

SUNSET ADVISORY COMMISSION

Teacher Retirement System of Texas

Staff Report
April 2006



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In 1977, the Texas Legislature created the Sunset Advisory Commission to identify and eliminate waste, duplication, and inefficiency in government agencies. The 12-member Commission is a legislative body that reviews the policies and programs of more than 150 government agencies every 12 years. The Commission questions the need for each agency, looks for potential duplication of other public services or programs, and considers new and innovative changes to improve each agency's operations and activities. The Commission seeks public input through hearings on every agency under Sunset review and recommends actions on each agency to the full Legislature. In most cases, agencies under Sunset review are automatically abolished unless legislation is enacted to continue them.

TEACHER RETIREMENT SYSTEM OF TEXAS

SUNSET STAFF REPORT

APRIL 2006

Table of Contents

	PAGE
SUMMARY	1
ISSUES/RECOMMENDATIONS	
1 Granting Service Credit Only in Whole-Year Increments Prevents TRS From Fairly Accounting for Time Worked by Members.....	5
2 TRS Does Not Provide Equal Access to Counseling Services to Members Across the State	11
3 TRS' Disability Retirement Benefit Program Is Not Properly Structured to Ensure Protection of Pension Trust Fund Assets.....	17
4 TRS Lacks Sufficient Authority in Its 403(b) Certification Program to Adequately Protect Public Education Employees.....	23
5 State Law Requires TRS to Produce a Costly Study That Is No Longer Useful.....	31
ACROSS-THE-BOARD RECOMMENDATIONS	35
AGENCY INFORMATION	37
APPENDICES	
Appendix A — Equal Employment Opportunity Statistics	57
Appendix B — Historically Underutilized Businesses Statistics.....	61
Appendix C — Staff Review Activities	65

SUMMARY

Summary

The Sunset staff review of the Teacher Retirement System of Texas followed a controversial previous review of the agency in 1995, which resulted in dramatic changes by the Legislature to increase the agency's accountability. The need for accountability is clear; more than 1 million educational employees rely upon TRS for retirement and health-care benefits, and contributions by those employees and the State have created a \$93.7 billion Pension Trust Fund to back the retirement benefits.

In forming its approach to this review, Sunset staff first focused on assessing how well the agency operates today, given the past review. Staff found a well-run agency that has distanced itself from past problems and is accountable to its members and the State. Sunset staff then assessed TRS' ability to fairly and effectively deliver benefits and programs to educational employees and retirees. While achieving fairness and effectiveness in a system involving so many members is difficult, Sunset staff found several ways in which the agency could improve.

- ◆ One area in which retirement systems must be fair to all members is in the allocation of service credits. A member's service credits determine eligibility for retirement and amount of pension benefits. The statutory provision that TRS grant service credit only in whole-year increments does not accurately account for actual time worked. For example, TRS rules allow members to work as little as 90 days to earn a full year of credit. Sunset staff found that fairness in awarding service credits would be improved with a more divisible accounting system. Staff also noted that, of the 10 largest educational retirement systems in the United States, TRS is the only system that does not allow for partial-year service credit.



Sunset staff assessed TRS' ability to fairly and effectively deliver benefits and programs to its 1 million members.

- ◆ TRS offers disability benefits to members unable to work until normal retirement age due to injury or illness. While disability retirement benefits provide needed replacement income for persons unable to work, the system lacks a mechanism to adjust disability benefits for individuals who enter new occupations and earn significant incomes. Sunset staff examined disability retirements to assess whether system assets are being distributed to reduce hardships and not as an entitlement. Sunset staff concluded that allowing individuals to earn disability retirement benefits as bonus income is an unfair use of the Pension Trust Fund. Staff also noted that TRS is the only major public retirement program in the United States that does not limit earnings by disability retirees.
- ◆ A retirement system should also offer services equally to all members. As educational employees must make many important decisions affecting their lifetime annuities before retiring, retirement counseling is a core function of TRS. Overall, TRS performs this function well; however, the agency does not provide in-person, one-on-one services fairly to all members across Texas. Members who live outside the capital must travel to Austin to access in-person counseling services. An examination of other retirement systems

found that TRS is the only retirement system of its peers to not offer individual counseling services at the members' place of employment or other field locations.

- ◆ TRS also needs statutory change in the administration of two programs: the 403(b) certification program, and the health insurance coverage comparability study. Public education employees are permitted to supplement their retirement by making tax-deferred contributions to a 403(b) plan, similar to private-sector 401(k) plans. In response to abuses in the 403(b) market, the Legislature gave TRS authority to set limits on fees that can be charged in such plans. However, TRS lacks sufficient oversight tools to effectively administer the 403(b) certification program and protect public education employees from excessive fees in investments.

Before the introduction of TRS-ActiveCare insurance, statute required TRS to compare health insurance coverage offered by local school districts, charter schools, and education service centers to coverage provided to state employees. With the offering of TRS-ActiveCare to all school districts, this comparison no longer produces sufficient information to justify its appropriations.

The recommendations in this report are designed to improve the fairness and effectiveness of TRS' management of member service credits, disability retirement, retirement counseling services, certification of 403(b) investment companies, and the health insurance comparability study. Since TRS is not subject to automatic termination under the Sunset Act, staff did not include an issue related to continuation of the agency in this report. A summary follows of the Sunset staff recommendations on the Teacher Retirement System.

Issues and Recommendations

Issue 1

Granting Service Credit Only in Whole-Year Increments Prevents TRS From Fairly Accounting for Time Worked by Members.

Key Recommendations

- ◆ Require TRS to grant membership service credit in half-year increments.
- ◆ Require TRS' Board of Trustees to create rules defining how much service constitutes a half-year of credit.

Issue 2

TRS Does Not Provide Equal Access to Counseling Services to Members Across the State.

Key Recommendations

- ◆ Require TRS to conduct in-person, individual member counseling in locations other than Austin.
- ◆ TRS should improve the convenience of counseling services for its members.

Issue 3

TRS' Disability Retirement Benefit Program Is Not Properly Structured to Ensure Protection of Pension Trust Fund Assets.

Key Recommendations

- ◆ Require TRS to adjust benefits for disability retirees who earn significant incomes.
- ◆ Grant TRS authority to require income reports from disability retirees who earn incomes in excess of limits set by TRS.
- ◆ Direct TRS to access Texas Workforce Commission records on disability retirees for the purpose of reviewing earnings.

Issue 4

TRS Lacks Sufficient Authority in Its 403(b) Certification Program to Adequately Protect Public Education Employees.

Key Recommendations

- ◆ Require certified 403(b) companies to register individual products offered for sale to Texas educators.
- ◆ Require TRS to list all registered 403(b) products and their fees on the TRS website.
- ◆ Grant TRS a greater range of oversight tools including suspension and administrative penalty authority.

Issue 5

State Law Requires TRS to Produce a Costly Study That Is No Longer Useful.

Key Recommendation

- ◆ Repeal the statutory requirement for TRS to conduct the Public School Employees' Health Coverage Comparability Study.

Fiscal Implication Summary

When fully implemented, the recommendations in this report would result in annual savings of \$2,325,000 to the General Revenue Fund. The specific fiscal impact of these recommendations is summarized below.

- ◆ Issue 1 – Requiring members to work the full number of years to earn corresponding credit would delay enrollment in TRS-Care insurance for some members, creating an estimated savings to the General Revenue Fund of \$2.2 million. The savings would begin to accrue in fiscal year 2009, following a one-year phase-in period. TRS would incur a one-time cost of up to \$900,000 to alter its database and tracking system. As TRS budgets about \$2 million per biennium for system upgrades, the agency could incorporate a portion of the changes required by this recommendation into its routine maintenance schedule.

Changing the basis on which the agency grants service credit would also result in a gain to the Pension Trust Fund as some members would continue contributing to the Pension Trust Fund while working their last full year before retirement eligibility. The amount of the savings cannot be estimated for this report.

- ◆ Issue 3 – Removing disability retirees, who are gainfully employed, from TRS-Care would have a positive fiscal impact to the State. Because the number of disability retirees who earn excessive incomes is unknown, the exact fiscal impact is difficult to estimate. Assuming that 5 percent of TRS disability retirees would be affected, the recommendation would save \$256,000 in General Revenue. These savings are not reflected in the five-year fiscal impact table due to their estimated nature.

Reducing the pensions of gainfully employed disability retirees would also have a positive fiscal impact to the Pension Trust Fund. TRS would reduce annuity payments from the Fund by \$6.45 million for disability retirees who are earning high incomes in other positions. These figures are not included in the five-year fiscal impact table.

- ◆ Issue 5 – Eliminating the unnecessary health coverage comparability study would result in a positive fiscal impact of \$125,000 per year to the State.

<i>Fiscal Year</i>	<i>Savings to the General Revenue Fund</i>
2008	\$125,000
2009	\$2,325,000
2010	\$2,325,000
2011	\$2,325,000
2012	\$2,325,000

ISSUES

Granting Service Credit Only in Whole-Year Increments Prevents TRS From Fairly Accounting for Time Worked by Members.

Summary

Key Recommendations

- ◆ Require TRS to grant membership service credit in half-year increments.
- ◆ Require TRS' Board of Trustees to create rules defining how much service constitutes a half-year of credit.

Key Findings

- ◆ Requiring TRS to grant service credit in whole-year increments unfairly benefits some members, while penalizing other members.
- ◆ Other educational retirement systems account for the specific work patterns of educators by granting service credit in partial-year increments.

Conclusion

Service credit determines eligibility for TRS retirement benefits, as well as the amount of those benefits. Current law requires TRS to grant service credit in one-year increments and allows TRS to define how much service constitutes a year of credit. TRS rules allow members who work at least one school semester to earn one year of service credit, while other members who work the entire school year earn the same credit. Sunset staff evaluated TRS' service credit system to see if the system is fair for all members and adequately protects the Pension Trust Fund.

Sunset staff found that TRS' service credit system is unfairly generous to some members, while others do not receive credit for work performed. Because TRS grants service credit in only whole-year increments, it does not accurately account for actual time worked by members, allowing some members to retire earlier and potentially depriving the Pension Trust Fund of needed contributions. Sunset staff found that of the 10 largest public, educational retirement systems in the United States, TRS is the only one that does not allow for partial-year service credit. Changing the current system of awarding service credits from whole-year to half-year credits would result in a more equitable system for all members.

Support

Service credit is the primary factor in determining eligibility for retirement and pension benefits.

- ◆ TRS members must meet age and service requirements established by law to be eligible for retirement and related benefits.¹ To qualify for normal service retirement, members must have at least five years of service credit, and either be 65 or meet the rule of 80.² The rule of 80 provides that the sum of the member's age and years of service equals or exceeds 80. Service retirement under TRS' defined benefit program qualifies a member to receive a lifetime monthly annuity.
- ◆ Service credit is also a factor in determining the amount of a member's annual retirement benefit.³ To calculate a standard annuity, TRS multiplies the average of a member's three highest annual salaries, times 2.3 percent for each year of service.⁴ For example, a teacher with 30 years of service and an average, three-year high salary of \$50,000 would receive 69 percent of that salary for a total of \$34,500 per year. In comparison, using the same formula, a teacher who retired with 20 years of service credit would receive only \$23,000 per year.
- ◆ Service credit also affects eligibility and associated costs of other TRS benefits. Retired members must have at least 10 years of service credit to be eligible for TRS-Care, the health-care plan for retirees. Monthly premiums paid by retirees participating in TRS-Care also vary, in part, based on the member's years of service credit. For example, for participation in TRS-Care's two most comprehensive plans, members with less service credit pay higher premiums.



TRS rules grant one year of service credit for 4-½ months of work.

Under current law, TRS grants service credit in one-year increments.

- ◆ Current law requires TRS to grant service credit to members only in whole-year increments. Members may earn up to one year of credit per school year. Although school districts and contract terms vary, school years generally run from September through August.
- ◆ Statute requires TRS to determine, by rule, how much service is required to earn one year of service credit. TRS rules, initially adopted in 1976, grant one year of service credit to members who are employed in an eligible position for at least 4-½ months during a school year.⁵
- ◆ Unlike employees of other retirement systems, educational employees have unique work schedules and contract periods. While the Employees Retirement System of Texas (ERS) grants service credit to state employees in one-month increments, educational employees typically work on a nine-month contract basis. In addition, Texas school districts' varying contract periods for employees further increase the complexity of service credit calculation and tracking by TRS.

Requiring TRS to grant service credit in whole-year increments unfairly benefits some members, while penalizing other members.

- ◆ The current system of granting service credit does not accurately reflect time worked by TRS members. In the absence of authority to grant partial-year credit, TRS' rules generously allow members who work as little as 90 working days to earn one year of service credit. This system rightfully recognizes that members working for one semester should earn some service credit, but unfairly awards the same amount of credit as members who worked a full year. Under the current system, a member working only 20 hours per week for one semester receives the same credit as a member working full time for an entire year. In fiscal year 2005, about 16 percent of TRS members retired in November, December, or January, likely earning a full year's credit for only one-half year's work.
- ◆ Just as the current system grants too much credit to some members, it also deprives other members of receiving credit for time worked. For example, because members must work at least 90 working days to earn service credit, teachers who are employed in the middle of the spring semester earn no credit for their work. Since the law limits TRS to whole-year increments, TRS cannot grant service credit for the time worked by these employees, despite the fact that they are members of the system and contribute toward their retirement.
- ◆ Allowing members to earn more service credit than actually worked can also have an impact on the Pension Trust Fund, as some members are able to accumulate an extra year of service credit over the course of their careers and retire earlier. For example, a member who begins a career in January earns one year of service credit for that school year. Later, nearing retirement, the member must work only 4½ months, or until December, to earn another year of service credit. By the end of the member's career, TRS would have granted two full years of service credit for only two semesters of work and contributions, making the member eligible for pension benefits sooner, for a longer period of time, and at a higher benefit. In fiscal year 2005, about 9,500 new members joined TRS in January or February, likely earning a full year's service credit for one-half year's work.

By retiring sooner, members contribute less money into the Pension Trust Fund. Currently, members contribute 6.4 percent of monthly salary as automatic deductions from their payroll checks. Members who are able to accrue two years of credit for only one year of work deprive the Fund of needed contributions. In addition, TRS loses its ability to earn investment income on these funds.



The current service credit system grants too much credit to some members and no credit to others.



Some members can earn two full years of credit for only two semesters of work, and retire earlier.

Other educational retirement systems account for the specific work patterns of educators by granting service credit in partial-year increments.

- ◆ Of the 10 most populous states, only Texas has a teacher retirement system that grants service credit in whole-year increments.⁶ While each state teacher retirement system defines the number of work days required to earn one year of service credit, the other systems all allow for fractional service credit.



TRS is the largest teacher retirement system to only grant service credit in whole-year increments.

The California State Teachers' Retirement System – the largest educational retirement system in the United States – credits service in daily or monthly increments, as reported by local school districts. Educational retirement system members of New York, Georgia, and New Jersey earn service credit on a monthly basis when working less than a full contract year. Members of the Florida, Illinois, and Pennsylvania educational retirement systems earn service credit in proportion to the number of days worked. For example, members of the Pennsylvania Public School Employees' Retirement System earn credit in relation to 180 working days, so a member who works 90 days receives a half-year of service credit. Each retirement system mentioned above grants no more than one year of credit for any one school year.

- ◆ Teacher retirement systems in the states bordering Texas also grant service credit in partial-year increments. The educational retirement systems of Arkansas and New Mexico grant service credit in quarter-year increments, while the Louisiana system grants credit based on the number of contract days worked in relation to a full contract year. Although the Teachers' Retirement System of Oklahoma requires its members to work at least six full school months to qualify for one year of service credit, members are eligible for partial credit for employment of fewer than six months.

Recommendations

Change in Statute

1.1 Require TRS to grant membership service credit in half-year increments.

This recommendation would require TRS to grant service credit to members in half-year increments, rather than in whole years as currently required in law. Although the states examined during the review use a variety of methods of granting service credit, Sunset staff recommends a half-year increment method based on the simplicity of the calculation and ease of transition to the new system. Creating a system that more precisely credits actual time worked would result in a fairer system for all members. The current prohibition in law restricting TRS from granting more than one year of credit for service performed in any one school year would still apply.

To avoid disrupting planned retirements, this change in service credit calculation should take effect on September 1, 2008, and apply to service credit earned after that date. Extending the implementation period for this recommendation would also afford TRS adequate opportunity to make necessary system changes. This recommendation would not apply to the purchase of service credits by members or affect TRS' calculations of members' age for purposes of determining retirement eligibility.

1.2 Require TRS' Board of Trustees to create rules defining how much service constitutes a half-year of credit.

This recommendation requires the TRS Board to amend its current rules relating to service credit to allow for half-year service credit accrual, beginning in September 2008. TRS would set the criteria under which members would earn one-half year of credit for service performed. TRS should adopt rules that ensure fairness to its members, and do not result in a negative impact to the Pension Trust Fund. TRS service credit rules, at a minimum, should better reflect actual time worked by members than current rules by requiring members to work more than one-half of a semester to receive one-half year of service credit.⁷

Fiscal Implication

Requiring members to work the full number of years to earn corresponding credit would delay enrollment in TRS-Care for some members, resulting in a savings to the General Revenue Fund. About 2,000 members retired in December or January in fiscal year 2005. Had these members worked until full retirement eligibility, an estimated \$2.2 million savings to TRS-Care would have been realized. Assuming no change in funding formulas established in State law, these savings would require fewer State supplemental appropriations for TRS-Care.⁸

TRS would incur some administrative costs as a result of altering its current system of crediting service. To revise its database and tracking system, TRS has estimated a one-time cost of \$800,000 to \$900,000, plus 10 full-time equivalent positions for one year. However, TRS historically budgets approximately \$2 million per biennium for system upgrades, and could incorporate a portion of the changes required by this recommendation into its routine maintenance schedule and reprioritize its existing workload.

