates nominated by employees of public school districts; 2. Current employee in the group represented; 3. Not disqualified under § 825.0032, Government Code; 4. Reside within Texas; 5. Constitutional oath of office	Conroe, Texas
Dory A. Wiley	Six-year term (2003- 2009); Appointed on October 29, 2003; Direct appointment by the Governor	1. Demonstrated financial expertise; 2. Worked in private business or industry; 3. Broad investment experience, preferably in investment of pension funds; 4. Not a member or annuitant of the retirement system; 5. Trustee and spouse not disqualified under § 825.0032, Government Code; 6. Reside within Texas; 7. Constitutional oath of office	Dallas, Texas
Linus D. Wright	Six-year term (1999- 2005); Appointed on October 20, 1999; Appointed by the Governor from three retired members nominated by retired TRS members	1. One of the top three retired member candidates nominated by retired TRS members; 2. Current retiree in the group represented; 3. Not disqualified under § 825.0032, Government Code; 4. Reside within Texas; 5. Constitutional oath of office	Dallas, Texas

The TRS Board of Trustees is responsible for the administration of the System under the provisions of the Texas Constitution and state law. The Board is composed of nine trustees who are appointed to staggered six-year terms. Three trustees are direct appointments of the Governor. Two trustees are appointed by the Governor from a list prepared by the State Board of Education. Two trustees are appointed by the Governor from the three public school district active member candidates who have been nominated for each position by eligible employees of public school districts. One trustee is appointed by the Governor from the three higher education active member candidates nominated by eligible employees of institutions of higher education. One trustee is appointed by the Governor from the three retired member candidates who are nominated by retired TRS participants. Appointments are subject to confirmation by the Senate. Board member terms expire on August 31 of odd-numbered years.

B. Describe the primary role and responsibilities of your policymaking body.

The Board of Trustees is the trustee of all TRS assets, is responsible for the general administration and operation of TRS, and is authorized to adopt rules for the administration of TRS and the transaction of the business of the Board. As trustee of the TRS assets, the Board may invest and reinvest those assets in compliance with the Texas Constitutional provision governing such investments. That provision states, “Each statewide benefit system must have a Board of Trustees to administer the system and to invest the funds of the system in such securities as the board may consider prudent investments. In making investments, a board shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital.” TEX. CONST. art. XVI, § 67(a)(1).

As part of its investment responsibilities, the Board may contract with private investment professionals to advise them about investing the assets of the retirement System. The Board employs performance measurement services to evaluate and analyze the investment results of those assets of the retirement system for which reliable and appropriate measurement methodology and procedures exist. The Board develops written investment objectives, and these services compare TRS investment results to these objectives, as well as with the investment results of other public funds. Additionally, the Board develops an investment policy and asset allocation strategies. [See generally TEX. GOV’T CODE § 825.301.]

C. How is the chair selected?

Section 825.201, Government Code, provides that the Governor appoints the chair of the Board of Trustees. The Board of Trustees elects its ViceChair.

D. List any special circumstances or unique features about your policymaking body or its responsibilities.

Because the retirement plan is established as a trust under TEX. CONST. art. XVI, § 67, the retirement system is governed by a Board of Trustees. By designating the TRS Board as one of “trustees” instead of board “members,” the constitution emphasizes that the retirement plan assets are held in trust, and the members of the governing board are required to act as fiduciaries in their administration of the plan and investment of the plan assets. The constitution requires that the assets of the System not be diverted. This imposes a duty on the TRS Board of Trustees to restrict use of assets to the benefit of the participants of the System. Use of the System assets for the benefit of the public in general, for the benefit of other programs or other program participants, or for the pursuit of other policies (such as social investing) are examples of situations that may amount to or can lead to diversion of System assets.

Statutory provisions also emphasize the Board’s role as fiduciary and the trust arrangement for plan assets and administration. For example, TEX. GOV’T CODE § 825.314 recognizes that, when necessary to perform their fiduciary duty, the Board of Trustees may expend trust funds in excess of the General Revenue funds identified for the pension fund’s administrative operations in the Appropriations Act. This section recognizes that the Board of Trustees, as fiduciaries, must have sufficient operating budget flexibility to fulfill their duties.

Another example is § 825.506, which provides that the provisions of subtitle C (that is, those applicable to the retirement plan) are intended to be construed and administered in a manner so that the retirement system’s benefit plan will be considered a qualified plan under Section 401(a) of the Internal Revenue Code of 1986 (26 U.S.C. Section 401). The Board is authorized to adopt rules that modify the plan to the extent necessary for the retirement system to be a qualified plan. Under Section 401(a), a trust forming part of a pension plan for the exclusive benefit of employees or their beneficiaries constitutes a qualified trust if:

- Contributions are made to the trust for the purpose of distributing to employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with the plan; and
- If under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of the employees or their beneficiaries.

The “exclusive benefit” requirement of IRC Section 401(a) is met by the provisions of the Texas Constitution requiring that the assets of the plan are held in trust for the benefit of members and may not be diverted. This provision is a key state and federal requirement because it obligates the retirement system to defend against possible diversion of the trust assets, including for public uses that may only incidentally benefit the beneficiaries of the trust.

An example is TEX. GOV'T CODE § 825.103, which provides that the Board of Trustees is the trustee of all assets of the retirement system and requires that the Board invest and reinvest the System's assets in compliance with the constitutional provisions.

Similarly, the two health benefit programs administered by TRS are also funded by trust funds, and the Board owes common law duties as trustees toward participants in those programs. The 403(b) certification program obtains its operating budget from fees paid by companies who certify they meet the requirements of law. TEX. REV. CIV. STAT. ANN. art. 6228a-5, § 7 requires those fees to be administered as a trust fund with the retirement system as a trustee.

E. In general, how often does your policymaking body meet? How many times did it meet in FY 2004? in FY 2005?

Generally, the TRS Board of Trustees meets approximately eight times each year. The Bylaws of the Board of Trustees of the Teacher Retirement System of Texas require that the Board meet at least four times per fiscal year. In FY 2004, the Board met nine times. The Board met eight times in FY 2005. The dates of TRS Board and committee meetings for FY 2004 and FY 2005 are shown below.

Board and Committee Meeting Dates	
FY 2004	FY 2005
September 25-26, 2003	September 23-24, 2004
November 21, 2003	November 18-19, 2004
December 18-19, 2003	December 16-17, 2004
January 29-30, 2004	February 25, 2005
March 25-26, 2004	March 23-24, 2005
May 21, 2004	May 6, 2005
June 17-18, 2004	June 9-10, 2005
July 23, 2004	July 8, 2005

Scheduled Board meetings for the remainder of the 2005 calendar year include:

Scheduled Board and Committee Meeting Dates
September 8-9, 2005
November 4, 2005
December 8-9, 2005

F. What type of training do members of your agency's policymaking body receive?

TEX. GOV'T CODE § 825.0041 provides that a prospective trustee must complete at least one

course of the training program established by the statute before the individual may assume Board duties and, if applicable, before the individual may be confirmed by the Senate. The training course established by Section 825.0041 requires that the prospective trustee be provided information regarding:

- The enabling legislation that created the retirement system and its policymaking body to which the individual is appointed to serve;
- The programs operated by the System;
- The role and functions of the System;
- The rules of the System with an emphasis on the rules that relate to disciplinary and investigatory authority;
- The current budget for the System;
- The results of the most recent formal audit of the System;
- The requirements of the open meetings law, open records law, and administrative procedure law;
- The requirements of the conflict of interest laws and other laws relating to public officials; and
- Any applicable ethics policies adopted by the System or the Texas Ethics Commission.

As part of their training, new trustees receive copies of various materials, including:

- Bylaws of the Board of Trustees;
- TRS Ethics Policy;
- Code of Ethics for Consultants, Agents, Financial Providers and Brokers;
- TRS Laws & Rules;
- Statutes Affecting Personal Responsibilities of State Agency Board Members;
- Open Meetings Handbook;
- Public Information Handbook;
- Investment Policies and Manual;
- The most recent agency budget;
- The most recent Strategic Plan;
- The most recent Comprehensive Annual Financial Report (CAFR);
- The most recent Actuarial Evaluation;
- The most recent Actuarial Experience Study;
- The most recent Asset/Liability Model of TRS;
- The most recent TRS-ActiveCare Benefits Administrators Guide;
- TRS-Care Plan Booklet;
- TRS-ActiveCare Benefits Booklet;
- TRS Benefits Handbook;
- The most recent TRS-Related Legislation pamphlet;
- Information on the history of benefit improvements;
- Information on the agency's obligations under the Health Insurance Portability and Accountability Act of 1996 (HIPAA); and
- Information on Deferred Retirement Option Plan (DROP) and Partial Lump Sum Option (PLSO).

The new trustees meet with TRS staff to discuss these various materials and ask questions. During their terms, trustees receive additional training on an *ad hoc* basis on issues that are identified. Section 1.10 of the Bylaws encourages trustees to attend workshops and training sessions on such matters as fiduciary duties, actuarial valuations, investment issues, and benefits delivery, which may enable trustees to better fulfill their responsibilities to the System. As is set out in more detail in question G below, the Bylaws were amended in 1995 to provide a separate budget for trustees to attend training seminars. Section 1.9.3 of the Bylaws provides that it is anticipated that each Board member will receive an allocation of one-ninth of an amount established through the budget process for reimbursement of allowable Board travel expenses to attend conferences and other activities so long as the purpose of the expense is related to the business of TRS and the Board and attendance at the function will benefit the Board in the exercise of its responsibilities.

G. Does your agency have policies that describe the respective roles of the policymaking body and agency staff in running the agency? If so, describe these policies.

TEX. GOV'T CODE § 825.113 provides that the Board “shall develop and implement policies that clearly separate the policymaking responsibilities of the Board and the management responsibilities of the Executive Director and the staff of the retirement system.” The TRS Board of Trustees has adopted the Bylaws of the Board of Trustees of the Teacher Retirement System of Texas, which set out the respective roles of the Board and agency staff. Additionally, the Policy Committee of the Board adopts a policy review schedule annually. Pursuant to that schedule, the Policy Committee and the Board review, amend (if necessary), and approve identified policies that set out the responsibilities of the Board and staff. Generally, operational matters are delegated to staff to be implemented in accordance with policies that the Board has reviewed and adopted.

Bylaws:

Section 1.8 of the Bylaws sets out the general responsibilities of the Board as follows:

1.8 Responsibilities of the Board. Board members are TRS fiduciaries and shall discharge their duties in the exclusive interest of members and annuitants for the purpose of providing authorized benefits to participants and their beneficiaries. The Board shall:

- (a) establish and periodically review the TRS mission in light of its constitutional and statutory authority and set clear goals for accomplishment;
- (b) adopt rules, regulations, and bylaws as deemed appropriate;
- (c) adopt and periodically review policies for the operation of the System;
- (d) select and evaluate the performance of the Executive Director;
- (e) provide oversight and direction to the Executive Director to ensure that effective management practices are followed in the organization;
- (f) approve the annual operating budget;
- (g) receive reports from the staff, investment counsel, and others regarding the investment portfolio;
- (h) review investment performance, asset mix, portfolio characteristics, cash flow,

- transactions, and monitor compliance with investment policies and guidelines;
- (i) ensure the establishment of a system for equitable and effective hiring, evaluation, compensation, and termination of employees;
 - (j) monitor and evaluate the effectiveness of the System;
 - (k) ensure an adequate working environment for staff members;
 - (l) establish committees to make recommendations to the Board and help carry out the Board's responsibilities; however, such committees may not exercise authority required under these Bylaws or by state or federal law to be exercised by the Board as a whole, and the Board may consider or take any action otherwise specified to be taken or considered by a committee created pursuant to article 3;
 - (m) delegate authority to the staff through the Executive Director;
 - (n) consider appeals as provided in Board rules;
 - (o) select and evaluate an actuary;
 - (p) select custodian(s) for the investment portfolio;
 - (q) select and evaluate investment counsel or other consultants to provide such expert advice and assistance to the Board as the Board deems necessary to exercise its investment and trust administration responsibilities;
 - (r) select and evaluate fiduciary counsel;
 - (s) appoint members of the Medical Board;
 - (t) appoint members and officers of the Retirees Advisory Committee;
 - (u) select the director of internal audit in consultation with the Audit Committee and Executive Director;
 - (v) select the deputy director and the chief investment officer, each in consultation with the Executive Director; and
 - (w) delegate to the Executive Director the responsibility for all administrative functions.

Section 4.1 of the Bylaws sets out the responsibilities of the Executive Director regarding the Board operations and certain responsibilities regarding TRS operations. For the Board, the Executive Director:

- Makes preparations, including trustee travel arrangements, for all Board and committee meetings;
- Under the direction of the Board or committee chair, prepares and distributes the agendas and appropriate documentation for all Board and committee meetings;
- Under the direction of the Board or committee chair, posts notices of all meetings and the subject matter thereof as required by law;
- Causes the secretary to the Board to record, prepare, and index the official minutes of the Board and its committees;
- Files and preserves all official documents, correspondence, and proceedings of the Board and its committees;
- Maintains custody of the TRS official seal and designates in writing those employees, in addition to the secretary to the Board, who may have custody of counterparts of the TRS seal and authority to affix the seal;
- Maintains the official copy of the Bylaws;
- As directed by the Board, establishes routine reporting mechanisms and procedures to the

- Board and prepares special reports to the Board; and
- Carries out other policies adopted by the Board.

For TRS, the Bylaws state that the Executive Director is the chief executive officer of TRS and is responsible to the Board for the general administration of the agency in accordance with state laws and policies adopted by the Board. The Executive Director's responsibilities are as follows:

- Manages the daily operations of TRS;
- Assumes managerial responsibility and leadership for the planning, operation, supervision, and evaluation of programs and services;
- Assumes authority and responsibility for the selection, evaluation, promotion and dismissal of all TRS personnel unless otherwise provided by the Bylaws;
- Prepares and submits an annual operating budget for Board consideration;
- Prepares recommendations for policies to be considered by the Board and oversees the implementation of adopted policies;
- Recommends to the Board the selection of the actuary, custodian for securities, investment and fiduciary counsel, deputy director, chief investment officer, and director of internal audit; and
- Organizes TRS to accommodate its mission.

Further, in Section 5.6, the Board expressly delegates authority for the following matters:

- Investment decisions, in accordance with TRS investment policies and applicable state law;
- Contracts for the purchase of goods and services to the Executive Director or his designee in accordance with the budget, resolutions, and policies adopted by the Board;
- Release of assets held in the name of TRS, its nominees, or other agents, in accordance with resolutions and policies of the Board;
- Approval of retirement, benefit payments and refunds in accordance with resolutions and policies of the Board and applicable state law;
- Execution of vouchers for payment of TRS funds, in accordance with resolutions and policies of the Board; and
- Initiation, defense, and settlement of lawsuits and other claims to the Executive Director or his designee, subject to applicable resolutions and policies of the Board.

Policies:

Pursuant to the Policy Review schedule (a copy of which is attached to this report as Attachment #25), the Policy Committee and the Board review, amend (if necessary), and approve identified policies that set out the responsibilities of the Board and staff. The policies that the Board reviews and approves are:

- Rules of the Board of Trustees;
- Bylaws of the Board of Trustees;

- Mission Statement;
- At-Will Employment;
- Authority to Approve Benefit and Refund Payments;
- Authorization to Approve and Sign Vouchers;
- Internal Audit Charter;
- Designation of Key Employees;
- Ethics Policy;
- Ethics Compliance Statement;
- Disciplinary Action Disclosure Statement;
- Notice of Preclearance Decision;
- Personal Security Transactions Disclosure Statement;
- Code of Ethics for Consultants, Agents, Financial Providers, and Brokers;
- Consultant, Agent, Financial Provider and Broker Annual Ethics Compliance Statement;
- Expenditure Reporting Memorandum;
- Expenditure Reporting Form for Contractors;
- Conflict of Interest Disclosure Statement;
- Disclosure Statement for Brokers and Financial Providers;
- Investment Policy Statement;
- Soft Dollar Policy;
- Proxy Voting Policy;
- Securities Lending Policy;
- Authority Resolution/Incumbency Certificate; and
- Board Governance Disclosure Policy and Procedures.

These policies, once approved by the Board, provide guidance to staff and delegate certain functions to staff. For example, the Investment Policy Statement distinguishes between the tasks to be performed by the Board and the tasks delegated to the Chief Investment Officer and TRS investment staff.

<p>H. What information is regularly presented to your policymaking body to keep them informed of your agency's performance?</p>
--

The TRS Board typically meets eight or nine times per year, with committee-level reviews of core agency operations occurring each quarter. Every three to five years, the Board commissions an external asset-liability study to test the validity of certain actuarial assumptions, ensure accurate actuarial valuations, and assist them in making informed decisions about asset allocation. The Board also receives regular independent input from its technical advisors, which include the following:

- General investment consultant
- Consulting actuary
- Fiduciary counsel
- Investment advisors
- Master custodian and securities lending agent
- Investment performance measurement consultant

- Private equity consultants
- Real estate consultant
- Absolute return portfolio consultant
- Health care consultant

In combination with measurement and reporting processes designed to comply with state government requirements and provide pertinent data for Board oversight functions, TRS uses a number of internal processes to monitor and measure its ongoing performance. The following chart reflects additional key measurement processes that are routinely reported to the Board.

Teacher Retirement System of Texas Supplemental Chart: Measurement Processes Reported to Board			
Process	Description	How Often Evaluated?	How Resulting Information Is Used
Administrative/Financial Processes			
Key Financial Measures			
▪ Financial Reporting	Comprehensive Annual Financial Report (CAFR)	CAFR prepared and reported to Board annually, with interim financial reports provided monthly.	Used to monitor financial condition of TRS.
▪ Expenditure Report	Monthly cash disbursements	Provided at each Board meeting.	To comply with TEX. GOV'T CODE § 825.314.
▪ Actuarial Valuation	Describes the actuarial condition of the TRS pension fund, including the extent to which the System's liabilities are unfunded, as required by TEX. GOV'T CODE § 825.108.	Annually.	To monitor the actuarial soundness of the fund and to assist with preparation of actuarial impact statements during legislative sessions.
▪ Actuarial Experience Study	Required by TEX. GOV'T CODE § 825.206, to investigate the mortality, service, and compensation experience of TRS participants	At least every five years.	To review all actuarial assumptions in light of experience; to modify actuarial tables and rates as necessary. To evaluate the assets and liabilities of the System.
▪ Actuarial Audit	Required by TEX. GOV'T CODE § 825.506, to review actuarial assumptions, verify demographic data, & confirm valuation results.	At least every five years.	To modify or confirm assumptions, and to determine effects of any recent plan changes through legislation.
HUB Utilization	Percent of total dollar value of purchasing contracts and subcontracts awarded	Tracked and reported to management semi-annually; reported to Board annually.	Used to analyze and enhance overall HUB utilization.

Process	Description	How Often Evaluated?	How Resulting Information Is Used
	to HUBs.		
Survey of Organizational Excellence	Survey (administered by the UT School of Social Work) designed to assess organizational effectiveness and improve the quality of life in the workplace.	Conducted and results reported to the Board every two years.	Used for two-way communication with all employees to develop appropriate actions to strengthen organizational effectiveness.
Litigation Report	Provides update on status of litigation in which TRS is a party; provides number of securities class action lawsuits in which TRS has filed a claim and the amount recovered	Quarterly.	Used for Board to monitor TRS litigation; used for staff to demonstrate efforts to recover funds owed in securities class action litigation in which TRS is a class member.
Departmental Presentations	Provides key staffing, workload, responsibilities, and other information for departments	Quarterly, on rotating basis among TRS departments.	Used by Audit Committee of TRS Board of Trustees to obtain more information about TRS processes in all areas, including Information Technology, Human Resources, and other departments that are not directly responsible for TRS program administration..
Health Benefit Processes			
TRS-ActiveCare Financial Statements	TRS staff and health care consultants make benefit and premium change recommendations.	Annually for each plan year beginning September 1 st .	Used to determine benefits and set rates for each plan year.
TRS-Care Financial Statements	Monitor cash flow and fund balances.	Reported to Board monthly.	To recommend any applicable plan/premium changes.
Actuarial Update Letter	Status update provided by actuarial consultant.	Reported to Board monthly.	To monitor actuarial experience and funding status.
Cost Analysis	Fiscal data on key cost indicators.	Reported to Board quarterly.	To update Board on claims activity, costs, and number of participants.
LBB Measures	Performance measure data.	Reported to Board annually.	To provide annual LBB performance measure results.
Internal Audit Processes			
Annual Audit Plan , as required by professional auditing standards and the TEX. GOV'T CODE § 2102.009	Planned audit projects for the current fiscal year.	Continually monitored by Internal Audit; reported to the	The plan provides guidance in providing and monitoring internal

Process	Description	How Often Evaluated?	How Resulting Information Is Used
		Audit Committee of the Board quarterly and at year-end.	auditing services for each fiscal year.
Annual Internal Audit Report , as required by the TEX. GOV'T CODE § 2102.009	Comparison of Internal Audit accomplishments to original Audit Plan.	Reported to Board annually.	Used to determine whether planned audit functions were completed.
Status Report on Implementation of Audit Recommendations	Lists the current status and management action plan for each internal and external audit recommendation.	Reported to Board Audit Committee quarterly.	To monitor all internal and external audit recommendations; to meet professional standards; and to demonstrate good business practices.
Operational Performance Measurement Processes			
Key Retirement Benefit Services Measures			
<ul style="list-style-type: none"> ▪ Retirement Estimates Mailed to Members ▪ Retirement Applications Processed ▪ Deferred Retirement Option Plan Applications Processed ▪ Refund Applications Processed ▪ Death Claims Processed and Closed ▪ New Service Purchase Bills Sent to Members ▪ Service Purchase Installment Agreements Set Up ▪ Member Telephone Calls ▪ Average Speed of Answer ▪ Automated Telephone System 	Statistical information on workload measures.	Tracked monthly; reported to Board semi-annually.	To monitor key benefit service-delivery activities to ensure that service-delivery standards are being met or exceeded; and to allow management to reallocate resources as needed to ensure service-delivery goals are met.
<ul style="list-style-type: none"> ▪ Telephone Counseling 	Telephone statistical report.	Monitored and reported to Board monthly (will begin quarterly reporting in September 2005).	To keep Board informed of average customer hold time.
<ul style="list-style-type: none"> ▪ Web Site Statistics 	Statistics on the number of visits to different areas of TRS Web site.	Reported to Board annually.	To keep Board informed of Web site activity.
<ul style="list-style-type: none"> ▪ Initial Pension Payments 	Detailed list of members and beneficiaries receiving initial payments.	Reported to Board quarterly.	To obtain approval/validation of payments.
<ul style="list-style-type: none"> ▪ Payroll Summary 	Two payroll summary reports by month.	Reported to Board quarterly.	To keep Board informed of payroll activity.
<ul style="list-style-type: none"> ▪ Disability Retirement 	Medical Board minutes.	Reported to Board quarterly.	To obtain approval/ratify minutes.
<ul style="list-style-type: none"> ▪ Customer Satisfaction Survey 	Independent survey	Conducted and	To assess and monitor

Process	Description	How Often Evaluated?	How Resulting Information Is Used
	conducted for TRS.	results reported to the Board every two years.	the level of customer satisfaction with TRS programs and services.
Key Investments Measures			
<ul style="list-style-type: none"> ▪ Performance Calculation by Asset Type and Total Fund 	Investment return information.	Reported internally daily, weekly, and monthly; reported to Board quarterly.	Evaluated against established benchmarks (weighted based on Board’s asset allocation).
<ul style="list-style-type: none"> ▪ Custodian Performance Evaluation 	Assesses Custodian’s performance in the areas of Investment Accounting, Performance and Analytics, Portfolio Management, Alternative Investments, Investment Services, Technical, and Trading.	Conducted and results reported to the Board bi-annually.	Used to identify and address areas of concern to internal staff (as well as areas of satisfaction) in the performance of the Custodian.
Investment Compliance Function	Established and staffed by a full-time Investment Compliance Officer since 1998.	Reported to Board quarterly.	Used to assess ongoing compliance with Board’s Investment Policy Statement.
Risk Management			
Business Impact Analysis/ Business Continuity Plan	An analysis of impact on agency if critical functions are unavailable.	Conducted and reported to Board annually, with interim updates as needed.	Used to assess and address areas of potential vulnerability, by means of the Business Continuity Plan.
Hot-Site Exercise	Actual demonstration of ability to restore infrastructure (including information technology and voice systems and to deploy essential staff) in the event of a disaster.	Conducted and results reported to Board annually.	Used to assess and address areas of potential vulnerability.
Insurance Assessment	Insurance policies are reviewed annually to ensure the policies address the exposures. Assessments may be dictated by current events.	Conducted and results reported to Board annually.	Used to determine that necessary and prudent insurance coverage remains in place.
Fraud Prevention, Detection, and Elimination Program (in line with Governor’s Executive Order RP-36)	Management analyzes and documents key processes, including process description, departmental interfaces, reliance on third parties,	Conducted training to the Agency Management team and presentation made to the Internal Audit Committee of the Board of Trustees	Used to identify and address areas of potential risk.

Process	Description	How Often Evaluated?	How Resulting Information Is Used
	possibilities of fraud, and risk controls.	in September 2004.	

TRS also operates under significant state government review and oversight. The System uses a combination of external performance measures and controls, ongoing oversight by the Board of Trustees (with advice from external technical consultants and advisors), and internal performance monitoring to ensure that performance goals are met. The Board approves or is advised of all external performance measure reports.

I. How does your policymaking body obtain input from the public regarding issues under the jurisdiction of the agency? How is this input incorporated into the operations of your agency?

The Board receives public input in several different ways. Section 2.2 of the Bylaws of the Board of Trustees of the Teacher Retirement System of Texas provides that the Board will allow reasonable time for public comment at the Board meetings. All TRS Board and Committee meeting agendas are posted in advance on the TRS Web site, in accordance with state law. The Board also receives public comment on proposed rules, which the Board considers as part of its rule-making authority. The Board considers all public comment and may respond by making changes to proposed rules before adoption or taking other action as appropriate.

TRS has had two public meetings in response to interest by stakeholder groups and TRS members to discuss proposed rules and programs; the topics of these meetings were the 403(b) certification program in 2002, and eligibility for the Pass-Through Supplemental Compensation, specifically the definition of “professional” in 2003. Periodically, TRS has conducted focus group meetings to solicit member feedback on various issues. Past topics have included annual statements, benefit handbooks, and benefit counseling.

TRS is charged with administering the benefits authorized by law. As a result, TRS’s discretion in most matters of concern to the public is limited to the adoption of rules for administration of the benefit plans. Rules generally are considered in a two-step process. First, the Policy Committee of the TRS Board of Trustees considers authorizing publication of a rule. Once the rule is published for the required length of time, it generally returns to the Policy Committee for recommendation to the TRS Board of Trustees regarding adoption. Policy Committee meetings are open to the public, and the committee will allow interested groups or individuals to comment on proposals. Second, the rule proposal (along with the Policy Committee’s recommendation), then is considered by the full TRS Board of Trustees, where again public comments generally are allowed before formal action is taken. When warranted, the TRS Board of Trustees has altered its approach or modified proposed rules based on public comment. Proposed rules also are posted for public comment on the *Texas Register*, in accordance with TEX. GOV’T CODE Chapter 2001, and any written comments that are submitted are addressed upon rule adoption.

Additionally, the Retirees’ Advisory Committee is established by statute to make

recommendations to TRS regarding the TRS-Care program. Committee comments and recommendations are presented to the Board for consideration as part of its deliberations concerning the plan design changes.

TRS conducts member satisfaction surveys every two years. The results of those surveys are presented to the Board. Additionally, the health benefit programs’ administrators also conduct customer satisfaction surveys annually, the results of which are presented to the Board.

Staff also provides information to the Board concerning public input that staff receives from a variety of sources. Staff presents statistics concerning Web site and TRS Information Line usage, including which Web pages are being accessed most often by visitors and what information members are seeking via the TRS Information Line. The Board may also receive reports from staff concerning inquiries and input from stakeholder groups on various issues.

J. If your policymaking body uses subcommittees or advisory committees to carry out its duties, fill in the following chart.