The fiscal impact to the Pension Trust Fund cannot be estimated for this report, as any impact to the Fund depends upon the service credit criteria adopted by TRS' Board of Trustees. Although some members would not draw pension benefits as early and would continue contributing to the Pension Trust Fund while working their last full year before retirement, other members who did not qualify for service credit under the current system would qualify for a half-year of credit under the new system. However, because TRS' Board would be required to adopt criteria that does not negatively impact the Fund, these recommendations would either be revenue-neutral or result in savings to the Fund.

<i>Fiscal Year</i>	<i>Savings to the General Revenue Fund</i>
2008	\$0
2009	\$2,200,000
2010	\$2,200,000
2011	\$2,200,000
2012	\$2,200,000

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<sup>1</sup> Texas Government Code, sec. 824.202.

<sup>2</sup> Texas Senate Bill 1691, 79th Legislature (2005) changed retirement eligibility requirements. To be eligible for an unreduced annuity, members who join TRS after September 1, 2007, must be at least 65 with five years of service; or age 60 with at least five years of service and meet the rule of 80. Members who are subject to these eligibility requirements and who retire before age 60 will be subject to a 5 percent annuity reduction for each year under age 60.

<sup>3</sup> Texas Government Code, sec. 824.203(a).

<sup>4</sup> S.B. 1691 (2005) changed the standard annuity formula from the average of the three highest salary years to the five highest salary years, for members who did not meet one of the following criteria on or before August 31, 2005: at least 50 years old, age and years of service equal at least 70, or member with at least 25 years of service.

<sup>5</sup> Texas Administrative Code, Title 34, part 3, rule 25.131.

<sup>6</sup> Compared to the California State Teachers' Retirement System; New York State Teachers' Retirement System; Florida Retirement System (Division of Retirement); Teachers' Retirement System of Illinois; Pennsylvania Public School Employees' Retirement System; State Teacher Retirement System of Ohio; Michigan Public School Employees Retirement System; Teacher Retirement System of Georgia; and the New Jersey Department of the Treasury - Division of Pensions and Benefits.

<sup>7</sup> Texas Education Code, sec. 25.081 requires school districts to provide at least 180 days of instruction for students.

<sup>8</sup> The Texas Insurance Code, sec. 1575.203(a) requires that each active employee contribute 0.65 percent of salary to TRS-Care. Further, the General Appropriations Act, 2006-2007 Biennium, sets the State's contribution rate at 1.00 percent of payroll, and school districts' contribution rate at 0.55 percent of total payroll for each fiscal year.

## *TRS Does Not Provide Equal Access to Counseling Services to Members Across the State.*

### **Summary**

#### **Key Recommendations**

- ◆ Require TRS to conduct in-person, individual member counseling in locations other than Austin.
- ◆ TRS should improve the convenience of counseling services for its members.

#### **Key Findings**

- ◆ Counseling members about their retirement options is a critical function for TRS.
- ◆ Members who need in-person, individual counseling on their retirement options must travel to Austin, a hardship for some members.
- ◆ Other major retirement systems conduct counseling sessions in ways that are more convenient to members.

#### **Conclusion**

Before retiring, TRS members make a multitude of decisions that affect their lifetime annuities. Because of the importance of these choices, providing counseling services to members is a core function of TRS, and the agency makes a large effort in providing these services. The Sunset staff review of TRS examined the agency's member services to assess the usefulness of these services and whether they are provided in ways that are fair to all members across the state.

Sunset staff found that, while the agency has taken great strides to provide in-person, individual counseling services, these services are only offered at TRS' headquarters in Austin – requiring members living outside the capital to travel to access the services. An examination of other retirement systems found that TRS is the only retirement system in its peer group to not offer individual counseling services at the members' places of employment or other field locations. In addition, TRS has not taken other steps to reduce the hardship on members working outside Austin, such as offering in-person counseling sessions after business hours, and allowing members to schedule telephone counseling sessions.

## Support

### Counseling members about their retirement options is a critical function for TRS.

- ◆ Because of the large number of retirement options and the relative complexity of the system, counseling members about their retirement choices is an important function of TRS. Options selected by members at the time of retirement affect their annuity payments for the rest of their lives. These options include decisions affecting whether to retire, when to retire, the amount of benefits, and financial life after retirement. The table, *Options Affecting TRS Retirements*, summarizes selected choices faced by retiring members.
- ◆ As TRS serves more than 1 million members, member counseling requires a large effort on the part of the agency. TRS' 57-employee, member-counseling staff advises members of their retirement options through group counseling sessions and one-on-one meetings with benefit counselors.



*TRS places an emphasis on in-person, one-on-one counseling, providing more than 8,500 sessions per year.*

TRS counselors travel throughout the state making half-day, general benefit presentations, which include information about the agency, retirement eligibility, benefit calculations, and retirement plan options. In fiscal year 2005, TRS made more than 150 group presentations to more than 13,000 members.<sup>1</sup> Many of these sessions are held after school hours or during the evening.

TRS also places an emphasis on in-person, one-on-one counseling sessions with members, referring to the sessions as the agency's 'core competency.' During one-on-one sessions, TRS counselors access a member's retirement files and assist the member with the choices affecting retirement. Individual sessions are generally one hour in length during which counselors guide members through the decision-making process to complete the retirement paperwork.

Individual sessions may be scheduled in advance or held on a walk-in basis. Counselors do not advise members on taxes, financial planning, or social security. In fiscal year 2005, TRS counseled about 8,600 members on a one-on-one basis about their retirement benefits, spending an average of \$179 per member on these sessions.<sup>2</sup> In that same year, 14,500 members retired.

### Members who need in-person, individual counseling on their retirement options must travel to Austin, a hardship for some members.

- ◆ Although TRS offers general benefits presentations throughout the state, the agency only conducts in-person, individual counseling sessions at its headquarters in Austin. Members who need one-on-one counseling must travel to Austin and pay for all travel expenses themselves – a hardship on members living far from the capital.

### ***Options Affecting TRS Retirements***

| Type of Decision                          | Option                                         | Explanation                                                                                                                                                                                                                                                                                                        |
|-------------------------------------------|------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Decisions on Whether to Retire            | Request of refund                              | Members may choose to withdraw their contributions with interest instead of retiring.                                                                                                                                                                                                                              |
|                                           | Service credit transfers                       | Members with service in TRS and the Employees Retirement System may choose to transfer credits and retire under either system.                                                                                                                                                                                     |
|                                           | Proportionate retirement                       | Members with service credit in more than one Texas state system may have all service considered to determine separate benefits from each system.                                                                                                                                                                   |
| Decisions Affecting Date of Retirement    | Timing of retirement                           | Members may choose to work longer as additional years of employment add extra credit to the retirement formula, resulting in higher benefits.                                                                                                                                                                      |
|                                           |                                                | Members can also get credit for an entire year of employment by working an additional 4½ months.                                                                                                                                                                                                                   |
|                                           | Purchasing of service credits                  | Federal Income Tax law requires members to begin receiving benefits by the later of April 1 of the year following the date the member turns 70½ or stopped working, whichever is later.                                                                                                                            |
|                                           | Early age retirement                           | Certain members can buy years of service credit for withdrawn service, unreported or substitute service, military service, Uniformed Services Employment and Reemployment Rights Act, membership waiting period, out-of-state service, developmental leave, career and technology work experience, and sick leave. |
| Decisions Affecting Retirement Benefits   | Partial lump sum options                       | Certain members may elect one of three options that pay a portion of retirement annuities as lump sums. For example, a retiree may opt to be paid 36 months of their standard annuity in three annual payments that are reduced from later payments.                                                               |
|                                           | Selecting joint and survivor retirement plans  | Members may take the standard annuity or may opt to have their benefits reduced in return for one of five plans that pays a guaranteed annuity to their survivors.                                                                                                                                                 |
| Decisions Affecting Life After Retirement | Limitations on ability to return to work       | Members who want to work after retiring are limited in their ability to work for TRS-covered employers.                                                                                                                                                                                                            |
|                                           | TRS-Care health insurance choices and Medicare | Members with at least 10 years of service may be eligible for one of three TRS-Care health insurance plans with differing benefits and premiums. Members must enroll at first eligibility. Recent changes in federal law affect TRS-Care health insurance for members who are eligible for Medicare.               |

TRS has not taken steps to mitigate the hardship on members who must travel to Austin. Unlike some other large retirement systems, TRS does not offer one-on-one counseling after normal business hours, requiring members who live outside of Austin to take at least one day off work to get counseling. Also unlike many of its peers, TRS does not make full use of the telephone by allowing members to schedule full telephone counseling sessions or provide members with retirement benefit estimates by phone.

TRS' website also lacks the functionality of other retirement systems as TRS does not offer all of its necessary forms online, and only some of

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*One West Texas school district has created its own assistance program, counseling more than 1,000 employees per year.*

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*TRS is the only retirement system among its peers that only offers one-on-one counseling at its headquarters.*

TRS' forms can be completed online. Further, TRS requires members to submit notarized affidavits before being able to gain online access to their accounts.

- ◆ Because TRS does not offer individual counseling outside of Austin, at least one West Texas school district has created its own assistance program to counsel employees preparing for retirement. The school district conducts about 1,000 in-person, individual sessions per year. District officials created the program out of fears that some employees were retiring without fully understanding their decisions or how to correctly complete the paperwork. This assistance, paid at the school district's expense, explains retirement options and helps employees to complete forms, but is no substitute for TRS' counseling.

For example, while the school district offers information and assistance, the counseling can never be considered as authoritative as that offered by TRS. In addition, the school district is the only district in its region to offer this service, and does not make the service available to other school districts.

#### **Other major retirement systems provide counseling in ways that are more convenient to members.**

- ◆ The State's other major retirement system, the Employees Retirement System (ERS), conducts retirement counseling sessions throughout Texas during periods of high numbers of retirements, such as when the Legislature grants retirement incentives. ERS offers in-person, individual counseling services to members, before and after normal business hours, during peak, annual retirement periods. ERS also allows members to schedule full telephone counseling sessions with counselors who are familiar with the specifics of the member's retirement. In addition, ERS makes effective use of its website as the agency issues passwords to members giving them the ability to access and complete forms online.
- ◆ Most retirement systems of similar size to TRS provide more accessible one-on-one counseling services. In a study of TRS' peer retirement systems that offered one-on-one counseling – including systems such as California Public Employees Retirement System, California State Teachers' Retirement System, ERS, and New York State and Local Retirement Systems – TRS was the *only* system that did not offer counseling at the member's place of employment or other field locations.<sup>3</sup>

The State Teachers Retirement System of Ohio (STRS) conducts individual retirement counseling sessions in ways that are convenient to its members. STRS counselors travel throughout Ohio to have individual sessions near the member's home or school. Like TRS, STRS has one-on-one counseling available at its headquarters. Unlike TRS, STRS counselors are also available for in-person counseling after normal work hours every weekday until 6 p.m. STRS also allows members to teleconference with counselors at set appointments where counselors have files available and can give accurate benefits estimates.<sup>4</sup>

## **Recommendations**

### **Change in Statute**

#### **2.1     Require TRS to conduct in-person, individual member counseling in locations other than Austin.**

This recommendation would allow members who live outside of Austin to access the in-person, individual counseling services now offered by TRS only at its headquarters. To enable the most effective delivery of these services, TRS should adopt policies regarding availability, timing, and scheduling. The agency should identify the geographic areas most in need of the counseling services and focus efforts on those areas. TRS should also make these individual counseling services available in conjunction with scheduled group sessions, and should announce the schedule with sufficient advance notice to permit members to schedule appointments and obtain up-to-date benefit estimates if needed.

TRS has stated that conducting one-on-one counseling throughout the state would not be feasible because the counselors would have to travel with the files of individual members. However, the agency has used technological solutions to solve similar problems. For example, TRS has created computerized images of most of the required documents and these files could be easily loaded on the laptop computers of counselors before departing from Austin. The agency could also preschedule the counseling sessions so that the files are available for counselors to bring to the sessions.

### **Management Action**

#### **2.2     TRS should improve the convenience of counseling services for its members.**

This recommendation would ease the hardship on members who live outside of central Texas and wish to access TRS' in-person counseling services. TRS should offer in-person counseling sessions after normal working hours on one or two days a week. This change would allow members outside of Austin to attend individual counseling sessions at the end of their workdays. TRS should also allow members to schedule telephone counseling sessions to speak with counselors familiar with their retirement details. TRS should improve the capability of its website to allow members to access and complete forms online, increasing the usefulness of TRS' website.

### **Fiscal Implication**

These recommendations would not have a fiscal impact to the State. TRS could incur greater costs, paid out of the Pension Trust Fund, and the agency may need to request an increase in its travel and employee caps through the appropriations process. The agency may need up to two additional employees for in-person, field counseling sessions. However, these field counseling sessions would reduce the number of sessions conducted in Austin. The agency could also offset the costs of these recommendations with changes in its work assignments. For example, extending the hours of counseling sessions in Austin and scheduling telephonic sessions would not have a cost to the agency as TRS could simply stagger the work schedules of its counselors.

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- <sup>1</sup> Teacher Retirement System of Texas, *Comprehensive Annual Financial Report, Fiscal Year 2005*, p. 11.
- <sup>2</sup> Cost Effectiveness Measurements, Inc., *Defined Benefit Administration Benchmarking Analysis*, (Toronto: CEM, Inc., 2005), p. 12.
- <sup>3</sup> CEM, Appendix C, p. 19.
- <sup>4</sup> State Teachers Retirement System of Ohio, [www.strsoh.org/resources/2b.html](http://www.strsoh.org/resources/2b.html). Accessed: January 30, 2006.

## ***TRS' Disability Retirement Benefit Program Is Not Properly Structured to Ensure Protection of Pension Trust Fund Assets.***

### **Summary**

#### **Key Recommendations**

- ◆ Require TRS to adjust benefits for disability retirees who earn significant incomes.
- ◆ Grant TRS authority to require income reports from disability retirees who earn incomes in excess of limits set by TRS.
- ◆ Direct TRS to access Texas Workforce Commission records on disability retirees for the purpose of reviewing earnings.

#### **Key Findings**

- ◆ TRS cannot adequately protect the Pension Trust Fund from potential abuses in the disability retirement program.
- ◆ Disability retirees earning high incomes inappropriately increase TRS-Care costs.
- ◆ TRS' lack of limitations on earnings by disability retirees is inconsistent with other retirement systems.
- ◆ Other state retirement systems provide greater oversight of disability retirement programs through reporting and reviewing functions.

#### **Conclusion**

Since 1937, TRS has offered disability benefits to members unable to work until normal service retirement due to injury or illness. While disability benefits provide needed replacement income for persons unable to work, TRS has no way of knowing if disability retirees are able to work and earn income sufficient to support themselves. Sunset staff evaluated TRS' disability retirement program to see if benefits are fairly applied and whether the agency has the ability to implement the necessary safeguards to protect the Pension Trust Fund.

Sunset staff found that TRS' disability retirement program does not adequately protect the Pension Trust Fund, as well as the TRS-Care Fund, because it lacks a mechanism to adjust disability benefits for individuals who earn a significant amount of money. Staff also noted that TRS is the only major retirement program that does not limit earnings by disability retirees.

## Support

**The Teacher Retirement System offers disability retirement benefits to members who can no longer perform duties related to their positions.**



*Disability  
retirement does not  
depend on inability  
to be employed in  
any other position.*



*TRS' disability  
retirement  
program functions  
more as an  
entitlement than  
a means of easing  
hardships.*

- ◆ According to state law, TRS may grant disability retirement to members who are mentally or physically unable to perform their current job duties and whose disability is likely permanent. Disability retirement does not depend upon one's inability to be gainfully employed in any position other than the one held immediately before retirement. Disability retirees receive a monthly annuity and health insurance coverage through TRS-Care.
- ◆ TRS certifies disability retirees through an application and review process. To qualify for disability, a member must apply to TRS with an attending physician's statement, relevant medical records, and workers' compensation records when applicable. TRS' Medical Board, a committee of three licensed physicians appointed by the TRS Board of Trustees, reviews the applications and recommends approval or denial of cases to the TRS Board.
- ◆ Certified disability retirees with at least 10 years of service receive the greater of \$150 per month or the standard monthly annuity calculated using the member's years of service credit, final average salary, and the standard multiplier established by the Legislature. Disability retirees with less than 10 years of service receive \$150 per month payable for the number of months worked in TRS-covered employment. Currently, TRS pays disability benefits to 8,327 retirees, with an average monthly benefit of \$1,280. Annually, TRS receives about 800 new applications and approves about 750 new disability retirees, for an approval rate of about 94 percent.<sup>1</sup> In 2005, total disability benefit costs were \$129 million, excluding the cost of TRS-Care health insurance.<sup>2</sup>

**TRS cannot adequately protect the Pension Trust Fund from potential abuses in the disability retirement program.**

- ◆ State law and TRS rules do not prohibit disability retirees from earning high incomes working outside of the Texas public education system while receiving disability benefits. Although disability retirement benefits are generally meant to provide income to injured or ill persons who are unable to work until normal service retirement or have significantly limited earning capacity, TRS' system is structured more like an entitlement program in which disability benefits could be used to supplement a working person's income.
- ◆ While some disabilities are totally and permanently debilitating, others are not. For example, the third most prevalent cause for disability retirement among TRS members is back problems, which could be accommodated in certain work environments. Since disability certification is based on inability

to perform current job duties, a teacher with back problems may collect benefits while working another more lucrative job that accommodates the disability.

- ◆ In the past, disability retirees had to report income to TRS. However, TRS did not use the information, and the Legislature eliminated the requirement in 2001. TRS now has no way of knowing if disability retirees are earning high incomes working outside of the public education system.
- ◆ Providing an annuity to disability retirees who work and earn significant incomes outside of the public education system unnecessarily strains the Pension Trust Fund. By conservatively estimating that 5 percent of disability retirees may earn incomes in excess of their previous salary, the Fund annually loses \$6.45 million in disability payments due to this unfair use of the program.

### **Disability retirees earning high incomes inappropriately increase TRS-Care costs.**

- ◆ Disability retirees also have access to health insurance coverage through TRS-Care, which the General Revenue Fund supplements. In 2005, disability retirees generated around \$54 million in health-care claims. Savings to the Pension Trust Fund and to the TRS-Care Fund could be realized if TRS had the ability to reduce or eliminate benefits for disability retirees who earned significant incomes. Assuming 5 percent of disability retirees earn high incomes, TRS-Care pays about \$2.7 million in annual health-care claims for this group.
- ◆ Currently, General Revenue, school district, and active member contributions support TRS-Care. In 2005, the Legislature appropriated about \$5.1 million of General Revenue to TRS-Care for disability retirees. School districts and active members also supplemented TRS-Care for disability retirees with about \$3.6 million in contributions. If 5 percent of retirees earn significant incomes, then General Revenue of \$256,000, and \$181,000 of school district and active member contributions, are supporting their health-care benefits.

### **TRS' lack of limitations on earnings by disability retirees is inconsistent with other retirement systems.**

- ◆ Of the 10 largest public U.S. retirement systems, TRS has the most lenient rules regarding limits for disability retirees' incomes earned from outside employment. All of these systems, like TRS, provide disability benefits, while limiting system-related employment. While most systems allow disability retirees to work in a limited manner as a means of supplementing low disability annuities, these other systems, unlike TRS, also annually reduce or eliminate benefits for disability retirees whose incomes exceed certain limits. The table, *Disability Retiree Earnings Limitations for the 10 Largest Public Retirement Systems*, provides further details on the earnings limits that can result in a reduction of disability retirement benefits.

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*Providing benefits to disability retirees who earn significant incomes is an unfair use of the Pension Trust Fund.*

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*Of the largest public retirement programs, TRS has the most lenient rules on disability retirees' incomes from outside employment.*

***Disability Retiree Earnings Limitations for the  
10 Largest Public Retirement Systems***

| <b>Rank</b> | <b>Retirement System</b>                           | <b>Earnings Limits for Disability Retirees</b>                                                                                                                                                                                                                    |
|-------------|----------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1           | California Public Employees Retirement System      | Prohibits disability retirees' earnings from jobs similar to previous position.                                                                                                                                                                                   |
| 2           | <b>TEXAS TRS</b>                                   | <i>No limits on outside earnings.</i>                                                                                                                                                                                                                             |
| 3           | Florida Division of Retirement                     | Prohibits all earnings from outside employment.                                                                                                                                                                                                                   |
| 4           | New York State and Local Retirement Systems        | Limits outside earnings to the difference between the maximum salary of the next highest paid position from the one which the individual retired and the individual's maximum annual pension.                                                                     |
| 5           | New Jersey Division of Pension and Benefits        | Limits outside earnings to difference between final compensation and annual pension.                                                                                                                                                                              |
| 6           | California State Teacher Retirement System         | Single-month and six-month earning restrictions based on an index factor, developed from the average salary increase of all active members.                                                                                                                       |
| 7           | North Carolina Retirement System                   | Limits outside earnings to difference between final compensation and annual pension.                                                                                                                                                                              |
| 8           | Ohio Public Employees Retirement System            | Limits outside earnings to 60 percent of previous salary of position from which member retired under disability.                                                                                                                                                  |
| 9           | Michigan Public School Employees Retirement System | Limits outside earnings to difference between final compensation and annual pension.                                                                                                                                                                              |
| 10          | Virginia Retirement System                         | Disability retirees who obtain work through the state's vocational rehabilitation program, may earn salaries without penalty to annuity while others' annuities will be reduced. Reduction depends on severity of disability, amount of income, and hours worked. |

- ◆ Within Texas, the Employees Retirement System (ERS) limits post-retirement earnings of disability retirees to 80 percent of the member's pre-retirement salary from an ERS employer. In addition, ERS does not allow disability retirees to hold jobs similar to the positions from which they retired. These restrictions strengthen oversight of ERS' disability program, preventing misuse of disability benefits and awarding benefits to those retirees truly unable to earn significant wages until normal service retirement.
- ◆ Municipalities in Texas grant retirement benefits and enforce earnings limitations for disability retirees. For example, the City of Austin prohibits a disability retiree from working more than six consecutive months and from working more than 29 hours per week. The textbox, *Disability Retirees' Earnings Limitations for Select Texas Municipalities*, provides more examples how Texas municipalities limit outside earnings.

***Disability Retirees' Earnings Limitations  
for Select Texas Municipalities***

- ◆ The City of Dallas limits monthly earnings of disability retirees to \$250 per month.
- ◆ The City of Houston prohibits monthly earnings of disability retirees from exceeding previous job's monthly salary, plus 3 percent.
- ◆ The cities of Galveston and San Antonio do not allow any additional salary if retiree has a permanent disability.

## **Other state retirement systems provide greater oversight of disability retirement programs through reporting and reviewing functions.**

- ◆ In 2001, ERS conducted a review with the assistance of the Texas Workforce Commission (TWC) to verify which retired employees were working outside of state government and how much they earned. An agency can enter into an inter-agency contract with TWC and conduct such reviews for minimal cost. The ERS review alerted the agency to 262 cases in which disability retirees were gainfully employed, possibly earning in excess of what is allowed by rule. ERS investigated 65 of these cases, and reduced or canceled benefits in 28 cases.
- ◆ Other public retirement systems track outside earnings. The Florida Division of Retirement collects quarterly reports on disability retirees' earnings with assistance from the Florida Department of Law Enforcement. The reports, based on tax filing information, list disability retirees' employers and salaries. The Florida Division of Retirement may conduct investigations and request that disability retirees undergo another medical examination before adjusting or canceling benefits.

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*Other retirement systems require disability retirees to report earnings and reduce or cancel benefits when earnings exceed reasonable levels.*

## **Recommendations**

### **Change in Statute**

#### **3.1      Require TRS to adjust benefits for disability retirees who earn significant incomes.**

This recommendation would make clear that disability retirement is meant as hardship relief and not as a supplemental income program. Under this recommendation, TRS should adopt rules to reduce or limit benefits, and provide for benefits to be reinstated when appropriate. The limitations should not prohibit disability retirees from earning supplemental income up to an appropriate level set by TRS. However, TRS should limit disability retirees' earnings to the amount less than or equal to their previous position's salary. This approach would prevent misuse of Pension Trust Fund assets as a bonus for disability retirees that also work for significant pay. Creating these limitations in rule would also give TRS flexibility to adjust the levels as needed. To avoid loss of health insurance, the statute would allow disability retirees, with at least 10 years of service credit, who lose benefits under this recommendation, to continue enrollment in TRS-Care by paying the appropriate premium.

#### **3.2      Grant TRS authority to require income reports from disability retirees who earn incomes in excess of limits set by TRS.**

This recommendation would require disability retirees, who earn significant incomes as defined by TRS, to report earned income. By only requiring disability retirees with incomes over a certain level to report to TRS, this process would not burden the majority of disability retirees. Presuming 5 percent of disability retirees would submit reports, TRS would receive about 400 reports. The agency would adjust or cancel benefits after investigating cases in which earnings exceed limitations. Should TRS require disability retirees to undergo medical examinations as part of its investigations, the Medical Board would review these records. However, TRS should make the benefit adjustments based strictly on

disability retirees' earnings. The recommendation would grant TRS rulemaking authority to establish the income parameters under which disability retirees would be required to report income. TRS also would be granted authority to determine when and how much to adjust benefits.

## **Management Action**

### **3.3 Direct TRS to access Texas Workforce Commission records on disability retirees for the purpose of reviewing earnings.**

This recommendation would direct TRS to enter into an inter-agency contract with TWC to verify income reports of disability retirees. The information would reveal to TRS which disability retirees are working and earning high salaries within Texas. TRS would use this information, along with the self-reporting required above, to ensure that disability retirees receive the income benefits they deserve, and no more.

## **Fiscal Implication**

The fiscal impact of these recommendations cannot be accurately assessed without knowing how many disability retirees earn high incomes. Assuming the system would reduce or cancel benefits for up to 5 percent of disability retirees earning high incomes, TRS could reduce annuity payments from the Fund by \$6.45 million. These savings would remain within the Fund to help reduce its current unfunded liability of \$13.2 billion.

TRS may incur some costs as a result of increased monitoring and enforcement efforts. For example, tracking disability retirees' earnings would have a small fiscal impact to TRS' administrative costs, which are paid out of the Pension Trust Fund. The cost to TRS for TWC's wage-data matches on all 8,327 disability retirees would be approximately \$600. Establishing reporting requirements for disability retirees would also result in an administrative cost to TRS, including additional record keeping. To minimize costs associated with record keeping, TRS should allow electronic reporting, which would reduce paper as well as personnel costs. While the total cost cannot be estimated until TRS determines specific earning limitations and reporting requirements in rule, the benefit to the Pension Trust Fund would outweigh the small cost of the additional workload. However, the agency may need to request, through the appropriations process, up to two additional employees for monitoring and recordkeeping.

These recommendations also could have a positive fiscal impact to the State if the number of disability retirees were reduced. Savings to the General Revenue Fund would result from reduced TRS-Care caseloads. In 2005, approximately \$5,138,550 of General Revenue supplemented TRS-Care for disability retirees. In addition, about \$3,634,000 in contributions from school districts and active members supplemented TRS-Care for disability retirees. Assuming the system reduces or cancels benefits for 5 percent of disability retirees due to earning limitations, \$256,000 of General Revenue, and \$181,000 of school district and active member contributions would supplement a smaller pool of retirees. In addition, the recommendations would reduce TRS-Care health-care claims costs by up to \$2.7 million if 5 percent of disability retirees were subject to benefit reduction or cancellation.

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<sup>1</sup> TRS staff communications with Sunset staff in December 2005 and January 2006.

<sup>2</sup> Teacher Retirement System, *Comprehensive Annual Financial Report 2005*, p. 96.

## ***TRS Lacks Sufficient Authority in Its 403(b) Certification Program to Adequately Protect Public Education Employees.***

### **Summary**

#### **Key Recommendations**

- ◆ Require certified 403(b) companies to register individual products offered for sale to Texas educators.
- ◆ Require TRS to list all registered 403(b) products and their fees on the TRS website.
- ◆ Grant TRS a greater range of oversight tools including suspension and administrative penalty authority.

#### **Key Findings**

- ◆ TRS lacks authority necessary to protect investors from excessive fees and adequately address violations by 403(b) companies.
- ◆ Other agencies have developed 403(b) oversight systems that provide more information and protection to investors.
- ◆ TRS could better assist public education employees by providing basic, unbiased information on 403(b) investment options.
- ◆ Other state agencies have more authority to better protect consumers.

#### **Conclusion**

Most public education employees will rely on their TRS pension and personal savings to provide a secure retirement, as few are covered by Social Security. However, current statutes limit TRS' ability to effectively protect educators' retirement savings.

The Internal Revenue Code allows public education employees to supplement their retirement by making tax-deferred contributions to a 403(b) plan, similar to private-sector 401(k) plans. In response to abuses in the 403(b) market beginning in the 1990s, the Legislature created a 403(b) certification program at TRS, and gave TRS authority to set limits on fees that can be charged in such plans. The Sunset review of TRS' 403(b) certification program sought to assess the degree to which public education employees are protected from excessive fees and other fraudulent practices concerning these optional retirement investments.

Sunset staff found that TRS lacks sufficient authority to effectively administer the 403(b) certification program and protect public education employees from excessive fees in investments. Expanding TRS' oversight of specific investment products, and granting the agency administrative penalty authority, would better protect Texas educators. In addition, TRS could provide basic investment-related information so that public education employees can make well-informed choices about retirement savings.



## Support

**TRS certifies companies that offer optional retirement savings plans to public education employees.**

*TRS administers a 403(b) certification program to protect educators who invest in annuities and mutual funds through payroll deductions.*

- ◆ Under state and federal law, public education institutions are allowed to offer employees 403(b) plans to save for retirement on a pre-tax basis through salary reduction agreements. A 403(b) plan, named after the controlling section of the Internal Revenue Code, is a tax-deferred plan similar to the 401(k) plans found in the private sector. Through 403(b) plans, public education employees can invest in annuities and mutual funds.
- ◆ Before 1986, local school districts could screen and approve 403(b) companies to sell investment products to employees. Because of allegations of sweetheart deals between schools boards and 403(b) vendors, the Legislature removed the ability of school districts to bar 403(b) companies from selling products to employees. An unintended consequence of the removal of school district discretion was a proliferation of 403(b) vendors and the emergence of some unscrupulous companies and agents. A series of class action lawsuits by Texas educators against 403(b) investment companies beginning in the 1990s exposed fraudulent marketing practices and unfavorable fee structures. In response, the Legislature required TRS to administer a limited 403(b) certification process.
- ◆ Through certification, TRS checks compliance of 403(b) companies with the State Securities Board (SSB) and the Texas Department of Insurance (TDI), caps fees that companies may charge, and requires that investors in annuities are given a uniform disclosure listing a product's fees and penalties. TRS posts a list of all certified companies on its website, and school districts may process employee payroll reductions only for listed companies. TRS' fee for five-year certification is \$5,000. Currently 78 companies are certified to offer 403(b) investments.



*TRS relies on companies to self-report violations of fee limitations on 403(b) products.*

**TRS lacks authority necessary to protect investors from excessive fees and adequately address violations by 403(b) companies.**

- ◆ As structured, TRS' 403(b) certification program is unable to prevent sales of investment products with excessive fees, which can considerably reduce retirement savings. Because TRS only lists certified companies, not products, salespersons can fraudulently sell unqualified products offered by certified companies without the agency's knowledge. Although TRS regulations limit fees, TRS does not know what fees are associated with products sold by certified 403(b) companies. TRS relies on companies and sales representatives to restrict the sale of 403(b) products through salary reductions to only products meeting TRS' fee limits.
- ◆ TRS lacks a sufficient mechanism to detect violations that have occurred. Companies are supposed to report violations, but self-reporting overlooks the fact that companies are not always aware of the actions of their salespersons.

Some educators may be investing in products with excessive fees through companies that have not discovered or reported such errors to TRS. TRS also lacks the ability to require companies to disclose which products are sold to educators.

- ◆ Statute does not clearly give TRS authority to enforce rules related to 403(b) certification as all complaints must be referred to SSB or TDI. Because complaint investigations by SSB and TDI are limited to violations of these agencies' rules or statutes, no agency has clear statutory authority to investigate violations of TRS' 403(b) rules.
- ◆ TRS lacks flexibility to apply appropriate penalties, even for minor, self-reported violations. TRS' only enforcement authority is to revoke certification if it discovers non-compliance, as the agency lacks the ability to temporarily suspend a non-compliant company or to impose administrative fines. This lack of flexibility prevents the agency from allowing a company that self-reports a violation to remain certified after correcting the problem and reimbursing investors. Companies whose certifications have been revoked must re-apply for certification after correcting the problems and pay a new \$5,000 certification fee.

Since the program's inception, two companies have self-reported that representatives sold products with excessive fees through salary reductions, and TRS revoked both companies' certifications. The companies expressed interest in correcting the fees, making investors whole, and returning to the program. Only one company, however, was willing to pay a second \$5,000 certification fee. Employees that invested with the other company were forced to decide between losing the tax-deferred status of their future investments or choosing an alternate, certified company with which to invest.

### **Other agencies have developed 403(b) oversight systems that provide more information and protection to investors.**

- ◆ Like Texas, California used to prohibit school districts from limiting access to 403(b) companies. In 2004, California started a uniform registration process for 403(b) investment products with the California State Teachers' Retirement System (CalSTRS) and required full disclosure of all fees. CalSTRS maintains a website that allows users to compare fees and performance of 403(b) companies *and* products. CalSTRS removes vendors from the website if they lose their license in California, submit inaccurate information, or fail to pay registration fees.
- ◆ Employees of institutions of higher education in Texas also have the ability to save on a tax-deferred basis for retirement through 403(b) plans. Since gaining the ability to screen 403(b) vendors for optional retirement savings, four of the six largest universities and university systems, the University of Texas System, the Texas A&M University System, the University of North Texas System, and Texas State University, have taken steps to provide



additional information or protection to employee-investors. As shown in the table, *Structure of 403(b) Certification Programs at Texas Universities*, three of the four universities require 403(b) companies to register specific products, while the Texas A&M University System also provides potential investors with a list of specific fees by product.