The TRS Bylaws provide for standing, special, advisory and auxiliary committees to assist the Board. The current standing committees are: Audit Committee, Benefits Committee, Budget Committee, Alternative Assets Committee, Policy Committee, and Ethics Committee. The Board has, from time-to-time, had special committees, which may be created by a Board resolution that sets forth the purpose and responsibilities of the committee and the terms for which it shall exist. A recent example of a special committee is the search committee that was involved in the selection of the current Executive Director. Advisory and auxiliary committees are those committees authorized or required by state law or Board policy. The standing committees typically meet during the Board’s quarterly meetings. Other committees meet as necessary, and the standing committees may meet more frequently than at the quarterly meetings.

Teacher Retirement System of Texas Exhibit 4: Subcommittees and Advisory Committees As of August 2005			
Name of Subcommittee or Advisory Committee	Size/Composition/How are members appointed?	Purpose/Duties	Legal Basis for Committee
Audit Committee	3 members/Board members Poole (Chair), Henry, and Hollingsworth /Members are appointed by Board resolution	The purpose and duties of the Audit Committee are: (1) to assist the Board in fulfilling its fiduciary oversight responsibilities for (a) the financial reporting process, (b) the risk management and internal control system, (c) the internal audit process, (d) the external audit process, (e) the process for monitoring compliance with laws and regulations, and (f) reporting and other activities; and (2) to coordinate and interface with the	Bylaws of the Teacher Retirement System of Texas Board of Trustees, § 3.1.1

Teacher Retirement System of Texas Exhibit 4: Subcommittees and Advisory Committees As of August 2005			
Name of Subcommittee or Advisory Committee	Size/Composition/How are members appointed?	Purpose/Duties	Legal Basis for Committee
		Board regarding Audit Committee activities and other pertinent matters.	
Benefits Committee	Not less than 3 and not more than 5 members /Board members Wright (Chair), Baker, Henry, Poole, Wiley/Members are appointed by Board resolution	The purpose of the committee is to assist the Board in carrying out its responsibility for delivery of benefits under programs administered by TRS. The committee (a) meets as necessary and at the call of the chairman of the committee to review and make recommendations to the Board as needed related to programs within its oversight; (b) receives cost-benefit analyses and recommendations from the Retirees Advisory Committee regarding TRS-Care, and recommends related actions to the Board; (c) recommends to the Board persons to serve on the Retirees Advisory Committee; (d) establishes performance standards for professional benefits consultants and participates in performance evaluations of those consultants; (e) recommends to the Board persons to serve on the Medical Board; and (f) reviews periodic reports by TRS staff or consultants on benefit delivery services, benefit-related trends, and other significant benefit topics.	Bylaws of the Teacher Retirement System of Texas Board of Trustees, § 3.1.2
Budget Committee	3 members unless otherwise provided by Board resolution/Board members Wright (Chair), Fonteno, Graham /Members are appointed by Board resolution	The purpose of this committee is to: (a) recommend budgets for approval by the Board; (b) recommend intra-budget transfers and budget amendments for approval by the Board; and (c) monitor implementation of the operating budgets of the pension trust and other programs.	Bylaws of the Teacher Retirement System of Texas Board of Trustees, § 3.1.3
Alternative Assets Committee	5 members/Board members Fonteno (Chair), Baker, Ellis, Hollingsworth, Wiley /Members are appointed by Board resolution	The purpose of this committee is to: (a) recommend individual investments in alternative assets when the committee's recommendation is required by the Board's Investment Policy Statement or resolutions adopted by the Board; and b) act as an advisory committee to the Board, based in each case on a specific referral adopted by the Board at a called meeting.	Bylaws of the Teacher Retirement System of Texas Board of Trustees, § 3.1.4
Policy Committee	3 members unless otherwise provided by Board resolution/Board members Hollingsworth (Chair), Graham, Wright/Members are appointed by Board resolution	The purpose of the Policy Committee is to assist the Board in fulfilling its policymaking responsibilities in accordance with TEX. GOV'T CODE § 825.113. The committee: (a) makes or reviews policy proposals, including those made by staff through procedures established by the Executive Director, and recommends	Bylaws of the Teacher Retirement System of Texas Board of Trustees, § 3.1.5

Teacher Retirement System of Texas Exhibit 4: Subcommittees and Advisory Committees As of August 2005			
Name of Subcommittee or Advisory Committee	Size/Composition/How are members appointed?	Purpose/Duties	Legal Basis for Committee
		new written Board policies and modifications to existing written policies as needed; (b) recommends new rules and rule amendments as needed and reviews existing rules periodically as required by law; (c) adopts and follows a plan of review for each fiscal year to ensure that all written TRS Board policies are reviewed periodically; and (d) ensures that proposed Board policies or policy changes have been appropriately reviewed, including by staff pursuant to procedures established by the Executive Director or by consultants as necessary.	
Ethics Committee	Whole Board/All nine Board members—Baker (Chair)/Appointed under Bylaws, which were adopted by Board resolution	This committee: (a) receives reports regarding conflict of interest disclosures from the general counsel or reports that are submitted directly to the chairman of the committee as prescribed in an applicable ethics policy; (b) makes recommendations to the Board regarding waivers of any disclosed conflict of interest or a waiver of the prohibition against involvement in any matter affected by a disclosed conflict of interest, at a meeting held in compliance with the Open Meetings Act; (c) makes recommendations to the Board regarding the prudence of contracting on behalf of TRS with any entity or a controlled affiliate of such entity that employs or is represented by a former trustee or former employee; (d) receives reports from the Executive Director of any approval given for outside employment by key employees, including the nature of the employment; (e) makes recommendations to the Board regarding approval in advance of any outside employment by the Executive Director; (f) receives reports from the Executive Director of any disciplinary action disclosed by key employees; (g) receives reports of violations of a TRS ethics policy and any resulting disciplinary actions; and (h) identifies any necessary revisions to ethics policies adopted by the Board and recommends such changes for review by the TRS Policy Committee.	Bylaws of the Teacher Retirement System of Texas Board of Trustees, § 3.1.6
Medical Board	3 members/Physicians who are licensed to practice medicine in Texas	The medical board: (1) reviews all medical examinations required by the TRS Government Code Subtitle; (2) investigates essential statements and	TEX. GOV'T CODE §§ 825.114 and 825.204

Teacher Retirement System of Texas Exhibit 4: Subcommittees and Advisory Committees As of August 2005			
Name of Subcommittee or Advisory Committee	Size/Composition/How are members appointed?	Purpose/Duties	Legal Basis for Committee
	and are in good standing in the medical and who are not eligible to participate in the retirement system /Appointed by the Board of Trustees	certificates made by or on behalf of a member of the retirement system in connection with an application for disability retirement; and (3) reports in writing to the Board of Trustees its conclusions and recommendations on all matters referred to it.	
Retirees' Advisory Committee	9 members/one active school administrator; one retired school administrator; two active teachers; three retired teachers; one active member of the auxiliary personnel of a school district; and one retired member of the auxiliary personnel of a school district; none can be required to register as a lobbyist under Chapter 305, Government Code/Appointed by the Board of Trustees	The purpose of this committee is to: (1) hold public hearings on TRS-Care group coverage; (2) recommend to TRS minimum standards and features of a plan under TRS-Care that the committee considers appropriate; and (3) recommend to TRS desirable changes in rules and legislation affecting TRS-Care.	Subchapter I, §§ 1575.401-1575.408, TEX. INS. CODE

V. Funding

A. Provide a brief description of your agency's funding.

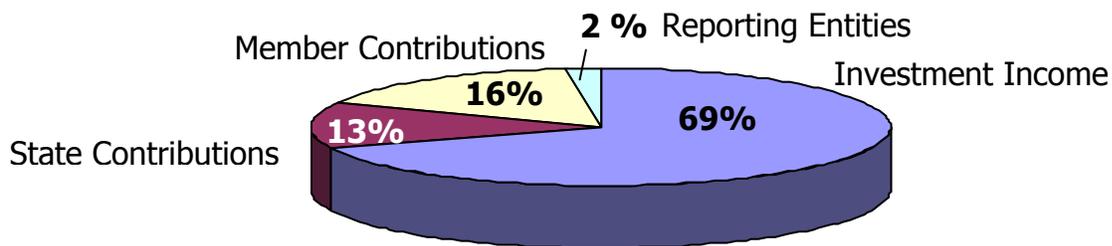
Pension Trust Fund:

Retirement Benefit Plan (and Investment Management Program)

Sources of funding for the Retirement Benefit Plan (and the Investment Management Program) include:

- Member contributions
- Contributions from the state’s General Revenue Fund
- Employer contributions
- Investment income

The most significant funding source is investment income. The average funding over the past 10 years (1995-2004) reflects that 69% of revenue comes from investment income, 16% from member contributions, 13% from state contributions, and 2% from reporting entities.



Funding sources and total amounts for 1995-2004 were as follows:

Investment Income	\$ 55.3 Billion
Member Contributions	13.1 Billion
State Contributions	10.6 Billion
Employer Contributions	1.2 Billion
Total:	\$ 80.2 Billion

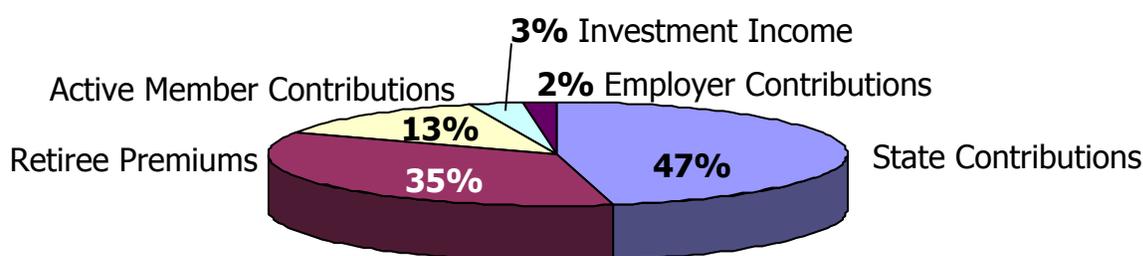
The Pension Trust Fund receives no General Revenue funding for administrative operating expenses, even though TEX. GOV’T CODE § 825.404(d) requires that the state provide General Revenue funding of TRS administrative operating expenses. The Board of Trustees, in order to perform its fiduciary duties, makes a finding under TEX. GOV’T CODE § 825.313(d) authorizing the use of Pension Trust Fund assets to cover the administrative operating expenses of the pension trust fund.

TRS-Care Retiree Health Benefit Program:

Sources of funding for the TRS-Care Retiree Plan include:

- Retiree premiums
- Contributions from the state’s General Revenue Fund
- Active member contributions
- Employer contributions
- Investment income

The average funding received over the past 10 years (1995-2004) reflects that 47% of revenue comes from state contributions, 35% from retiree premiums, 13% from active member contributions, 3% from investment income, and 2% from employer contributions.



Funding sources and total amounts for 1995-2004 were as follows:

State Contributions	\$ 1,691,879,248
Retiree Premiums	1,253,860,129
Member Contributions	453,542,523
Investment Income	105,058,898
Employer Contributions*	79,457,387
Total:	\$ 3,583,798,185

* This amount represents contributions only for FY 2004, as employers did not contribute to TRS-Care prior to 2004.

TRS-ActiveCare Public School Employee Health Benefit Program:

This program receives all funding from health benefit premiums and interest earned on these deposits.

Additional Programs:

Long-Term Care Insurance Program

This program provides optional long-term care insurance for active members, retirees, and eligible family members. It receives all funding from administrative fees built into the premiums and remitted by the carrier.

Pass-Through Supplemental Compensation Program

This program receives all funding from the state’s General Revenue Fund.

Local Health Care Comparability Study

This comparability study of local school district health care plans is conducted every even-numbered fiscal year. During FY 2004, no funding was received from the state’s General Revenue Fund, and expenses were paid from the TRS-ActiveCare fund. Funding from the state’s General Revenue Fund has been authorized for the FY 2006 study.

403(b) Certification Program

This program receives all funding from certification fees and interest earned on these deposits.

B. List all riders that significantly impact your agency's budget.

There are numerous riders in Article IX of the General Appropriations Act (FY 2006-2007) that could impact TRS. The agency-specific riders are identified in Article III, pp. 31-34, and are as follows:

- 2. Capital Budget
- 4. State Contribution to Teacher Retirement Program
- 5. State Contribution to Texas Public School Retired Employees Group Insurance Program
- 7. Transfer of Other Educational and General Income
- 10. Annual School District Contribution Rate to TRS-Care
- 11. Medicare Part D, Prescription Drug Benefit
- 12. Cost Savings Measures and Limitation on Retiree Premium Increase

C. Show your agency’s expenditures by strategy.

Teacher Retirement System of Texas	
Exhibit 5: Expenditures by Strategy - Fiscal Year 2004 (Actual)	
Goal/Strategy	Amount
A. Goal: Teacher Retirement System	
A.1.1: TRS-Public Education Retirement	\$ 4,758,370,935
A.1.2.: TRS-Higher Education Retirement	954,475,648
A.1.3.: Administrative Operations	41,093,945
A.2.1.: Retiree Health	607,687,157
A.3.1.: Active Health—TRS-ActiveCare Plan	\$ 657,476,693
A.3.1.: Active Health—Long-Term Care Insurance Program	3,749
A.3.1.: Active Health—Pass-Through Supplemental Compensation	281,157,858
A.3.1.: Active Health—Local Health Care Comparability Study	211,649

GRAND TOTAL:	\$ 7,300,477,634
---------------------	-------------------------

Notes:

- Item A.1.1. These expenditures reflect actual, direct payments to members (and beneficiaries) for annuities, death benefits, and refunded contributions.
- Item A.1.2. These expenditures reflect actual, direct payments to higher education members (and beneficiaries) for annuities, death benefits, and refunded contributions.
- Item A.1.3. Administrative operations for the pension fund include benefit and investment expenses of approximately \$25 million and \$16 million, respectively.
- Item A.2.1. This item includes payments for retiree health benefit claims and administrative operations.
- Item A.3.1. TRS-ActiveCare Plan includes payments for health benefit claims and administrative operations. The Pass-Through Supplemental Compensation Program funds are disbursed in full to TRS-covered employers for distribution to their eligible employees. *Under legislation enacted by the 79th Legislature, this function will be transferred to TEA effective September 1, 2005.*

D. Show your agency’s objects of expense for each category of expense listed for your agency in the General Appropriations Act FY 2005-2006.

Teacher Retirement System of Texas					
Exhibit 6: Objects of Expense by Program or Function - Fiscal Year 2005					
Object of Expense Informational Listing	A.1.1: TRS-Public Education Retirement	A.1.2: TRS-Higher Education Retirement	A.1.3.: Administrative Operations	A.2.1.: Retiree Health	A.3.1.: Active Health (Pass-Through Supplemental Compensation)
Salaries and Wages			\$ 24,999,875		
Other Personnel Costs	\$ 1,186,844,375	\$ 239,103,606	290,000	\$ 290,821,049	\$ 240,021,553
Operating Costs			16,385,912		
Capital Expenditures			1,764,213		
Total, FY 2005 Object-of-Expense Informational Listing	\$ 1,186,844,375	\$ 239,103,606	\$ 43,440,000	\$ 290,821,049	\$ 240,021,553

Teacher Retirement System of Texas					
Exhibit 6: Objects of Expense by Program or Function - Fiscal Year 2006					
Object of Expense	A.1.1: TRS-Public Education Retirement	A.1.2.: TRS-Higher Education Retirement	A.1.3.: Administrative Operations	A.2.1.: Retiree Health	A.4.1.: Active Health (Comparability Study)
Salaries and Wages			\$ 22,370,000		\$ 50,000
Other Personnel Costs	\$ 1,139,378,709	\$ 259,466,436	187,900	\$ 210,780,824	
Operating Costs			19,278,439		200,000
Capital Expenditures			1,517,880		
Total, FY 2006 Object-of-Expense Informational Listing	\$ 1,139,378,709	\$ 259,466,436	\$ 43,354,219	\$ 210,780,824	\$ 250,000

The information provided in question D varies from that provided in question C because the information in question D reflects only the portion of TRS’s revenue from the state’s General Revenue Fund.

E. Show your agency’s sources of revenue. Include all local, state, and federal appropriations, all professional and operating fees, and all other sources of revenue collected by the agency, including taxes and fines.

Teacher Retirement System of Texas	
Exhibit 7: Sources of Revenue - Fiscal Year 2004 (Actual)	
Source	Amount
<i>Pension Trust Fund:</i>	
Retirement Benefit Plan (and Investment Management Program):	
Member Contributions	\$ 1,721,504,445
Contributions from State's General Revenue Fund	1,242,305,696
Contributions from Reporting Entities	192,395,672
Investment Income	9,162,111,876
Reimbursements from ERS	5,600,176
Other	1,909
Unappropriated Deposits to General Revenue	152,944,578
TOTAL	\$ 12,476,864,352
<i>TRS-Care Retired Plan:</i>	
Health Care Premiums	\$ 248,552,679
Contributions from the State's General Revenue Fund	454,828,830
Active Member Contributions	99,297,097
Contributions from Reporting Entities	79,457,387
Investment Income	4,803,809
Transfer from TRS-ActiveCare	42,000,000
Unappropriated Deposits to General Revenue	15,139,425
TOTAL	\$ 944,079,227
<i>TRS-ActiveCare Active Plan:</i>	
Health Care Premiums	\$ 758,062,552
Investment Income	3,641,100
On Behalf Fringe Benefits/from the State's General Revenue Fund	24,050
SUBTOTAL	\$ 761,727,702
<i>Long-Term Care Insurance Program:</i>	
Administrative Fees	\$ 192,763
SUBTOTAL	\$ 192,763
<i>Pass-Through Supplemental Compensation Program:*</i>	
Legislative Appropriations from General Revenue	\$ 281,149,405
On Behalf Fringe Benefits/from the State's General Revenue Fund	8,453
SUBTOTAL	\$ 281,157,858
<i>Local Health Care Comparability Study:</i>	
TOTAL	\$ 1,043,078,323
<i>403(b) Certification Program:</i>	
Certification Fees	\$ 15,000
Investment Income	3,495
TOTAL	\$ 18,495

* Responsibility for administering the Pass-Through Supplemental Compensation Program will be transferred to TEA effective September 1, 2005.

F. If you receive funds from multiple federal programs, show the types of federal funding sources.

Not applicable to TRS. No federal funds received. (Exhibit 8 deleted.)

In 2006, TRS will begin to receive Medicare Part D partial subsidy for prescription drug reimbursements on behalf of eligible participants.

G. If applicable, provide detailed information on fees collected by your agency.

Teacher Retirement System of Texas Exhibit 9: Fee Revenue and Statutory Fee Levels - Fiscal Year 2004				
Description/Program/Statutory Citation	Current Fee/Statutory Maximum	Number of persons or entities paying fee	Fee Revenue	Where fee revenue is deposited
Pension Fund: Member Contribution Reinstatement Fees; TAC, Title 34, Part III, Chapter 27, Rule 27.6 Member Installment Fees Government Code, §825.410(g)	6% compounded annually of amount withdrawn 9% per annum calculated on a declining balance method on lump sum due when payments began.	14,106 10,043	\$ 66,867,238 \$ 2,752,829	Pension Trust Fund 960 Pension Trust Fund 960
Long-Term Care Administrative Fees: Administrative Fees, Texas Insurance Code, Chapter 1576	\$1.65 per certificate of coverage	9,736 (average)	\$ 192,763	Enterprise Fund Fund 855
403(b) Certification Program: Certification Fees; VTCS, Article 6228a-5, Section 7	\$5,000 per five-year certification	3 entities	\$ 15,000	Special Revenue Fund 864

VI. Organization

A. Provide an organizational chart that includes major programs and divisions, and shows the number of FTEs in each program or division.

The General Appropriations Act (GAA) sets a maximum FTE level of 427 for the Pension Trust Fund for FY 2006-2007.¹³ The TRS-Care and TRS-ActiveCare programs do not have an established FTE cap in the GAA, as no administrative operating expenses for these programs are included in the GAA. While the legislature does not set a maximum FTE level for these programs, the TRS Board of Trustees (at their July 2005 meeting) authorized staffing levels for each program for FY 2006 as follows:

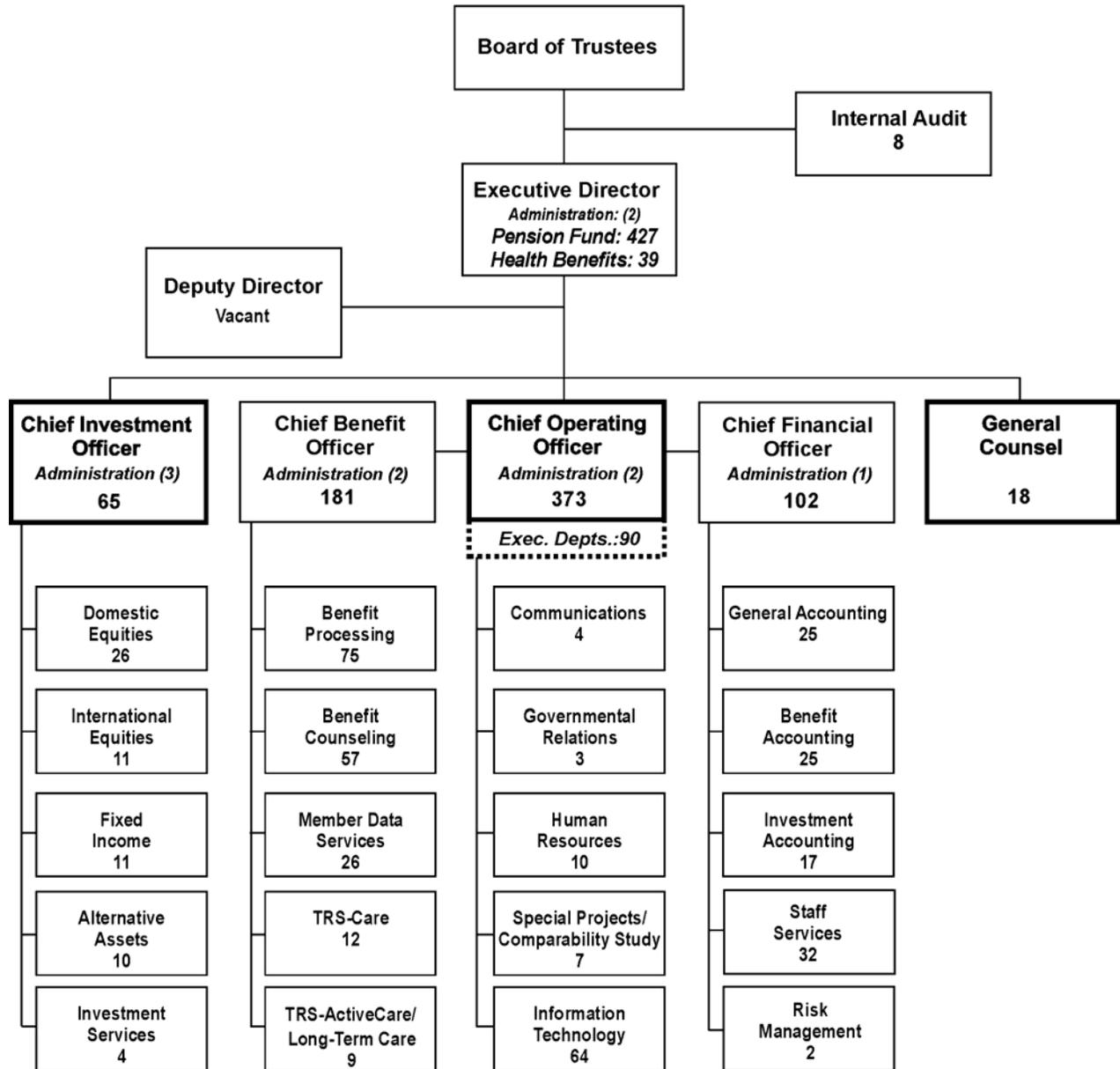
TRS-Care Program	22
TRS-ActiveCare Program	15
Long-Term Care Insurance	1
Local Health Care Comparability Study	1
+ Pension Trust Fund	427
Organization Total:	466

The following organization charts reflect budgeted FTEs.

¹³ The Pension Trust Fund receives no General Revenue funding for administrative operating expenses, even though § 825.404(d) of the TEX. GOV'T CODE requires that the state provide General Revenue funding of TRS administrative operating expenses. The allocation of the FTE cap on the Pension Trust Fund originated with that statute. Because no General Revenue funding is provided, the Board of Trustees (in order to perform its fiduciary duties) makes a finding under § 825.313(d) authorizing the use of Pension Trust Fund assets to cover the administrative operating expenses of the Pension Trust Fund.

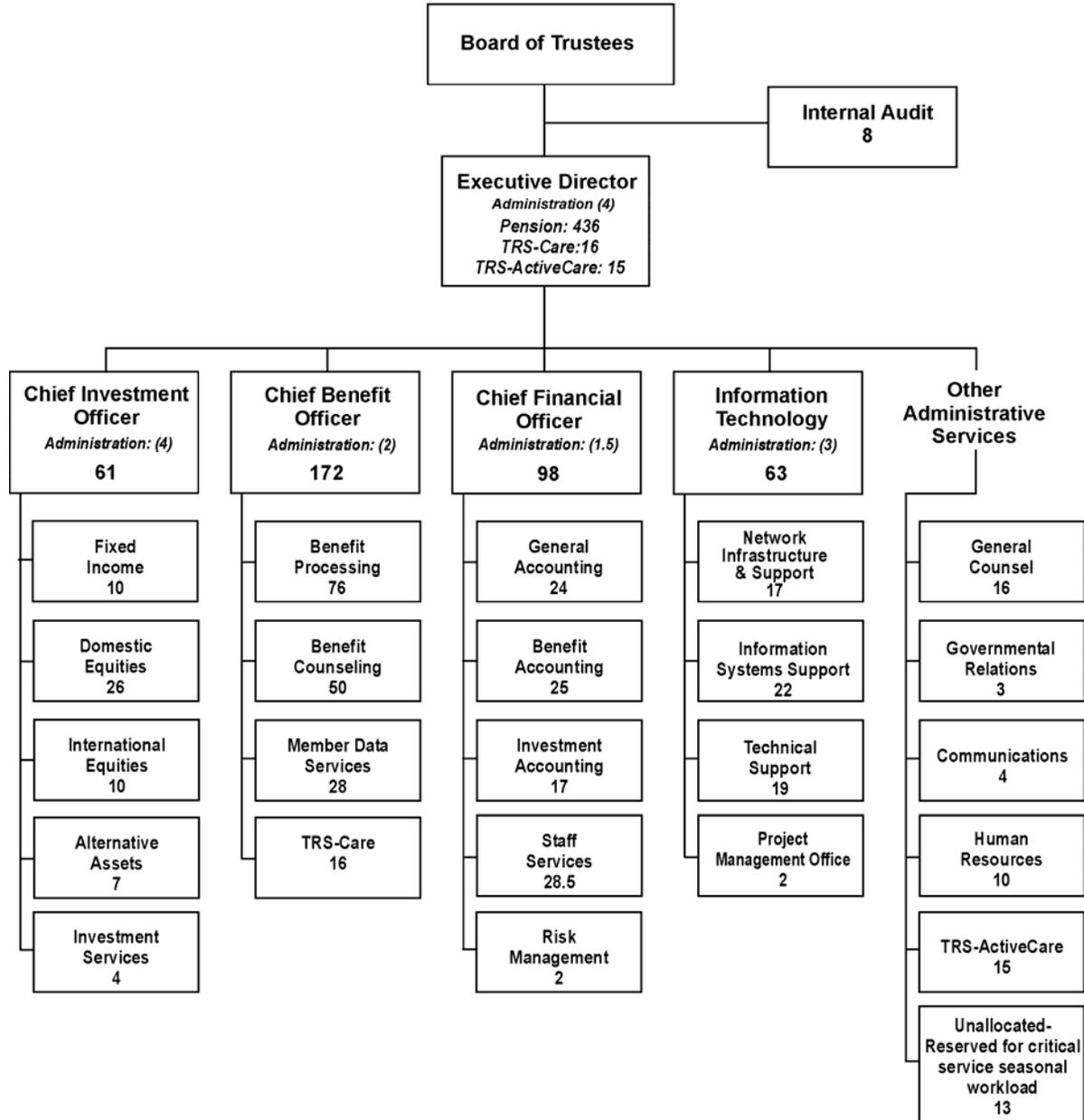
TRS ORGANIZATION CHART

As of September 1, 2005



TRS ORGANIZATION CHART

As of August 31, 2004



B. If applicable, fill in the chart below listing field or regional offices.

TRS has no field offices.