**Structure of 403(b) Certification Programs at Texas Universities**

| University or System                                          | Registration of Companies or Products | Information Given to Employees                                              |
|---------------------------------------------------------------|---------------------------------------|-----------------------------------------------------------------------------|
| University of Texas System<br>(Program begins September 2006) | Products                              | ♦ List of authorized companies.                                             |
| Texas A&M University System                                   | Products                              | ♦ List of authorized companies and products.<br>♦ Specific fees by product. |
| University of North Texas System                              | Companies                             | ♦ List of authorized companies.                                             |
| Texas State University                                        | Products                              | ♦ List of authorized companies.                                             |

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*Access to unbiased, comparative information on 403(b) products would allow educators to make more informed investment decisions.*

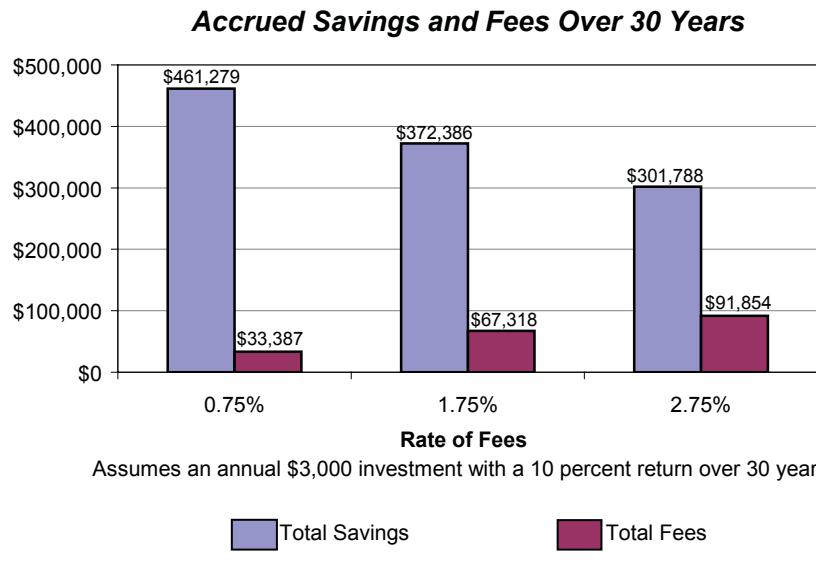
- ♦ The Employees Retirement System of Texas (ERS) makes comparative fund performance and fee information available on its website and through a toll-free phone number. Through ERS, state employees can invest in a 401(k) or 457 plan, which are similar to a 403(b) plan. Based on investment performance, fees, and other criteria, the ERS Board of Trustees has selected 10 mutual fund options and a self-directed brokerage account in which state employees can invest through salary reduction agreements.

**TRS could better assist public education employees by providing basic, unbiased information on 403(b) investment options.**

- ♦ If 403(b) companies were required to register qualified 403(b) products with TRS, the agency could make unbiased, comparative information on 403(b) investment options available to public education employees. By creating a 403(b) certification program that caps fees and requires uniform disclosure, the Legislature acknowledged that excessive fees have a detrimental effect on savings and that investors need clear information on the terms of an investment. With nearly 80 certified 403(b) companies offering various products, and no source for information on fees and services other than companies and agents, potential investors face a challenge finding the investment options that best meet their needs.

Accessing comparative information on fees is especially important to investors. Over the course of a career, even small differences in fees make a large difference in retirement savings. The chart, *Accrued Savings and Fees Over 30 Years*, shows how fees of 0.75 percent, 1.75 percent, and 2.75 percent of total assets would impact an annual investment of \$3,000 with

a rate of return of 10 percent over the course of 30 years. The investment with fees of 0.75 percent will produce more than \$461,000 in retirement savings, but if fees are increased to 2.75 percent, savings will be reduced by almost \$160,000.



Most agencies  
that protect  
the financial  
transactions of  
Texas consumers  
have more  
appropriate  
oversight tools.

### Other state agencies have more authority to better protect consumers.

- ◆ Agencies that protect the financial transactions of Texas consumers – the primary purpose of TRS' 403(b) certification program – have more tools to better enable them to accomplish their missions. The table, *Authority of Texas Financial Regulatory Agencies*, lists selected agencies that protect consumers' financial transactions in ways similar to TRS, and gives examples of their oversight tools.

**Authority of Texas Financial Regulatory Agencies**

| Agency                                     | Mission                                                                   | Entities Overseen                                                                                       | Tools                                                                                                   |
|--------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------|
| State Securities Board                     | Protect Texas investors                                                   | ♦ Securities dealers<br>♦ Investment advisors                                                           | ♦ Complaint investigation<br>♦ Suspension of registrations<br>♦ Administrative penalties                |
| Office of Consumer Credit Commissioner     | Regulate the credit industry and educate consumers and creditors          | ♦ Non-depository lenders<br>♦ Motor vehicle sales finance dealers<br>♦ Pawnshops and pawnshop employees | ♦ Complaint investigation<br>♦ License suspension<br>♦ Administrative penalties                         |
| Department of Savings and Mortgage Lending | Ensure sound state-chartered savings banks and a stable mortgage industry | ♦ State-chartered banks<br>♦ Mortgage brokers and loan offices<br>♦ Mortgage bankers                    | ♦ Complaint investigation<br>♦ Routine monitoring<br>♦ License suspension<br>♦ Administrative penalties |

## **Recommendations**

### **Change in Statute**

#### **4.1      Require certified 403(b) companies to register individual products offered for sale to Texas educators.**

This recommendation would retain the basic structure of the 403(b) certification program and add a requirement for companies to register all individual 403(b) products with TRS before being marketed to public education employees in Texas. Adding product registration to TRS' 403(b) certification would allow the agency to know exactly which products companies represent as meeting the fee limitations and the actual fees charged. Companies would register products by submitting an annuity policy form or a mutual fund prospectus to TRS in addition to a standardized form listing fees assessed in each of the categories capped by TRS: front-end or back-end load, annual administrative fee, surrender charge, loan application or origination fee, and other aggregate charges as a percentage of total assets. TRS should have authority to determine other relevant information that would be submitted for product registration as well as the form in which it would be submitted.

School districts currently ensure that a 403(b) company is on TRS' list of certified companies before processing a salary reduction agreement. Under this recommendation, school districts should ensure that a selected investment product is registered with TRS, before processing a salary reduction, by checking TRS' website.

Companies still would certify financial stability to TRS at five-year intervals. TRS should have the authority to re-structure its 403(b) fees to incorporate product registration with company certification.

#### **4.2      Require TRS to list all registered 403(b) products and their fees on the TRS website.**

This recommendation would require TRS to list all registered 403(b) products on its website as well as information on the fees in each category and other relevant information collected during registration. This change would greatly increase public education employees' access to comprehensive, unbiased information on 403(b) products.

#### **4.3      Grant TRS a greater range of oversight tools including suspension and administrative penalty authority.**

The recommendation would grant TRS a range of oversight tools to better protect public education employees in the 403(b) market. Specifically, TRS would have authority to conduct complaint-based or self-generated investigations of certified companies and registered products to determine compliance. TRS would also have the ability to require companies to specify which products have been sold to public education employees. Additionally, TRS would have authority to suspend certification and levy administrative penalties up to \$1,000 per violation. TRS should adopt a penalty matrix in rule that specifies the fine amounts for various offenses by severity. This recommendation will give TRS the ability to detect registered 403(b) products that violate TRS' fee limitations, and the flexibility to work with a 403(b) company that has reported a violation to come back into compliance.

## **Fiscal Implication**

These recommendations would not have a fiscal impact to the State. While additional oversight authority may require additional staff, the cost should be offset by restructured product registration or certification fees. In addition, as currently structured, TRS' 403(b) certification program generates more revenue than needed for operations. From fiscal year 2002, when implemented, through 2005, the program generated revenues of \$425,000 and had expenses of \$217,000. At the beginning of fiscal year 2006, TRS' 403(b) certification program had a fund balance of \$208,000. Granting TRS administrative penalty authority may produce revenue in the form of fines. However, these fines would vary from year to year and cannot be estimated.



## *State Law Requires TRS to Produce a Costly Study That Is No Longer Useful.*

### **Summary**

#### **Key Recommendation**

- ◆ Repeal the statutory requirement for TRS to conduct the Public School Employees' Health Coverage Comparability Study.

#### **Key Findings**

- ◆ State law requires TRS to conduct a study comparing health insurance coverage offered by public schools.
- ◆ The Health Coverage Comparability Study is no longer necessary.
- ◆ The Legislature has shown interest in removing agency reporting requirements that are no longer useful or necessary.

#### **Conclusion**

Since 1997, statute has required TRS to study the health insurance coverage offered by local school districts, charter schools, and education service centers and compare that coverage to the basic coverage provided to state employees. The Legislature established this study before the introduction of TRS-ActiveCare, which makes health coverage comparable to the basic state employees' plan accessible to all public education entities. Sunset staff examined this reporting requirement to see if the information obtained justified the expense of the study and the burden on school districts to comply with TRS' information requests.

Sunset staff found that the study no longer produces sufficient valuable information to justify biennial appropriations of \$250,000 in General Revenue Funds. Repealing the study requirement would produce savings for the State, and reduce school district reporting requirements.

## Support

**State law requires TRS to conduct a study comparing health insurance coverage offered by public schools.**

- ◆ Since 1991, the Legislature has required school districts in Texas to offer employees a health insurance plan that is comparable to the basic coverage plan (HealthSelect) provided to state employees under the Texas Employees Group Benefits Act. HealthSelect provides comprehensive insurance coverage including: no deductible for in-network care, 80 percent coverage for in-network hospital care, a \$20 co-payment for visits to primary care physicians, a \$30 co-payment for visits to specialists, and prescription drug coverage with tiered co-payments of \$10 to \$55 per prescription.
- ◆ In 1997, the Legislature required TRS to conduct the Public School Employees' Health Coverage Comparability Study (Comparability Study) to assess whether school districts were complying with the state's health insurance comparability requirement. The Comparability Study compares the coverage in health insurance plans offered by local school districts, open-enrollment charter schools, and education service centers to HealthSelect. TRS has released a Comparability Study every other year since 1998. In 2005, the Legislature appropriated \$250,000 in General Revenue Funds to conduct the 2006 Comparability Study.
- ◆ Districts that fail to offer comparable insurance coverage, as evidenced by the Comparability Study, are not required by the Legislature to be brought into compliance. The Comparability Study provides information on local health insurance coverage to school districts, the Legislature, and the Legislative Budget Board, but the report is for information only.

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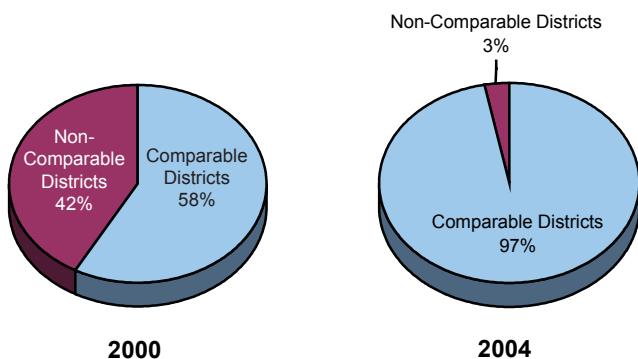
*Because all public education employers have access to TRS-ActiveCare, the Comparability Study is not as useful as when first required.*

**The Health Coverage Comparability Study is no longer necessary.**

- ◆ In 2001, the Legislature created TRS-ActiveCare (ActiveCare) to increase access to coverage for small and rural school districts. Because all public education entities have access to ActiveCare, a health insurance plan that offers coverage comparable to HealthSelect, TRS' Comparability Study is less useful today than when first required. By the 2003-2004 school year, all school districts, open enrollment charter schools, and education service centers had access to ActiveCare. As of 2005, 1,042 public education entities participated in ActiveCare, and 202 did not.
- ◆ Because most school employers participate in ActiveCare, the 2006 Comparability Study will evaluate plans from only 16 percent of public education entities. The first set of studies conducted by TRS compared plans from all school districts, open enrollment charter schools, and education service centers, but TRS no longer does evaluations for entities that participate in ActiveCare.

- ♦ The Comparability Study also is no longer needed because most public education entities comply with the requirement to offer health-care coverage comparable to HealthSelect. In 2004, TRS certified 97 percent of public education entities as comparable. Of note, the 3 percent of entities not comparable employ around 7 percent of all public education employees. The pie charts, *Reporting Districts Certified as Comparable*, show the dramatic increase in the percentage of districts with comparable coverage following the introduction of ActiveCare in September 2002.

***Reporting Districts Certified as Comparable***



**The Legislature has shown interest in removing agency reporting requirements that are no longer useful or necessary.**

- ♦ To identify statutorily required reports that are no longer useful or necessary, the Legislature in 2005 instructed the Library and Archives Commission to compile a list of all required reports with an assessment of the continued usefulness prepared by the individual agency. These assessments will help identify unnecessary reports that can be eliminated to save staff time and cut costs of printing, distributing, and storing reports.

## Recommendation

### Change in Statute

#### **5.1 Repeal the statutory requirement for TRS to conduct the Public School Employees' Health Coverage Comparability Study.**

This recommendation would eliminate the statutory provision that requires TRS to analyze health coverage data submitted by public education entities, certify coverage that is comparable, and produce the Comparability Study every other year. Eliminating this requirement will save staff time at TRS in producing the reports and in school districts responding to TRS' information requests. Because the information is no longer useful, eliminating the report will not result in a significant loss of needed data.

## **Fiscal Implication**

This recommendation would result in a positive fiscal impact of \$250,000 per biennium to the State. In 2005, the Legislature appropriated \$250,000 of General Revenue to TRS to complete the 2006 Comparability Study, and these funds would no longer be needed.

| <b><i>Fiscal Year</i></b> | <b><i>Savings to the General Revenue Fund</i></b> |
|---------------------------|---------------------------------------------------|
| 2008                      | \$125,000                                         |
| 2009                      | \$125,000                                         |
| 2010                      | \$125,000                                         |
| 2011                      | \$125,000                                         |
| 2012                      | \$125,000                                         |

## **ACROSS-THE-BOARD RECOMMENDATIONS**



### Teacher Retirement System of Texas

| Recommendations    | Across-the-Board Provisions                                                               |
|--------------------|-------------------------------------------------------------------------------------------|
| Already in Statute | 1. Require public membership on the agency's policymaking body.                           |
| Update             | 2. Require provisions relating to conflicts of interest.                                  |
| Already in Statute | 3. Require unbiased appointments to the agency's policymaking body.                       |
| Already in Statute | 4. Provide that the Governor designate the presiding officer of the policymaking body.    |
| Update             | 5. Specify grounds for removal of a member of the policymaking body.                      |
| Modify             | 6. Require training for members of the policymaking body.                                 |
| Already in Statute | 7. Require separation of policymaking and agency staff functions.                         |
| Already in Statute | 8. Provide for public testimony at meetings of the policymaking body.                     |
| Modify             | 9. Require information to be maintained on complaints.                                    |
| Apply              | 10. Require the agency to use technology to increase public access.                       |
| Modify             | 11. Develop and use appropriate alternative rulemaking and dispute resolution procedures. |



## **Agency Information**



# Agency Information

## Agency at a Glance

The Teacher Retirement System of Texas delivers retirement benefits to employees of public schools and state-supported colleges and universities, and manages assets held in trust to provide future benefits for members and their beneficiaries. Following voter passage of a constitutional amendment, the Legislature created the agency in 1937. To accomplish its mission, the Board of Trustees:

- ◆ administers and operates a system to provide retirement, disability, death, and survivor benefits for more than 1 million Texas public and higher education employees, retirees, and beneficiaries;
- ◆ invests and manages the \$93.7 billion Pension Trust Fund;
- ◆ offers health and long-term care insurance to eligible public education employees, retirees, and their dependents; and
- ◆ provides counseling services and information about retirement and health-care benefits and other agency activities.

### Key Facts

- ◆ **State Funding.** TRS' fiscal year 2006 appropriation totals \$1.65 billion, including \$1.6 billion from the General Revenue Fund, and \$44.7 million from the TRS Trust Account for administrative expenses.
- ◆ **Staffing.** TRS has 466 employees in fiscal year 2006, all based in Austin. The majority of TRS staff, 427 employees, assist the agency in investing the Pension Trust Fund (Fund) and delivering retirement benefits, while 39 employees assist with the administration of health-care benefits and other TRS functions.
- ◆ **TRS Membership.** Employees and retirees of 1,363 independent school districts, charter schools, education service centers, and colleges and universities comprise the membership of TRS. At the end of fiscal year 2005, TRS membership totaled 1.1 million persons, which included 867,000 current members and 249,000 annuitants.
- ◆ **Pension Trust Fund.** TRS' Pension Trust Fund is currently the eighth largest pension fund in the nation, valued at \$93.7 billion.<sup>1</sup> The Fund holds contributions from TRS members, the State, educational employers, and accumulated investment returns. In fiscal year 2005, members contributed \$1.6 billion into the Pension Trust Fund, the State contributed \$1.3 billion, and educational employers contributed \$221 million.



*The Teacher Retirement System delivers health insurance and retirement benefits to more than 1 million educational employees and invests the \$93.7 billion Pension Trust Fund.*

  
*In 2005 TRS paid  
249,000 retirees  
and beneficiaries  
\$5.4 billion  
in benefits, an  
average monthly  
pension of \$1,788.*

- ◆ **Retirement Program.** TRS administers a defined benefit plan to provide a lifetime stream of income to eligible members during retirement years. In fiscal year 2005, TRS paid 249,000 retirees and their beneficiaries \$5.4 billion, with an average monthly retirement benefit of \$1,788.
- ◆ **Investments.** TRS manages and invests monies in the Pension Trust Fund and other funds it administers. In fiscal year 2005, TRS earned a 14.4 percent return on its investment portfolio, a gain of \$12 billion. TRS' investment-related administrative costs to achieve that gain totaled \$17.4 million. During the past 10 years, TRS' investment performance has averaged 9.28 percent.
- ◆ **TRS-Care.** TRS offers a health insurance plan to retired public school employees and their dependents. In fiscal year 2005, of the 225,000 eligible TRS retirees, 187,000 participated in TRS-Care. TRS contracts with Aetna to administer the health plan and Caremark for pharmacy benefits.
- ◆ **TRS-ActiveCare.** TRS offers a health insurance plan to active public education employees whose employers have chosen to participate. Of the 1,244 school districts eligible to participate, about 1,042 or 84 percent have enrolled. Currently, about 276,000 TRS members and dependents receive health insurance from TRS-ActiveCare. TRS contracts with BlueCross BlueShield of Texas to administer the health plan and Medco Health Solutions to administer pharmacy benefits.
- ◆ **Member Services.** TRS provides information to members, retirees, and the general public through publications, the agency's toll-free telephone number and website, one-on-one counseling, and group presentations. In fiscal year 2005, TRS counseled 9,000 members on a one-on-one basis about their retirement benefits, made more than 150 group presentations, received 655,000 telephone calls and 1.5 million website visits. The table, *Quick Facts About TRS Members*, provides information on the average age, salary, and benefits of TRS active and retired members.