Teacher Retirement System of Texas Exhibit 10: FTEs by Location—Fiscal Year 2004			
Headquarters, Region, or Field Office	Location	Number of Budgeted FTEs, FY 2004	Number of Actual FTEs as of August 31, 2004
Headquarters	1000 Red River Street Austin, Texas 78701	467	452.8
TOTAL		467	452.8

The FTEs noted above include all full-time, part-time and temporary TRS employees.

C. What are your agency’s FTE caps for fiscal years 2004 - 2007?

Teacher Retirement System of Texas Supplemental Chart: FTE Caps for Fiscal Years 2004—2007				
Fiscal Year	Pension Fund	TRS-Care	TRS-ActiveCare	TRS Total
2004	436	None	None	436
2005	436	None	None	436
2006	427	None	None	427
2007	427	None	None	427

D. How many temporary or contract employees did your agency have as of August 31, 2004?

On August 31, 2004, TRS employed four (4) temporary employees (all part-time TRS employees) and six (6) contract employees (three of whom count toward the FTE cap; the other three are not paid from appropriated funds).

E. List each of your agency’s key programs or functions, along with expenditures and FTEs by program.

Teacher Retirement System of Texas		
Exhibit 11: List of Program FTEs and Expenditures--Fiscal Year 2004		
Program	FTE's as of August 31, 2004	Total Expenditures
Pension Fund	424.8	\$ 5,753,940,528
TRS-Care Retired Plan	16.0	\$ 607,687,157
TRS-ActiveCare Active Plan	8.0	\$ 657,476,693
Long-Term Care Insurance Program	0.0	\$ 3,749
Pass-Through Supplemental Compensation*	4.0	\$ 281,157,858
Local Health Care Comparability Study	0.0	\$ 211,649
403(b) Certification Program	0.0	\$ 24,000
TOTAL:	452.8	\$ 7,300,501,634

* Responsibility for administering the Pass-Through Supplemental Compensation Program will be transferred to TEA effective September 1, 2005.

VII. Guide to Agency Programs

The key functions of TRS include providing a retirement program, investing the System’s funds, and overseeing retiree and public school health benefit programs. Additional programs include conducting a biennial comparability study of local health care coverage, and administering a long-term care insurance program and a 403(b) certification program. Each of these functions is discussed in the following sections. A number of administrative functions provide supporting services for all program areas. These include: Information Technology, Financial Services, Communication, Legal Services, Governmental Relations, and Human Resources.

This report refers to two types of TRS participants, active members and retirees. Active members are those members who are employees of public schools and institutions of higher education. Retirees are those participants who have retired under the TRS pension plan with service in public schools and institutions of higher education.

Pension Trust Fund:

Retirement Benefit Plan:

A. Provide the following information at the beginning of each program description.

Name of Program or Function	TRS Retirement Program
Location/Division	Benefit Services Division
Contact Name	Marianne Woods Wiley
Actual Expenditures (Benefits Paid), FY 2004	\$ 5,712,846,583
Actual Expenditures (Benefit Administration), FY 2004*	\$ 24,841,300
Total Members Served	1,185,423
Number of FTEs as of August 31, 2004**	307.1

* Excludes Investment Management Program administration expenditures.

** This total includes direct and allocated support and administrative personnel.

B. What is the objective of this program or function? Describe the major activities performed under this program.

The objective of the TRS retirement program is to provide a fixed level of replacement income during the retirement years of public education employees. The program provides related death and disability benefits as well.

The TRS retirement plan is a defined benefit plan, which means that service retirement benefits are determined by a formula based on service credit, final average salary, and a multiplier at the time of retirement. The plan specifies the age at which a member becomes eligible for retirement. The TRS plan pays pension benefits in a fixed sum on a monthly basis for the life of a service retiree.

The major activities of the retirement program are:

- **Enrollment** of a member, collection of member contributions, maintenance of member records for service credit and salary
- **Refunds** of member contributions
- **Retirement benefit payments** upon service or disability retirement
- **Death or survivor benefit payments** to beneficiary of a member or retiree

Enrollment. TRS membership eligibility is described in question E. TRS membership is mandatory for all eligible employees. Member contributions also are mandatory for those employed in eligible positions by Texas public education institutions. For active TRS members, 6.4 percent of salary is automatically deducted and contributed to the retirement system. TRS receives monthly reports from reporting entities regarding employee salary and position changes. TRS maintains these member records, updating them when necessary. In fiscal year 2004, there were more than 718,266 active TRS members employed in public schools, colleges, and universities throughout Texas.

The Commissioner of Education and some higher education employees in certain positions specified by law may choose the Optional Retirement Program (ORP) instead of TRS. The ORP, administered by the Texas Higher Education Coordinating Board, is a defined contribution plan. This program was created by the legislature in 1967 to accommodate and attract more mobile college and university faculty members who might not remain employed long enough to be vested in the standard TRS retirement program. Funding for the ORP is provided by state and active member contributions. Election to participate in the ORP must be made within 90 days of first becoming eligible to do so. This election is a one-time, irrevocable decision between the two distinct plans. If ORP election is not made at the beginning of the 90-day election period, TRS contributions are deducted until the ORP election is made, and at that time TRS contributions are refunded. If the ORP election is not made within the 90-day election period, the employee remains a TRS member.

A person enrolled in TRS earns a year of membership service credit for a sufficient length of service performed in a school year in accordance with rules established by the TRS Board of Trustees. See TEX. GOV'T CODE §823.002 and 34 TEX. ADMIN. CODE §25.131. Service credit is important to a member because it is an element of eligibility for service retirement and other benefits. It also is a factor in determining the amount of the retirement benefit that may be paid. Under current law, one year of service credit may result in a retirement benefit in the amount of 2.3% of final average salary at the time of TRS retirement.

A member may also establish equivalent service credit for eligible service that is not TRS-covered employment. This category of service credit often is referred to as special service credit. Types of special service credit include credit for military service, Uniformed Services

Employment and Re-employment Rights Act (USERRA) service, out-of-state service, substitute service, service purchased through the service credit purchase option, state sick and/or personal leave credit, service credit for work experience by a career or technology teacher, developmental leave service, and membership waiting period service. Members may also purchase service credit for unreported and withdrawn TRS service.

Refunds. A member may request a refund of member contributions plus the statutory interest when the member terminates employment in a Texas public education institution. State contributions paid to TRS on behalf of the person's membership to fund retirement benefits are not refundable to the member. The contributions are retained by the System and serve to fund benefits for the members who remain in the System until retirement.

During FY 2004, TRS processed 94.9 percent of refunds within 60 days. Over \$220 million was distributed to more than 38,500 terminating members. On average, it took 20 days from the time of request until warrant issuance. This period includes wait time associated with member submission of necessary information that was not supplied at the time of application, and elapsed time awaiting school district submission of final payroll data.

When a member obtains a refund, he or she terminates membership in TRS. Thus, the person no longer will be eligible for any other TRS benefits or payments.

A person is not required to terminate TRS membership upon termination of employment in a Texas public education institution. A member may allow contributions to remain with TRS and thus maintain membership, under the following conditions.

- For a member with at least five years of membership service credit, absence from service does not terminate membership, regardless of the length of the absence. The member will become eligible for a service retirement benefit upon meeting age and service credit requirements.
- For a member with less than five years of service credit, absence from service will terminate TRS membership when the member does not qualify for service credit for five consecutive years, although TEX. GOV'T CODE § 822.003 provides some limited exceptions.

Retirements. TRS members may retire at what is called normal age retirement and receive full retirement benefits or at an earlier age and receive reduced benefits. At TRS, normal age retirement is either:

- At age 65 with five or more years of service (65/5), or
- The member's age and years of service credit total 80, and the member has at least five years of service credit (Rule of 80).

Senate Bill 1691, 79th Legislature, Regular Session, amended normal age retirement eligibility requirements for members who join TRS after August 31, 2007. Although the 65/5 requirement was not changed, the "Rule of 80" requirement was changed by adding the requirement that the member be at least age 60. For retirement before age 60, early age eligibility requirements still

would apply; however, benefit reductions also would apply. These changes were designed to encourage members to work longer.

With regard to early age retirement, state law currently permits retirement at age 55 with at least five years of service credit. However, a member would receive only 47 percent of the standard annuity available at normal age retirement. (See TEX. GOV'T CODE § 824.204(b)) At age 55 with at least 20 years of service credit, the member would receive 90 percent of the normal age standard annuity. (See TEX. GOV'T CODE § 824.204(c).) This more generous percentage when a member has at least 20 years of service credit is referred to as “subsidized” early age retirement, since the amount of the reduction is less than the actuarial cost of the benefit provided. Senate Bill 1691 modified the early retirement laws by repealing the subsidized early age provision, unless a member is grandfathered.¹⁴

When applying for retirement, a member chooses from one of five payment plans. The plans range from receiving the full monthly retirement benefit with benefits ceasing upon the death of the retiree, to receiving an optional payment plan retirement benefit that provides an actuarially reduced monthly benefit with a selected percentage of payment continuing to the designated beneficiary for a specified period of time after the death of the retiree.

In fiscal year 2004, there were 27,289 service retirements. However, this number is higher than normal, partly as a result of changes in federal law related to Social Security that took effect in the summer of 2004.

TRS also provides disability benefits to its members. A member may apply for disability retirement upon meeting the eligibility requirements, regardless of age. A three-member medical board examines disability applications initially to certify disability and, at defined intervals, to re-assess the status of the disability. The Executive Director of TRS is authorized to approve disability retirements after they have been approved by a majority of the medical board. Disability retirees may select benefit options similar to those of service retirees. In FY 2004, there were 856 disability retirements.

The major TRS retirement benefits are:

Service Retirement

Normal Retirement Eligibility— Age 65 with five years of credited service, or when the sum of member’s age and years of credited service equals or exceeds 80.¹⁵

Standard Annuity— A monthly benefit payable at retirement throughout the retiree’s lifetime and calculated according to the statutory benefit formula.

¹⁴ Senate Bill 1691 grandfathered current law concerning subsidized early age retirement, Partial Lump Sum Option (PLSO) described below in this report, and use of the highest three salaries (instead of five) in the computation of the standard annuity. These laws are grandfathered for members who, by August 31, 2005, attain age 50, have at least 25 years of service credit, or have age and years of service credit totaling at least 70.

¹⁵ See Senate Bill 1691, Section 11, for eligibility changes for those joining TRS after August 31, 2007.

Benefit Formula — 2.3 percent times the average of the three highest annual creditable salaries times years of credited service equals an annual standard annuity. The formula will use the five highest salaries after August 31, 2005, except for members who meet grandfather requirements.

Minimum Benefit — \$150 per month less any reduction for early age or optional annuity selection.

Early Retirement Eligibility — Age 55 with at least five years of credited service, or any age below 50 with 30 or more years of credited service, provided the sum of the member's age and years of credited service is less than 80.¹⁶

Early Retirement Benefit — The standard annuity calculated under the benefit formula (or the minimum benefit, if applicable) reduced in accordance with statutory percentages for early retirement.

Disability Retirement

Eligibility — Physical or mental disability precludes the member's continued performance of current duties and the disability is probably permanent, as certified by the TRS Medical Board.

Benefit — For disabled members with at least 10 years of credited service, the standard annuity unreduced for early payment, or \$150 per month minimum benefit less any reduction for the selection of an optional annuity. For disabled members with fewer than 10 years of credited service, a \$150 per month benefit is provided.

Duration — For retirees with 10 or more years of credited service, payments continue for as long as the disability continues. For those with fewer than 10 years of credited service, payments continue for the life of the retiree, the duration of the disability or the number of months of credited service, whichever is shorter.

Annuity Payment Options

Service or disability retirees may select an optional form of payment that reduces the standard annuity by application of age-related actuarial reduction factors in order to continue payment to a beneficiary after the retiree's death. Actuarial factors for disability retirees are different from those for service retirees because of different assumptions about life expectancy for the two groups. The available options include 100, 75 and 50 percent joint and survivor annuities, and five- and 10-year guaranteed period annuities.

¹⁶ Early age retirement is also affected by Senate Bill 1691, Section 11, for members joining after August 31, 2007. For example, Rule of 80 alone will be insufficient for normal age retirement eligibility; a member also will be required to be age 60. Retirement before age 60 will result in a reduction of 5 percent to the normal age standard annuity for each year below age 60. In some isolated instances, the grandfather provision preserving subsidized early age retirement may allow a member who met the grandfather requirements but later terminated membership and then returned to membership after August 31, 2007 to retire under Rule of 80 (but below age 60) with an unreduced normal age standard annuity.

The Pop-Up Provision

If a designated beneficiary under any of the joint and survivor options dies while the retiree is still living, the retiree's future monthly payment increases to the amount of the standard annuity.

Partial Lump Sum Option (PLSO)

A Partial Lump Sum Option became available for eligible TRS members in 1999. Through this option, at the time of retirement, qualifying members may elect to receive an actuarially reduced service retirement annuity plus a cash lump sum distribution.

Members may participate in the Partial Lump Sum Option if they are eligible for service retirement benefits that are not reduced for early age retirement, are not participating in the Deferred Retirement Option Plan (DROP), and are not retiring with disability benefits. Members retiring under the proportionate retirement program are not eligible to elect the PLSO.

Senate Bill 1691, effective September 1, 2005, will require a member to meet the Rule of 90 (age and service credit total at least 90 by the date of retirement) to be eligible to elect PLSO. Members who meet one of the grandfather requirements continue to be eligible to elect PLSO under current law requirements.¹⁷

Partial lump sum distributions equal to 12, 24, or 36 months of a standard service retirement annuity may be selected. When a member selects this option, the monthly annuity payment is actuarially reduced.

Flexible distribution options are available, including rollover to another eligible retirement plan.

Deferred Retirement Option Plan (DROP)

Effective September 1, 1997, DROP was created as a pre-retirement benefit provision for active members once they become eligible for normal age service retirement and have at least 25 years of credited service.

The program allows eligible active members to elect to freeze their standard annuity and to have 60 percent of the frozen standard annuity deposited into a DROP account while continuing to work for a TRS-covered employer. Interest on DROP accounts is credited at the rate of five percent per annum. Members are not considered to be retired while participating in DROP.

The law allows an election to participate in 12-month increments for up to five years. During DROP participation, the member does not accrue additional service credit, nor is any compensation earned during DROP participation to be considered in calculating the standard annuity. Also, during DROP participation, the member's statutory contributions to TRS

¹⁷ Senate Bill 1691 grandfathered current law concerning subsidized early age retirement, Partial Lump Sum Option (PLSO), and use of the highest three salaries (instead of five) in the computation of the standard annuity. These laws are grandfathered for members who, by August 31, 2005, attain age 50, have at least 25 years of service credit, or have age and years of service credit totaling at least 70.

continue; however, contributions are not credited to the member's contribution account and are not subject to refund.

Participation in DROP ends at the earliest of the expiration of the election period, retirement, or death. The accumulated DROP account may be distributed at the member's election as a single lump sum or in monthly or yearly installments covering five or 10 years; distributions commence at retirement or in the event the member dies before retiring, at the member's death. Eligible distributions may be rolled over to another eligible retirement plan.

Senate Bill 1691 modifies DROP by closing it to new participants effective December 31, 2005. Additionally, although a DROP election normally is irrevocable, the legislature has for a third time allowed a window of opportunity to revoke DROP election, with the new window to run from September 1, 2005 through December 30, 2005.

Minimum Service Credit Required for Service Retirement Benefits

Under current law, a member who has completed at least five years of credited service has earned a right to service retirement benefits, with payment deferred to eligible retirement age, provided that the member's accumulated contributions are not withdrawn from the System. An eligible member must apply for benefits and meet other requirements, such as termination of Texas public education employment, in order to begin receiving benefits.

Proportionate Retirement and ERS/TRS Service Transfer

Members of both TRS and the Employees Retirement System of Texas (ERS) are eligible at the time of retirement to combine service credits under one system. Additionally, members with active service credit in more than one Texas public statewide retirement system may combine that service in order to satisfy the length of service requirements used to determine eligibility for service retirement. In such cases, the retirement benefit is paid separately from each system, based only on the service the member rendered in that system.

Death and Survivor Benefits. Death and survivor benefits are paid to both active member and retiree beneficiaries. Upon the death of either an active member or retiree, the beneficiary will receive benefits ranging from a lump sum payment to lifetime payments at a reduced monthly amount. In FY 2004, there were 6,879 active member and retiree deaths.

Active Members

The primary beneficiary of an active member may elect to receive one of the following benefits in the event of the member's death before retirement, if the member dies during a school year in which the member performed service. These benefits also are available due to death when the member is absent from service as described by law, such as when the absence is due to sickness, accident, or other involuntary cause or when the member is within five years of being eligible to retire when leaving employment.

1. A lump sum payment equal to twice the member's annual compensation or \$80,000, whichever is less.
2. Sixty monthly payments equal to the member's standard annuity without reduction for

early age.

3. For a sole beneficiary, lifetime payments equal to a 100 percent joint and survivor annuity, provided the member had at least five years of service credit.
4. A return of the member's contributions with accumulated interest.
5. Survivor benefits of \$2,500 lump sum payment plus a monthly benefit. For example, \$350 per month is payable to a beneficiary spouse with minor children, continuing until the youngest child reaches age 18. At age 65, the spouse would begin receiving \$250 per month for life.

In addition to these five options, a lump sum death benefit of \$160,000 is available if the active member is employed in a TRS-covered position and dies as the result of a physical assault during the performance of the employee's regular job duties.

Also, the DROP beneficiary of a DROP participant will receive the accumulated DROP account balance, payable as a lump sum or in periodic installments.

Retirees

In addition to any joint and survivor or guaranteed period annuity that may be payable under an optional form of payment a retiree elected, the primary beneficiary of a service or disability retiree is entitled to a \$10,000 lump sum payment. Eligible survivors may select alternate payment options in lieu of the lump sum benefit. The alternate payment options include a lump sum payment of \$2,500 and an applicable monthly survivor benefit.

If total payments made before death to a retiree and, when applicable, to a designated beneficiary for an optional service retirement annuity are less than accumulated contributions at retirement, any remainder is paid to the beneficiary or as otherwise provided by law. Should a retiree die prior to receiving all partial lump sum option payments that are due, TRS will pay any remaining partial lump sum option payments in a single lump sum payment to the designated beneficiary.

<p>C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.</p>

TRS serves more than one million members, retirees, and other annuitants. Ninety-nine percent of TRS retirees received their first annuity payments within 31 days of the date they were eligible for their first payment. Based on the 2004 *Member Satisfaction Survey*, overall, 97 percent of the retired members and 93.3 percent of the active members reported that they were either satisfied or very satisfied with TRS's member services.

During FY 2004, TRS processed 94.9 percent of refunds within 60 days. Over \$220 million was distributed to more than 38,500 terminating members. On average, it took 20 days from the time of request until warrant issuance. This period includes wait time associated with member

submission of necessary information that was not supplied at the time of application, and elapsed time awaiting school district submission of final payroll data.

A standard measure of efficiency among public retirement systems is the “cost per member,” which assesses the costs associated with administering the retirement system in proportion to the population served. Based on work done by an outside entity¹⁸, TRS administrative pension costs are among the lowest in the nation: less than \$25 per member for FY 2004. TRS’s cost per member is less than one-half the same cost among its peer groups (based on asset size). In addition, TRS serves twice as many members per System employee as the peer-group systems.

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

A number of retirement benefit enhancements have been made over the years. The formulas for calculating benefits have greatly improved the level of benefits that a retiree may receive. For example, retirement benefits were originally based on the member’s average salary over all the years worked. In 1963, that calculation method was changed to the member’s highest 10-year average salary. In 1971, it was further enhanced to the best five-year average salary, and currently it is based on the highest three-year average salary. However, under new legislation passed during the 79th Legislature, Regular Session, effective September 1, 2005, the five-year average will be used, except for TRS members who meet grandfather criteria (age 50, meet Rule of 70, or have at least 25 years of service credit by August 31, 2005) and are permitted to retain the three-year average method.

Another example is the number of years required for a member to be eligible for service retirement benefits upon reaching retirement age. The required number of years of service has decreased from 25 to five years. Another enhancement example is the minimum age for service retirement with an unreduced benefit. Under current law, a member may retire upon meeting the “Rule of 80”—that is, when the member’s age and years of service credit total at least 80 and the member has at least five years of service credit. However, the legislature recently amended this provision to require a minimum age 60 for unreduced service retirement for members joining TRS after August 31, 2007. (See Senate Bill 1691, Section 11.) Except for the recent changes noted above, a summary of all retirement benefit changes is available in the “History of Benefit Improvements” brochure.¹⁹

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

¹⁸ *Cost Effectiveness Measures for Defined Benefit Administration*, provided as Attachment #10.

¹⁹ Provided as Attachment #11.

Eligible employment for membership in TRS is defined as employment in a public, state-supported educational institution in Texas for one half or more of the standard workload at a rate comparable to the rate of compensation for other persons employed in similar positions. Any employee of a public, state-supported educational institution in Texas shall be considered to meet these requirements if the member's customary employment is for 20 hours or more for each week and for four and one-half months or more in one school year. All eligible employees of the public education system in Texas must participate in TRS, unless an exception to TRS membership applies. The exceptions to TRS membership include:

- An employee who began employment on or after September 1, 2003, and who was not already a TRS member at the time of employment has been subject to a 90-day waiting period before membership begins. The requirement for a membership-waiting period will expire on August 31, 2005. Effective September 1, 2005, employees become TRS members on their first day of eligible employment.
- An employee who is working less than half-time. However, an employee who is regularly employed as a bus driver and whose customary employment requires driving at least one route approved by the Texas Education Agency is required to be a member of TRS.
- A TRS retiree who returns to employment with a TRS-covered employer.
- Employees who elect to participate in the Optional Retirement Program (ORP).
- An employee of an institution of higher education who is required to be enrolled concurrently as a student in the employing institution.
- A person serving on a daily, on-call basis as a substitute in a TRS-covered position normally filled by another regular employee.

As of August 31, 2004, TRS membership consisted of the following:

<u>Current Members:</u>	
Active Contributing	718,266
Active Noncontributing	95,697
Deferred Retirement Option	1,575
Inactive Non-vested	12,597
Inactive Vested	16,661
Total Current Members	<u>844,796</u>
<u>Retirement Recipients</u>	
Service	221,654
Disability	9,746
Survivor	9,227
Total Retirement Recipients	<u>240,627</u>
TOTAL MEMBERSHIP	<u>1,085,423</u>

Of the current members, 719, 841 (Active Contributing and Deferred Retirement Option Participants) were employed during fiscal year 2004 and made contributions to the System. The

remaining 124,955 members are no longer employed by TRS-covered employers, but have maintained their membership in TRS by leaving their funds with the System.

As of August 31, 2004 TRS was paying benefits to 240,627 recipients. Service recipients include 209,299 retirees and 12,355 beneficiaries receiving continuing monthly annuity payments. Disability recipients are disabled members who are receiving continuing monthly disability payments. Survivor recipients are beneficiaries who have elected to receive death benefits in the form of monthly benefits.

As of August 31, 2004, participating entities included the following:

Public Schools, Service Centers and Charter Schools	1,253
Community and Junior Colleges	51
Senior Colleges and Universities	43
Medical and Dental Schools	8
Other Entities	3
Total	1,358

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

TRS does not have any field offices. However, benefit counselors travel throughout the state to make group presentations for members nearing retirement eligibility. In FY 2004, more than 19,896 people attended 202 group presentations, and 34,500 people attended nine conventions where TRS was represented. These presentations were conducted statewide in over 32 different locations. In addition, 10,575 people visited with TRS counselors in Austin during FY 2004.

The key TRS retirement plan processes and their objectives are listed below.

Process Enrollments: To add new members to TRS database. When a public education institution employs a person in a position eligible for TRS membership, the employer begins reporting the person to TRS as a member on a monthly basis. The reporting entity sends TRS the relevant member information and also transmits member contributions deducted from employees' salaries. The majority of TRS reporting entities now report electronically through the automated TRS Reporting and Query System (TRAQS). However, some small districts and open enrollment charter schools report new members through a manual process.

Record Beneficiary Designations: To enter new or updated beneficiary information on active and retired member accounts. Member sends TRS form indicating designation. Data

Management checks for proper endorsements and notarization.

Image Member Benefit Documents: To scan and index all member benefits documents into the imaging system for reference and processing by other agency departments. The process starts with documents being received through the incoming mail through the Mail Center and documents generated by other TRS departments (outgoing mail). The end result of the process is scanned images that can be used by staff who work with members.

Update Demographic Information: To update member demographic information such as name or address when member sends TRS form or written correspondence requesting update, or to verify age upon receipt of proof of age documents.

Provide Benefit Counseling: To explain member benefits by phone and in person (office visits or presentations) to assist members regarding their TRS benefits. Process normally starts with member calling or visiting TRS or a TRS presentation statewide.

Process Requests to Purchase Special Service: To provide members the cost to establish or reestablish service credit that they are eligible to purchase and to receive payment from the members.

Process Refunds: To refund the amount in a member's account when the member is no longer employed by a public education institution and has requested that the TRS account be paid to him or her.

Process Retirement Setup or Estimate Requests: To verify that the member is eligible to retire, to determine years of service credit, to provide a retirement benefit estimate, to determine eligibility for TRS-Care, and to provide the member a packet of materials that includes forms necessary for retirement and information on TRS-Care and the enrollment application.

Process Retirement Mail: To change the status of an individual from member to retiree and to ensure that the correct annuity is paid within 31 days of the date of retirement. The retirement mail process starts when a pertinent form is received from either the member or the reporting entity.

Enter Tax Withholding Elections: To enter withholding election of annuitant. Retired member sends TRS form indicating the amount of taxes to be withheld from annuity payment.

Process Direct Deposit Requests: To establish direct deposit or warrant for annuity payment. Member sends TRS form with bank or mailing information. Data Management reviews for proper endorsements and establishes electronic funds transfer (EFT) or check mailing address, per member's instructions.

Process Death Claims: To pay benefits due after a TRS participant's death to the beneficiary designated by the member.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

Retirement benefits are financed by member and state contributions and through investment earnings of the pension trust fund. Therefore, the funding sources of the TRS Retirement Benefit Plan are identical to those reflected for the pension trust fund, as identified in Section V, questions A and E, and include: investment income, member contributions, contributions from the state’s General Revenue Fund, and employer contributions.

Teacher Retirement System of Texas	
Pension Trust Fund Sources of Revenue - Fiscal Year 2004 (Actual)	
Source	Amount
<i>Pension Trust Fund</i>	
Retirement Benefit Plan (and Investment Management Program):	
Member Contributions	\$ 1,721,504,445
Contributions from State's General Revenue Fund	1,242,305,696
Contributions from Reporting Entities	192,395,672
Investment Income	9,162,111,876
Reimbursements from ERS	5,600,176
Other	1,909
Unappropriated Deposits to General Revenue	152,944,578
TOTAL	\$ 12,476,864,352

Member and state contribution rates are set by law according to the requirements of the TEX. CONST. art. XVI, § 67, which provides that member contributions shall be a minimum of 6% of salary, while state contributions shall be within a range of 6% to 10%. Member contributions currently are 6.4%, as required by TEX. GOV'T CODE § 825.402, and state contributions are 6.0% as established by the GAA. Current law specifies that reporting entities shall pay the state contribution on salaries above the statutory minimum.

Effective September 1, 2005, SB 1691 provides for two additional sources of funds for the pension plan. First, public education employers will be required to pay the TRS pension fund the equivalent of the state contribution amount in the first 90 days of employment for new employees. Second, public education employers who employ TRS retirees will be required to pay the TRS pension fund the equivalent of the member and state contribution rates (currently 12.4 percent) applied to the retirees’ salaries. Certain retirees will be grandfathered, resulting in employer exemption from the surcharge.

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

There are some programs external to TRS that provide similar services or functions. Viewed

broadly, similar programs include any public employer plan that helps public employees develop their opportunities for retirement income.

One similar program is the defined benefit plan administered by the Employees Retirement System (ERS) for state employees. Membership eligibility is not available to public education employees. Further, many plan details differ, including:

- Member contribution rates (6.0 percent for ERS, 6.4 percent for TRS).
- Special service credit (TRS offers more service credit options).
- Lump sum early retirement incentives (some ERS members were eligible for this temporary incentive; no similar incentive existed for TRS members).
- Method of crediting service (ERS monthly; TRS annually).
- Final salary averaging (ERS three-year; TRS after August 31, 2005, five-year except for those grandfathered).
- Retirement eligibility (ERS does not offer early retirement options; TRS does).

Other programs similar in objective (though not in plan design) are the 457 and 403(b) plans offered by some school districts or colleges as supplemental plans. These are defined contribution plans with voluntary member participation, which generally offer no contributions by the employer. They function similarly to the better-known private sector 401(k) plans.²⁰ These programs permit participants to accumulate tax-deferred dollars for withdrawal in their retirement years.

Finally, the ORP program for eligible higher education employees was created as an alternative to the TRS defined benefit plan. ORP is structured as a 403(b) plan under the federal tax code, and thus it is a defined contribution plan. As such, its focus is capital accumulation, not income replacement through a fixed payment at regular intervals. Members select among various investment options, and their final account balance reflects their investment performance. Generally, such plans do not include features such as disability retirement or annuities for survivors upon the death of a member or retiree; only the account balance amount is payable, regardless of circumstances.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency's customers. If applicable, briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

ERS and ORP are available to state employees and eligible higher education employees (respectively), but they are not broadly available to public education employees. As a result, TRS serves a completely different population than ERS. Although TRS serves higher education faculty eligible to join ORP, once such members elect ORP, they are no longer eligible for TRS participation, and duplication is avoided.

²⁰ Governmental employers no longer are permitted to establish new 401(k) plans.

Locally administered 457 or 403(b) plans are employer-based and are designed only as voluntary, supplementary retirement plans. In most instances, employer contributions are not provided to these plans on behalf of the employees. For these reasons, participation and contributions may be inadequate to support the retirement needs of many public school employees. The TRS defined benefit plan serves as the primary plan for these employees, and the employer-sponsored plans are not designed to duplicate TRS functions.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

The retirement plan collects member contributions from the public education employers who employ the members. School districts, open enrollment charter schools, regional education service centers, and higher education institutions deduct member contributions of 6.4% from their employees' salaries and deposit those amounts with TRS on a monthly basis. The employers also report their employees' monthly salary amounts to TRS so that TRS can maintain salary records necessary to determine benefits at retirement, since benefits are a percentage of final, average salaries as specified by statute.

TRS also relies on public education employers (including school districts) to report the employment of TRS retirees. Under TEX. GOV'T CODE §§ 824.601-.602, a TRS retiree who exceeds the allowable amount of employment after retirement (with a Texas public educational institution, as defined by statute) forfeits the monthly annuity normally due. In order to implement this statutory requirement, TRS must receive employer reports from the school districts and institutions of higher education that employ TRS retirees.

Additionally, effective September 1, 2005, public education employers will be required to make two new types of payments to the TRS pension plan. (See question G above for detail.) TRS will rely upon school districts and other public education employers to accurately calculate and report the new employee payment on a monthly basis, as well as the surcharge for employment of TRS retirees on a monthly basis.

TRS also must work with the United States Internal Revenue Service (IRS) by reporting income paid to members, retirees, and beneficiaries. TRS issues IRS 1099-R forms annually to payees for their use in personal income tax reporting to the IRS.

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

This program is not contracted out.

L. What statutory changes could be made to assist this program in performing its functions?

Explain.

During the 79th Legislature, Regular Session, several administrative provisions governing TRS were amended to reinforce the retirement plan's status as a trust. These changes clarify the authority of the TRS Board of Trustees and its flexibility to manage the plan appropriately as a trust. TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

Although the TRS plan is largely governed by state law, the federal tax code also affects how TRS operates. Under TEX. GOV'T CODE § 825.506, TRS is to operate the pension plan as a qualified plan under 26 U.S.C. Section 401(a). Several plan features and indeed the requirement that assets be held in trust for the benefit of members are grounded in federal tax code requirements for qualified pension plans.

One such plan qualification requirement limits benefits payable in a year to the amount described under Section 415(b) of the Internal Revenue Code. Consequently, the TRS pension benefit of some more highly paid TRS members exceeds the allowable amount. The TRS pension fund may not pay the excess amount to the member at retirement. To address this situation, TEX. GOV'T CODE § 825.517 established an excess benefit arrangement, to be administered by TRS outside of the pension trust fund. The purpose is to permit these members to receive the difference between the benefit limitation and what they otherwise would be eligible to receive from the pension fund.

N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:

- why the regulation is needed;
- the scope of, and procedures for, inspections or audits of regulated entities;
- follow-up activities conducted when non-compliance is identified;
- sanctions available to the agency to ensure compliance; and
- procedures for handling consumer/public complaints against regulated entities.

Not applicable.

O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.

No regulatory function is associated with this TRS program. (Exhibit 12 deleted.)

Investment Management Program:

A. Provide the following information at the beginning of each program description.

Name of Program or Function	Investment Management Program
Location/Division	Investments Division
Contact Name	James R. Hille, Chief Investment Officer
Actual Expenditures (Administrative), FY 2004	\$ 16,252,645
Total Assets Managed, FY 2004	\$ 84,202,981,707
Investment Income, FY 2004	\$ 9,177,588,585
Number of FTEs as of August 31, 2004*	117.7

* This total includes direct and allocated support and administrative personnel.

B. What is the objective of this program or function? Describe the major activities performed under this program.

The trust fund was established in 1937 by state constitutional authority, now found at TEX. CONST. art. XVI, § 67. As authorized, the Board of Trustees developed the investment program in order to manage assets of the Fund (as authorized by Tx. Govt Code § 825.103) and achieve returns necessary to meet liabilities. Liabilities include annuities, death and survivor benefits, and disability benefits.

The TRS mission is, in part, “to prudently invest and manage assets held in trust for members and beneficiaries in an actuarially sound system administered in accordance with applicable fiduciary principles.” The investment division’s fundamental strategy is to be broadly diversified, not only in different securities, but also in asset classes. As noted in the Board of Trustees’ Investment Policy Statement, the total investment portfolio (the “Total Fund”) is managed with a long-term perspective and structured to:

1. Control risk by diversification of asset classes and by establishing risk-adjusted return expectations; and
2. Achieve a long-term rate of return that:
 - a. Exceeds the assumed actuarial rate of return adopted by the Board;
 - b. Exceeds the long-term rate of inflation by an annualized 4%; and
 - c. Exceeds the return of a composite benchmark of the respective long-term normal asset mix weighting of the major asset classes.

The Investments Division manages roughly six major asset classes totaling over \$90 billion, and staffs each area based on the size of assets or their level of complexity. The asset classes are reflected in the charts below.

ASSET CLASS	Range		Long-Term Normal (%)
	Minimum (%)	Maximum (%)	
<u>Fixed Income Portfolios</u>			
Investment Grade	20	40	27.5
High-Yield	0	3	2
Range of Total Fixed Income	20	40	29.5
<u>Equity Portfolios</u>			
Domestic Equity Portfolio	45	59	48.5
International Equity Portfolio	10	17	13
Range of Total Equities	55	72*	61.5
<u>Alternative Assets Portfolios</u>			
Private Equity	2	6	4
Absolute Return	1	2	1.5
Real Estate	1	4	3
Range of Total Alternative Assets	4	12	8.5
Cash Equivalents	0	3	0.5
Total Fund	N/A	N/A	100

N/A means that columns are not additive to 100.

*The Board's intent is for the maximum Total Equity weight to reduce to 68% as Private Equity and Real Estate are fully funded (max. Domestic Equity weight reduces to 56%, max. International Equity weight reduced to 16%)

Investment Allocations by Asset As of June 30, 2005		
	Long-Term Normal (%)	Current (%)
<u>Fixed Income Portfolios</u>		
Investment Grade	27.5	25.75
High Yield	2.0	1.91
Total Fixed Income	29.5	27.66
<u>Equity Portfolios</u>		
Domestic Equity Portfolio	48.5	52.69
International Equity Portfolio	13.0	14.54
Total Equities	61.5	67.23
<u>Alternative Assets Portfolios</u>		
Private Equity	4.0	1.67
Absolute Return	1.5	1.39
Real Estate	3.0	0.29
Total Alternative Assets	8.5	3.35
Cash Equivalents	0.5	1.76
Total Fund	100.0	100.0

Long term normal policy allocations are determined by the Board of Trustees with the recommendations of staff and various consultants during periodic (no more than five years) asset-liability modeling studies. Staff is expected to position the assets within the minimum and maximum allowable ranges, rebalancing as appropriate and necessary. Reasons for deviation from policy “normals” include: market volatility, short-term asset class attractiveness or unattractiveness, fund cash flows and long-term funding requirements for alternative assets.

C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.

TRS manages the trust fund at a cost of less than .02% of plan assets per year (less than two basis points or “bps”) while achieving investment policy objectives. Funds that use outside money managers have investment costs many times greater, typically 10-20 basis points. TRS is one of the largest funds that internally manage all investments, enhancing trust fund value over time through substantial management cost savings.

Fund performance has exceeded the 8% actuarial assumption over the ten-year period, returning approximately 9.88%. Fund performance has exceeded the average rate of inflation of 2.5% for the ten-year period ending June 30, 2005 by 6.72%. The Fund has outperformed its composite benchmark nine of the last 10 years, five of the last five years, and three of the last three years. The fund has outperformed on average 21 basis points per year in the last five years (with a standard deviation of just 13 bps), compared to two basis points per year in the previous five-year period (with a much higher standard deviation of 97 bps). In the more recent three-year period, the fund has improved the annual average out-performance by five basis points per year (to 25 basis points annually from 20 bps in the previous three-year period), with very little change in standard deviation of returns.

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

There have been a number of changes in the agency’s investment authority. In general, TRS is charged with making prudent investments in securities. The original constitutional amendment approved by the voters in 1936 only authorized the investment of System funds in government and municipal bonds. In 1956, this was expanded to permit investing of funds in corporate bonds and common stocks. The Board of Trustees approves the System’s asset mix and allocation range within the parameters established by state law. Additional specific historical information related to the investment management function is provided below.

- **Former Real Estate Program:**

TEX. CONST. art. XVI § 67, provides that the Board of the retirement system is responsible “to invest the funds of the System in such securities as the board may consider prudent investments.” In the early 1980s, the retirement system requested an

attorney general's opinion whether real estate mortgages were "securities." Relying on an affirmative opinion, TRS began investing directly as a lender in single-asset commercial real estate mortgages. Due to market conditions and 1986 federal income tax reforms, the TRS real estate mortgage portfolio experienced difficulties, including foreclosures.

In 1987, the attorney general sued the retirement system and several trustees, alleging that a title-holding corporation formed by TRS created an unlawful diversion of trust assets constituting a breach of fiduciary duties. The attorney general agreed to settle the case, provided that TRS made certain changes in its title-holding corporations.

In 1993, in response to an opinion request regarding TRS's authority with respect to foreclosed properties, the attorney general investigated, issued a written report, and held a press conference questioning the administration and operations of the real estate program. The report expressed concerns about an apparent intention by internal managers to retain foreclosed assets indefinitely, actual or perceived possible conflicts of interest relating to travel and entertainment provided to TRS employees by real estate advisors, commercial or business relationships of certain employees, fees paid to real estate advisors by title-holding corporations holding foreclosed properties, and the absence of Board oversight and policies and procedures. Personnel changes followed, including a new TRS Executive Director and new management for the real estate program.

The Board adopted new policies and procedures for the real estate program. The legislature enacted ethics legislation and reorganized the TRS Board. TRS underwent two sunset reviews during consecutive biennia. The retirement system sold its foreclosed assets over a period of years. On a portfolio basis, the real estate program realized its long-term investment goals.

- **Investment standard:**

Legislation enacted in 1999 provides that investment decisions of the boards of the Employees Retirement System and the Teacher Retirement System respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust. This standard is consistent with portfolio theory, which holds that a properly diversified portfolio is less risky than its individual assets.

- **Attorney General opinions regarding investment in partnerships:**

In the late 1990s, with the former real estate portfolio under gradual liquidation, the Board considered its options to diversify the total TRS fund, engaging a consultant to recommend options for a new real estate program. In 1997, the Board deadlocked 4-4 on the question of whether to commence a new real estate program and 4-4 on the question of whether to stay out of real estate (one trustee was absent). Subsequently, the Board decided to request an attorney general's opinion about the meaning of the word "securities" in the constitution. In Tex. Att'y Gen. Op. No. JC-43 (1999), issued during the regular session of the legislature, the attorney general opined that "securities" had the meaning set forth in Article 8 of the Uniform Commercial Code. Under Article 8, an

interest in a limited partnership would not be a “security” unless the parties agreed that the interest would be a security for purposes of Article 8. In response to this opinion, the legislature amended TEX. GOV’T CODE § 825.301(a) to clarify that the securities laws define what “securities” are for the purposes of the Board’s investment authority, instead of Article 8. AG Op. No. JC-43 also held that the TRS Board does not have authority to delegate investment discretion to external managers, and that an existing statute authorizing the Board to engage managers to “assist and advise” the Board did not authorize delegation.

- **Legislation affecting public disclosure of certain investment matters:**
Senate Bill 121, enacted by the 79th Legislature, Regular Session, amended the Public Information Act to address disclosure of information relating to state fund investments in private investment funds. The bill provides a 16-item list of information that is public under the Act, and expressly provides that certain other information about private investment funds is confidential and exempt from disclosure under the Act. Senate Bill 121 became effective immediately upon signature by the Governor, on June 18, 2005.

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

The investment program directly affects:

- a. Over one million active and retired members;
- b. Approximately 1,500 domestic public and private companies through equity and fixed income investments and proxy voting;
- c. Approximately 1,000 international public companies through equity investments and proxy voting;
- d. Approximately 80 broker/dealers who assist in transactions and provide market research; and
- e. Numerous capital markets.

As the 8th largest pension fund in the U.S.,²¹ TRS is a major investor in public markets.

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

As noted in the TRS Investment Policy Statement, regarding the Roles of Board, Staff and Advisors:

²¹ Based on asset size as identified in “The P&I 1,000” listing from the January 24, 2005 edition of *Pension & Investments*.

“The Board has the primary fiduciary responsibility for investing TRS trust assets in accordance with TEX. CONST. art. XVI § 67 and with applicable law. The Board establishes investment objectives and policy, obtains expert advice and assistance, and oversees the employment of a qualified and competent investment staff (‘Investment Staff’) and legal staff. The Board also monitors the actions of staff and advisors to ensure compliance with its policies. The Board has a Policy Committee of the Board, and an Alternative Assets Committee of the Board (‘AACB’), both of which are standing committees of the Board charged with those responsibilities set forth in the Bylaws of the Board (the ‘Bylaws’). The Board and the Investment Staff are assisted by outside investment consultants and legal counsel.

1. Investment Staff exercises the same fiduciary responsibility under applicable law as the Board. Investment Staff manages the portfolio according to the Board’s policies, advises and informs the Executive Director and the Board about investments, and recommends modifications to this Policy. The Investment Staff executes all transactions and prepares investment reports.
2. Investment Counsel (‘Investment Counsel’) selected by the Board provides education and advice, provides commentary and discussion as requested at Board meetings, assists with development and review of investment policies and procedures, reports on the progress of the fund in meeting its investment objectives, and compares the performance of the portfolio to established benchmarks. Investment Staff and Investment Counsel provide information as needed to assist the consulting actuary in performance of actuarial services.
3. The AACB has been established and charged with those responsibilities set forth in the Bylaws, and specifically, the consideration of all potential investment opportunities to be included in the Alternative Assets Portfolio, except as otherwise specified in this Policy.
4. All proposed changes to this Policy will be reviewed by the legal staff for compliance with state and federal laws regarding fiduciary responsibility, investment prudence, ethical compliance, and other applicable standards or requirements before submission to the Policy Committee. Proposed changes to this Policy will first be presented to the Policy Committee, which will consider recommending the proposed changes to the Board. This Policy shall be reviewed upon the completion of each asset-liability modeling study.”

Further, as noted in the TRS Investment Policy Statement, regarding the Total Fund Investment Standard: “TEX. CONST. art. XVI, § 67(a)(3) and TEX. GOV’T CODE § 825.301(a) states that the standard of prudence for TRS investments is a ‘prudent person’ standard. TEX. GOV’T CODE § 825.301(a) provides that TEX. PROP. CODE § 117.004(b) applies to TRS investment decisions. TEX. PROP. CODE § 117.004(b) generally states that the determination of the prudence of a single investment decision will be made taking into consideration the investment of all of the assets of the trust, or the assets of the collective investment vehicle, as the case may be, rather than a consideration as to the prudence of the single investment of the trust, or the single investment of the collective investment vehicle, as the case may be.

“All investments made by the Total Fund must be in ‘securities’ as defined in TEX. GOV’T CODE § 825.301(a).

“The Board and the Investment Staff may obtain the assistance and advice of external investment experts and consultants as needed.”

In addition to the policy statements noted above:

- An asset liability modeling study is conducted at least every five years.
- Once asset allocations are determined, staff executes them by attempting to deliver returns of that asset class benchmark, plus a little more, by implementing appropriate strategies (either active or passive). If the strategy is passive, TRS tracks the benchmark by replicating the components of it as closely as possible. If the strategy is active, TRS deviates from the benchmark by varying degrees, based on pertinent analysis, anomalies, quantitative strategies, etc. Alternative Assets classes are generally very active because they tend to be securities-specific.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

The trust fund was established in 1937 by Constitutional authority, currently art. XVI, § 67. The TRS Board of Trustees holds System assets in trust and oversees the investment of the System’s funds in accordance with applicable constitutional and statutory provisions. Therefore, the funding sources of the TRS Investment Program are identical to those reflected for the pension trust fund (as identified in Section V, question A and Section V, question E), and include: investment income, member contributions, contributions from the state’s General Revenue Fund, and employer contributions.

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

TRS investment functions are constitutionally mandated; however, there are other state entities that perform similar functions. The Employees Retirement System (ERS) also invests funds, as does the University of Texas Investment Management Company (UTIMCO). In addition, there are many private entities in the business of money management and pension administration.

The Texas Attorney General has determined that TRS may not delegate investment discretion to external money managers. (An “external manager” is defined as “[a] person or firm that makes investment portfolio decisions and executes transactions independently, subject to the overall restrictions agreed upon by contract between the fiduciary for the fund and the external manager.”) TRS does contract with investment consultants and advisors who provide advice to the Board and investment management on broad investment strategy issues.

Other pension funds that use external money managers to invest their funds typically experience much higher costs than TRS. By using in-house professional investment staff, TRS manages the trust fund at a cost of less than .02 % of plan assets per year (less than two basis points) while achieving investment policy objectives. Funds that use outside money managers have investment costs many times greater, typically 10-20 basis points. TRS is one of the largest funds in the U.S. that internally manages all investments, which has enhanced trust fund value over time through substantial management cost savings.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency's customers. If applicable, briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

Because the trust fund exists to serve a specific population (employees of Texas public education and higher education systems), duplication or conflict with other investment programs is generally not an issue.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

The TRS investment function is self-contained and not coordinated with or linked to other governmental entities. All operational investment authority and responsibility is vested exclusively in the TRS Board of Trustees and the TRS staff (subject to legislative oversight).

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

As noted above, all investment functions of TRS are managed internally and are not contracted out.

L. What statutory changes could be made to assist this program in performing its functions? Explain.

TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

A copy of the latest independent management audit of the TRS Investment Program is included as Attachment #6 to this report.

- N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:**
- why the regulation is needed;
 - the scope of, and procedures for, inspections or audits of regulated entities;
 - follow-up activities conducted when non-compliance is identified;
 - sanctions available to the agency to ensure compliance; and
 - procedures for handling consumer/public complaints against regulated entities.

Not applicable.

- O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.**

No regulatory program is associated with the investment functions of TRS. (Exhibit 12 deleted.)

TRS-Care Retiree Health Benefit Program**A. Provide the following information at the beginning of each program description.**

Name of Program or Function	TRS-Care—Retiree Health Benefit Program
Location/Division	Benefit Services Division
Contact Name	Frank DiLorenzo
Claims and Claims Processing Expenses, FY 2004	\$ 605,269,808
Actual Expenditures (Administrative), FY 2004	\$ 2,417,349
Number of FTEs as of August 31, 2004	16

B. What is the objective of this program or function? Describe the major activities performed under this program.

The health benefit program offered pursuant to the Texas Public School Retired Employees Group Benefits Act, Chapter 1575, TEX. INS. CODE (known as TRS-Care) provides group health benefit coverage to numerous TRS public school retirees who are not eligible for coverage under a plan provided under Chapter 1551 or 1601, TEX. INS. CODE, such as the programs available to state employees or higher education employees.

TRS-Care makes a basic level of health coverage available without cost to eligible TRS public school retirees, as well as optional levels of coverage that require participant payments. TRS-Care is administered through a separate trust that provides comprehensive health benefit coverage for eligible retired members and eligible family members. TRS is designated by law as trustee. Determination of eligibility and the collection of contributions and retiree premiums are made by the trustee. Claim submissions, claim payments, and claim appeals are adjudicated through contractors for medical benefits and prescription drug benefits.

C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.

TRS monitors several measures for the TRS-Care program to assure participant satisfaction and cost efficiency. The following key statistics indicate the program's performance:

- **Customer satisfaction.** Ninety-one percent of TRS-Care participants rated TRS-Care services as satisfactory or better for FY 2004. This was higher than expected in light of legislative changes designed to address rising health care costs.

- **Participating network savings.** In FY 2004, TRS-Care had \$349 million in participating network savings. This indicates the savings estimated from reasonable and customary charges through the discounted network participating fees. This measure is the sum of the prescription drug plan savings and the medical plan savings, based on claims paid. The FY 2004 estimated savings are more than the original target savings for the period.
- **Claims adjudication.** TRS-Care settled 94% of claims within 14 days of receipt by the claims administrator in FY 2004. This indicates prompt processing of claims submitted by participants. The percentage is slightly higher than the targeted 93.0%.

TRS-Care regularly reports key statistics to the TRS Board of Trustees, including number of participants in each retiree health plan, the number of eligible retirees who declined coverage, and average medical and prescription claims cost per participant. For FY 2004, of the 213,673 total eligible for TRS-Care, only 31,558 declined coverage. A total of 182,115 participants were enrolled in TRS-Care, compared to 163,397 in the prior fiscal year. The total cost per participant, including claims cost and administrative fees, was \$3,501. As of August 1, 2005, total TRS-Care enrollment was 187,623.

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

Since the inception of the TRS-Care program, there have been changes in various program features, including eligibility rules, cost sharing (including premiums, deductibles, maximums, co-payments, and coinsurance), plan design, utilization management, administrative services, and participating provider networks, all for the purpose of cost containment. Plan design features such as these are determined by the TRS Board of Trustees (see F). Effective September 1, 1997, the program is fully self-funded.

The following chart provides a summary of benefit changes that have occurred since the inception of the program.

TRS-Care				
Established by statute in 1985, first coverage in the retiree health coverage plan began in September 1986. The program has three coverage options (TRS-Care 1, 2, and 3), which are referred to in this table as T1-T3. The table summarizes benefit changes that have been adopted over time either by law or by the TRS Board of Trustees.				
Plan Year	Cost Sharing	Plan Design	Utilization Management	Administration
	<ul style="list-style-type: none"> • Contribution sources and rates • Participant premiums, deductibles, co-insurance and co-pays, for both medical and Rx • Vendor discounts 	<ul style="list-style-type: none"> • Office visits • Wellness programs • Coverage changes, including limitations and exclusions • Rx benefit 	<ul style="list-style-type: none"> • Pre-certification • Managed prior authorization • Drug utilization review-prospective, concurrent, and retroactive • Open enrollment 	<ul style="list-style-type: none"> • Manager selection • Network management
1986-1987	<ul style="list-style-type: none"> • Initial contribution rates were 0.35% for the state, building in subsequent years to 0.50%; and 0.25% for active employees • T1 deductible began at \$5,000, T2 at \$2,000, and T3 at \$200 • Member 20% co-insurance for T1-T3, after satisfying out-of-pocket limit equal to member coinsurance requirement of \$5,000 plus deductible • Rx retail covered as a medical expense... mail Rx copay began at \$7.50 	<ul style="list-style-type: none"> • Indemnity plan model • Rx benefit arranged under medical administrator contract • \$1 million lifetime benefit limit 	<ul style="list-style-type: none"> • Pre-certification of some procedures required • Second surgical opinion mandatory for specific procedures 	<ul style="list-style-type: none"> • Aetna competitively selected under a minimum premium indemnity arrangement, effective 9-1-1986 • Included mail Rx services through subcontract with National Rx
1987-1988	<ul style="list-style-type: none"> • State contribution increased from 0.35% to 0.40% • Reduced mail order Rx co-pay from \$7.50 to \$7.00 		<ul style="list-style-type: none"> • Plan limits consideration of charges that should have been pre-certified to 50% of such charges 	
1988-1989	<ul style="list-style-type: none"> • State contribution rate increased from 0.40% to 0.45% 			
1989-1990	<ul style="list-style-type: none"> • State contribution rate increased from 0.45% to 0.50% • Retiree premiums increased 38% A-T-B, effective 1-1-1990 • Reduced deductibles: T1 reduced from 		<ul style="list-style-type: none"> • First open enrollment on 1-1-1990 • Mandatory pre-certification for certain outpatient services 	

Plan Year	Cost Sharing	Plan Design	Utilization Management	Administration
	<p>\$5,000 to \$4,000; T2 from 2,000 to \$1,600; T3 maintained at \$200</p>			
1990-1991		<ul style="list-style-type: none"> • Increased maximum number of outpatient mental/nervous visits from 25 to 52 	<ul style="list-style-type: none"> • Expanded outpatient procedures requiring pre-certification • Discontinued mandatory 2nd surgical opinion 	
1991-1992	<ul style="list-style-type: none"> • Retiree premiums raised 15% A-T-B, effective 9-1-1991 • Increased member deductibles: from \$4,000 to \$4,400 for T1; from \$1,600 to \$1,750 for T2; and from \$200 to \$220 for T3 • Increased member co-insurance requirement from \$5,000 for all plans to \$5,500 	<ul style="list-style-type: none"> • Increased lifetime benefit from \$1 million to \$1.1 million 	<ul style="list-style-type: none"> • Increased from 50% to 75% the amount of covered charges that plan would consider that were not compliant with pre-certification requirements 	
1992-1993	<ul style="list-style-type: none"> • Increased T3 member premiums 9%, effective 9-1-1992 • Increased deductibles: from \$4,400 to \$4,750 for T1; \$1,750 to \$1,890 for T2; and \$220 to \$240 for T3 • Increased member co-insurance requirement from \$5,500 for all plans to \$5,940 	<ul style="list-style-type: none"> • Established Medco retail pharmacy network with \$50 deductible for T3 • Added mammogram screening • Mental/nervous paid as any other illness • Increased maximum lifetime benefit from \$1.1 million to \$1.2 million 	<ul style="list-style-type: none"> • Second open enrollment effective 9-1-1993 	<ul style="list-style-type: none"> • Aetna competitively re-selected as plan administrator, effective 9-1-1992 • National Rx continued under Aetna contract
1993-1994	<ul style="list-style-type: none"> • Increased member premiums 8% A-T-B, effective 9-1-1993 • Increased deductibles: from \$4,750 to \$5,000 for T1; \$1,890 to \$2,000 for T2; and \$240 to \$250 for T3 • Increased member co-insurance requirement from \$5,940 for all plans to \$6,250 	<ul style="list-style-type: none"> • Increased maximum lifetime benefit from \$1.2 million to \$1.3 million 	<ul style="list-style-type: none"> • Eliminated some procedures from pre-certification requirement • Implemented TRS Coordinated Care Statewide Network of hospitals 	
1994-1995	<ul style="list-style-type: none"> • Increased member premiums 7.4% for T3, effective 9-1-1994 	<ul style="list-style-type: none"> • Added coverage for flu shots, smoking cessation and pap smear 	<ul style="list-style-type: none"> • Added statewide physician network to TCC 	