#### ***Quick Facts About TRS Members***

|                                         |          |
|-----------------------------------------|----------|
| Average Age of Active Members           | 43.6     |
| Average Annual Salary of Active Members | \$36,278 |
| Average Age of Retirees                 | 69.3     |
| Average Age at Time of Retirement       | 59.7     |
| Average Years of Service at Retirement  | 24.8     |
| Average Annual Salary at Retirement     | \$33,405 |
| Average Monthly Benefit of Retirees     | \$1,788  |
| Ratio of Active Members to Retirees     | 3.5 to 1 |

## **Major Events in Agency History**

- 1936 Voters approved a constitutional amendment creating the Teacher Retirement System to provide a retirement program for public school teachers and administrators and higher education employees.
- 1937 The Legislature established TRS and extended membership to public school professional and business administrators, supervisors, and instructors. Annual membership fees funded the retirement system operations, while member and State contributions of 5 percent of payroll supported the Pension Trust Fund.
- 1949 TRS membership extended to all public school employees, including non-teaching and administrative positions, such as cafeteria workers and bus drivers.
- 1955 The Legislature expanded member benefits to include disability, death, and survivor benefit coverage.
- 1967 The Legislature established the Optional Retirement Program (ORP), a transferable retirement plan for certain higher education faculty, administered by the Higher Education Coordinating Board.
- 1985 The Legislature established TRS-Care, providing health insurance for TRS retirees.
- 1993 The Legislature approved members of both TRS and the Employees Retirement System (ERS) to transfer retirement credit between programs.
- 1995 The Legislature approved a \$1.6 billion benefit enhancement, including an increase in the minimum retirement benefit to compensate the longest retired members whose annuities were based on comparatively low salaries. The Legislature also clarified that TRS may not lobby for legislative action, restructured the Board of Trustees, and subjected TRS' operating budget to the legislative appropriations process.
- 1999 Legislation authorized TRS to offer an optional long-term care insurance program for active members and retirees.
- 2001 The Legislature established TRS-ActiveCare to provide health insurance for eligible, active TRS members.
- 2005 The Legislature restructured provisions of TRS' retirement program to improve its long-term stability. Changes included requiring members who purchase out-of-state service to pay the full cost of the projected benefit, increasing the number of years used to calculate average annual compensation, and requiring employers that rehire TRS retirees to contribute to the pension plan and to TRS-Care.

# Organization

## Policy Body

  
*When making investments, the Board must exercise the judgment and care that persons of ordinary prudence use in their own affairs.*

A nine-member Board of Trustees oversees the Teacher Retirement System. The Governor appoints Trustees to serve six-year terms and selects the presiding officer. The Governor directly appoints three Trustees who have demonstrated financial expertise and are not members of the system. The Governor makes two appointments from a list of persons with demonstrated financial expertise submitted by the State Board of Education (SBOE), two appointments from a list of school district employees nominated by those employees, one appointment from a list of higher education employees nominated by those employees, and one appointment from a list of retired TRS members nominated by retirees. The table, *Teacher Retirement System Board of Trustees*, provides information about each member.

The Board of Trustees is responsible for administration of assets including development of investment policies and strategies; adoption of rates, mortality, and service tables; rulemaking for membership eligibility; and general administration and operation of the agency. The Constitution requires the Board, when making investments, to exercise the judgment and care that persons of ordinary prudence exercise in their own affairs.

The Board meets about eight times per year and has seven committees to divide its workload – Alternative Assets, Audit, Benefits, Budget, Compensation, Ethics, and Policy. The Board's Audit Committee oversees an Internal Auditor, with a staff of eight employees, to help ensure the accountability of agency operations.

The Board contracts with a number of outside parties for assistance in overseeing TRS. The Board contracts with an actuary to review the long-term health of the Pension Trust Fund; investment advisors and consultants to provide expertise on specific types of investments; and a health-insurance consultant to advise on TRS-Care, TRS-ActiveCare, and long-term care.

### **Teacher Retirement System Board of Trustees**

| <b>Member</b>                  | <b>City</b>    | <b>Nominated By</b>              | <b>Term Expires</b> |
|--------------------------------|----------------|----------------------------------|---------------------|
| Jarvis V. Hollingsworth, Chair | Missouri City  | Direct Appointment by Governor   | 2007                |
| Linus D. Wright, Vice Chair    | Dallas         | TRS Retirees                     | 2011                |
| Terence (Terry) Ellis          | New Ulm        | Direct Appointment by Governor   | 2005                |
| John Graham, Jr.               | Fredericksburg | State Board of Education         | 2009                |
| John "Mark" Henry, Ed.D.       | Galena Park    | Public School District Employees | 2009                |
| James H. Lee                   | Houston        | State Board of Education         | 2007                |
| Philip Mullins                 | Austin         | Higher Education Employees       | 2011                |
| Greg Poole, Ed.D.              | Conroe         | Public School District Employees | 2007                |
| Dory A. Wiley                  | Dallas         | Direct Appointment by Governor   | 2009                |

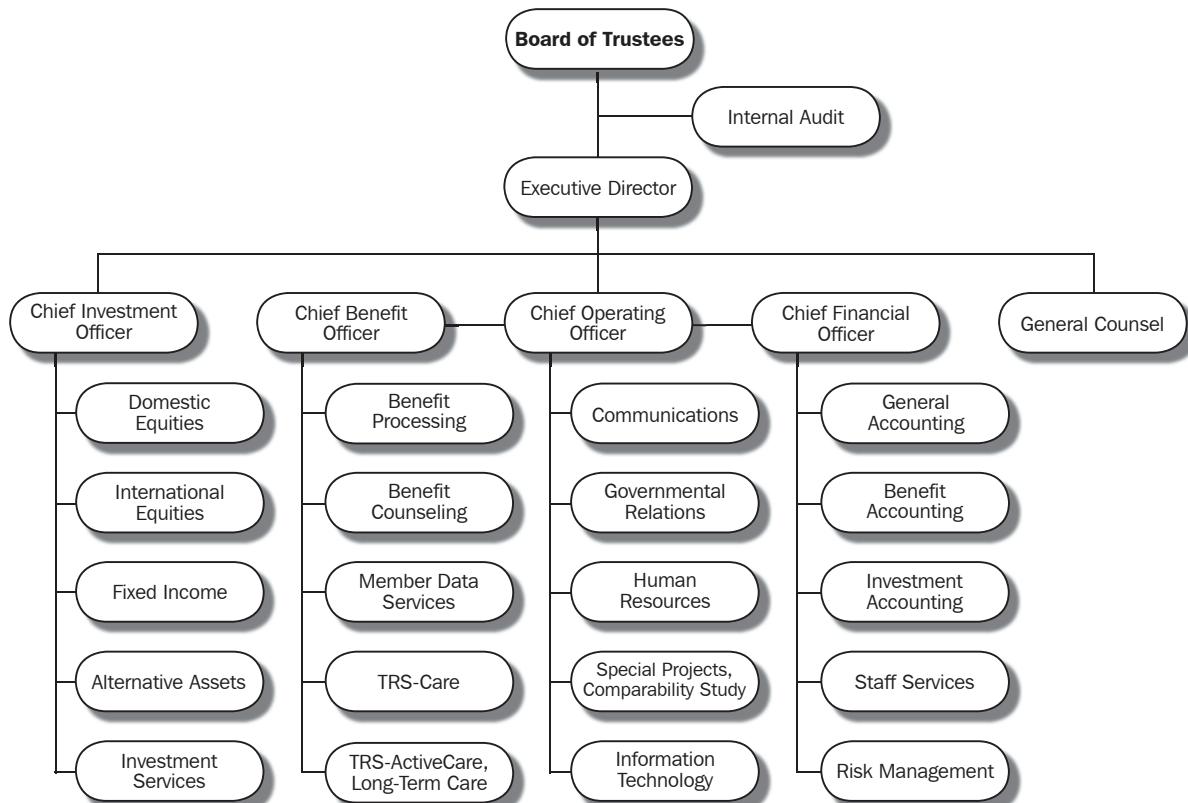
The Board also contracts with an outside fiduciary counsel who, along with attorneys from TRS' legal division, advises the Board on ethical issues and their fiduciary responsibilities to the membership. The Board also appoints two advisory committees to gain expertise in specific areas – the Medical Board and the Retirees Advisory Committee. The three-member Medical Board reviews applications for disability retirements and makes recommendations to the Board, while the nine-member Retirees Advisory Committee makes recommendations to the Board relating to the TRS-Care health insurance program.

## **Staff**

The Board appoints an Executive Director to administer the daily operations of the agency and coordinate the activities of agency staff. The *Teacher Retirement System Organizational Chart* depicts the agency's structure. TRS' 466 full-time equivalent (FTE) employees are located at the headquarters in Austin. The General Appropriations Act set a cap of 427 FTEs for the 2006-2007 biennium. However, the cap does not apply to TRS' insurance programs, TRS-Care and TRS-ActiveCare.

Appendix A compares the agency's workforce to the civilian labor force for the past three years. While TRS has exceeded some of the civilian labor force percentages, it has fallen below others.

***Teacher Retirement System  
Organizational Chart***



## Funding



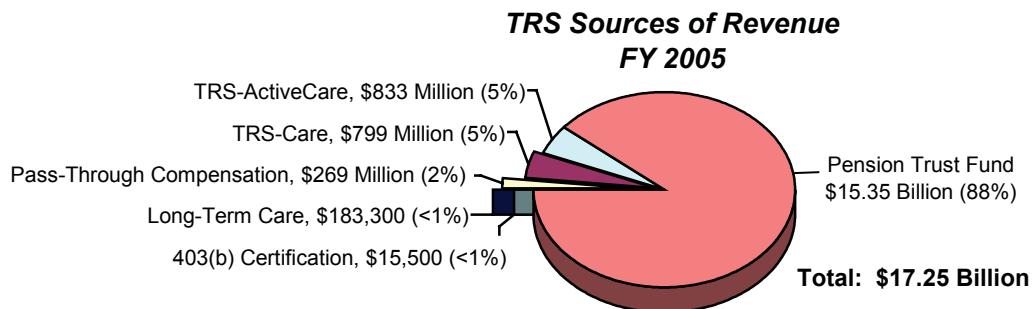
TRS' revenues totaled \$17 billion in fiscal year 2005.

TRS' funding pattern differs significantly from most other state agencies, as TRS receives the majority of its funding from sources other than the State. In addition, TRS maintains separate funds for each program it administers.

The material below first describes TRS' overall revenues and expenditures, and then describes revenues and expenditures for each of TRS' major funds: the Pension Trust Fund; Health Benefits Trust Fund (TRS-Care Fund); and TRS-ActiveCare Enterprise Fund (TRS-ActiveCare Fund).

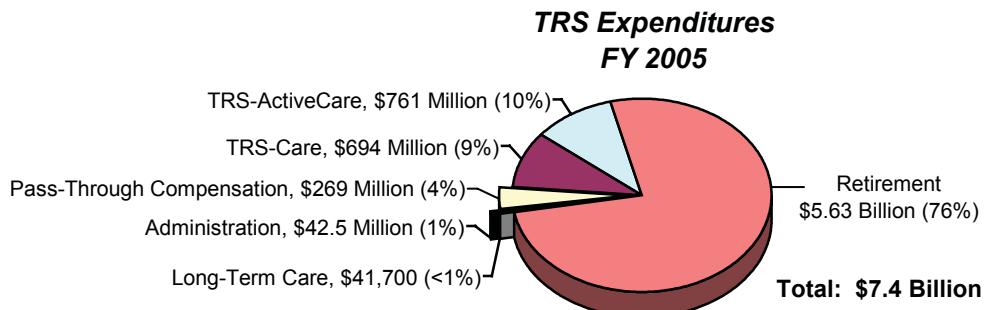
### Overall Revenues

TRS' Board of Trustees manages and invests the Pension Trust Fund, the TRS-Care Fund, and the TRS-ActiveCare Fund. In addition, TRS maintains separate funds for the Long-Term Care insurance program, the Local Health Coverage Comparability Study, and the 403(b) Certification Program. The pie chart, *TRS Sources of Revenue*, shows how all the programs contribute to TRS' total funding stream of \$17.3 billion. In addition, TRS was responsible for transferring funds from the General Revenue Fund to educators to supplement the cost of health care, shown in the chart as pass-through compensation. Beginning in fiscal year 2006, the Legislature transferred responsibility for these pass-through funds to the Texas Education Agency. As a result, those funds will no longer appear on TRS' financial statements.



### Overall Expenditures

TRS' Trustees separately manage the costs of the retirement, health care, and other programs the agency administers. In fiscal year 2005, the total costs of all of these programs amounted to \$7.4 billion. The pie chart, *TRS Expenditures*, shows how these costs were divided among all of the programs.



Appendix B describes the agency's use of Historically Underutilized Businesses (HUBs) in purchasing goods and services for fiscal years 2002 to 2005. TRS has consistently surpassed the goal for commodities and recently exceeded the goal for special trade, but generally falls behind the statewide goals in the professional services and other services categories.

The following material explains the funding and expenditures for each of TRS' major programs.

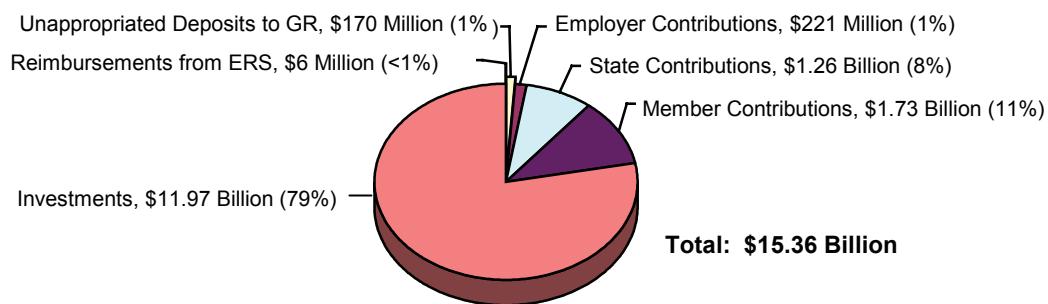
### Pension Trust Fund

The Pension Trust Fund receives revenue from four main sources: contributions paid by members, State contributions, employer contributions, and investment earnings. The contributions made by the members, State, and employers are each based upon a percentage of salaries. In addition, TRS and the Employees Retirement System reimburse one another each year for the retirement costs of members who have service in both systems. The pie chart, *Pension Trust Fund – Sources of Revenue*, shows the amount of each of these contributions to the Fund in fiscal year 2005.



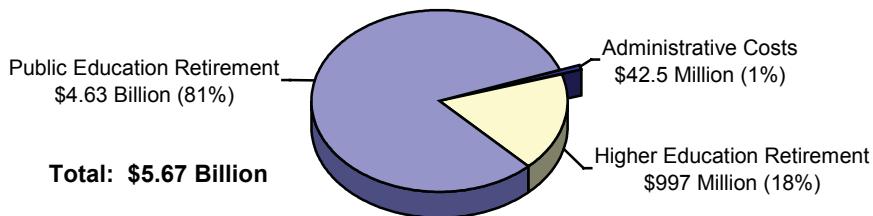
*Investments of  
the Pension Trust  
Fund earned \$11.9  
billion in 2005.*

**Pension Trust Fund – Sources of Revenue  
FY 2005**



From the Pension Trust Fund, TRS pays retirement benefits to retirees or their designated beneficiaries, and also pays the agency's costs of administering the retirement program. In addition, when members terminate their employment with public education entities and request a withdrawal of their retirement contribution, TRS refunds the members' contributions plus 5 percent accrued interest. TRS also pays death and disability retirement benefits from the Fund. The pie chart, *Pension Trust Fund Expenditures*, shows the total costs paid out of the Fund.

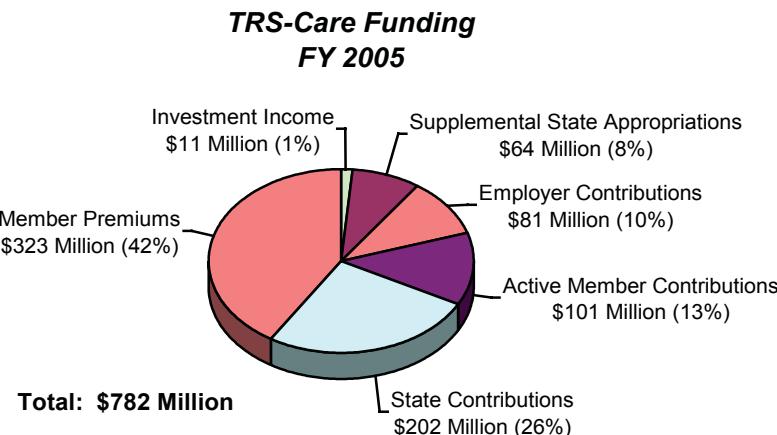
**Pension Trust Fund Expenditures  
FY 2005**



## **TRS-Care**

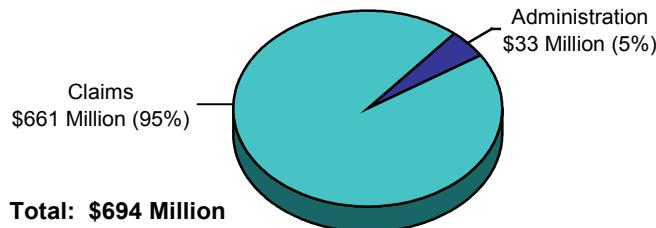
Funding for TRS-Care comes from legislative appropriations, contributions from active members and employers, and retiree premiums. The Legislature appropriated an amount equal to 1 percent of the total public education payroll, or \$202 million in General Revenue funds in fiscal year 2005. The Legislature also contributed an additional \$64 million in fiscal year 2005 in supplemental appropriations to TRS-Care, not tied to the public education payroll. In fiscal year 2005, active members contributed 0.5 percent of salary to TRS-Care, a total of \$101 million, and employers contributed 0.4 percent of payroll, or about \$81 million.<sup>2</sup> Retirees contribute to the program through premiums for the two more comprehensive TRS-Care plans. Total health-care premiums in fiscal year 2005 were \$323 million.

An additional source of funds is investment income made from investing the balance of the TRS-Care Fund. TRS-Care earned \$11 million in fiscal year 2005 in investment returns. The pie chart, *TRS-Care Funding*, shows the contribution of each funding source, totaling \$782 million.



TRS uses the TRS-Care Fund to hold and invest excess funds as a means of defraying the costs of years with high claims. In fiscal year 2005, the TRS-Care Fund had a beginning balance of \$238 million and an ending balance of \$327 million. Beginning in 2007, a new source of funding will become available to TRS-Care as the new Medicare Part D prescription benefit will replace about \$89 million in State funds.

## ***TRS-Care Expenditures FY 2005***



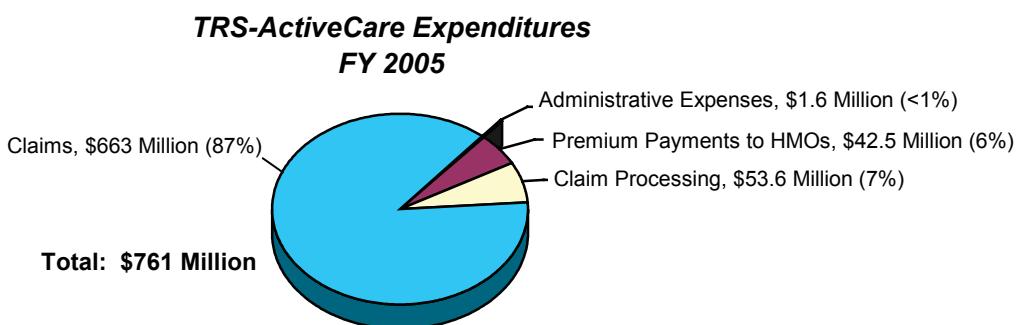
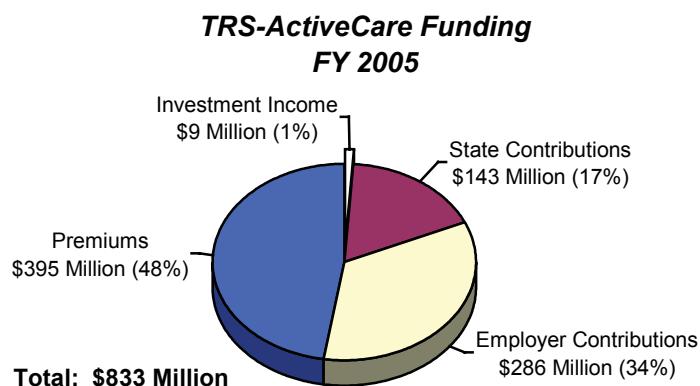
In fiscal year 2005, TRS-Care paid \$661 million in claims costs, and its administrative costs amounted to \$33 million. The pie chart, *TRS-Care Expenditures*, shows the percentage of each expenditure category. Members also paid \$222 million in out-of-pocket deductibles, coinsurance, and copayments.

## **TRS-ActiveCare**

As shown in the pie chart, *TRS-ActiveCare Funding*, funding sources of TRS-ActiveCare totaled \$833 million in fiscal year 2005. Employee premiums made up nearly half of the program's total funding, with contributions from employers and the State constituting the remainder. Educational employers contribute at least \$150 each month per participant, while the State contributes \$75 per month, per participant, through school finance formulas. Members then pay the remaining balance of premiums. Investment income also added \$8.9 million to the fund in fiscal year 2005.

Although not reflected in the pie chart, the State directly contributes to TRS members, through the Pass-Through Supplemental Compensation Program, an additional \$41.66 per month to non-professional, full-time employees, or \$20.83 to part-time employees. The member may use the funds to help offset premium costs. School districts and other employers collect and remit premiums to TRS monthly.

In fiscal year 2005, TRS-ActiveCare paid \$663 million in claims costs. Additional expenditures were made for the costs of processing claims, premium payments to health maintenance organizations, and for administrative expenses. The total of all expenditures in fiscal year 2005 was \$761 million. The pie chart, *TRS-ActiveCare Expenditures*, shows the relative cost of each part of the program. ActiveCare participants in preferred provider organization plans also paid an additional \$189 million in out-of-pocket deductibles, coinsurance, and co-payments. These payments were made directly to providers and are not shown on the chart.



## **Agency Operations**

To meet its mission, TRS delivers pensions to eligible retirees; administers and invests assets held in trust for TRS members; oversees retiree and public school health insurance programs; and operates related support programs assigned by the Legislature. The following material describes TRS' operations in providing these services.

## Retirement Program

The Teacher Retirement System administers a defined benefit plan that provides service and disability retirement, as well as death and survivor benefits, to eligible Texas public education employees and their beneficiaries. The major activities of TRS' retirement program include enrolling eligible members in the retirement system and tracking participation; paying benefits upon service retirement, disability, or death of the member; refunding member contributions when members exit the system; and providing members, beneficiaries and the public with information about TRS benefits and other related services.

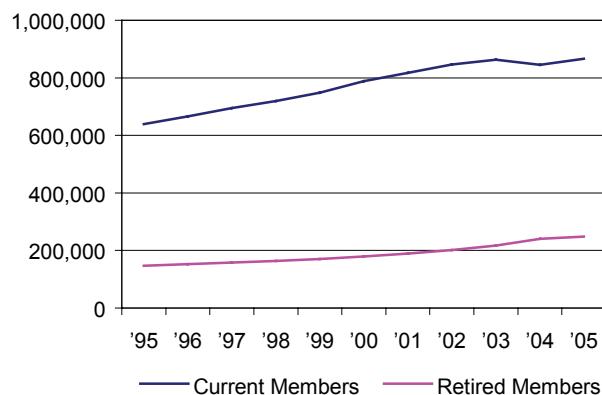
### Membership Eligibility

Active employees and retirees of the Texas education system comprise the membership of TRS. TRS serves both public and higher education entities by providing benefits to their employees. At the end of fiscal year 2005, 1,363 educational institutions participated in TRS, as shown in the table, *Employers Participating in TRS*.

**Employers Participating in TRS  
FY 2005**

| Type                               | Number       |
|------------------------------------|--------------|
| Independent School Districts       | 1,038        |
| Charter Schools                    | 191          |
| Community and Junior Colleges      | 51           |
| Senior Colleges and Universities   | 43           |
| Regional Education Service Centers | 20           |
| Education Districts                | 9            |
| Medical and Dental Schools         | 8            |
| State Agencies                     | 3            |
| <b>TOTAL</b>                       | <b>1,363</b> |

**TRS Membership  
FYs 1995 – 2005**



TRS automatically enrolls employees of these entities into the system as long as they work at least 20 hours per week for 4-½ months during a school year. For example, these employees included public school teachers, school and district administrators, food service personnel, maintenance staff, as well as charter school employees. Many higher education employees may participate in an alternate retirement plan, called the Optional Retirement Program, making them exempt from TRS membership.

In terms of membership, TRS is the largest state public pension fund in Texas, and the second largest in the United States.<sup>3</sup> In fiscal year 2005, TRS membership totaled more than one million persons, including more than 867,000 current members, and 249,000 retirees. Retirees receiving annuities from TRS account for about 22 percent of total TRS membership. As shown in the chart, *TRS Membership*, membership has grown since 1995, both in terms of current members and retirees. During the last 10 years, active membership has increased an average of 1.3 percent, while the number of retirees has grown an average of 5.4 percent per year.

### **Retirement Eligibility and Benefits**

To initiate retirement benefits, members must apply with TRS for retirement, meet age and service requirements, and terminate employment. Currently, a member meets age and service requirements for retirement when the member is age 65 with five or more years of service credit; or when the member's age and years of service credit total 80, and the member has at least five years of service credit.<sup>4</sup> Members are fully vested in the system after accruing five years of service credit.<sup>5</sup>

In calculating service credit, TRS grants one year of credit to each member who works at least half of the standard workload for 4½ months in an eligible position during the school year. In addition to earning credit, eligible TRS members may also purchase credit towards retirement under certain circumstances. For example, eligible members may purchase TRS membership credit for time served in the United States armed forces and for employment in an out-of-state public school system or college. The cost of purchasing service credit varies by the type of service purchased and by the timing of the purchase. TRS currently has nine types of special service credit, as listed in the textbox, *Types of Service Credit Purchases*.

Unlike other types of pension plans, the defined benefit plan administered by TRS guarantees pensions to qualifying members regardless of the actual contribution amount made by the member. Generally, retirement benefits extend for the life of the member and cease upon the member's death. However, a member may choose alternate benefit plans that reduce the standard annuity in return for benefits payable to a beneficiary after the member's death. The table, *TRS Retirement Benefit Options*, gives greater detail about annuity payment options.

#### **Types of Service Credit Purchases**

Under certain circumstances, members may purchase credit towards retirement for the following types of service or leave:

- ◆ developmental leave;
- ◆ military service/Uniformed Services Employment and Reemployment Rights Act;
- ◆ out-of-state service;
- ◆ previously withdrawn service credit;
- ◆ sick or personal leave;
- ◆ substitute service;
- ◆ unreported service;
- ◆ work experience by a career or technology teacher; and
- ◆ service earned during the 90-day membership waiting period.

### **TRS Retirement Benefit Options**

|                 |                                                                                                                                                                                             |
|-----------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Standard</b> | Provides a monthly benefit payable at retirement throughout the retiree's lifetime.                                                                                                         |
| <b>Option 1</b> | Provides a lifetime, reduced annuity to the retiree and, in the event of the retiree's death, provides all of the lifetime, reduced annuity to a beneficiary.                               |
| <b>Option 2</b> | Provides a lifetime, reduced annuity to the retiree. In the event of the retiree's death, provides a beneficiary with one-half of the reduced annuity for life.                             |
| <b>Option 3</b> | Provides a lifetime, reduced annuity payable to the retiree. If the retiree dies within five years, the beneficiary receives the payments remaining within the guaranteed five-year period. |
| <b>Option 4</b> | Provides a lifetime, reduced annuity payable to the retiree. If the retiree dies within 10 years, the beneficiary receives the payments remaining within the guaranteed 10-year period.     |
| <b>Option 5</b> | Provides a lifetime, reduced annuity to the retiree. In the event of the retiree's death, provides a beneficiary with three-fourths of the reduced annuity for life.                        |



*In 2005, 14,500  
educators retired.*

TRS calculates standard retirement benefits by using a formula determined by a member's years of service credit, final average salary, and a multiplier established by the Legislature. Currently, under the standard annuity formula, TRS multiplies 2.3 percent by the average of the member's three highest salary years, and then multiplies the result against the number of years of service credit.<sup>6</sup> For example, a teacher with 30 years of service and an average, three-year high salary of \$50,000 would receive 69 percent of that salary (2.3 percent times 30) for a total annual, standard annuity of \$34,500. On average, educators retire at age 60 with 25 years of employment, and an average salary of \$33,400.

In fiscal year 2005, 14,500 members retired under service or disability retirement, bringing the total number of retirees to about 249,000. That year, retirement benefits paid by TRS totaled \$5.39 billion. As of August 2005, TRS' monthly annuity payroll had grown to \$414 million.

In addition to service retirements, TRS also offers disability retirement to members who are mentally or physically unable to perform their current job duties, and whose disability is probably permanent. Qualified members with at least 10 years of service are eligible to receive an unreduced monthly annuity based on the standard formula for retirement. Members with fewer than 10 years of service are eligible for a \$150 monthly benefit for a period equal to the shortest of the number of months of creditable service, duration of the disability, or life.

TRS also pays death and survivor benefits to beneficiaries of active and retired members. Beneficiaries may select from a variety of benefit options, including lump sums and reduced, monthly payments. In fiscal year 2005, 6,760 TRS active members and retirees died. In addition, TRS pays a lump-sum death benefit of \$160,000 to the beneficiary of an active member who dies as a result of a physical assault during the performance of regular job duties. To date, one member has died as a result of a physical assault that occurred at work.

### ***Member Refunds***

Upon ending employment in a Texas public education institution, members may request a refund of their retirement contributions plus 5 percent interest, accrued annually. In fiscal year 2005, TRS returned \$243 million to 40,000 members who withdrew their contributions. TRS was able to quickly process these requests for refunds, with an average turnaround of 19 days and completing 95 percent of the requests within 60 days.

### ***Benefit Counseling***

Because of the large number of retirement options and the relative complexity of the system, counseling members about their retirement choices is an important function of TRS. The agency has dedicated a staff of 57 full-time employees to this counseling function.

TRS advises members of their retirement options through telephone and website inquiries, group counseling sessions, and one-on-one meetings with benefit counselors. In fiscal year 2005, TRS received more than 655,000 telephone calls and 1.5 million website visits. TRS counselors also travel

throughout the state making group presentations about benefits. In fiscal year 2005, TRS held more than 150 of these half-day sessions which include information about the agency, retirement eligibility, benefit calculations, retirement plan options, choosing retirement dates, and federal income taxes and social security as these programs relate to TRS benefits.

TRS places an emphasis on counseling sessions with members. During these sessions, TRS counselors have access to the member's retirement documents and can help members understand their retirement options. TRS conducts these sessions in Austin and will assist members on either an appointment or walk-in basis. In fiscal year 2005, TRS conducted almost 9,000 one-on-one retirement counseling sessions.

### Pension Trust Fund

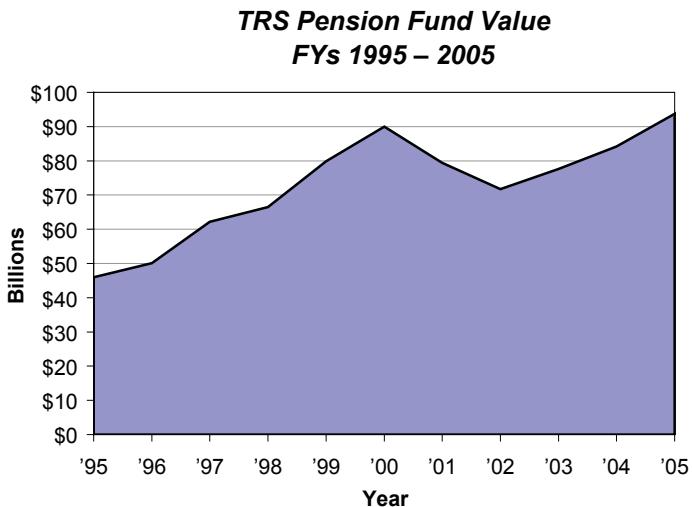
The Pension Trust Fund holds the accumulated contributions of TRS members, the State, employers, and investments earnings. The Texas Constitution requires the Legislature to establish contribution rates for active members and the State, providing that members pay at least 6 percent of annual salary, and the State contributes between 6 to 10 percent of total annual compensation. Currently, each active member of TRS contributes 6.4 percent of monthly salary as automatic deductions from their payroll checks, while the State's contribution is 6 percent. The table, *History of TRS Contribution Rates*, shows the State's and members' contribution rates since TRS' inception.

In addition, under certain circumstances, state law requires employers to pay a portion of the State's contribution to the Fund. Education employers, such as school districts and charter schools, pay the State's contribution for the portion of salaries above the minimum salary level for that position established in state law. All employers, including institutions of higher education, pay the State's contribution during a member's first 90 days of employment. In addition, beginning in fiscal year 2006, state law requires employers to pay an amount equal to the contributions of the State and the member, or a total of 12.4 percent of salary, for most retirees who return to work in a TRS-covered position.

In fiscal year 2005, total contributions paid to the Fund totaled \$3 billion, of which \$1.6 billion came from members, \$1.3 billion from the State, and \$221 million from employers. In addition, the Legislature permits the Fund to retain the State's contribution when members terminate from TRS-covered employment and withdraw their funds. The value of the State's contributions that remained in the Fund was \$228 million in fiscal year 2005. That same year, TRS' costs to administer the Pension Trust Fund, totaled \$25.1 million, excluding investment expenses. This averaged about \$22.52 per member.