Plan Year	Cost Sharing	Plan Design	Utilization Management	Administration
	<ul style="list-style-type: none"> Increased deductibles: from \$5,000 to \$5,200 for T1; \$2,000 to \$2,100 for T2; and \$250 to \$260 for T3 Increased member co-insurance requirement from \$6,250 for all plans to \$6,500 Modified Rx copays: for mail, \$2 generic and \$10 brand; for retail, \$50 member deductible, then 90% reimbursement for generic and 70% for brand 	<ul style="list-style-type: none"> Increased maximum lifetime benefit from \$1.3 million to \$1.4 million 		
1995-1996	<ul style="list-style-type: none"> Member premiums reduced 10% A-T-B (SB 9), effective 11-1-1995 Reduced member deductibles: from \$5,200 to \$4,500 for T1; from \$2,100 to \$1,800 for T2; and from \$260 to \$240 for T3 	<ul style="list-style-type: none"> Added \$5,000 lifetime cap for hospice coverage 	<ul style="list-style-type: none"> Third open enrollment effective 9-1-1996 	<ul style="list-style-type: none"> Legislatively mandated study by Value Health Management and Gabriel Roeder & Smith
1996-1997		<ul style="list-style-type: none"> Increased discounts for hospital and physician participants in TCC Added \$15 office visits 	<ul style="list-style-type: none"> Simplified pre-certification by excluding small claims under \$100 	<ul style="list-style-type: none"> Plan administration arrangement modified to provide for TRS self-insured risk under an administrative services contract Retention expense audit
1997-1998	<ul style="list-style-type: none"> Decreased member co-insurance requirement from \$6,500 for all plans to \$5,000 Modified Rx copays: retail increased to \$8 generic and \$16 brand with mandatory generic substitution 	<ul style="list-style-type: none"> Added coverage for PSA testing Increased discounts for hospital and physician participants in TCC Added Medicare HMO Pilot plans Established an unlimited cap on lifetime services 		<ul style="list-style-type: none"> Established separate pharmacy benefits management (PBM) contract with Merck-Medco, effective 9-1-1997 RFP process audit Merck-Medco claim administration audit Medicare HMO RFP process audit
1998-1999	<ul style="list-style-type: none"> Introduced Medicare + Choice pilot project for an 11-county area in North Texas. 	<ul style="list-style-type: none"> Increased discounts for hospital and physician participants in TCC 		<ul style="list-style-type: none"> Re-bid PBM contracts effective 9-1-1998 First time that medical and Rx services separately bid

Plan Year	Cost Sharing	Plan Design	Utilization Management	Administration
				<ul style="list-style-type: none"> • Aetna again selected for medical plan and overall claims administration • Merck-Medco selected as pharmacy benefit manager • Internal operations audit
1999-2000	<ul style="list-style-type: none"> • Increased member premiums for T3 ranging from 14 to 42% • Increased Rx mail order co-pays to \$8 generic and \$16 brand 			<ul style="list-style-type: none"> • Aetna and Merck-Medco administration and claims payment audit • Management controls audit • Wolcott administration and claims audit of Aetna and Merck-Medco
2000-2001				
2001-2002	<ul style="list-style-type: none"> • Increased Rx mail co-pays from \$8/\$16 to \$12 generic and \$24 brand, effective 1-1-2002 • Increased Rx discounts in conjunction with selection of ActiveCare PBM 	<ul style="list-style-type: none"> • Limited chiropractic to 20 visits per year • Increased benefits for PAP, PSA and MAMMOG • Added a pharmacy discount card to TRS-Care 1 and 2 	<ul style="list-style-type: none"> • Revised procedures applicable to pre-certification 	<ul style="list-style-type: none"> • Wolcott administration and claims audit of Aetna and Merck-Medco
2002-2003	<ul style="list-style-type: none"> • Discontinued Medicare + Choice Pilot Project, but grandfathered existing participants 	<ul style="list-style-type: none"> • Added Access to Aetna Provider Network for out-of-state residents, eff. 2/1/03 		
2003-2004	<p>Effective 9/1/03:</p> <p>Increased Rx copays:</p> <ul style="list-style-type: none"> • Retail: Generic—\$10; Brand Formulary—\$25; Brand Non-formulary—\$40 • Home Delivery: Generic—\$20; Brand Formulary—\$50; Brand Non-formulary—\$80 <p>Increased Network (in-state) Provider O.V. copay to \$25.</p>		<ul style="list-style-type: none"> • Effective 9/1/03 the TRS Coordinated Care Network was reduced by 90% in a switch to the more cost-effective Aetna network for savings of more than \$30 million per year. 	<ul style="list-style-type: none"> • A competitive bid process for both the Medical Administrator and the Pharmacy Benefits Manager was conducted from October 2003 through January 2004. • Effective 9/1/04, Aetna was selected as Medical Administrator. Caremark Inc. was selected to replace Medco Health Solutions as the Pharmacy Benefits Manager for a projected savings of \$4.5 million for the

Plan Year	Cost Sharing	Plan Design	Utilization Management	Administration
				biennium.

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

By law, TRS-Care makes a basic level of health coverage available without cost to eligible TRS public school retirees. Eligible retirees and family members may pay premiums and participate in a plan of more comprehensive benefits and coverage. Eligibility for TRS-Care is established by statute, and the requirements have become quite complex in the last few years. For service retirements effective on or before August 31, 2004, eligible retirees are those who have retired from a position in Texas public schools after 10 or more years of service credit and are not eligible for other statewide health insurance. Upon retirement, members who took a service retirement after August 31, 2004, were required to meet new eligibility requirements; for some retirees, the new requirements meant that they were eligible but would be required to pay the total cost of coverage as their premium. However, eligibility changes from the 79th Legislature, Regular Session will allow these members to qualify for TRS-Care under the pre-September 1, 2004 eligibility requirements described above, effective September 1, 2005. This most recent change will allow retirees who in 2004-2005 were eligible only by paying the total cost of coverage instead to pay a premium in an amount less than total cost, beginning September 1, 2005.

The detailed eligibility requirements effective September 1, 2004 and September 1, 2005 (respectively) are shown below. Disability retirees are eligible for TRS-Care as long as they are receiving disability retirement benefits from the pension fund administered by TRS.

TRS-Care Eligibility (Effective September 1, 2004 through August 31, 2005)

For all disability and service retirees, regardless of their retirement date—To be eligible for TRS-Care, a retiree **cannot** be eligible for Employees Retirement System (ERS), University of Texas System (UT System), or Texas A&M System health care coverage. Additionally, a service retiree must meet the applicable eligibility requirements.

A. DISABILITY RETIREES: Disability retirees are eligible to participate in the program when they become a disability retiree. Once enrolled in TRS-Care as a disability retiree, they may continue to participate as long as they remain a disability retiree. Coverage for a disability retiree with fewer than 10 years of service will end when disability retirement benefits end.

B. SERVICE RETIREES: To be eligible for TRS-Care, an individual must meet

one of the following four qualification standards:

Qualification 1.

- Be at least age 65, **and**
- Have taken a TRS service retirement, and
- Have at least 10 years of service credit in the system, which may include up to 5 years of military service credit but which may not include any other special service purchased.

Qualification 2.

- Have taken a TRS service retirement **and**
- Have at least 10 years of service credit in the system, which may include up to 5 years of military service credit but which may not include any other special service purchased, and
- The sum of age plus service credit described by this paragraph equals or exceeds 80 (*TRS-Care Rule of 80*).

Qualification 3.

- Purchase service credit that was credited by 8/31/03 (excludes all withdrawn, unreported, substitute, and transferred ERS service credit); **and**
- Have the sum of age, plus service credit for actual service in Texas public schools or higher education (including all purchased withdrawn, unreported, and substitute service credit and transferred ERS service credit), plus any other purchased service credit that was credited by 8/31/03, equal or exceed 80 (*Grandfathered TRS-Care Rule of 80*); and
- At the time of retirement, have at least 10 years of Texas public school or higher education service credit, five of which can be out-of-state service credit, so long as the out-of-state service was credited by 8/31/03; and
- Take a normal age service retirement, as determined by TRS pension law, by 8/31/09.

Note: Service retirees who meet all the requirements of Qualification 3 except the Grandfathered TRS-Care Rule of 80 at the time of retirement can age into TRS-Care eligibility under Qualification 3 only if they will meet the Grandfathered TRS-Care Rule of 80 by August 31, 2009. Retirees who take an early-age retirement can never meet the requirements of Qualification 3, because it requires a normal age service retirement.

Qualification 4.

- Have been employed in actual service in Texas public schools or higher education during or before the 2003-2004 school year, **and**
- Have taken a TRS service retirement, and
- At the time of retirement, have at least 10 years of Texas public school service (includes higher education), five of which can be out-of-state service credit.

A retiree eligible to participate under Qualification 4 is required to pay the total cost of TRS-Care until the date the retiree qualifies for TRS-Care under

Qualification 1, 2, or 3 above.

Second Enrollment Opportunity for those who are eligible for TRS-Care only under Qualification 4:

A service retiree who is eligible for TRS-Care only under number 4 will have a second initial enrollment period for TRS-Care when he or she first meets the requirements of either Qualification 1, 2, or 3. Retirees who declined, waived, or dropped TRS-Care coverage under Qualification 4 are still eligible for the second enrollment opportunity.

Service retirees who retire after September 1, 2004 under either Qualification 1 or Qualification 2, and who participated in the Deferred Retirement Option Plan (DROP) may use any years of service credit that they would have received had they not participated in DROP as service credit to qualify for TRS-Care under only Qualification 1 or 2 above.

Effective for retirements on or after September 1, 2005, the TRS-Care eligibility requirements were changed to the following:

On September 1, 2005, to be eligible for TRS-Care, the member must have at least 10 years of service credit in the System. This service credit may include up to five years of military service credit, but it may not include any other special or equivalent service credit purchased. **Additionally, the member must meet one of the following requirements:**

- The sum of the retiree's age and years of service credit in the System equals or exceeds 80 at the time of retirement, regardless of whether the retiree had a reduction in the retirement annuity for early age (years of service credit can include all purchased service); *or*
- The retiree has 30 or more years of service credit in the retirement system at the time of retirement. (Years of service credit can include all purchased service.)

TRS-Care Eligibility Changes, Effective September 1, 2005

The following description includes changes to TRS-Care that were recently approved by the 79th Texas Legislature:

Service Retirees Who Retire after September 1, 2005: To be eligible for TRS-Care, the member must have at least 10 years of service credit in the System. This service credit may include up to five years of military service credit, but it may not include any other special or equivalent service credit purchased. **Additionally, the member must meet one of the following requirements:**

- The sum of the retiree's age and years of service credit in the System equals or exceeds 80 at the time of retirement, regardless of whether the retiree had

a reduction in the retirement annuity for early age (years of service credit can include all purchased service); *or*

- The retiree has 30 or more years of service credit in the retirement system at the time of retirement. (Years of service credit can include all purchased service.)

Service Retirees Who Retired After September 1, 2004, but on or before August 31, 2005: To be eligible for TRS-Care, an individual, on September 1, 2005, either must qualify through one of the following three methods:

Qualification 1. Meet TRS-Care eligibility requirements, as they existed on August 31, 2004. Under these requirements, an individual must:

- Have taken a TRS service retirement with either at least 10 years of service credit in the retirement system for actual service in public schools in this state; *or*
- Have at least five years of service credit for actual service in Texas public schools and up to five years of out-of-state service credit in the System.

Qualification 2. Meet the requirements for eligibility outlined above for an individual taking a service retirement after September 1, 2005.

Qualification 3. Be enrolled in TRS-Care and was enrolled in TRS-Care on August 31, 2005.

The following information describes eligibility details that remain unchanged by recent legislation:

Service Retirees Who Retired Before September 1, 2004: Individuals who have taken a service retirement under TRS on or before August 31, 2004 and are enrolled in TRS-Care on August 31, 2005 continue to be eligible for TRS-Care.

Disability Retirees: Individuals are eligible to participate in TRS-Care when they become a disability retiree. Once enrolled in TRS-Care as a disability retiree, participation continues as long as the individual is a disability retiree. *Note: Coverage for a disability retiree with fewer than 10 years of service will end when disability retirement benefits end.*

For All Disability and Service Retirees, Regardless of their Retirement Date: To be eligible for TRS-Care, a retiree **cannot** be eligible for Employees Retirement System, University of Texas System, or Texas A&M System health benefit program coverage.

TRS-Care Enrollment by Option			
As of 8/31/2004			
TRS-Care 1	TRS-Care 2	TRS-Care 3	Total

16,913	23,835	141,367	182,115
--------	--------	---------	----------------

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

TRS-Care is administered through a separate trust that provides comprehensive health benefit coverage for eligible retired members and eligible family members. Determination of eligibility and the collection of contributions and retiree premiums are made by the Trustee. Claim submissions, claim payments, and claim appeals are adjudicated through the contractors for medical benefits and prescription drug benefits. The Trustee assists retirees with difficult claim problems when required.

The TRS Board of Trustees establishes the basic features of the benefit program by resolution adopted periodically, after recommendations by the TRS staff and health care consultants. The Board establishes co-payment amounts, deductibles, and premium amounts for each coverage group and each plan level. The Retirees Advisory Committee, as provided by TEX. INS. CODE §§ 1575.401-.408, provides recommendations as to plan design, premiums, and administration.

TRS-Care serves retirees throughout the state through toll-free numbers and Web site information. TRS benefit counselors address TRS-Care eligibility and benefits through group presentations made around the state at the same time that retirement plan information is presented to TRS members who are nearing retirement.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

This program is financed by contributions from the state's General Revenue Fund, active public school employees, school districts and other public school employers, retiree premiums, and investment earnings of the TRS-Care trust fund. State funds for TRS-Care are reflected in Article III, pp. 31-34 of the FY 2006-2007 General Appropriations Act; Riders 5, 10, 11, and 12.

Teacher Retirement System of Texas	
TRS-Care Retiree Health Benefit Program Sources of Revenue - Fiscal Year 2004 (Actual)	
Source	Amount
TRS-Care Retired Plan:	
Health Care Premiums	\$ 248,552,679
Contributions from the State's General Revenue Fund	454,828,830
Active Member Contributions	99,297,097
Contributions from Reporting Entities	79,457,387
Investment Income	4,803,809
Transfer from TRS-Active Care	42,000,000
Unappropriated Deposits to General Revenue	15,139,425
TOTAL	\$ 944,079,227

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

TRS-ActiveCare provides health coverage to eligible active TRS members and certain employees of participating entities who are not TRS members. This health benefit program employs the services of a plan administrator and a pharmacy benefit manager. The health care needs of a retired population, with an average age of 69, are significantly different from those of TRS-ActiveCare, in which the average age is 38.

The Employees Retirement System provides health coverage to active and retired state employees. The University of Texas System and the Texas A&M System provide health coverage to active and retired university employees. All three of these Systems integrate active and retiree participants into one plan.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency's customers. If applicable, briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

The programs described in our response to Question H were all created by different legislation to provide health coverage to different populations and are funded by different means. There is no duplication between the TRS-Care and TRS-ActiveCare programs, since TRS retirees are ineligible for TRS-ActiveCare coverage and vice versa.

Subject to § 1575.004 of the TEX. INS. CODE, Texas public school retirees are eligible to be enrolled in TRS-Care unless they are eligible for other coverage as an employee or retiree of the State of Texas or of a public college or university in the state. Retirees are not eligible for TRS-ActiveCare coverage (except as a dependent or if the retiree is not eligible for TRS-Care). An eligible person may also elect to cover his or her spouse and/or eligible dependent children. Also eligible are surviving spouses and surviving dependent children of these retirees, and

surviving spouses and surviving dependent children of deceased active public school employees who died after August 31, 1986, who contributed to this fund.

The program incorporates standard Coordination of Benefit provisions, which include being secondary to all “group-like” coverages such as AARP Medicare Supplement plans. Claims are paid according to the Government Exclusion Rule when Medicare is involved. All claims are paid assuming Medicare Part B for those covered persons who are eligible to purchase Part B even if it is not purchased or if it has been dropped.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

TRS-Care collects active employee contributions and employer contributions to the program on a monthly basis. The collection process is handled through monthly reports by the public school employers that are required by law to make contributions to TRS-Care.

Starting September 1, 2005, TRS-Care also will receive an additional payment from any Texas public education employer that hires a retiree enrolled in TRS-Care, unless that employee is grandfathered. The amount will be the difference between the retiree’s contribution to the program and the actual cost of participation by the retiree and any other individuals enrolled in TRS-Care under the same account. The employer will be required to pay the “gap” amount on a monthly basis. This change results from Senate Bill 1691, 79th Legislature, Regular Session.

Effective January 1, 2006 TRS will offer Medicare-enrolled TRS-Care plan participants creditable coverage under the Medicare Part D program. In coordination with the Centers for Medicare and Medicaid Services (CMS), TRS will receive a subsidy from CMS for approximately 28% of pharmacy benefits issued to Medicare-enrolled TRS-Care plan participants.

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

TRS contracts with a health plan administrator and a pharmacy benefit manager to provide claims payment and other services for TRS-Care. The contracts contain specific performance requirements and measures, and the vendors self-report their performance in detail to TRS through quarterly and annual review meetings and reports. TRS also has access to all of the claims data and conducts reviews and audits with independent audit firms and the TRS health care consultants to verify the vendors’ self-reported performance. A competitive bidding process is used for selection of these vendors. In managing both of these contracts, TRS uses:

- A third-party health care consultant to assist in evaluating Requests for Proposals (RFPs), contracts, and the reasonableness of proposed fees.
- Quarterly contract compliance meetings.

- Contractual performance guarantees with penalties.
- Contractual auditing rights.
- Funding reconciliation based on plan participant census.
- Third-party auditing firms every other year to audit claims processed during the two-year period.
- Member satisfaction surveys conducted annually by the administrator and by TRS.
- On-going member liaison by the TRS-Care Member Services Team.

L. What statutory changes could be made to assist this program in performing its functions? Explain.

TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

The retired school employees group benefits fund is separate and distinct from any other trust fund of TRS (including the pension trust fund) and from any other group benefit program, such as TRS-ActiveCare. Financial reports are provided to the TRS Board on a monthly basis and annually to the Legislative Budget Board and state leadership in order to provide close monitoring of the financial condition of the fund. TRS-Care program performance and financial data are also included in the TRS Comprehensive Annual Financial Report (CAFR).

TRS-Care provides coverage only to TRS retirees who meet the eligibility requirements. Due to cost constraints, coverage is not available to every TRS retiree. Some retirees may be eligible to retire under the TRS pension plan but still may be ineligible for TRS-Care or any other Texas public employee group plan. However, generally, a TRS member may work additional years in public education and thus obtain eligibility for TRS-Care.

Additionally, some retirees who declined enrollment when they had an opportunity to participate now wish to enroll in the program. However, due to cost constraints, TRS-Care cannot offer an open enrollment period to those retirees who declined coverage but now wish to enroll or to those who enrolled but wish to move to a higher level of coverage.

N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:

- why the regulation is needed;
- the scope of, and procedures for, inspections or audits of regulated entities;
- follow-up activities conducted when non-compliance is identified;
- sanctions available to the agency to ensure compliance; and
- procedures for handling consumer/public complaints against regulated entities.

Not applicable.

O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.

No regulatory function is associated with this TRS program. (Exhibit 12 deleted.)

TRS-ActiveCare Public School Employee Health Benefit Program:

A. Provide the following information at the beginning of each program description.

Name of Program or Function	TRS-ActiveCare—Public School Employee Health Benefits Program
Location/Division	Benefit Services Division
Contact Name	Bob Jordan
HMO Payments, Claims, and Claims Processing Expenses, FY 2004	\$ 614,476,693
Actual Expenditures (Administrative), FY 2004	\$ 918,619
Number of FTEs as of August 31, 2004	8

B. What is the objective of this program or function? Describe the major activities performed under this program.

TRS administers TRS-ActiveCare, the statewide health benefit program for eligible public education employees of participating entities. The program went into effect on September 1, 2002, and (as of September 1, 2004), 246,914 employees and family members were covered under the program. The only source of funds received by TRS-ActiveCare is the premiums paid by covered public school employees of participating entities. Although TRS-ActiveCare receives all funding directly through premiums, state and district funding reduces the premium cost payable by many participating employees. Eligible employees may choose health coverage for themselves and their eligible family members from three TRS-ActiveCare plans providing access to a statewide provider network. Employees in areas of the state served by participating health maintenance organizations (HMOs) have the additional choice of HMO coverage. All school districts are eligible to elect to participate in TRS-ActiveCare in accordance with established procedure, and coverage choices for employees may be expanded further to meet the changing needs of Texas public school employees and their families.

C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.

TRS monitors several measures for the TRS-ActiveCare program to assure participant satisfaction and cost efficiency. The following key statistics indicate the program’s performance:

- **Customer satisfaction.** Ninety-one percent of TRS-ActiveCare participants rated TRS-

ActiveCare services as satisfactory or better for FY 2004, based on the *2004 Member Satisfaction Survey*. (Separate customer satisfaction information provided by the vendor is included in the TRS-ActiveCare Program Review attachments.)

- **Participating network savings.** In FY 2004, TRS-ActiveCare had \$630 million in participating provider network savings. This indicates the difference between provider-billed charges and the discounted network fees accepted by participating providers. This measure is the sum of the prescription drug plan savings and the medical plan savings, based on claims paid.
- **Claims adjudication.** TRS-ActiveCare settled 100% of complete claims within 15 days of receipt by the claims administrator in FY 2004. This indicates prompt processing of claims submitted by participants and providers. The percentage is slightly higher than the targeted 99.0%.

Additionally, TRS-ActiveCare regularly reports key statistics to the TRS Board of Trustees, including number of participants in each health plan, the number of eligible employees who declined coverage, and average medical and prescription claims cost per participant. For FY 2004, of the 213,177 employees eligible for TRS-ActiveCare, 62,508 declined coverage. Most declined due to other coverage. In FY 2004, 150,669 employees and 96,245 family members were enrolled in TRS-ActiveCare for a total of 246,914 participants, compared to 212,356 in the prior fiscal year. In FY 2004, there were 1,030 participating districts in TRS-ActiveCare. This was an increase of 24 districts from FY 2003. The total cost per participant, including claims cost and administrative fees, was \$2,427. As of July 1, 2005, 259,312 participants from 1,039 districts were enrolled in TRS-ActiveCare, and 12 new districts are joining TRS-ActiveCare for FY 2006.

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

Enacted by the 77th Legislature, Chapter 1579, TEX. INS. CODE, governs the Texas School Employees Uniform Group Health Coverage. Comparability studies conducted by TRS on behalf of the Texas Legislature indicated that prior to the creation of TRS-ActiveCare, most Texas public school employees did not have affordable health coverage that was comparable to the coverage offered to state employees. In fact, many had no health coverage available to them through their employers. TRS-ActiveCare was designed to provide comparable health coverage and alternative coverage choices to all eligible employees of participating school districts.

TRS-ActiveCare, the statewide health benefit program for employees of school districts, open enrollment charter schools, regional education service centers, and other educational districts whose employees are members of TRS, went into effect on September 1, 2002. The program initially addressed the most critical areas of the state with regard to availability and affordability of health care benefits for public school employees and therefore focused on smaller districts. The program has now been expanded to include larger school districts and more than 1,000 entities participated in the program in fiscal year 2004. Employees of participating entities can choose from three preferred provider organization plans, and employees of certain

areas also have the option of choosing coverage under a health maintenance organization.

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

The eligibility requirements are specified in Chapter 1579, TEX. INS. CODE, and the TRS rules (34 TEX. ADMIN. CODE, Ch. 41, Subch. C), adopted to administer TRS-ActiveCare. Most employees of public school entities that participate in TRS-ActiveCare are eligible for coverage. The following chart illustrates the covered lives by plan as of the end of FY 2004:

	TRS-ActiveCare PPO Plan Options			TRS-ActiveCare Regional HMO Options			Totals
	Plan 1	Plan 2	Plan 3	FirstCare	Mercy Health	Scott & White	
Employees	21,944	88,796	31,074	2,716	119	6,020	150,669
Dependents	15,747	59,356	14,762	2,429	44	3,907	96,245
Total	37,691	148,152	45,836	5,145	163	9,927	246,914

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

The participating entities enroll their eligible employees and their family members through the plan administrator. The plan administrator bills the participating entities monthly for the required premiums to cover their employees, and the participating entities remit the funds to TRS. The plan administrator pays medical and certain prescription drug claims and submits a weekly invoice to TRS for reimbursement. Claims reimbursement invoices are processed for prescription drugs by the pharmacy benefit manager bi-weekly. The administration of the plan is guided by TEX. INS. CODE, Chapter 1579 and 34 TEX. ADMIN. CODE, Ch. 41, Subch. C.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

The only source of funds received by TRS-ActiveCare is the premiums paid by covered public school employees of participating entities. All medical and prescription drug claims, as well as program administration expenses, are paid with these funds.

Although TRS-ActiveCare receives all funding directly through premiums, state and district funding reduces the premium-cost share of participating employees. Through the Pass-Through Supplemental Compensation Program, eligible public school employees receive a fixed payment from the state to assist them with the purchase of health coverage. The state also provides

funding to districts (through school-finance formulas) that is required to be used by the district to provide a fixed amount toward the cost of coverage for employees who are TRS members. Also, school districts are required to provide an additional minimum amount to their employees who are TRS members. The covered employees pay any remaining premium amount for the level of coverage selected by the employee.

Note: With the exception of charter schools, employees of entities that do not participate in TRS-ActiveCare are also eligible for the funding described above.

Teacher Retirement System of Texas	
TRS-ActiveCare Health Benefit Program Sources of Revenue - Fiscal Year 2004 (Actual)	
<i>TRS-ActiveCare Active Plan:</i>	
Health Care Premiums	\$ 758,062,552
Investment Income	3,641,100
On Behalf Fringe Benefits/from the State's General Revenue Fund	24,050
SUBTOTAL	\$ 761,727,702
<i>Long-Term Care Insurance Program:</i>	
Administrative Fees	\$ 192,763
SUBTOTAL	\$ 192,763
<i>Pass-Through Supplemental Compensation Program:</i>	
Legislative Appropriations from General Revenue	\$ 281,149,405
On Behalf Fringe Benefits/from the State's General Revenue Fund	8,453
SUBTOTAL	\$ 281,157,858
<i>Local Health Care Comparability Study:</i>	
TOTAL	\$ 1,043,078,323

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

TRS-Care provides health coverage to eligible TRS retirees and employs the services of a plan administrator and a pharmacy benefit manager, but the health care needs of a retired population with an average age of 69 are significantly different from those of TRS-ActiveCare, in which the average age is 38.

The Employees Retirement System provides health coverage to active and retired state employees. The University of Texas System provides health coverage to active and retired University of Texas employees. Both plans integrate active and retiree participants into one plan.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency's customers. If applicable, briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

The programs described in our response to Question H were all created by different legislation to provide health coverage to very different populations and are funded by different methodologies. There is no duplication between the TRS-Care and TRS-ActiveCare programs, since TRS retirees are ineligible for TRS-ActiveCare coverage and vice versa. The program incorporates standard Coordination of Benefit provisions.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

Approximately 1,030 public school entities participate in TRS-ActiveCare, and there is frequent interaction with them by TRS and the TRS-ActiveCare plan administrator. Each participating employer generally handles the enrollment of eligible employees in the program. The participating employers also are responsible for collecting employee premiums through the payroll process and remitting the premiums to TRS-ActiveCare.

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

TRS contracts with a health plan administrator and a pharmacy benefit manager to provide claims payment and other services. The contracts contain specific performance requirements and measures, and the vendors self-report their performance in detail to TRS through quarterly and annual review meetings and reports. TRS also has access to all of the claims data and conducts reviews and audits with independent audit firms and the TRS health care consultants to verify the vendors' self-reported performance. A competitive bidding process is used for selection of these vendors. In managing both of these contracts, TRS uses:

- A third-party health care consultant to assist in evaluating Request for Proposals (RFPs), contracts, and the reasonableness of proposed fees.
- Quarterly contract compliance meetings.
- Contractual performance guarantees with penalties.
- Contractual auditing rights.
- Funding reconciliation based on plan participant census.
- Third-party auditing firms every other year to audit claims processed during the two-year period.
- Member satisfaction surveys conducted annually by the administrator and by TRS.
- On-going member liaison by the TRS-Care Member Services Team.

L. What statutory changes could be made to assist this program in performing its functions? Explain.

TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

TRS-ActiveCare continues to grow as additional school districts elect to join the program. It is becoming increasingly difficult for non-participating districts to provide affordable health coverage to their employees and absorb large, unexpected claims. TRS-ActiveCare offers the advantages of a large risk pool that has provided relatively stable benefits and rates since the program began on September 1, 2002. This stability is aided by the requirement that districts electing to join TRS-ActiveCare must remain in the program.

N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:

- why the regulation is needed;
- the scope of, and procedures for, inspections or audits of regulated entities;
- follow-up activities conducted when non-compliance is identified;
- sanctions available to the agency to ensure compliance; and
- procedures for handling consumer/public complaints against regulated entities.

Not applicable.

O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.

No regulatory function is associated with this TRS program. (Exhibit 12 deleted.)

Additional Programs:

Long-Term Care Insurance Program

A. Provide the following information at the beginning of each program description.

Name of Program or Function	Long-Term Care Insurance Program
Location/Division	Benefit Services Division
Contact Name	Bob Jordan
Actual Expenditures, FY 2004	\$ 3,749
Number of FTEs as of August 31, 2004	0

B. What is the objective of this program or function? Describe the major activities performed under this program.

The Long-Term Care Insurance for Public School Employees program administered by TRS provides voluntary long-term care insurance for eligible active and retired public school employees and their eligible family members. The program is underwritten by a long-term care insurance carrier selected by the TRS Board of Trustees through a competitive bidding process conducted at least every six years. The carrier conducts enrollment, premium billing and collection, customer service, and claims adjudication functions.

C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.

Education and enrollment activities conducted by carrier (Aetna):

- 7,000 Enrollment kits mailed to eligible individuals
- 195 days of employee meetings conducted
- Mailed 244,617 flyers

Financial statistics reported by carrier and verified by TRS health care consultants:

- Active life reserves of \$19,551,918
- Disabled life reserves of \$1,958,504
- Incurred but not reported reserves of \$648,836
- 18 ongoing claims
- Loss ratio of 77%

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

The first participants enrolled in the Long-Term Care Insurance for Public School Employees program on October 1, 2000. Eligible active and retired public school employees and their eligible family members may apply for coverage, subject to the carrier's underwriting guidelines, as applicable. New public school employees meeting the eligibility requirements may enroll without proof of good health during their first 90 days of TRS membership. If TRS changes program carriers, enrolled individuals have the opportunity to continue their coverage with the prior carrier on an individual basis or transition to the new carrier's group policy. There are approximately 9,261 active and retired public school employees and eligible family members covered by this program.

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

Eligible active and retired members, their family members, and certain other family members may participate in the TRS long-term care insurance program. The plan is available on an enrollee-pay-all basis.

The plan pays benefits if the participant becomes unable to perform at least two activities of daily living without substantial assistance from another person. The plan also pays benefits as a result of a severe cognitive impairment that requires supervision or verbal direction from another person in order to protect the member or others from serious injury.

Members can select a Daily Benefit Amount (DBA) of \$100, \$125 or \$150. The plan will reimburse the member for the actual expenses incurred up to specified amounts depending on the type of care received.

Effective September 1, 2005, Chapter 1576, TEX. INS. CODE governs the Long-Term Care Insurance for Public School Employees program. Chapter 1576 and TRS Rules established eligibility requirements and other program criteria.

The enrolled active employees represent virtually all public school districts in Texas and their employers deduct their monthly premiums from their payroll. TRS deducts monthly premiums from the monthly annuity payments to enrolled TRS retirees. The school districts and TRS both remit the collected premiums to the carrier on a monthly basis.

The following chart reflects participation as of August 31, 2004:

	Retiree/Family	Member/Family	Total
Enrolled	4,507	4,754	9,261
Avg. Issue Age	61.8	52.5	57.0*
Avg. Ann. Premium	\$1,170	\$678	\$918*
Annualized Premium	\$5,273,748	\$3,224,221	\$8,497,968

* These figures are averages and therefore retiree and member figures do not total. All figures provided by the vendor, Aetna.

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

The insurance carrier receives and processes applications for coverage and issues certificates of coverage to applicants meeting their underwriting guidelines, when applicable. The carrier also provides all customer service to potential and existing certificate-holders through a toll-free phone number, carrier Web site, email, and ground mail. TRS monitors the carriers’ activities and performance to a set of criteria established in each carrier’s contract with TRS. TRS also handles any complaints about the carrier or the program. As indicated in our response to Question F, TRS collects and remits premiums from the annuity checks of TRS retirees who are enrolled in the program.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

The program is completely voluntary and all the premiums paid to the carrier come from the enrolled participants (as noted in Section V, questions A and E). There is no state funding and the carrier pays TRS a monthly administration fee to cover the incidental expenses incurred by the agency to administer the program.

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

The Employees Retirement System, the University of Texas System, and the Texas A&M System all offer similar voluntary long-term care insurance programs to their eligible active employees and retirees.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency’s customers. If applicable,

briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

The legislation establishing each of the programs listed in our response to Question H set the eligibility requirements for each plan, and differences exist to reflect the divergent nature of the populations served.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

Not applicable to TRS.

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

TRS conducts annual review meetings with the vendor, and the self-reported performance data supplied by the vendor is reviewed and verified by the TRS health care consultants and actuaries.

L. What statutory changes could be made to assist this program in performing its functions? Explain.

TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

The long-term care insurance program administered by TRS and underwritten by Aetna Life Insurance Company is a tax-qualified plan under the regulations created by the Health Insurance Portability and Accessibility Act (HIPAA) in 1996. As such, premiums paid by participants may be included with other qualified medical expenses for federal income tax purposes when itemizing deductions. Also, the benefits are not taxable when received due to the loss of two or more activities of daily living. The financial costs for custodial care for elderly and disabled public school employees and retirees is more than most can bear themselves, and long-term care insurance fills a vital need for their financial planning. The program is administered in such a way that there is no cost to the state or TRS, and participants benefit from group rating.

- N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:**
- why the regulation is needed;
 - the scope of, and procedures for, inspections or audits of regulated entities;
 - follow-up activities conducted when non-compliance is identified;
 - sanctions available to the agency to ensure compliance; and
 - procedures for handling consumer/public complaints against regulated entities.

Not applicable.

- O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.**

No regulatory function is associated with this TRS program. (Exhibit 12 deleted.)

Local Health Care Comparability Study

A. Provide the following information at the beginning of each program description.

Name of Program or Function	Local Health Care Comparability Study
Location/Division	Benefit Services Division
Contact Name	Betsey Jones
Actual Expenditures, FY 2004	\$ 211,649
Number of FTEs as of August 31, 2004	0

B. What is the objective of this program or function? Describe the major activities performed under this program.

TEX. EDUC. CODE § 22.004 requires that TRS conduct a comparability study in even-numbered fiscal years to determine whether the basic health coverage provided by local school districts is comparable to that provided to state employees as required by state law. To determine comparability, TRS obtains and analyzes plan information provided by school districts that do not participate in TRS-ActiveCare. TRS-ActiveCare is required by law to offer a plan comparable to that provided to state employees. Therefore, TRS-ActiveCare participating districts are automatically certified as comparable.

C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.

TRS submits a Certification Report and Comparability Study to the Legislative Budget Board. The last study, dated August 31, 2004 obtained and analyzed information on almost 600 plans from 226 of the 239 districts that did not participate in TRS-ActiveCare in 2004.

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

TRS-ActiveCare was established effective September 1, 2002 in response to the need for access to health care, especially in smaller school districts. The comparability studies conducted in 1998 and 2000 provided support for this concern. The study continues to provide compliance information on districts that do not participate in TRS-ActiveCare.

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

This study provides information to TRS members and to the Texas Legislature regarding district compliance with the law to provide health care coverage that is comparable to that provided to state employees.

In 2004 TRS requested information from the 239 districts that did not participate in TRS-ActiveCare in 2004 regarding health care plans offered to employees. These 239 districts employ about 60% of the total district employee population.

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

- In December, notification letters that comparability packets will be coming are sent via certified mail to district superintendents.
- In January, packets are sent via certified mail to districts for completion.
- During March through July, plans are analyzed, and comparability is determined.
- In August, individual plan results of the study are sent to districts.
- On August 31, a full report is delivered to the Legislative Budget Board and also placed on the TRS Web site.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

No appropriations were provided for studies completed to date. The 79th Legislature, Regular Session, appropriated \$250,000 from the state's General Revenue Fund for the 2006 study. Expenses for the 2004 study were paid from the TRS-ActiveCare trust fund, as noted in Section V, questions A and E.

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

We are not aware of another entity performing this service.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency's customers. If applicable, briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

Not applicable.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

The study requires information from districts that do not participate in TRS-ActiveCare.

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

To determine comparability, plans are analyzed using an evaluation tool called the benefit replacement ratio. The calculation of the benefit replacement ratio is outsourced to our health care consultant. TRS and the consultant are in contact continuously during the study to monitor progress.

L. What statutory changes could be made to assist this program in performing its functions? Explain.

TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

No additional information is needed to understand the program.

N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:

- why the regulation is needed;
- the scope of, and procedures for, inspections or audits of regulated entities;
- follow-up activities conducted when non-compliance is identified;
- sanctions available to the agency to ensure compliance; and
- procedures for handling consumer/public complaints against regulated entities.

Not applicable.

O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.

No regulatory function is associated with this TRS program. (Exhibit 12 deleted.)

403(b) Certification Program**A. Provide the following information at the beginning of each program description.**

Name of Program or Function	403(b) Certification Program
Location/Division	Governmental Relations
Contact Name	Pattie Featherston
Actual Expenditures, FY 2004	\$ 24,000
Number of FTEs as of August 31, 2004	0

B. What is the objective of this program or function? Describe the major activities performed under this program.

The function of this program is to accept certification by companies offering 403(b) plan investments to public school employees in the State of Texas that the companies meet established criteria. Certification is a pre-requisite to receiving payments through salary reduction agreements between the employees and their employers. Certification indicates that the companies meet the financial and other requirements established by statute and by TRS rule. When TRS determines that the company's certification is acceptable, TRS includes the name of the company on a list on the TRS Web site for reference by employers and employees. When an employee selects a certified company as the recipient of the employee's investment dollars, the employee and the employer execute a salary reduction agreement for the monthly amount, and the employer forwards the investment funds to the certified company.

Section 403(b) plans take their name from the section of the Internal Revenue Code that permits qualified employers to establish retirement savings plans through salary reduction agreements between employers and employees. Section 403(b) plans permit employees to accumulate assets for retirement on a tax-deferred basis. These are defined contribution plans with voluntary employee participation. Section 403(b) of the Code limits the type of investments that may be offered to employees participating in such plans to annuities (often referred to as tax-sheltered annuities or "TSAs") and mutual fund investments.

C. What evidence can you provide that shows the effectiveness and efficiency of this program or function? Provide a summary of key statistics and performance measures that best convey the effectiveness and efficiency of this function or program.

TRS currently lists 76 certified companies on the TRS Web site. Of these, 46 companies offer annuity products, and 33 companies offer mutual fund investments. (Three companies offer both types of products.) The number of certified companies indicates that employees have a wide

range of investment options from which to choose when they participate in 403(b) plans through payroll reduction.

Effectiveness of the program is indicated by participation of companies in the certification function. Of the top 40 Texas annuity insurers in 2003 (as identified by the Texas Department of Insurance), 17 have certified with TRS. These 17 companies accounted for over a third (34.7%) of the Texas annuity market in 2003. Additionally, six of the 20 top annuity companies nationally as rated by Weiss Ratings Inc. are certified companies. Of the 20 largest mutual fund companies in 2005 (as identified by the Investment Company Institute), 11 have certified with TRS. These 11 companies accounted for 46% of the national mutual fund market in 2005. Efficiency of this program is indicated by the average 10 working days between receipt of a certification by TRS and its acceptance. A second measure of efficiency is the average cost of the program, which during its first three years (2002-2005) cost an average of \$62,681 per year.

D. Describe any important history regarding this program not included in the general agency history section, including how the services or functions have changed from the original intent.

The certification requirement for companies offering investment products paid through salary reduction agreements was enacted by the 77th Legislature in 2001 through the passage of Senate Bill 273. TRS adopted rules to implement the program in 2002. Since those dates, the program functions have remained the same as originally intended.

E. Describe who or what this program or function affects. List any qualifications or eligibility requirements for persons or entities affected. Provide a statistical breakdown of persons or entities affected.

TEX. REV. CIV. STAT. ANN. Art. 6228a-5 establishes the certification requirements and applicability.

This program affects the following persons or entities:

- Employees of Texas school districts or open enrollment charter schools;
- Employers that are Texas school districts or open enrollment charter schools; and
- Companies that offer investment products that meet the requirements of Section 403(b), Internal Revenue Code, to employees of Texas educational institutions.

There are approximately 600,000 public school employees eligible for participation in 403(b) plans. Currently, a total of 76 companies have certified compliance with applicable requirements and thus are on the TRS list of certified companies. TRS does not have statistical information on the total number of companies that may be eligible to certify but choose not to do so. Some companies may choose to sell annuity and other investment products directly to customers without the use of salary reduction agreements between employees and their employers. If an employee chooses to invest without use of a 403(b) salary reduction

agreement, the mutual fund or annuity company is not required to certify to TRS, but instead simply must meet any applicable regulatory requirements, such as insurance or securities regulations.

F. Describe how your program or function is administered. Include flowcharts, timelines, or other illustrations as necessary to describe agency policies and procedures. List any field or regional services.

A company that wishes to certify to TRS submits relevant information on a TRS form. TRS reviews the company's submission to determine whether all required information has been submitted, and verifies the company's status with state regulatory agencies. When TRS has completed its review, it notifies the company whether its certification has been accepted. On average, the certification process is completed within 10 days.

Additionally, a certified company must submit an annual demonstration that its representatives are properly licensed and qualified (by training and continuing education) to sell and service the company's eligible qualified investments. If a company fails to submit the annual demonstration, TRS will indicate on its Web site that the company has not met this requirement.

TRS also is required to make available a standard sample disclosure notice for use by a person who offers to sell an annuity contract. TRS developed and posted the form of the notice on its Web site when the certification program began.

G. Identify all funding sources and amounts for the program or function, including federal grants and pass-through monies. Describe any funding formulas or funding conventions. For state funding sources, please specify (e.g., general revenue, appropriations rider, budget strategy, fees/dues).

TRS is authorized to collect a certification or re-certification fee of not more than \$5,000 for its administrative costs. See TEX. REV. CIV. STAT. ANN. Art. 6228a-5, § 7. A certification is effective for five years.

TRS rule 34 TEX. ADMIN. CODE §53.7 establishes the fee at \$5,000. Fees are deposited to the credit of the 403(b) administrative trust fund, which is administered by TRS as trustee. As a trust fund, interest earned is retained in the fund. Annual receipts vary according to the number of companies that certify in a fiscal year.

Teacher Retirement System of Texas	
403(b) Certification Program Sources of Revenue - Fiscal Year 2004 (Actual)	
403(b) Certification Program:	
Certification Fees	\$ 15,000
Investment Income	3,495
TOTAL	\$ 18,495

H. Identify any programs, internal or external to your agency, that provide identical or similar services or functions. Describe the similarities and differences.

The TRS 403(b) certification program is similar to the set of requirements under Chapter 609, TEX. GOV'T CODE, relating to deferred compensation plans. Chapter 609 establishes requirements for both 401(k) and 457 deferred compensation plans, which are functionally similar to 403(b) plans but are governed by different sections of the Internal Revenue Code. Chapter 609 applies to political subdivisions, including school districts. Section 609.002 provides that a vendor may be a qualified vendor for a 457 plan or a 401(k) plan created by a political subdivision only if the vendor satisfies the requirements for participation provided by Chapter 609 and the plan administrator.

Subchapter B of Chapter 609 addresses deferred compensation plans for employees of political subdivisions. It authorizes political subdivisions to create and administer 457 plans for their employees. Section 609.113 requires a plan administrator to develop and implement criteria and procedures for evaluating a vendor's application to become a qualified vendor. TRS has no specific information regarding the number of school districts that have established 457 plans for their employees.

A key difference between the provisions of Chapter 609 and the TRS 403(b) certification program is that under Chapter 609, each district with a 457 plan is responsible for establishing and administering vendor qualifications. Under the 403(b) certification, TRS administers statewide company qualifications for all districts with 403(b) plans. Another key difference between Chapter 609 and the 403(b) certification program is that Chapter 609 addresses the entire responsibility of administering a 457 plan, whereas the 403(b) certification program is intended to address only certain basic requirements for a company to be able to offer their investment products through salary reduction agreements. Other provisions applicable to the administration of a 403(b) plan are addressed by federal tax law relating to such plans.

I. Discuss how the program or function is coordinating its activities to avoid duplication or conflict with the other programs listed in Question H and with the agency's customers. If applicable, briefly discuss any memorandums of understanding (MOUs), interagency agreements, or interagency contracts.

Because Chapter 609 does not apply to 403(b) plans or vendors, there is no duplication or conflict with the TRS 403(b) certification program. Districts may choose whether they wish to offer 457 plans, 403(b) plans, or both to their employees.

J. If the program or function works with local, regional, or federal units of government include a brief description of these entities and their relationship to the agency.

The list of certifying companies is posted on the TRS Web site so that school districts and open enrollment charter schools may refer to the list to determine whether a particular company is eligible to receive employee salary reduction amounts. TRS responds to questions by employers about 403(b) certification as necessary.

K. If this program or function is contracted out, provide a description of how you ensure accountability for funding and performance.

The program is not contracted out.

L. What statutory changes could be made to assist this program in performing its functions? Explain.

TRS has identified no additional changes needed at this time.

M. Provide any additional information needed to gain a preliminary understanding of the program or function.

No additional information is needed to understand the program.

N. Regulatory programs relate to the licensing, registration, certification, or permitting of a person, business, or other entity. For each regulatory program, if applicable, describe:

- why the regulation is needed;
- the scope of, and procedures for, inspections or audits of regulated entities;
- follow-up activities conducted when non-compliance is identified;
- sanctions available to the agency to ensure compliance; and
- procedures for handling consumer/public complaints against regulated entities.

Not applicable.

O. For each regulatory program, if applicable, provide the following complaint information. The chart headings may be changed if needed to better reflect your agency's practices.

No regulatory function is associated with this TRS program. (Exhibit 12 deleted.)

VIII. Statutory Authority and Recent Legislation

A. Fill in the following chart, listing citations for all state and federal statutes that grant authority to or otherwise significantly impact your agency. Do not include general state statutes that apply to all agencies, such as the Public Information Act, the Open Meetings Act, or the Administrative Procedure Act. Provide information on Attorney General opinions from FY 2001 – 2005, or earlier significant Attorney General opinions, that affect your agency’s operations.

Teacher Retirement System of Texas Exhibit 13: Statutes/Attorney General Opinions	
Statutes	
Citation/Title ²²	Authority/Impact on Agency
<i>STATE LAWS</i>	
TEX. CONST. Art. XVI, Sec. 67	Authorizes programs of retirement for Texas public education employees and provides for the administration of such programs; establishes minimum state and member contributions to retirement programs. Requires retirement plan assets to be held in trust for the benefit of participants. Establishes TRS plan as a trust and requires administration by trustees, thus triggering fiduciary responsibilities; establishes authority and restrictions on investment authority of TRS Board.
TEX. CONST. Art. XVI, Sec. 70	Authorizes the Texas Growth Fund and TRS investment in it. Provides specific authority for using Texas public pension plan assets for private equity investments in Texas companies.
Chapter 802, Tex. Gov’t. Code	Administrative requirements for Texas public retirement systems. TRS is excluded from many sections. Impact relates mainly to reporting requirements and information to membership.
Ch. 803, Tex. Gov’t. Code	Proportionate Retirement Program for members with service in more than one participating Texas public retirement system. Provides TRS and other plan members greater portability of benefits.
Ch. 804, Tex. Gov’t. Code	Domestic Relations Orders and Spousal Consent – Authorizes payment to former spouse or other alternate payee pursuant to a qualified domestic relations order (QDRO); authorizes a public pension system to require spousal consent for a form of retirement payment other than joint and survivor annuity or for selection of beneficiary other than spouse for death benefits. Impact is primarily administrative, to review orders and divide payments between member and non-member spouse when authorized.
Ch. 805, Tex. Gov’t. Code	Credit Transfer Between ERS and TRS – Authorizes transfer of credit between two systems by a member with credit in both. Statute provides greater portability of benefits between these two systems.
Title 8, Subtitle C, Tex. Gov’t. Code Chapters 821 through 825	Establishes the program of retirement benefits, authorizes rules for membership in and the management and operation of TRS. These are the key statutory provisions for the administration of the pension plan, defining the benefits available, eligibility, computation of benefits, service credit available, allowable employment after retirement without loss of benefits, and other necessary details.

²² Listing is for statutes as they exist at the time of submission of the Self-Evaluation Report.

Citation/Title ²²	Authority/Impact on Agency
Chapter 830, Tex. Gov't. Code	Authorizes eligible employees of Texas public education higher education institutions and the Commissioner of Education to elect to participate in the Optional Retirement Program (ORP) instead of TRS. ORP is administered by the employing higher education institution with oversight by the Texas Higher Education Coordination Board.
Sections 12.012, 12.057, 12.105-12.057, TEX. EDUC. CODE	Address the eligibility of certain charter school employees for participation in the TRS retirement program.
TEX. EDUC. CODE § 22.004	Requires TRS to perform a comparability study, comparing public schools' insurance with the state employees' insurance program.
Article 3.50-7A, TEX. INS. CODE, as added by Acts 2003, 78 th Legislature, ch. 201, § 56	Requires TRS-ActiveCare to not exclude certain general hospitals from its provider network.
Article 3.50-7A, TEX. INS. CODE, as added by Acts 2003, 78 th Legislature, ch. 213, § 4	Requires TRS-ActiveCare to mandate prior authorization for certain categories of prescription drugs.
Article 3.50-7B, TEX. INS. CODE	Requires TRS-ActiveCare to implement a disease management program.
Subchapter B, Chapter 1204, TEX. INS. CODE	Requires TRS-Care to permit the assignment of benefits payments.
Chapter 1207, TEX. INS. CODE	Requires TRS-Care to enroll eligible individuals whom the Health and Human Services Commission determines are eligible for Medicaid or CHIP.
Chapter 1575, TEX. INS. CODE	Requires TRS to administer the TRS-Care program and provides authority for same.
Chapter 1576, TEX. INS. CODE	Requires TRS to administer a long-term care insurance program for active and retired public school employees.
Chapter 1577, TEX. INS. CODE*	Requires TRS to offer long-term care, life, and disability insurance to active and retired public school employees.
Chapter 1579, TEX. INS. CODE	Requires TRS to administer the TRS-ActiveCare program and provides authority for same.
Chapter 1580, TEX. INS. CODE*	Requires TRS to administer a supplemental compensation/HRA program for active public school employees.
Chapter 1581, TEX. INS. CODE	Requires TRS to administer a minimum effort transition assistance program.
TEX. REV. CIV. STAT. ANN. art. 4413(34e)	Requires TRS to file reports regarding its pension trust fund.
TEX. REV. CIV. STAT. ANN. art.. 6228a-5, V.T.C.S.	Provides for TRS to administer 403(b) company certification requirements. Internal Revenue Code Section 403(b) (26 USC 403(b)) permits educational employers to offer 403(b) retirement plans to their employees and governs the terms of these plans.
FEDERAL LAWS	
26 USC §401(a), Internal Revenue Code (IRC) of 1986, related sections, and associated regulations	Establishes plan qualification requirements for governmental and private retirement plans that wish to operate as qualified plans. Section 825.506, Tex. Gov't. Code, establishes intent for TRS to operate as a qualified plan under IRC Section 401(a). Plan qualification requires TRS to administer plan as a trust for the exclusive benefit of participants, imposes certain limitations such as on the amount of benefits payable from the trust, and mandates other operational features. Law also provides for rollovers between plans, improving portability of retirement savings.
26 USC §414(d)	IRC provision defines governmental retirement plans. Such plans are exempt from Titles I and IV of ERISA (Employee Retirement Income Security Act of 1974) and from some tax code plan qualification provisions made applicable by ERISA to retirement plans. Impact: To maintain TRS's status as a governmental plan, state must restrict participation to <i>public</i> education employees.
26 USC § 414(h)	IRC provision allowing employer pick-up of employee

* Repealed effective September 1, 2005 by SB 1691, 79th Legislature, Regular Session.

Citation/Title ²²	Authority/Impact on Agency
	contributions. Allows members to contribute to TRS on a tax-deferred basis. See also TEX. GOV'T CODE § 825.409. Impact: Saves tax dollars for members during their working years; member pays when benefits are distributed, normally when tax bracket is lower.
26 USC §§415(b) and 415(m)	IRC limits the amount of benefits payable by a qualified plan to a retiree on an annual basis. Any excess benefit amount may not be paid from the TRS trust fund. State law establishes an "excess benefit arrangement" (TEX. GOV'T. CODE § 825. 517) to permit such recipients to receive the excess amount from the State of Texas in the form of compensation instead of a benefit from the pension plan.
26 USC §§ 72, 402, 3405, 6321, & 6331	Provisions of the IRC that establish requirements for TRS as a payor, such as withholding of taxes, reporting retirement benefit income to the IRS, and compliance with IRS liens and levies. Section 72 imposes a 10% penalty on plan participants for early withdrawal of retirement plan savings or benefits.
Uniformed Services Employment and Reemployment Rights Act (USERRA) 38 USC § 4301 et seq.	Protects employment rights and benefits of personnel called to military duty, including retirement and health care benefit rights. USERRA service credit available under TEX. GOV'T CODE § 823.304.
Age Discrimination in Employment Act of 1967 (ADEA) Pub. L. 90-202 (29 USC § 621 et seq.)	Prohibits limiting or reducing benefit accruals or prohibiting plan participation on account of age.
Employee Retirement Income Security Act of 1974 (ERISA) 29 USC §§ 1001-1461	Establishes plan design and administrative requirements for retirement plans in order to protect participants. Government plans are exempt from Titles I and IV of ERISA. Regulatory and court rulings under ERISA often address issues of interest for governmental plans, even when those rulings are not binding on such plans.
Consolidated Omnibus Budget and Reconciliation Act of 1985 (COBRA) 26 USC § 4980B	Establishes rights of health plan participants to continue participation in group health benefit programs under certain conditions.
Health Insurance Portability and Accountability Act of 1996 (HIPAA) Pub. L. 104-191	Requires procedures to protect privacy of protected health information (PHI).
<ul style="list-style-type: none"> • Social Security OASDI 42 USC 410 • Social Security Government Pension Offset (GPO) 42 USC § 402(k) (5) (A) • Social Security Windfall Elimination Provision (WEP) 42 USC § 428(e) • Social Security "Section 419" notice Pub. L. 108-203, § 419 (42 USC 1320b-13(a)(2)) 	<ul style="list-style-type: none"> • State and local governmental employees covered by an acceptable alternative retirement plan such as TRS are exempt from otherwise mandatory Social Security OASDI coverage. While some districts in Texas participate in Social Security, the vast majority do not. Non-participation may trigger GPO and WEP effects described below. • GPO reduces spousal Social Security benefits based on TRS benefits when the employee's employment prior to retirement was not covered by Social Security. Amendments to the GPO in 2004, which tightened the applicability of GPO, affected TRS 2004 retirement patterns, causing some members to retire early before the GPO changes took effect. • WEP reduces Social Security benefits of persons employed in positions not covered by Social Security. WEP affects TRS retirees who are eligible to receive Social Security but who also worked in districts not covered by Social Security. • Employers are required to give their employees "Section 419" notice concerning the GPO and WEP resulting from work not covered by Social Security. Employers must send a copy of the notice to TRS.