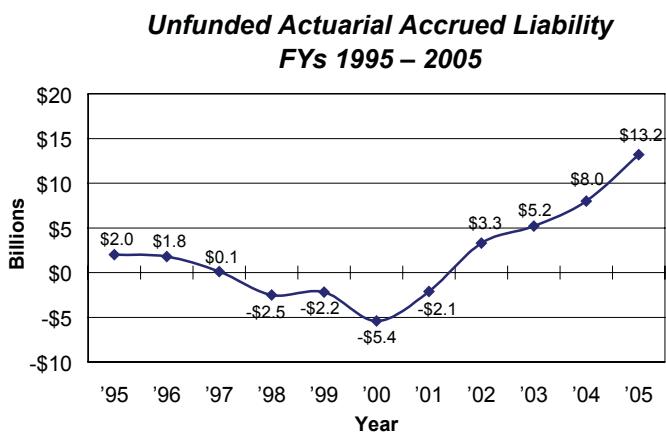
***History of TRS Contribution Rates***

| Fiscal Year  | State Contribution | Member Contribution | Salary Basis |
|--------------|--------------------|---------------------|--------------|
| 1938 to 1957 | 5.0%               | 5.0%                | 1st \$3,600  |
| 1958 to 1969 | 6.0%               | 6.0%                | 1st \$8,400  |
| 1970 to 1977 | 6.0%               | 6.0%                | 1st \$25,000 |
| 1978 to 1979 | 7.5%               | 6.65%               | 1st \$25,000 |
| 1980 to 1983 | 8.5%               | 6.65%               | Total        |
| 1984 to 1985 | 7.1%               | 6.0%                | Total        |
| 1986 to 1987 | 8.0%               | 6.4%                | Total        |
| 1988 to 1989 | 7.2%               | 6.4%                | Total        |
| 1990 to 1991 | 7.65%              | 6.4%                | Total        |
| 1992 to 1995 | 7.31%              | 6.4%                | Total        |
| 1996 to 2007 | 6.0%               | 6.4%                | Total        |



The Fund, valued at \$93.7 billion at the end of fiscal year 2005, is the eighth largest public pension fund in the United States, in terms of assets. The chart, *TRS Pension Fund Value*, shows the value of the pension fund over time. The Constitution, and state and federal law require TRS to hold these assets in trust for the exclusive benefit of members and prevent funds from being diverted for other purposes.

State law requires TRS to conduct an actuarial valuation of the fund on an annual basis to evaluate the soundness of the fund, including the adequacy of current statutory contributions and the extent to which the Fund's liabilities exceed assets.<sup>7</sup> In addition, at least every five years, TRS' Board hires a consultant to conduct an actuarial experience study to review actuarial assumptions and methods, and compare them to actual experience, trends, and economic projections.<sup>8</sup> In conjunction with the study, the Board contracts for an actuarial audit to ensure the accuracy of valuation results.



The actuary's report as of August 31, 2005, showed that the system is under-funded by \$13.2 billion, despite above-market investment returns in fiscal year 2005. The chart, *Unfunded Actuarial Accrued Liability*, shows the status of the fund for the last 10 years. The system's funded ratio, which is the ratio of actuarial assets to actuarial accrued liability, is 87.1 percent. Assuming State and member contribution rates remain stable, the number of years required to amortize the unfunded actuarial accrued liability is infinity or never. State law prohibits the Legislature from increasing

retirement benefits when the time needed to amortize the unfunded actuarial liabilities exceed 31 years.<sup>9</sup>

## Investment Management

To supplement contributions, TRS invests funds to earn investment income. In overseeing the Pension Trust Fund, the Constitution requires TRS' Board of Trustees to exercise the judgment and care that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs.<sup>10</sup>

The Board of Trustees establishes investment objectives and policies, and oversees investment decisions made by TRS investment staff. The investment policy contains specific guidelines for performance expectations, eligible

holdings, and portfolio characteristics. The Board evaluates TRS investment results against established objectives and against the performance of other public funds.

The Constitution and state law require the Board to make all investment decisions, and the Attorney General has opined that TRS lacks statutory authority to delegate investment decisions to external investment managers.<sup>11</sup> However, the Board seeks the advice of investment consultants in establishing investment objectives and reviewing performance and compliance with investment policies. The Board receives independent advice on a regular basis from technical advisors such as general investment consultants; a consulting actuary; fiduciary counsel; investment advisors; investment performance measurement consultants; private equity, real estate and absolute return portfolio consultants; and a master custodian and securities lending agent.

TRS is the largest public pension fund in the United States to strictly manage funds internally. Managing investments internally has allowed TRS to keep investment costs at a minimum, less than 0.02 percent of plan assets, or \$17 million, in fiscal year 2005. The table, *Management of Major Texas Investment Funds*, compares the State's largest funds as of fiscal year 2004, the latest data available.<sup>12</sup> As shown, most funds use internal staff to oversee the external managers, but have higher investment costs than TRS.



*TRS is the largest U.S. public pension fund to manage all investments internally.*

#### ***Management of Major Texas Investment Funds FY 2004***

| Fund                                    | Market Value<br>(in Billions) | Degree<br>Internally<br>Managed | Degree<br>Externally<br>Managed | Investment<br>Costs | 5-Year<br>Rate of<br>Return |
|-----------------------------------------|-------------------------------|---------------------------------|---------------------------------|---------------------|-----------------------------|
| Teacher Retirement System               | \$84.4                        | 100.0%                          | 0.0%                            | .02%                | 3.18                        |
| Employees Retirement System             | \$19.5                        | 68.7%                           | 31.3%                           | .07%                | 2.89                        |
| Permanent School Fund                   | \$19.3                        | 80.4%                           | 19.6%                           | .04%                | 2.95                        |
| Permanent University Fund               | \$8.1                         | 30.3%                           | 69.7%                           | .32%                | 5.03                        |
| Tobacco Settlement Permanent Trust Fund | \$1.8                         | 26.2%                           | 73.8%                           | .29%                | 2.94                        |
| Texas Guaranteed Tuition Plan Fund      | \$1.3                         | 9.1%                            | 90.9%                           | .30%                | 4.43                        |
| Permanent Health Fund                   | \$.8                          | 24.0%                           | 76.0%                           | .34%                | 4.95                        |
| Permanent Public Health Fund            | \$.4                          | 18.4%                           | 81.6%                           | .45%                | 2.01                        |
| Permanent Higher Education Fund         | \$.04                         | 15.7%                           | 84.3%                           | .43%                | 1.63                        |

TRS' investment staff perform the day-to-day investment transactions in accordance with the Board's policies. Staff research potential investments, place orders to buy and sell investments from a Board-approved list of brokers, and monitor the performance of all investments.

By diversifying investments, the Board seeks to control risk and enhance returns. TRS structures its total investment portfolio to achieve a long-term rate of return that exceeds the assumed actuarial rate of return adopted by the Board, currently 8 percent. In addition, TRS also evaluates the investment performance of certain common indexes, such as the Standard & Poor's 500

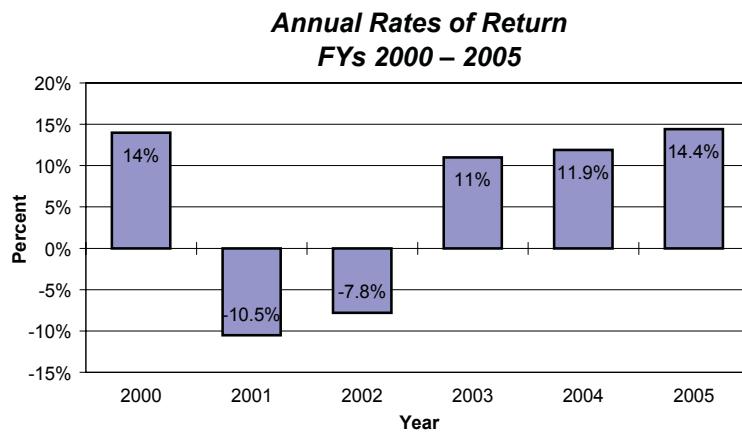
Composite Index and the Lehman Brothers Aggregate Bond Index, and develops custom benchmarks to assess the performance of each separate segment of a particular asset class.

TRS investment staff divide the system's total assets of \$93.7 billion among asset classes such as domestic equity (U.S. stocks); international equity (international stocks); fixed income (bonds); alternative assets (a variety of nontraditional investments, such as real estate, hedge funds, and privately held investments); and cash equivalents (money market funds, U.S. Treasury bills and other short-term investments).

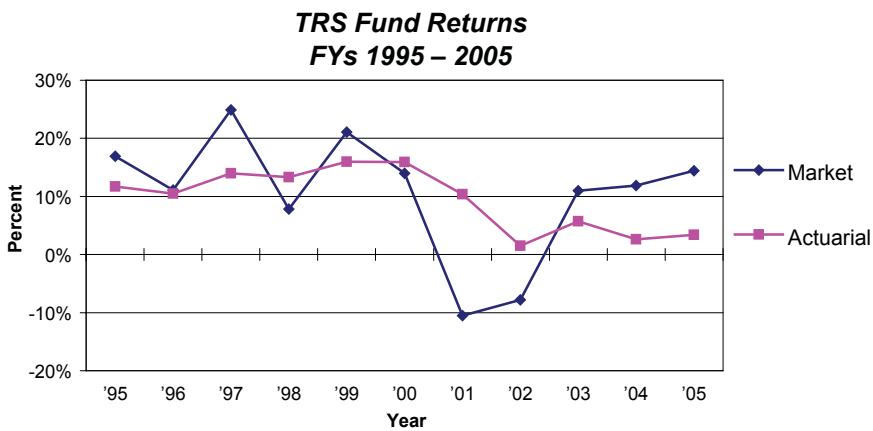
### ***Investment Performance***

TRS' total portfolio rate of return for fiscal year 2005 was 14.4 percent, resulting in net investment income of \$12 billion. TRS has performed better than its

8 percent assumed rate of return for the past three years, as shown in the chart, *Annual Rates of Return*. TRS' average investment performance for the last 10 years, has exceeded the 8 percent actuarial assumption, returning 9.88 percent.



volatility of investment markets. The chart, *TRS Fund Returns*, shows the actual market gains or losses of the Fund compared to the actuarial value produced by the five-year rolling average technique.



### **TRS-Care – Retiree Health Insurance**

In 1985, the Legislature established TRS-Care to provide uniform, statewide health insurance coverage for public school retirees who were not eligible for coverage under a state or higher education insurance plan. TRS-Care

offers a basic level of health coverage to eligible retirees at no monthly cost, and allows retirees and their eligible family members to purchase additional coverage. TRS' Board of Trustees establishes the basic features of the program in consultation with TRS staff, contracted health-care consultants, and an advisory committee of TRS members. For example, the Board sets co-payment amounts, deductibles, and premium amounts for each coverage group and plan level. TRS administers the program through a trust, separate from the Pension Trust Fund and the TRS-ActiveCare Fund. TRS-Care is self-insured and, as such, bears all financial risk for claims incurred.

TRS contracts with a plan administrator, currently Aetna Life Insurance Company, and a pharmacy benefits manager, currently Caremark, to provide access to a network of hospitals and physicians and to process claims, payments, and appeals. On a quarterly basis, TRS and its health-care consultant review costs and savings to the plan, as well as vendors' contractual performance. Every other year, TRS audits claims submitted by vendors to ensure the accuracy and timeliness of the claim payments.

TRS offers three plan levels under TRS-Care. TRS-Care 1 offers basic coverage without requiring premiums; TRS-Care 2 offers comprehensive benefits, but requires retirees to pay premiums, co-payments for services, and a \$1,000 deductible; and TRS-Care 3 offers a comprehensive plan with lower co-payments and a \$300 deductible, but requires retirees to pay higher premiums. Monthly premiums for retirees range from no cost to \$310 depending on the member's selected level of coverage, years of service credit, and Medicare eligibility. Enrollment in each plan is listed in the table, *Enrollment by TRS-Care Plan*. The average cost per participant was \$3,862, including \$2,257 for medical claims and \$1,605 for pharmacy claims.

***Enrollment by TRS-Care Plan  
as of September 2005***

| TRS-Care Plan | Monthly Premium Range (Retiree Only) | Monthly Premium Range (Retiree and Spouse) | Number of Total Enrollees | Percentage of Total Enrollees |
|---------------|--------------------------------------|--------------------------------------------|---------------------------|-------------------------------|
| TRS-Care 1    | \$0                                  | \$20 to \$140                              | 37,234                    | 20%                           |
| TRS-Care 2    | \$60 to \$210                        | \$160 to \$450                             | 8,119                     | 4%                            |
| TRS-Care 3    | \$90 to \$310                        | \$235 to \$665                             | 141,980                   | 76%                           |
| <b>TOTAL</b>  |                                      |                                            | <b>187,333</b>            | <b>100%</b>                   |

### **TRS-ActiveCare – Current Educators' Health Insurance**

The Legislature established TRS-ActiveCare in 2001 to make uniform health insurance coverage available to public school employees and their family members.<sup>13</sup> Before the creation of TRS-ActiveCare, many school districts, especially small districts in rural areas, were unable to offer affordable health insurance to employees, and as a result, faced difficulty attracting and retaining qualified employees. In response, the Legislature created TRS-ActiveCare, which began offering coverage effective September 1, 2002.

Today, TRS-ActiveCare enrollment is open to all public school districts, charter schools, and regional education service centers. As of December 2005, 1,042 of 1,244 eligible public education entities participated in TRS-ActiveCare, as shown in the table, *TRS-ActiveCare Participation*. Higher education institutions do not participate in TRS-ActiveCare, but instead offer coverage through plans offered by the University of Texas System, Texas A&M University System, and the Employees Retirement System.

***TRS-ActiveCare Participation  
as of December 2005***

| Entity Type                        | Number Eligible | Number Participating | Percentage Participating |
|------------------------------------|-----------------|----------------------|--------------------------|
| Independent School Districts       | 1,035           | 885                  | 86%                      |
| Charter Schools                    | 180             | 129                  | 72%                      |
| Regional Education Service Centers | 20              | 20                   | 100%                     |
| Other                              | 9               | 8                    | 89%                      |
| <b>TOTAL</b>                       | <b>1,244</b>    | <b>1,042</b>         | <b>84%</b>               |

TRS-ActiveCare is available to employees of participating school districts who are active, contributing members of TRS or are employed at least 10 hours per week. TRS also offers coverage to eligible family members of enrolled employees. As of January 2006, enrollment in TRS-ActiveCare totaled 276,427, of which 167,776 were TRS members and 108,651 were dependents. The average cost per participant was \$2,777, including \$2,184 for medical claims and \$593 for pharmacy claims.

TRS-ActiveCare offers three levels of preferred provider organization health-care coverage. ActiveCare 1 provides basic coverage, ActiveCare 2 offers expanded benefits at higher premiums, and ActiveCare 3 is the most comprehensive and expensive level of coverage. State law requires TRS to offer a plan comparable to the health insurance plan offered to state employees (currently ActiveCare 3). In addition, as of September 1, 2003, members who live in certain areas of the State may select coverage through one of four participating Health Maintenance Organizations (HMOs). About 6 percent of members have elected coverage in HMO plans. Premium and enrollment information is listed in the table, *Enrollment by TRS-ActiveCare Plan*.

***Enrollment by TRS-ActiveCare Plan  
as of January 2006***

| TRS-ActiveCare Plan | Monthly Premiums (Employee Only) | Monthly Premiums (Employee and Family) | Number of Enrollees | Percentage of Enrollees |
|---------------------|----------------------------------|----------------------------------------|---------------------|-------------------------|
| TRS-ActiveCare 1    | \$249                            | \$623                                  | 46,562              | 17%                     |
| TRS-ActiveCare 2    | \$331                            | \$828                                  | 183,536             | 66%                     |
| TRS-ActiveCare 3    | \$446                            | \$1,115                                | 29,371              | 11%                     |
| HMOs                | \$310 to \$451                   | \$785 to \$1,458                       | 16,958              | 6%                      |
|                     |                                  |                                        | <b>TOTAL</b>        | <b>276,427</b>          |
|                     |                                  |                                        |                     | <b>100%</b>             |

TRS contracts with BlueCross BlueShield of Texas to provide access to provider networks and process claims, payments and appeals, and with Medco Health Solutions, Inc., for prescription drug benefits. TRS-ActiveCare is a self-insured, managed care plan and bears all financial risk for claims incurred.

Participating school districts enroll their eligible employees in the program, collect employee premiums, and remit the funds to TRS. In turn, TRS

reimburses plan administrators for claims. In fiscal year 2005, TRS-ActiveCare reports that it settled 100 percent of complete claims within 15 days.

### **Local Health Coverage Comparability Study**

In 1997, the Legislature directed TRS to study whether the health insurance plans offered by local school districts are comparable to the coverage provided to state employees, as required in statute.<sup>14</sup> To fulfill this mandate, TRS conducts a biennial study, collecting data on school districts' health plans and certifying if the plans are comparable to the Texas Employee Uniform Group Insurance Program. TRS reports the results to the Legislative Budget Board. The Legislature appropriated TRS \$250,000 from the General Revenue Fund to conduct the 2006 Health Coverage Comparability Study, which TRS will complete by September 2006.

In the most recent comparability study conducted by TRS in fiscal year 2004, TRS automatically certified the 1,004 school districts participating in TRS-ActiveCare and evaluated only the health-care plans of the 239 districts not in TRS-ActiveCare. In this study, TRS found that 97 percent of districts were offering comparable plans. Of the 43 districts without a comparable plan, half had fewer than 100 employees.

### **Long-Term Care Insurance**

In 1999, the Legislature authorized TRS to develop an optional long-term care insurance program. TRS began offering policy coverage in October 2000, making long-term care insurance available to eligible active and retired public school employees and their family members at group rates. Enrollees pay the full cost of the plan through premiums and administrative fees.

TRS gives active members the opportunity to enroll in long-term care without evidence of insurability during the first 90 days of TRS membership. Active members outside the 90-day window, retirees, and eligible family members must meet underwriting guidelines to join the plan. The table, *Long-Term Care Insurance*, provides information about member participation in the program.

**Long-Term Care Insurance  
FY 2005**

|                                | <b>Retirees/Family</b> | <b>Members/Family</b> | <b>Total</b> |
|--------------------------------|------------------------|-----------------------|--------------|
| Enrolled                       | 4,689                  | 4,562                 | 9,251        |
| Average Age When Policy Issued | 62                     | 53                    | 57           |
| Average Annual Premium         | \$1,173                | \$689                 | \$934        |
| Annualized Premiums            | \$5,500,748            | \$3,142,029           | \$8,642,777  |

TRS selects a long-term care underwriter for the program through competitive bidding every six years. The current carrier, Aetna Life Insurance Company, provides enrollment processing, underwriting, premium collection, customer service, and claims payment. TRS annually reviews the program and Aetna's performance. Aetna remits administrative fees monthly to TRS as reimbursement for TRS' administrative costs.