Citation/Title ²²	Authority/Impact on Agency
<ul style="list-style-type: none"> • Medicare Social Security Act of 1965, Pub.L. 89-97 (42 USC § 1395 et. seq.) • Medicare Part D Prescription Drug Improvement, Medicare and Modernization Act of 2003, Pub.L. 108-173 	<p>Medicare provides health benefit coverage to retired employees age 65 or older. Medicare coverage reduces costs to TRS-Care for TRS-Care participants who are Medicare-eligible.</p> <p>The new Medicare Part D prescription drug coverage program will go into operation in 2006 and will affect TRS-Care participants who enroll. Medicare Part D will partially reimburse TRS-Care for the cost of prescription drug benefits.</p>
Attorney General Opinions	
Attorney General Opinion No.	Impact on Agency
Tex. Att’y Gen. ORD – 593 (1991)	Ruling allowed TRS to withhold from public disclosure certain information about a real estate investment; this ORD and subsequent similar rulings were relied upon for a number of years with respect to alternative assets investments, including real estate and private equity.
Op. Tex. Att’y Gen. No. JC-0043 (1999)	Defining “security” for TRS investment purposes and determining that the TRS Board may not delegate its discretionary authority over investments to private investment managers. This opinion is significant for the manner in which TRS investments are made and the type of investments that may be made.
Op. Tex. Att’y Gen. No. GA-0018 (2003)	Former teachers who accept temporary employment with third-party contractors that provide educational services to school districts do not forfeit retirement benefits as a matter of law.
Op. Tex. Att’y Gen. No. GA-0019 (2003)	Information held by the Interagency Council on Pharmaceuticals Bulk Purchasing, of which TRS is a member, is confidential by law; members may not share confidential information with their employing agency.
Op. Tex. Att’y Gen. No. GA-0075 (2003)	Determined that TRS is not required to pay a share of the state employees workers’ compensation pooled claims but instead may pay actual claims incurred. The pooling mechanism would have required TRS to use trust funds to subsidize other state agencies’ workers’ compensation claims.
Tex. Att’y Gen. Memorandum Opinion (October 16, 2003)	Concludes that TRS is exempt from Section 2165.007, Tex. Gov’t. Code, because TRS property was purchased with TRS trust funds, thereby impressing the property with the character of a trust and making that property part of the trust assets.
Tex. Att’y Gen. Memorandum Opinion (September 16, 2004) and subsequent correspondence from Lieutenant Governor and Speaker of the House	Advised state leadership on issues relating to the Health Reimbursement Arrangement (HRA) program. Additional communications followed from state leadership to TRS. The TRS Board ultimately halted HRA program development and continued the supplemental compensation program due to absence of funding for HRAs.
Tex. Att’y Gen. OR 2004-6227 (2004)	Ruling that TRS is not permitted to withhold from public disclosure “historical” information regarding TRS’s Texas Growth Fund investments or related portfolio companies. This ruling is now subject to litigation. Also, SB 121 addresses the same issues and delineates which private equity investment information is confidential and which is presumed public information.
Op. Tex. Att’y Gen. No. GA-0300 (2005)	Payment for accumulated vacation time, paid as salary under an employment contract, is not creditable compensation for the purpose of determining TRS benefits. This confirmed TRS’s administration of creditable compensation laws to prevent large lump sum payments for unused leave from being treated as salary and thus significantly increasing a member’s benefit computation in the last few years before retirement, which

Citation/Title ²²	Authority/Impact on Agency
	imposes actuarial costs on the pension plan.

B. Provide a summary of recent legislation regarding your agency by filling in the chart below or attaching information already available in an agency-developed format. Briefly summarize the key provisions. For bills that did not pass, briefly explain the key provisions and issues that resulted in failure of the bill to pass (e.g., opposition to a new fee, or high cost of implementation).

Teacher Retirement System of Texas Exhibit 14: 79th Legislative Session Chart		
Legislation Enacted - 79th Legislative Session		
Bill Number	Author	Summary of Key Provisions
HB 10	Rep. Pitts	Includes FY 05 funds for TRS supplemental compensation, totaling \$30.7 million, due to appropriation shortfall and August delay during the 78 th Legislature.
HB 26	Rep. Delisi	Requires state agencies to provide certain information related to “major contracts” having a value of at least \$5 million to the Texas Building & Procurement Commission (TBPC) not later than June 1, 2006. The information will include each major contract entered into by the agency and each request for proposal, invitation to bid, or comparable solicitation related to the major contract. The TBPC shall post the information on the electronic procurement marketplace allowing public access. Affects contracts entered into after effective date of bill.
HB 407	Rep. Uresti	Allows a school district employee who is the spouse of another school district employee to be covered under a health benefit plan as an employee or the dependent of the other employee.
HB 423	Rep. Delisi	Requires a state agency to make its mailed publications available in electronic format on its Web site and available for distribution via electronic notification to recipients who choose this method.
HB 880	Rep. Delisi	For health care contracts of \$250 million or more, TRS is required to involve the Attorney General in the contracting process. The AG may require TRS to enter into an interagency agreement or to obtain outside legal services required by this act if the AG determines that the AG office does not have sufficient subject matter expertise or resources. This act applies only to a contract entered into on or after 11/1/05.
HB 905	Rep. Delisi	Requires state agencies to include contract terms that provide the state auditor with access to relevant information when a contracting entity that is receiving state funds is the subject of an audit or investigation.
HB 916	Rep. Woolley	Establishes the Texas Health Care Policy Council, which will meet at least once a year. The Executive Director of TRS, or a designee, will hold a position on the Council. Provides for the hiring of a director and a staff. The purpose of the Council is to identify problems in the health care system that create systemic or substantial negative impacts on the participants in the health care system, study those problems, identify possible solutions for the state or other participants in the system, and report this information to the Governor and others

		biannually.
HB 3169	Rep. Crownover	Repeals the service credit purchase option, which allows an eligible member to buy up to three years of service credit; also known as air time. Grandfathers active purchase installment agreements between members and TRS that existed by 1/1/06.
SB 1	Sen. Ogden	Relates to the General Appropriations Act. Pension Funding: 6% state contribution. 90-day wait for TRS pension plan membership will still expire 9/1/05. Estimated state contributions to pension fund of \$46 million restored with statutory requirement that local employers pay state contribution (6%) during first 90 days of a new employee's employment. Administrative Budget: \$43.4 million for each year in FY 06 and FY 07, an amount about \$4.6 million less than requested, which would keep expenditures at the FY 05 appropriation level. Reduces FTE cap by 2%, from 436 to approximately 427. TRS-Care: \$58 million additional state supplemental (for total of \$76 million over 1% contribution). \$58 million increase in active member contribution from .5% of salary to .65%. \$58 million increase in district contribution from .4% of payroll to .55%. Adds GAA legislative intent rider that TRS should apply cost savings to eliminate or limit increases to retiree premiums. Includes reduction in TRS-Care funding by \$116 million associated by Medicare Part D subsidy.
SB 121	Sen. Duncan	Amends open records law affecting state governmental bodies by clarifying public access to specific investment-related information. For example, the bill requires disclosure of the name of the fund the governmental body has invested in; the amount of dollars committed to any fund or investment entity; the rate of return; the fees, expenses and charges assessed to the governmental body by the investment entity; and, any conflict of interest board members of the agency may have with the investment. Expands the list of items that must be disclosed; however, provisions were added that deem all other information not listed as confidential and excepted from disclosure.
SB 132	Sen. Nelson	Nursing faculty will be allowed employment after retirement in a professional nursing program (with a TRS-covered employer) without loss of annuity if they have been separated from service for at least 12 months.
SB 213	Sen. Shapleigh	Requires each state agency to make a reasonable effort to develop a system of accessing online services by Spanish-speaking persons of limited English proficiency.
SB 286	Sen. Wentworth	Requires open meetings training for agency board members within 90 days of qualifying for office. Requires open records training for board members and the public information officer of a governmental body within the same time periods. It also ensures that the Attorney General will provide a training option by videotape.
SB 1691	Sen. Duncan	The final average salary for computing benefits will be determined by the 5 highest years instead of the highest 3 years of salaries. [Members who on 8/31/05, meet the Rule of 70, or are age 50, or have 25 years of service are grandfathered and will have their benefits calculated with the 3 highest years salary.] The primary actuarial supplement for early age retirement , which applied to members age 55 with at least 20 years of service, is eliminated. [However, members who on 8/31/05, meet the Rule of 70, or are age 50, or have 25 years of service are grandfathered and will continue to use the repealed reduction factors.] Those who establish TRS membership on

		<p>or after 9/1/2007 and meet the Rule of 80, must be at least age 60 at the time of retirement to qualify for an unreduced annuity. “Air time” is repealed 1/1/06. [Installment agreements established before 12/31/05 will be honored if terms are met.] Out-of-state service credit purchase will be priced at the full actuarial cost after 1/1/06. [However, TRS members as of 12/31/05, who have previous out-of-state service, may purchase this service credit at the current reduced rate anytime in the future.] Special service purchases will count toward TRS-Care eligibility. Partial Lump Sum Option eligibility is increased to the Rule of 90 [Members who on 8/31/05, meet the Rule of 70, or are age 50, or have 25 years of service are grandfathered.] Beginning 1/1/06, a member can no longer enter the Deferred Retirement Option Program (DROP), and current DROP participants may revoke existing DROP from 9/1/05 through 12/30/05. Local employers pay the pension fund contribution (6%) for the first 90 days of employment of a new member. Local employers will be required to contribute to the pension fund an amount for each retired employee based on the combined state and member contribution rates (currently 12.4%); plus, they must pay the difference between the retiree’s premium to TRS-Care and the actual cost of the coverage as determined by TRS. [Local employer payments as described above do not apply for a retired employee reported by the district to TRS as working for that employer in January 2005. The payment is also waived in the event of district consolidations before 9/1/05, if the retired employee was reported by either district as working for that district in January 2005.] The active member contribution to TRS-Care will increase from .5% to .65% of salary. The bill also better aligns certain aspects of TRS law with ERS law. It clarifies board authority over risk management, contract disputes, purchasing, administrative appeals, salaries and travel, and data management. There are also various clean-up provisions related to insurance. It further aligns state law with federal tax law regarding permissive service credit.</p>
SB 1863	Sen. Ogden	<p>Transfers from TRS to the Texas Education Agency responsibility for the supplemental compensation program for active school employees; requires a 90-day waiting period for this program. Raises the contribution of a school employee’s salary to TRS-Care from 0.5 percent to 0.65 percent. Changes the current statutory provision stipulating the State’s contribution to the TRS pension fund from 8 percent per year to a range of at least 6 percent but not more than 8 percent of aggregate annual compensation of TRS members. Local employers pay 6% contribution for the first 90 days of employment of a new member. Miscellaneous cleanup of insurance provisions.</p>

Legislation Not Passed - 79th Legislative Session		
Bill Number	Author	Summary of Key Provisions/Reason the Bill Did Not Pass
HB 2	Rep. Grusendorf	<p>In FY 06, provides \$2,000 additional salary for each minimum-salary schedule employee (reduced to \$1,500 unless HB 3, tax bill, passes with immediate effect). In FY 07, provides \$3,500 additional salary for each minimum-salary schedule employee (reduced to \$3,000 unless HB 3, tax bill, passes with immediate effect). Allows districts to pay below the minimum salary schedule for TRS retirees who return to</p>

Legislation Not Passed - 79th Legislative Session		
		work, as well as for educators who are teaching under a probationary, temporary, or emergency certificate. Directs schools to provide a wage increase of \$1,000 to full-time employees not subject to the minimum salary schedule and \$500 to part-time employees, excluding administrators. Employees, other than administrators, who participate in a cafeteria health plan may elect that a portion of their salary equal to \$1,000 for full-time and \$500 for part-time be received as health care supplement.
HB 52	Rep. Hopson	Restores the \$1,000 supplemental compensation to all active public school employees. Repeals law establishing the health care reimbursement accounts. The \$1,000 shall be distributed through a cafeteria plan or paid to the active employee as supplemental compensation.
HB 186	Rep. Van Arsdale	Stipulates that the Board of Trustees of an independent school district may not make a severance payment to a superintendent unless the payment is approved by TRS.
HB 235	Rep. Van Arsdale	Amends the computation of a standard service retirement annuity for a member who, during any month of the member's service, received compensation of \$5,000 or more. The computation is based on the member's median monthly compensation for the highest 60 months of compensation, whether consecutive or not.
HB 324	Rep. Mowery	Includes a provision to restore the \$1,000 supplemental compensation to all active public school employees and repeals law establishing the health care reimbursement accounts. The \$1,000 shall be distributed through a cafeteria plan or paid to the active employee as supplemental compensation.
HB 346	Rep. Escobar	Appropriates amounts in FY 06 approximately equivalent to a 7% state contribution and in FY 07 approximately equivalent to an 8% state contribution.
HB 583	Rep. Zedler	Creates a statewide risk pool for school districts (not including the other 3 types of participating entities currently covered by TRS-ActiveCare) to replace TRS-ActiveCare. All eligible employees will be enrolled unless they opt out in writing. Subject to approval by the Commissioner of Insurance. TRS-ActiveCare must transfer all funds and records to the new risk pool.
CSHB 712	Rep. Eissler	Requires TRS-ActiveCare coverage for children under 19 diagnosed with anorexia nervosa and bulimia nervosa with same terms as coverage for physical illness. Requires study and report by Sunset Commission by 1/1/2011 on impact of coverage utilization.
HB 815	Rep. Burnam	Prohibits investment of state funds in entities doing business in the Sudan. The bill applies to state funds managed or invested by public retirement systems, institutions of higher education, and other state government entity.
HB 817	Rep. Yvonne Davis	Prohibits a public retirement system from investing state funds in a domestic private entity that during the previous two years created employment suitable for performance in the U.S. in another country and as a result eliminated or failed to create similar employment in the U.S.
HB 844	Rep. Gonzales	Allows a TRS retiree to be employed without restriction or loss of benefits up to full-time by a school district or open-enrollment charter school if the member retired before January 1, 2005.
HB 1064	Rep. Delisi	Establishes the Governor's Health Care Coordinating Council, with the

Legislation Not Passed - 79th Legislative Session		
		Executive Director of TRS, or a designee, holding a position on the Council. Mandates that the Council’s member agencies provide staff for the Council. The Council shall ensure the most effective collaboration among state agencies in the purchase of health care products or services, requiring state agencies to assist each other in the purchase of health care products and services and to notify the Council of a pending purchase of products or services before issuing a request for purchases in order to obtain the Council’s assistance. After a state agency enters into a contract for the purchase of health care products or services, the agency must report to the Council the name of the seller, the products or services being purchased, and the purchase price for the products or services. Also under this bill, this Council is replacing the Interagency Council on Pharmaceuticals Bulk Purchasing.
HB 1198	Rep. Guillen	Aside from proposing new funding methods for public school education, this bill provides that state assistance for health care will be available not only to employees of school districts and charter schools that participate in TRS-ActiveCare, but also to school districts that do not participate in the TRS-ActiveCare program. The state assistance is to be distributed in equal monthly installments.
HB 1336	Rep. Isett	Establishes regulation by the Texas Department of Insurance for pharmacy benefit managers that provide claims processing services for state-funded health care programs. Regulated pharmacy benefit managers would be required to be bonded and to pay \$500 examination fees, \$1000 filing fees for annual examinations, and their proportion of other regulatory expenses. Contract forms between pharmacy benefit managers and health care programs would require approval by the Commissioner of Insurance. Reimbursement costs to pharmacy benefit managers would have to be based on the average wholesale price found in national reference sources. Pharmacy benefit managers would be prohibited from influencing pharmacy choice by program participants. Violations would be subject to criminal and administrative penalties.
HB 1416	Rep. Martinez	Requires TRS to set at least one 30-day open enrollment period for each calendar year, the first to take place no later than July 1, 2006. Requires the state to pay the same percentage of the cost of coverage for TRS-Care participants as is contributed for state employees’ health coverage. Requires that a coinsurance payment not exceed 10 percent.
HB 1420	Rep. Phillips	Authorizes TRS to release names and addresses of participants to a nonprofit association of retired school employees for notifying the participants of the association’s purpose and the opportunity to join the association.
HB 1463	Rep. Flores	Allows a TRS retiree to be employed up to full-time by a school district or open-enrollment charter school if the member retired before January 1, 2005. Continues current law to allow retiree to work full-time as classroom teacher after 12-month break in service, but deletes requirement that they must teach in an acute shortage area.
HB 1579	Rep. Kolkhorst	Repeals the exception for principals and bus drivers. Requires employers to pay the combined contribution rate (12.4%) and the subsidized portion of TRS-Care costs for each retired employee after the effective date of the Act. The committee substitute would not change the current law impact to benefits for employees that return to

Legislation Not Passed - 79th Legislative Session		
		work, with the exception of bus drivers for which it is stipulated that this must be their primary employment. A grandfather provision is added in the committee substitute for employees reported by an employer as a retired employee in January 2005, if they remain employed by that employer.
HB 1755	Rep. Herrero	Establishes a public retirement system work group to develop and implement a plan to permit transfer of service credit or proportionate participation among all Texas public retirement systems. TRS would have a representative on the work group.
HB 1960	Rep. McReynolds	Commissioned law enforcement officers employed in higher education would become members of the Employees Retirement System of Texas (ERS) instead of TRS. TRS service credit would be transferred, and TRS would transfer money to pay for the part of the benefit attributable to service under TRS.
HB 2145	Rep. Hupp	Prohibits pharmacists from changing a drug or medication prescribed by a practitioner for a TRS-Care or TRS-ActiveCare participant, but exempts generic substitution from the prohibition.
HB 2146	Rep. Hupp	Prohibits pharmacy benefit managers from referring participants of TRS-Care or TRS-ActiveCare to a mail order prescription plan that is owned by the pharmacy benefit manager.
HB 2147	Rep. Hupp	Requires that TRS ensure that patient counseling from a Texas-licensed pharmacist is available for each participant of TRS-Care or TRS-ActiveCare who receives mail order prescriptions.
HB 2512	Rep. Kolkhorst	Repeals the expiration of the 90-day membership wait. Regardless of statutory language to the contrary, the bill authorizes the legislature to reduce the appropriations for educational agencies and institutions as necessary to balance the state budget, including TRS.
HB 2523	Rep. Coleman	Commissioned law enforcement officers employed in higher education would become members of the Employees Retirement System of Texas (ERS) instead of TRS. TRS service credit would be transferred, and TRS would transfer money to pay for the part of the benefit attributable to service under TRS.
HB 2567	Rep. Eiland	Requires TRS to submit to the Pension Review Board an asset and liability study on a quarterly basis. Specifies various required components.
HB 2570	Rep. Eiland	Requires that prescription drug benefits offered through health benefit plans, including TRS-Care and TRS-ActiveCare, not require exclusive use of mail order pharmacies or discriminate between mail order pharmacies and retail pharmacies. Provides injunctive relief.
HB 2599	Rep. Guillen	Restores the supplemental compensation to all TRS members to \$1,000 or the amount provided for in the General Appropriations Act.
HB 2608	Rep. Guillen	Establishes varying multipliers for retirement calculation based on the combination of age and years of service. Sets 2.3% for retirees with a combined age and service of 80 to 84; 2.35% between 85 and 89; 2.4% between 90-94; 2.45% for 95-99; and 2.5% for a combined number of 100.
HB 2634	Rep. Vo	Limits Governor appointments to the three non-elected trustees in addition to those nominated by the SBOE. Specifies that the remaining positions are elected; mirrors current positions for representation but without referral to the Governor for appointment.
HB 2674	Rep. Hupp	Requires TRS-Care and TRS-ActiveCare to use the drug formularies adopted by the Health and Human Services Commission. Also,

Legislation Not Passed - 79th Legislative Session		
		prohibits pharmacy benefit managers from referring participants to a mail order prescription plan that is owned by or provides incentives to the pharmacy benefit manager.
HB 2757	Rep. McReynolds	Establishes a higher multiplier of 2.5% for those that reach a combined age and service of 90.
HB 2842	Rep. Chisum	Amends the Penal Code to make it a felony offense for an officer or director for a public interest entity, which includes a pension plan, to fraudulently influence or mislead an accounting firm engaged in an audit of the entity's financial statements. It also would be a felony offense to fraudulently communicate false information or fail to notify the accounting firm that information correct when provided is no longer correct.
HB 2971	Rep. Eissler	Restores the supplemental compensation to full-time nonprofessional TRS members to \$500 and part-time nonprofessional TRS members to \$250 or the amount provided for in the General Appropriations Act.
HB 2975	Rep. Hegar	Repeals the expiration of the 90-day waiting period, currently scheduled for August 31, 2005.
HB 3005	Rep. Zedler	Provides various incentives for nursing school faculty, including an exception regarding TRS return to work for nursing school faculty during a nine-year period, fall of 2005 to spring of 2015.
HB 3137	Rep. Taylor	Permits a TRS member to purchase up to two years of service credit for service in the Peace Corps at the rate established for out of state service.
HB 3254	Rep. Van Arsdale	Reduces the 12-month break in service for teachers in acute shortage areas to one month. Acute shortage areas are determined by the commissioner of education, not local school districts, including on a regional basis. Imposes additional requirements for the TEA determination and for reporting by school districts.
HB 3261	Rep. Van Arsdale	Requires TRS approval of an ISD contract with a superintendent if it provides for an annual salary increase of 20% or more.
HB 3330	Rep. Farabee	Establishes a nine-member advisory committee appointed by TRS for TRS-ActiveCare. Committee will consist of two school administrators, four teachers, and three auxiliary district employees.
HCR 63	Rep. Noriega	Urging Congress to repeal the Government Pension Offset provision and the Windfall Elimination Provision of the Social Security Act.
HCR 143	Rep. Burnam	Prohibits investment of state funds in entities doing business in the Sudan. The bill applies to state funds managed or invested by public retirement systems, institutions of higher education, and other state government entity.
SB 62	Sen. Staples	Restores the \$1,000 supplemental compensation to all active public school employees. Repeals law establishing the health care reimbursement accounts. The \$1,000 shall be distributed through a cafeteria plan or paid to the active employee as supplemental compensation.
SB 84	Sen. Shapleigh	Creates a bonus, up to \$5,000 for certain new classroom teachers, which is to be included as creditable compensation for TRS retirement. In addition, the stipend (maximum \$5,000) enacted last session that is paid to selected certified master science teachers employed at high-need campuses is also included as creditable compensation.
SB 319	Sen. Shapleigh	Requires an entity, including a public retirement system, that is responsible for the administration of a state investment fund to post quarterly reports on the Internet. The report would include all

Legislation Not Passed - 79th Legislative Session		
		purchases and sales of domestic equities or bonds, including commission information; information about investment consultants and managers, including fees paid; and information about fees and commissions paid, categorized by HUB status, principal place of business, and race/ethnicity/gender of the controlling ownership.
SB 329	Sen. Hinojosa	Allows a TRS retiree to be employed without restriction or loss of up to full-time by a school district or open-enrollment charter school if the member retired before January 1, 2005.
SB 482	Sen. Shapiro	Allows a retiree to be employed on full-time basis as a mentor if certified, has taught five years, and has been separated from service for at least 12 months.
SB 719	Sen. Deuell	Prohibits pharmacy benefit managers from referring participants of TRS-Care or TRS-ActiveCare to a mail order prescription plan that is owned by the pharmacy benefit manager.
SB 720	Sen. Deuell	Requires that TRS ensure that patient counseling from a Texas-licensed pharmacist is available for each participant of TRS-Care or TRS-ActiveCare who receives mail order prescriptions.
SB 749	Sen. Van de Putte	Establishes regulation by the Texas Department of Insurance for pharmacy benefit managers that provide claims processing services for state-funded health care programs. Regulated pharmacy benefit managers would be required to be bonded and to pay \$500 examination fees, \$1000 filing fees for annual examinations, and their proportion of other regulatory expenses. Contract forms between pharmacy benefit managers and health care programs would require approval by the Commissioner of Insurance. Reimbursement costs to pharmacy benefit managers would have to be based on the average wholesale price found in national reference sources. Pharmacy benefit managers would be prohibited from influencing pharmacy choice by program participants. Violations would be subject to criminal and administrative penalties.
SB 1024	Sen. Deuell	Prohibits pharmacists from changing a drug or medication prescribed by a practitioner for a TRS-Care or TRS-ActiveCare participant, but exempts generic substitution from the prohibition.
SB 1324	Sen. Armbrister	Requires that prescription drug benefits offered through health benefit plans, including TRS-Care and TRS-ActiveCare, not require exclusive use of mail order pharmacies or discriminate between mail order pharmacies and retail pharmacies. Provides injunctive relief.
SB 1449	Sen. Averitt	Requires TRS to submit to the Pension Review Board an asset and liability study on a quarterly basis. Specifies various required components.
SB 1513	Sen. Averitt	Authorizes a joint interim committee to study establishing a separate state agency to administer the health benefit programs administered by TRS, ERS, UT and A&M.
SB 1520	Sen. Deuell	Requires TRS-Care and TRS-ActiveCare to use the drug formularies adopted by the Health and Human Services Commission. Also, prohibits pharmacy benefit managers from referring participants to a mail order prescription plan that is owned by or provides incentives to the pharmacy benefit manager.
SB 1532	Sen. Averitt	Entitles employees who terminate after the end of the school year to health care coverage offered through the district and the supplemental compensation through the remainder of the plan year.
SB 1536	Sen. Armbrister	Requires that prescription drug benefits offered through health benefit

Legislation Not Passed - 79th Legislative Session		
		plans, including TRS-Care and TRS-ActiveCare, not require exclusive use of mail order pharmacies or discriminate between mail order pharmacies and retail pharmacies. Provides injunctive relief.
SB 1607	Sen. Ogden	Makes supplemental appropriations in the amount of \$1,000,000 to each of the agencies and programs in need of FY 05 dollars, including TRS, HHSC (Medicaid and CHIP), Child Protective Services, TEA, and reduces other agencies.
SB 1608	Sen. Ogden	Repeals the expiration of the 90-day membership wait. Regardless of statutory language to the contrary, the bill authorizes the legislature to reduce the appropriations for educational agencies and institutions as necessary to balance the state budget, including TRS.
SB 1649	Sen. Staples	Exempts all classroom teachers after 9/1/05 with regard to return to work restrictions. Further requires that these retired employees must make contributions to the retirement system similar to an active employee, without accruing new benefits, and they cannot withdraw the post-retirement contributions.
SB 1759	Sen. Gallegos	Commissioned law enforcement officers employed in higher education would become members of the Employees Retirement System of Texas (ERS) instead of TRS. TRS service credit would be transferred, and TRS would transfer money to pay for the part of the benefit attributable to service under TRS.
SB 1861	Sen. Rodney Ellis	Prohibits investment of state funds in entities doing business in the Sudan. The bill applies to state funds managed or invested by public retirement systems, institutions of higher education, and other state government entity.
SCR 5	Sen. Gallegos	Urging Congress to repeal the Government Pension Offset provision and the Windfall Elimination Provision of the Social Security Act.

IX. Policy Issues

The TRS Board of Trustees has indicated its interest in further consideration and discussion of issues affecting the system. The Board meeting schedule this year does not include an August 2005 meeting date. As a result, TRS requested and received permission from Sunset staff to delay any response to this portion of the Self-Evaluation Report until after the next meeting of the board in September 2005.

Under TEX. GOV'T CODE § 825.215, employees of TRS are prohibited from advocacy, which includes advocating increased benefits or engaging in activities to advocate or influence legislative action or inaction. Further, § 821.008 of the code specifies, "The purpose of the retirement system is to invest and protect the funds of the retirement system and to deliver the benefits provided by statute, not to advocate or influence legislative action or inaction or to advocate higher benefits." Because of these provisions, TRS is not addressing specific policy issues as areas for prospective legislative changes.

TRS would like to point out that the two key broad issues facing the System are long-term funding solvency for the Pension Trust Fund and long-term funding solvency for TRS-Care, the retiree health benefit program.

X. Other Contacts

A. Fill in the following chart with updated information on people with an interest in your agency, and be sure to include the most recent e-mail address.

Teacher Retirement System of Texas Exhibit 15: Contacts			
INTEREST GROUPS (groups affected by agency actions or that represent others served by or affected by agency actions)			
Group or Association Name/ Contact Person	Address	Telephone	E-mail Address
Association of Texas Professional Educators (ATPE) Doug Rogers, Executive Director	305 East Huntland Drive, Suite 300 Austin, TX 78752-3792	512-467-0071	www.atpe.org
Texas Association of College Teachers (TACT) Chuck Hempstead, Executive Director	5750 Balcones Drive, Suite 201 Austin, TX 78731	512-873-8195	www.tact.org
Texas Association of School Administrators (TASA) Dr. Johnny Veselka, Executive Director	406 East 11 th Street Austin, TX 78701-2617	512-477-6361	www.tasenet.org
Texas Association of School Boards (TASB) James B. Crow, Executive Director	P.O. Box 400 Austin, TX 78767-0400	512-467-0222	www.tasb.org
Texas Association of School Business Officials (TASBO) Gwen Santiago, Executive Director	2538 S. Congress Avenue Austin, TX 78704	512-462-1711	www.tasbo.org
Texas Association of School Personnel Administrators (TASPA) Dr. Alejandra Martin, Executive Director	406 East 11 th Street, Suite 105 Austin, TX 78701	512-494-9353	www.taspa.org
Texas Classroom Teachers Association (TCTA) Jeri Stone, Executive Director	P.O. Box 1489 Austin, TX 78767	512-477-9415	www.tcta.org
Texas Federation of Teachers (TFT) Linda Bridges, President	3000 South IH 35, #175 Austin, TX 78704	512-448-0130	www.tft.org
Texas Retired Teachers Association (TRTA) Tim Lee, Executive Director	313 E. 12 th Street, Suite 200 Austin, TX 78701	512-476-1622	www.trta.org
Texas State Teachers Association (TSTA) E.C. Walker, Executive Director	316 West 12 th Street Austin, TX 78701	512-476-5355	www.tsta.org
INTERAGENCY, STATE, OR NATIONAL ASSOCIATIONS (that serve as an information clearinghouse or regularly interact with your agency)			
National Association of Public Pension Attorneys (NAPPA) Everard Davenport, President	930 Florin Road, Suite 200 Sacramento, CA 95821	916-429-2545 916-429-8616 (fax)	www.nappa.org
National Association of State Retirement Administrators (NASRA) Glenda Chambers, Executive Director	P. O. Box 14117 Baton Rouge, LA 70898	225-757-9558 225-757-9765 (fax)	www.nasra.org
National Conference on Public Employee Retirement Systems (NCPERS) Frederick H. Nesbitt, Executive Director and Legislative Counsel	444 N Capitol Street NW, Ste. 221 Washington DC 20001	202-624-1456 202-624-1439 (fax)	www.ncpers.org
National Council on Teacher Retirement (NCTR) Jim Mosman, Executive Director	7600 Greenhaven Drive, Suite 302 Sacramento, CA 95831	916-394-2075 916-392-0295 (fax)	www.nctr.org
Public Retirement Information Systems Management (PRISM) Sonja Korb, Secretary	Virginia Retirement System P.O. Box 2500, 1200 E. Main Street Richmond, VA 23218-2500	804-649-8059 804-786-1541 (fax)	www.prism-assoc.org

Group or Association Name/ Contact Person	Address	Telephone	E-mail Address
LIAISONS AT OTHER STATE AGENCIES (with which your agency maintains an ongoing relationship, e.g., the agency's assigned analyst at the Legislative Budget Board, or attorney at the Attorney General's office)			
Attorney General's Office Greg Abbott, Attorney General	209 West 14 th Street Austin, Texas 78701	512-463-2191	www.oag.state.tx.us
Comptroller's Office Carole Keeton Strayhorn, Comptroller	111 E. 17 th Street Austin, Texas 78701	512-463-4000	www.cpa.state.tx.us
Department Information Resources Larry A. Olson, Executive Director	300 W. 15 th Street, Suite 1300 Austin, Texas 78701	512-475-4720	www.dir.state.tx.us
Employees Retirement System Ann Fuelberg, Executive Director	1801 Brazos Austin, Texas 78701	512-867-7711	www.ers.state.tx.us
Legislative Budget Board Jennifer Schiess, Analyst	1501 Congress Avenue, 5 th Floor Austin, Texas 78701	512-463-1200	www.lbb.state.tx.us
Optional Retirement Program Texas Higher Education Coordinating Board Toni Alexander, ORP Coordinator	1200 East Anderson Austin, Texas 78752	512-427-6195	www.TexORP@theccb.state.tx.us
Pension Review Board Ginger Smith, Executive Director	300 W. 15 th Street, Room 406 Austin, Texas 78701	512-463-1736	www.prb.state.tx.us
State Auditor's Office Carol Smith, Audit Manager	1501 N. Congress Avenue, Ste. 4.224 Austin, Texas 78701	512-936-9500	www.sao.state.tx.us
State Office of Administrative Hearings Shelia Bailey Taylor, Chief Administrative Law Judge	300 W. 15 th , Suite 502 Austin, Texas 78701	512-475-4993	www.soah.state.tx.us
State Office of Risk Management (SORM) Jonathan Bow, Executive Director Stuart Cargile, Director of Fund Accounting Joe Deering (risk management issues) Sally Becker (insurance issues)	300 W. 15 th , 6 th Floor Austin, Texas 78701	512-936-1502 (Mr. Bow); 512-936-1523 (Mr. Cargile); 512-936-1568 (Mr. Deering); 512-936-1573 (Ms. Becker); 512-472-0228 (fax)	www.sorm.state.tx.us
State Securities Board Denise Voigt Crawford, Commissioner	208 East 10 th Street, 5 th Floor Austin, Texas 78701	512-305-8300	www.ssb.state.tx.us
Texas Building & Procurement Commission Cindy Reed, Executive Director	1711 San Jacinto Austin, Texas 78701	512-463-6363	www.tbpc.state.tx.us
Texas Department of Insurance Michael Scott Geeslin, Commissioner of Insurance	333 Guadalupe Austin, Texas 78701	512-463-6169	www.tdi.state.tx.us
Texas Education Agency Dr. Shirley Neeley, Commissioner of Education	1701 Congress Avenue Austin, Texas 78701	512-463-9734	www.tea.state.tx.us

XI. Additional Information

A. Fill in the following chart detailing information on complaints regarding your agency. Do not include complaints received against people or entities you regulate. The chart headings may be changed if needed to better reflect your agency's practices.

TRS is regarded as a highly service-oriented organization. Concerns related to services or member-specific issues are routinely expedited and resolved without requiring the member to enter any formal complaint or appeals process. The 2004 *Member Satisfaction Survey*²³ reflects that less than one percent of the members surveyed had ever filed a complaint regarding TRS. Of the survey respondents who had filed a complaint, all were satisfied or very satisfied with the timeliness and courtesy of the TRS response.

In most cases, matters relating to delivery of services are settled by correspondence or informal conference, as suggested in TRS Board rule 23.1 (34 TEX. ADMIN. CODE §23.1). If the matter is resolved, it generally will not be considered a complaint. However, an individual may wish to pursue a more formal complaint process, which is also described in this Board rule and on the TRS Web site. TRS has a designated Complaint Officer to handle the most formal complaints.

The TRS complaint process defines a complaint as a communication that involves an expressed dissatisfaction with TRS actions or inaction and involves only matters about which TRS may make some change that helps with, solves, or modifies the concern. For example, a TRS complaint is not about a law over which TRS has no control. As a result of the service-oriented culture of the organization and the option of the administrative appeals process, TRS has a very low number of complaints. During FY 2003 and FY 2004, TRS received only two complaints, which were resolved within 10 work days.

The complaint process is available as an alternative to, or in addition to, the appeal processes available for benefit program matters (retirement plan, TRS-Care, and TRS-ActiveCare). The appeal processes generally are more formal ways of reviewing specific benefit claims under one of the TRS benefit programs.

Relevant statutory and rule provisions for appeal processes are as follows:

- TEX. GOV'T CODE, § 825.111 (general administrative law provision).
- 34 TEX. ADMIN. CODE Chapter 43 (appeal procedures for retirement plan matters).
- TEX. INS. CODE § 1579.052 (authorization to adopt rules relating to the adjudication of TRS-ActiveCare claims and expulsion for fraud).
- TEX. INS. CODE §§ 1575.052 and 1575.501-.506 (authorization for procedures for claims administration and appeals for TRS-Care, including expulsion for fraud).

²³ Conducted for TRS by the Survey Research Center of the University of North Texas. The report is provided as an attachment.

- 34 TEX. ADMIN. CODE §§ 41.14, 41.50, 41.51, and 41.52 (rules relating to TRS-Care and TRS-ActiveCare).

Retirement Plan Appeals: Retirement plan appeals are handled under Chapter 43 of TRS Board rules. The vast majority of member issues are handled by TRS benefit counselors, benefit specialists, or team leaders, who can either take action consistent with a request or explain why such action is not possible, due to applicable laws and rules. Many requests at this stage are handled by telephone. Chapter 43 establishes a process by which a person who is adversely affected by a decision or action of TRS departmental personnel may ask the manager of the department and then the chief officer over that department to review the matter. Since pension plan benefits are statutory in nature and there often is no discretion to grant the requested relief, most complainants elect not to pursue requests for review beyond the level of departmental manager. However, the option to pursue a request to the division's chief officer is available.

If a person wishes to pursue a formal appeal of a chief officer decision relating to a retirement plan matter, Chapter 43 establishes the process for an appeal to the TRS Executive Director and ultimately to the TRS Board of Trustees. If a matter is appealed to the Executive Director in a timely manner, it is referred to the State Office of Administrative Hearings (SOAH) for an evidentiary hearing before the decision of the Executive Director is made. Following the hearing, SOAH issues a recommendation to the TRS Executive Director, who then makes a decision. The Executive Director's decision may be appealed to the TRS Board of Trustees. If this final stage of appeal is pursued, the Board will consider the matter in open meeting.

TRS-ActiveCare Appeals: Appeals in the TRS-ActiveCare program are handled according to TRS rules 41.50-.52. Appeals relating to claims or eligibility generally will be handled through the TRS Appeals Committee and then the Executive Director. However, if the person participates in a health maintenance organization (HMO), then the HMO appeal process will be applicable. In a situation involving expulsion for fraud, TRS rule 41.52 procedures would apply.

Although the rules address the formal appeal process at TRS, the administering firm (currently Blue Cross Blue Shield of Texas for medical benefits) and the pharmacy benefit manager (currently Medco Health) also have processes by which participants may pursue relief when they believe they have been adversely affected by actions or decisions that are inconsistent with plan terms.

TRS-Care Appeals: Appeals in the TRS-Care program are handled primarily by the administering firm (currently Aetna) for medical claims and by the pharmacy benefit manager (currently Caremark) for pharmacy claims according to processes established by those entities. During a claims process, the participant or the contractor may contact TRS-Care staff for relevant information. With respect to participant eligibility matters, TRS-Care through the level of program director addresses any concerns by reviewing the requested action against applicable laws, rules, or plan terms. TRS rule 41.14 specifically addresses the process for expulsion for fraud.

The following chart summarizes TRS appeal data for FY 2003 and FY 2004:

Teacher Retirement System of Texas		
Exhibit 16: Administrative Appeals to the Agency—Fiscal Years 2003 and 2004		
TRS Benefit Appeals	FY 2003	FY 2004
Pension benefit appeals filed:		
Appeals to the Chief Officers—	24	31
Number of appeals granted	0	13*
Number of appeals denied	24	18
Average time to decide an appeal	35 days	27 days**
Appeals to the Executive Director—	13	8
Number of appeals granted	0	0
Number of appeals denied	3	3
Other (withdrawn, settled, or pending)	10	4
Appeals to the Board of Trustees—	1	1
Number of appeals granted	0	0
Number of appeals denied	1	1
Retiree health benefit appeals filed:	130	97
Number of appeals granted	45	34
Number of appeals denied	85	63
Average time to decide an appeal	23 days	22 days
Active member health benefit appeals filed (includes eligibility):	185	230
Number of appeals granted	35	19
Number of appeals denied	97	97
Other (appeals opened but resolved by staff before reaching the appeals committee, or not pursued by complaining party)	53	114
Average time to decide an appeal	13 days	16 days
<p>* <i>11 appeals approved in FY 2004 by the Chief Benefit Officer dealt with one issue from the same school district, which affected 11 members.</i></p> <p>** <i>Appeals may be extended to provide opportunities for disputing parties (for example, persons challenging the beneficiary designation of a deceased member) to settle their claims.</i></p>		

B. Fill in the following chart detailing your agency's Historically Underutilized Business (HUB) purchases.

Teacher Retirement System of Texas				
Exhibit 17: Purchases from HUBs				
FISCAL YEAR 2002				
Category	Total \$ Spent	Total HUB \$ Spent	Percent	Statewide Goal
Heavy Construction	N/A	N/A	N/A	11.9%
Building Construction	N/A	N/A	N/A	26.1%
Special Trade	\$ 272,842	\$ 27,080	9.9%	57.2%
Professional Services	802,183	82,749	10.30%	20.0%
Other Services	6,028,546	994,098	16.4%	33.0%
Commodities	2,465,399	928,006	37.6%	12.6%
TOTAL	\$ 9,568,970	\$ 2,031,933	21.2%	
FISCAL YEAR 2003				
Category	Total \$ Spent	Total HUB \$ Spent	Percent	Statewide Goal
Heavy Construction	N/A	N/A	N/A	11.9%
Building Construction	N/A	N/A	N/A	26.1%
Special Trade	\$ 402,799	\$ 25,746	6.4%	57.2%
Professional Services	425,244	66,600	15.60%	20.0%
Other Services	6,899,943	1,138,780	16.5%	33.0%
Commodities	1,546,945	719,200	46.4%	12.6%
TOTAL	\$ 9,274,931	\$ 1,950,326	21.0%	
FISCAL YEAR 2004				
Category	Total \$ Spent	Total HUB \$ Spent	Percent	Statewide Goal
Heavy Construction	N/A	N/A	N/A	11.9%
Building Construction	N/A	N/A	N/A	26.1%
Special Trade	\$ 891,406	\$ 212,942	23.8%	57.2%
Professional Services	3,316,293	33,818	1.01%	20.0%
Other Services	5,558,890	820,614	14.7%	33.0%
Commodities	1,757,583	1,004,103	57.1%	12.6%
TOTAL	\$ 11,524,172	\$ 2,071,477	17.9%	

C. Does your agency have a HUB policy? How does your agency address performance shortfalls related to the policy?

Yes, the TRS Board of Trustees adopted a HUB policy in December 2000 through adoption of 34 TEX. ADMIN. CODE § 51.11 for the purpose of making purchases with funds appropriated to TRS. The policy adopted by reference the HUB rule promulgated by the General Services Commission (GSC), now Texas Building and Procurement Commission (TBPC), as well as the rule promulgated by the Department of Information Resources (DIR).

The HUB Coordinator presents an annual report to the Board of Trustees each December to review the progress of the prior fiscal year, and to discuss future initiatives. HUB program requirements are included in the TRS Contract Administration Manual issued May 1, 2003.

D. For agencies with contracts valued at \$100,000 or more: Does your agency follow a HUB subcontracting plan to solicit bids, proposals, offers, or other applicable expressions of interest for subcontracting opportunities available for contracts of \$100,000 or more? (Tex. Government Code, Sec. 2161.252; TAC 111.14)

Yes. The HUB Coordinator, with the assistance of the TRS department that is the contract sponsor, determines if subcontracting is probable for each contract estimated to exceed \$100,000. This determination is documented with an internal memo, which is issued by the contract sponsor and signed by the HUB Coordinator and the Executive Director. TRS makes known this determination in the solicitation document, and the respondents are also required to include in their responses whether subcontracting is probable and to complete the applicable HUB Subcontracting Plan documents, if appropriate.

E. For agencies with biennial appropriations exceeding \$10 million, answer the following HUB questions.

	Response / Agency Contact
1. Do you have a HUB coordinator? (TEX. GOV'T CODE § 2161.062; TAC 111.126)	Yes. TRS has had a HUB Coordinator since FY 1994.
2. Has your agency designed a program of HUB forums in which businesses are invited to deliver presentations that demonstrate their capability to do business with your agency? (TEX. GOV'T CODE § 2161.066; TAC 111.127)	The HUB Coordinator, Purchasing Staff, and agency staff conduct on-site meetings with HUB vendors to learn of new product/service information. In addition, TRS sponsors an annual forum with Texas Workforce Commission. FY 2005 was the fifth year for this forum.
3. Has your agency developed a mentor-protégé program to foster long-term relationships between prime contractors and HUBs and to increase the ability of HUBs to contract with the state or to receive subcontracts under a state contract? (TEX. GOV'T CODE § 2161.065; TAC 111.128)	Yes. TRS sponsored a mentor-protégé agreement between CFS, Inc. and Creative Computer West, Inc. from August 2002 through January 2004. TRS is currently sponsoring a second mentor-protégé agreement between Allied Consultants, Inc. and Salima Technologies, effective April 2004 through April 2006.

F. Fill in the chart below detailing your agency's Equal Employment Opportunity (EEO) statistics.

Note: Workforce data is as of the last day of each fiscal year. Data for FY 2002 and FY 2003 includes only classified, regular, full-time employees. Data for FY 2004 includes all regular employees.

Teacher Retirement System of Texas							
Exhibit 18: Equal Employment Opportunity Statistics							
FISCAL YEAR 2002							
Job Category	Total Positions	Minority Workforce Percentages					
		Black		Hispanic		Female	
		Agency	Civilian Labor Force %	Agency	Civilian Labor Force %	Agency	Civilian Labor Force %
Officials/Administration	20	0%	7%	5%	11%	40%	31%
Professional	211	5%	9%	13%	10%	52%	47%
Technical	17	12%	14%	29%	18%	29%	39%
Protective Services	0	—	—	—	—	—	—
Para-Professionals	158	13%	18%	29%	31%	89%	56%
Administrative Support	13	31%	19%	39%	27%	85%	80%
Skilled Craft	0	—	—	—	—	—	—
Service/Maintenance	12	33%	18%	25%	44%	8%	26%
FISCAL YEAR 2003							
Job Category	Total Positions	Minority Workforce Percentages					
		Black		Hispanic		Female	
		Agency	Civilian Labor Force %	Agency	Civilian Labor Force %	Agency	Civilian Labor Force %
Officials/Administration	21	0%	7%	10%	12%	38%	32%
Professional	196	5%	9%	13%	11%	53%	47%
Technical	13	15%	14%	31%	19%	39%	39%
Protective Services	0	—	—	—	—	—	—
Para-Professionals	172	13%	18%	29%	31%	87%	56%
Administrative Support	5	20%	20%	60%	26%	80%	80%
Skilled Craft	0	—	—	—	—	—	—
Service/Maintenance	11	36%	18%	18%	44%	9%	25%

FISCAL YEAR 2004							
Job Category	Total Positions	Minority Workforce Percentages					
		Black		Hispanic		Female	
		Agency	Civilian Labor Force %	Agency	Civilian Labor Force %	Agency	Civilian Labor Force %
Officials/Administration	26	0%	7%	8%	12%	31%	32%
Professional	208	4%	9%	15%	11%	54%	48%
Technical	14	14%	14%	36%	19%	50%	40%
Protective Services	0	—	—	—	—	—	—
Para-Professionals	185	14%	18%	29%	32%	85%	56%
Administrative Support	5	20%	19%	60%	26%	20%	79%
Skilled Craft	0	—	—	—	—	—	—
Service/Maintenance	16	19%	19%	25%	44%	6%	26%

G. Does your agency have an equal employment opportunity policy? How does your agency address performance shortfalls related to the policy?

Yes. TRS addresses prevention of unlawful discrimination and performance shortfalls in the *Equal Employment Opportunity Policy* (attached) and the *Workforce Diversity Program* document (attached).

The EEO Policy asserts that TRS is an equal employment opportunity employer and does not discriminate on any basis prohibited or protected by federal or state law including race, color, disability, sex, religion, age, or national origin in the recruitment, evaluation, selection, appointment/hiring, training, promotion of personnel, or any other personnel decisions. It further states that TRS strives to recruit qualified applicants in protected classes and complies with all applicable laws in the selection of applicants for employment. The EEO Policy also details the process to be used when reporting possible discriminatory practices, prohibits retaliation against an employee who complains of discrimination, and states that violation of this policy by a TRS employee is grounds for corrective action, including termination without warning.

The *Workforce Diversity Program* document was developed to promote strategies and processes that ensure positive steps are taken to provide equal employment opportunity. The steps include:

- Analyzing the TRS workforce at least once during each fiscal year to determine the number of African Americans, Hispanic Americans, and females employed by TRS in each job category.
- Comparing the number of African Americans, Hispanic Americans, and females in each EEO job category to the number available in the statewide civilian workforce as calculated and published by the Civil Rights Division of the Texas Workforce Commission to

- determine the percentage, if any, underutilization within each EEO job category.
- Implementing special recruitment efforts to attract diverse, representative applicant pools to be considered for TRS employment opportunities.
 - Selecting applicants or making personnel decisions on the basis of job-related standards of education, training, experience, skills, knowledge, abilities.
 - Assessing TRS's progress in achieving a workforce that is representative of the availability of African Americans, Hispanic Americans, and females in the civilian labor force.
 - Initiating new strategies, as needed, to heighten employee awareness of the value of developing a diverse workforce.

The *Workforce Diversity Program* also requires the EEO Coordinator to report annually on TRS's progress in achieving program objectives. The annual Program report summarizes actions taken during the year to strengthen workforce diversity at TRS and identifies future strategies for supporting the program. Other workforce reports may be created as needed to effectively monitor the program.

Additionally, TRS launched a Workplace Diversity Initiative during FY 2004 with the creation of a Diversity Statement (attached) and the establishment of a Diversity Council, comprised of 12 TRS employees (copy of Diversity Council Charter attached). The Diversity Council is charged with taking actions to ensure that the agency is a respectful, inclusive workplace for our employees, applicants, members, vendors and others with whom we work. The Diversity Council annually provides a "Diversity Impact Study" to show what actions and results have occurred in meeting the following objectives:

- To sustain leadership accountability in order to achieve diversity objectives.
- To foster diversity awareness and promote respect and inclusiveness in the workplace.
- To positively influence the TRS culture through diversity training.
- To recruit and maintain a diverse workforce.
- To demonstrate our commitment to diversity to our members and in the community.

Some of the key accomplishments of the Diversity Initiative through August 2005 include:

- Goals and commitments related to diversity in workforce contribution and HUB utilization were included in the 2005-2009 TRS Strategic Plan adopted in July 2004.
- The Diversity Intranet Site was launched in August 2004.
- TRS managers and team leaders received special training in diversity management, including a presentation by the Diversity Council and Dr. Toby Egan at the August 2004 Agency Management Team meeting and an eight-hour workshop, "The Power of Perspectives: Positively Shaping and Influencing the TRS Culture," facilitated by Dr. Egan in October 2004.
- Ten "The Power of Perspective: Opening New Doors" diversity awareness workshops attended by about 200 TRS employees were facilitated by Dr. Egan and the Diversity Council during June – August 2005.
- TRS engaged the Toigo Foundation to help enhance diversity in recruitment of investment professionals.
- TRS co-hosted the 5th Annual Purchasing and HUB Forum in February 2005.

The biennial *Survey of Organizational Excellence* provides feedback on how our employees view the agency's commitment to equal employment opportunity and diversity. Results have been positive, and we expect this trend to continue.

XII. Agency Comments

When reviewing the Teacher Retirement System, it would be helpful to keep certain key attributes in mind during the evaluation process. TRS is a public entity fulfilling an essential state purpose as established by the Texas Constitution. The System is governed by fiduciaries who by law must be responsible first and foremost to the members of the System. This factor is only one of the ways in which TRS is a unique organization as compared to other state government entities.

Another important attribute relates to the sheer size of the organization. The benefit delivery component of TRS serves over one million members, or about one in every 20 Texans. This fact, coupled with the size of assets, positions TRS as one of the largest public pension systems in the nation. In FY 2004, TRS paid out \$5.7 billion in benefits to 280,000 members, including about 40,000 refunds. Approximately 95% of this amount stays in Texas. It is also important to note that the state's contribution to the System (in terms of tax dollars) paid only \$1.4 billion of the \$5.7 billion. The remainder is funded partly by employee contributions, but primarily through investment earnings. TRS administrative operations are distinctively efficient as compared to peer groups on a state and national basis. The pension administrative costs per member are about \$2.00 per month, one of the lowest in the nation. TRS also pays over \$1 billion a year in health benefits that serve 400,000 active and retired participants and their family members.

The financial attributes of TRS also demonstrate the impact of the System's size, which involves the investment management of over \$90 billion (again placing TRS among the top pension systems in the nation, based on assets managed). The long-term earning results are strong (10% during the last 10 years), well exceeding the 8% long-term actuarial assumption. Returns totaled \$9.1 billion in 2004. Administrative efficiency due to internal investment management is optimal, costing below two basis points (or 2/100 of one percent of assets), which is far below the investment management costs of most other systems. TRS achieves these efficiencies through the effective use of technology, streamlined processes, and a highly skilled and dedicated workforce.

TRS has been successful in striking a suitable balance of maintaining internal operations (such as investment management), while augmenting as appropriate with outsourcing (such as the health care delivery contracts that manage medical and pharmaceutical claims and network administration).

TRS and the State of Texas will continue to face funding challenges in the Pension Trust Fund and the Retiree Health Care program. These will likely remain key priorities for quite some time into the future.

We are looking forward to working with the Sunset Commission throughout its evaluation, and we anticipate a very constructive and helpful process.

List of Attachments

Number: Description:

1. Actuarial Audit—July 2005, conducted by Milliman USA, Consultants and Actuaries
2. Actuarial Audit Response—“Comments on July 2005 Actuarial Audit by Milliman USA” prepared by Gabriel, Roeder, Smith & Company
3. Actuarial Experience Study—May 2004, conducted by Gabriel, Roeder, Smith & Company
4. Actuarial Valuation—August 31, 2004, conducted by Gabriel, Roeder, Smith & Company
5. Actuarial Update—“Results of TRS Valuation Update as of February 28, 2005” prepared by Gabriel, Roeder, Smith & Company
6. *An Independent Review of the Teacher Retirement System (TRS) Investment Program—February 2002—* Conducted by Independent Fiduciary Services (IFS), as submitted to the Legislative Audit Committee.
7. Biographical Information for TRS Board of Trustees
8. Bylaws of the Board of Trustees, as amended June 9, 2005
9. Comprehensive Annual Financial Reports—FY 2002 through FY 2004
10. *Cost Effectiveness Measures for Defined Benefit Administration*—CEM, June 16, 2005
11. “History of Benefit Improvements” brochure, September 2001
12. Internal Audit Reports List—FY 2001 through FY 2005
13. Internal Audit Plan—FY 2005
14. Investment Policy Statement Adopted June 9, 2005
15. Laws and Rules—September 2004 (including emergency rules implementing SB 1691)
16. Legislative Appropriations Requests—FY 2006 and FY 2007
17. Map and Directions to TRS
18. *Member Satisfaction Survey—May 20, 2004*
19. Memorandum Opinions of the Texas Attorney General (2):
 - Tex. Att’y Gen. Memorandum Opinion (October 16, 2003)
 - Tex. Att’y Gen. Memorandum Opinion (September 16, 2004) and subsequent correspondence from the Lieutenant Governor and Speaker of the House
20. Newsletters, FY 2003 through FY 2004:
 - External Newsletters—
 - *TRS News* (to all members and retirees)
 - *Update* (to district reporting officials)
 - Internal Newsletter—*The TRS Chalkboard*
21. Operating Budget—FY 2004 (includes FY 2002 and FY 2003 information)
22. Operating Budgets (Administrative)—FY 2002 through FY 2006
23. Performance Reports:
 - EnnisKnupp & Associates
 - State Street
24. Plan Qualification Advantages and Requirements for the TRS Pension Trust Fund
25. Policies and Guidelines Review Plan of the Board—September 23, 2004
26. Publications List
27. Quarterly Performance Reports for Outcome Measures and Outcome Efficiency Measures—FY 2002 through FY 2004
28. State Auditor Reports, List of—FY 2001 through FY 2005
29. Strategic Plan—FY 2005 through FY 2009
30. Studies of Interest to TRS, List of
31. TRS-ActiveCare Performance Review for 2003-2004, (2 reports, one from each vendor)
32. TRS-Care Performance Review for 2003-2004, (2 reports, one from each vendor)
33. Various Studies of Major Pension Plans and Related Issues
34. Workforce Diversity Program (includes EEO Policy, EEO Policy Statement, and Diversity Statement)