## 403(b) Certification Program

In 2001, the Legislature established a program for certification by companies that offer 403(b) investment plans to educational employees. Named after a section of Internal Revenue Code, 403(b) plans permit employees to save for retirement on a tax-deferred basis. Tax laws limit investments of 403(b) plans to tax-sheltered annuities or mutual funds. Participation in 403(b) plans is voluntary and employers generally do not contribute.

Companies offering these investment products to school employees through payroll reductions must certify to TRS that they meet certain requirements, including compliance with financial standards and allowed maximum fees. TRS assesses a \$5,000 fee for a five-year certification. In addition, certified companies must annually demonstrate to TRS that sales representatives are properly licensed and meet continuing education requirements. To keep school districts and members informed, TRS maintains a list of certified companies on its website. In 2005, TRS' list included 48 companies selling annuity products and 33 companies selling mutual fund products.

<sup>1</sup> Pensions & Investments Online, *The top 200 pension funds/sponsors*, Ranked by total assets, in U.S. millions (January 24, 2005).

<sup>2</sup> Texas Senate Bill 1691, 79th Legislature (2005) increased the contribution rate of active members from 0.50 percent to 0.65 percent. Also in 2005, the Legislature, through the General Appropriations Act, increased the contribution rate for employers from 0.4 percent to 0.55 percent.

<sup>3</sup> The California Public Employees Retirement System is the largest public state pension fund in the United States with 1.2 million members.

<sup>4</sup> S.B. 1691 (2005) changed retirement eligibility requirements. To be eligible for an unreduced annuity, members who join TRS after September 1, 2007, must be at least 65 with five years of service; or age 60 with at least five years of service and meet the rule of 80. Members who are subject to these eligibility requirements and who retire before age 60 will be subject to a 5 percent annuity reduction for each year under age 60.

<sup>5</sup> Vesting means members qualify for retirement benefits when they reach retirement age, provided their contributions remain in the Fund.

<sup>6</sup> S.B. 1691 (2005) changed the standard annuity formula from the average of the three highest salary years to the five highest salary years for members who did not meet the following criteria: at least 50 years old, age and years of service equal at least 70, or member with at least 25 years of service.

<sup>7</sup> Texas Government Code, sec. 825.108.

<sup>8</sup> Texas Government Code, sec. 825.206.

<sup>9</sup> Texas Government Code, sec. 821.006.

<sup>10</sup> Texas Constitution, Art. 16, sec. 67(a)(3).

<sup>11</sup> Texas Constitution, Art. 16, sec. 67(a)(3); Texas Government Code, sec. 825.301(a); Op. Tex. Att'y Gen. JC-0043 (1999).

<sup>12</sup> Legislative Budget Board, *Annual Report on Major State Investment Funds*, Fiscal Year 2004 (Austin, Texas, 2005). Online. Available: [www.lbb.state.tx.us/Investment\\_Funds/AnnualReport\\_MajorStateFunds\\_0405.pdf](http://www.lbb.state.tx.us/Investment_Funds/AnnualReport_MajorStateFunds_0405.pdf). Accessed: January 19, 2006.

<sup>13</sup> Texas House Bill 3343, 77th Legislature (2001).

<sup>14</sup> Texas Education Code, sec. 22.004.

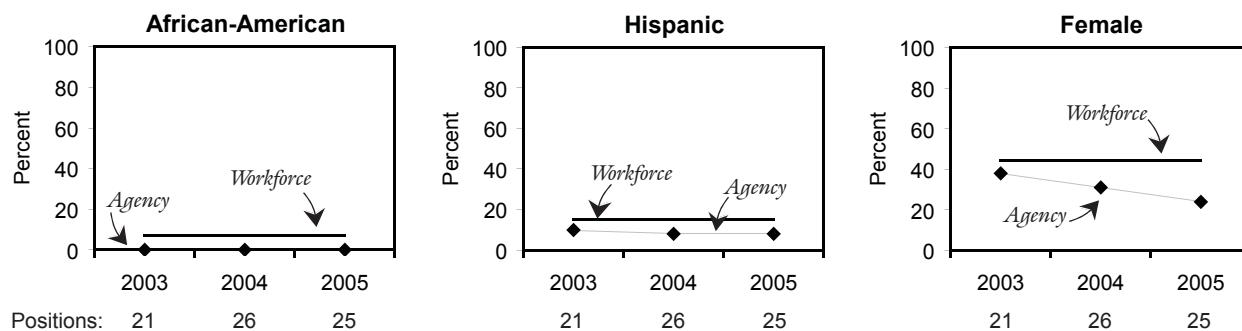
## **APPENDICES**



## Equal Employment Opportunity Statistics 2003 to 2005

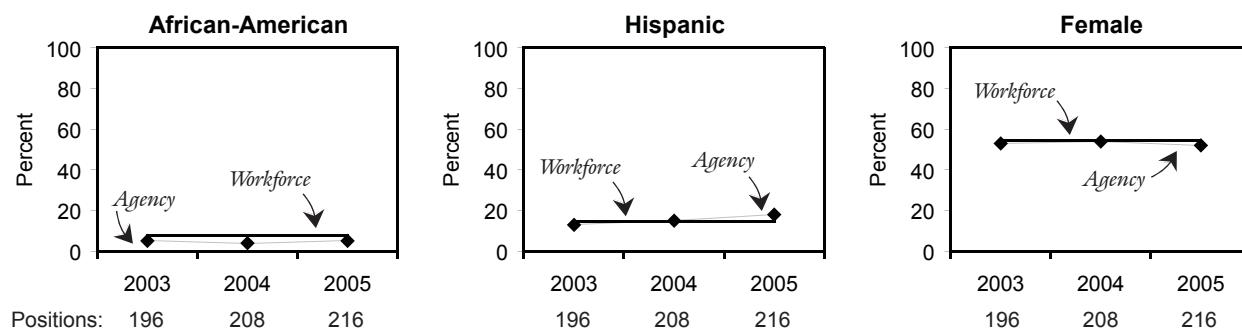
In accordance with the requirements of the Sunset Act, the following material shows trend information for the Teacher Retirement System employment of minorities and females in all applicable categories.<sup>1</sup> The agency maintains and reports this information under guidelines established by the Texas Workforce Commission.<sup>2</sup> In the charts, the flat lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the agency's actual employment percentages in each job category from 2003 to 2005. While the agency has exceeded some of the civilian labor force guidelines, it has fallen below others. The agency does not employ persons in the skilled craft category.

### Administration



The agency fell below the statewide civilian workforce percentages in all three categories each year.

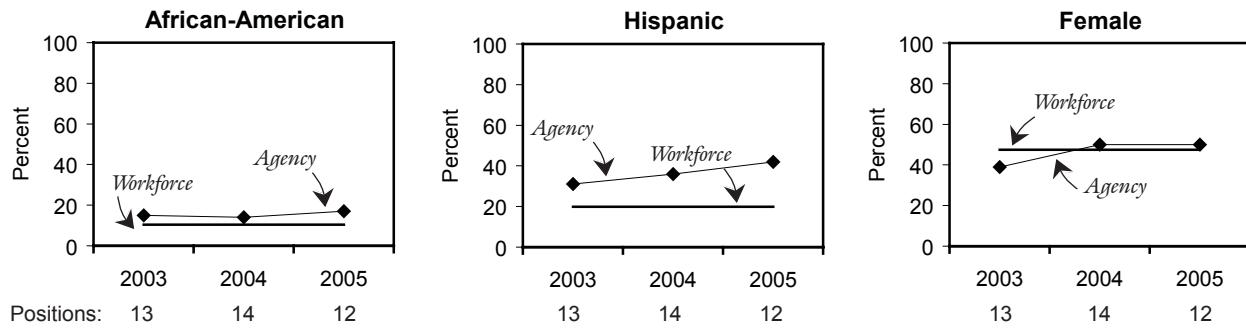
### Professional



The agency fell slightly below the percentages for African-American employment, but generally met or exceeded percentages for Hispanic and female employment.

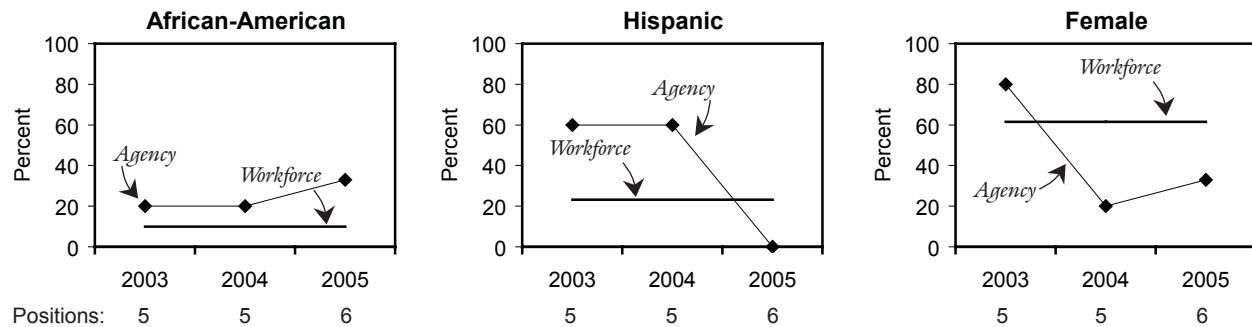
## Appendix A

### Technical



With the exception of female employment in 2003, the agency met or exceeded statewide civilian workforce percentages in all three categories.

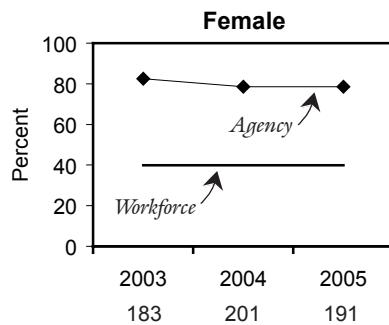
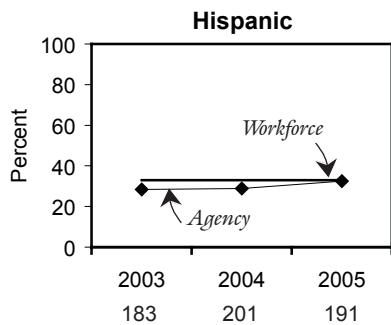
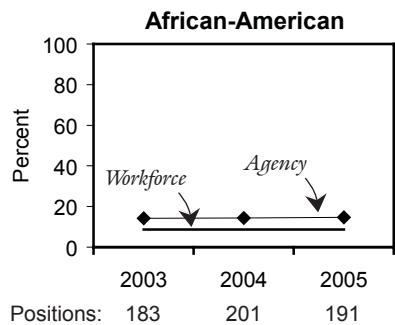
### Administrative Support



The agency exceeded percentages for African-American employment in all three years, but the agency has fallen short of the percentages for Hispanic and female employment in recent years.

## Appendix A

### Service/Maintenance



The agency slightly exceeded percentages for African-American employment and greatly exceeded percentages for female employment in all three years. The agency met or fell slightly below the percentages for Hispanic employment.

<sup>1</sup> Texas Government Code, sec. 325.011(9)(A).

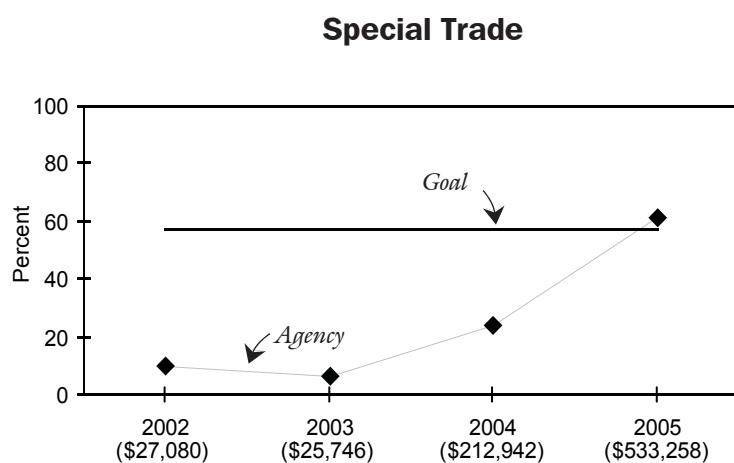
<sup>2</sup> Texas Labor Code, sec. 21.501.



## Historically Underutilized Businesses Statistics 2002 to 2005

The Legislature has encouraged state agencies to increase their use of Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.<sup>1</sup> The review of the Teacher Retirement System (TRS) revealed that the agency is complying with all State requirements concerning HUB purchases.

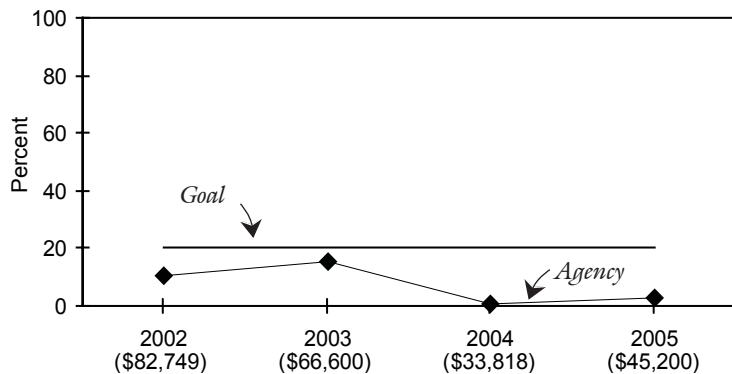
The following material shows trend information for TRS' use of HUBs in purchasing goods and services. The agency maintains and reports this information under guidelines in the Texas Building and Procurement Commission's statute.<sup>2</sup> In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Texas Building and Procurement Commission. The diamond lines represent the percentage of agency spending with HUBs in each purchasing category from 2002 to 2005. Finally, the number in parentheses under each year shows the total amount the agency spent in each purchasing category. In 2005, TRS met or exceeded the state's goals for expenditures with HUBs in the categories of special trade and commodities spending, but fell below the goals for spending on professional and other services. From 2002 to 2005, TRS reported no expenditures in the categories of heavy construction and building construction.



The agency has increased its HUB spending in this category in recent years, and slightly exceeded the state goal for spending in 2005.

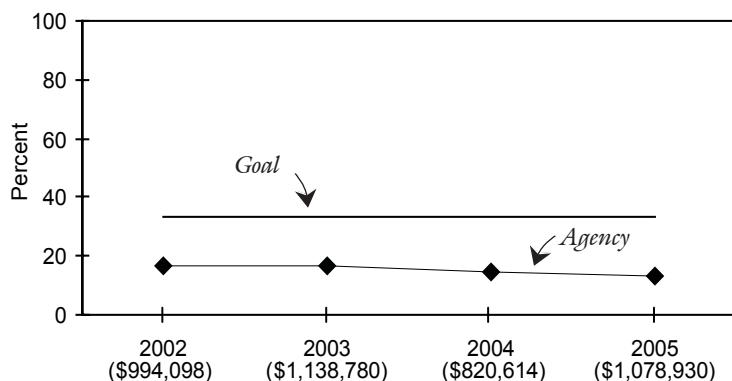
## Appendix B

### Professional Services



The agency has fallen below the state goal for HUB spending on professional services for the last four years.

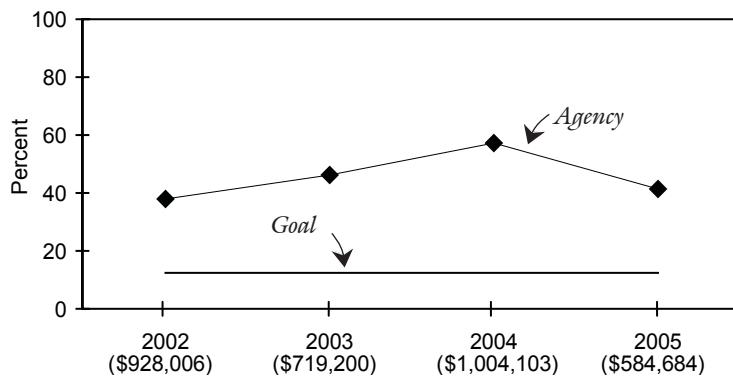
### Other Services



The agency has fallen below the state goal for HUB spending on other services for the last four years.

## Appendix B

### Commodities



The agency has consistently exceeded the state goal for commodities spending since 2002.

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<sup>1</sup> Texas Government Code, sec. 325.011(9)(B).

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





# Appendix C

## Staff Review Activities

During the review of the Teacher Retirement System, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with agency personnel; attended Board and committee meetings; met with Board members; met with staff from key legislative offices, Governor's office, Legislative Budget Board, and State Auditor's Office; conducted interviews and solicited written comments from interest groups and the public; reviewed agency documents and reports, state statutes and rules, legislative reports, previous legislation, and literature; researched the organization and functions of similar state agencies in other states; and performed background and comparative research using the Internet.

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

- ◆ Interviewed staff from retirement systems in other states.
- ◆ Interviewed staff from the Pension Review Board, State Securities Board, Employees Retirement System, Texas Workforce Commission, Texas Department of Insurance, and Department of Aging and Disability Services.
- ◆ Attended meetings of the TRS Medical Board and the Retirees Advisory Committee.
- ◆ Attended a TRS group general benefit presentation.
- ◆ Attended a briefing by TRS' third-party actuary for the Pension Trust Fund, TRS-Care, and TRS-ActiveCare.
- ◆ Attended meetings of agency staff with TRS-ActiveCare's plan administrator and pharmacy benefit manager.



**SUNSET REVIEW OF THE  
TEACHER RETIREMENT SYSTEM OF TEXAS**

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