

Texas Local Fire Fighters Retirement Act

# Trustee Manual 2022



TLFFRA Peer Review Committee  
TLFFRA Pension Conference Foundation  
Texas Pension Review Board

Revision Sheet

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## Executive Summary

Congratulations on your decision to serve as a trustee for your local fire fighter’s retirement fund! This manual will introduce you to the core concepts you’ll need to be effective in this role. It’s not exhaustive; you can’t replace education and experience with a few printed pages, but this manual will give you a starting point.

This manual is broken into sections broadly covering:

1. The trustee
2. The board
3. The board meeting
4. Financial and actuarial basics
5. Introduction to investments
6. Appendix<sup>1</sup>

### The trustee

You are now one of seven board members serving on a TLFRA board. You will have individual responsibilities in addition to the responsibilities assigned to the board as a whole.

Your individual responsibilities as a trustee may vary dependent on what type of position you hold. For example, trustees who are members of the fund may hear concerns from other plan members. This brings us to a key point: as a trustee, you are a **fiduciary**, which means you are charged with the responsibility to act only **in the interest of the plan**—and not any single stakeholder group or individual. As a fiduciary, you must work to improve the *plan*, even if that means disagreeing with sponsor or member plan design requests.

As an individual trustee, you must put in the effort to serve your plan effectively. You’ll be one of seven votes making complex plan design, administrative, actuarial, and investment decisions, so you’ll need to understand them. While your plan may be fortunate enough to have expert staff or consultants, you nonetheless must be prepared to push back on recommendations. To do so, you must seek proper **education**. Under Texas law, you must meet Minimum Educational Training (MET) requirements, but these are only the minimum. Going above and beyond the minimum education requirements will help you better serve your plan and members. You don’t need to be an expert, but you must *master* the basics.

### The board

A TLFRA board is tasked with making broad, long-term, strategic decisions. It must focus on the big picture; the board must consider the next two or three decades, not only the next two or three years.

The board is responsible for making specific policy decisions, often centered on matters of benefit administration, **plan design**, and **actuarial and investment matters**. For instance, a plan design decision might adjust the formula used to calculate a member’s benefit at retirement. An actuarial decision might modify the assumed rate of return on the plan’s investments (a key factor in determining whether the plan is expected to be able to pay the benefits earned).

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<sup>1</sup> An appendix at the end of this manual contains additional reference material such as statutes and policies that you may find helpful during your time as a TLFRA trustee.

To make decisions like these, TLFRA boards often hire outside consultants and staff. These professionals advise the board, but the ultimate responsibility for decisions remains with the board.

Board decision making culminates in the development of formal, written policies. Often, the work of developing written policies leads the board to see where there may be differences in understanding or interpretation that need to be ironed out. Do not assume everyone understands the board's intent.

Finally, the board is responsible for complying with the requirements of state law, including filing certain documents with the Pension Review Board, as well as posting documents online.

## **The board meeting**

A TLFRA board exercises its formal powers at board meetings, which are public events where the board comes together as one to decide the best path forward for the plan. The board meeting uses specific procedures that may be unfamiliar to new trustees. Many of these rules may seem overly complicated or unnecessary. To understand why they exist, we must consider the function of a board meeting.

The goals of any board meeting are to **make good decisions and make them efficiently**. However, these goals may appear to conflict with each other. For instance, engaging in extensive deliberation may produce a better decision, but doing so slows the process. That's where rules and procedures come in to balance the need to engage in activities that help improve the quality of the decisions.

To operate effectively, boards select **officers**, may form **committees**, and engage in formal **agenda development** processes. They adopt **formal rules** to provide structure to public board meetings. For sensitive matters, boards may enter **executive/closed session** in limited circumstances.

## **Financial and actuarial basics**

Your board operates a **defined benefit (DB) pension plan**, which introduces specific challenges for trustees, such as estimating how much money will be needed to pay promised benefits. This is a function of projected employment patterns, salary patterns, and other factors. These matters are addressed using **actuarial methods**. Actuaries produce several key measures of plan health, including the plan's **funded ratio** and **amortization period**.

## **Introduction to investments**

A key function of a pre-funded pension system is to enable contributions to the plan to grow over time. **If investment earnings are inadequate, contributions may need to increase, or benefits may need to decrease to account for the shortfall.**

Investing is all about risk. Riskier investments may produce higher rates of return in the long-term but may also have significant variance in the short-term. Thus, one of the key tasks of a retirement system trustee is to strike a balance between investing the assets in a way that provides sufficient returns to fund future benefits while avoiding large losses that may jeopardize payment of benefits.

Pension plans invest in various asset classes, such as cash, public equities, fixed income, real assets, and alternative/other. Each class carries different risks and return potentials. Other characteristics may be relevant, including whether an asset provides current income via interest payments or dividends, or is liquid or illiquid.

Boards aim to develop an investment portfolio that maximizes returns at an acceptable level of risk, while making allowance for other necessary factors, such as liquidity or investment management fees.

## **Introduction**

### **Texas Local Fire Fighters Retirement Act (TLFFRA)**

The Texas Local Fire Fighters Retirement Act (TLFFRA) was originally created in 1937 by the 45th Legislature and named the Firemen's Relief and Retirement Fund. In 1989, the Act was restated under Article 6243e and renamed as the Texas Local Fire Fighters Retirement Act. The Act allows for paid and part-paid fire departments and volunteer fire departments in participating cities to administer their own local retirement systems.

The Act provides general guidelines for fund management, including some investment restrictions, but leaves administration, plan design, contributions, and specific investments to each system's local board. Systems operating under TLFFRA are entirely locally funded.

Local retirement systems established under TLFFRA have authority to determine member contribution rates, benefit levels, and other plan provisions locally through procedures outlined in TLFFRA. However, the composition of TLFFRA boards of trustees is set in statute. The composition of the TLFFRA board represents the interests of the member, governing entity and taxpayers. Sponsoring municipalities of TLFFRA systems must meet a statutory minimum contribution rate but may adopt by ordinance a higher contribution rate than that set in statute.

Currently, there are 42 retirement systems organized under TLFFRA.

### **Volunteer TLFFRA Systems**

Volunteer members are eligible for full retirement at the age of 55 with 20 years of service and receive a benefit of \$25 per month for the remainder of their lives. Survivor, death, and disability benefits are also included under the TLFFRA statute. The volunteer benefit is funded through both employer and employee contributions. A majority of the volunteer TLFFRA pension systems do not have a trust fund balance; therefore, they are considered pay-as-you-go-systems. The employer contribution is the total amount of benefits paid to retirees and beneficiaries in a calendar year. The volunteer firefighters contribute a very small amount each year (some volunteer TLFFRA systems require their members to pay an annual contribution of five dollars). The employer may at any time make the member contributions.

There are currently 81 volunteer TLFFRA plans registered with the PRB.



1. The Trustee

**1. THE TRUSTEE**

## 1. The Trustee

### 1.1 What does a trustee do?

Like many Americans, you have chosen to volunteer your time to be a part of a group that will improve the future, both for yourself and for others. You have chosen to serve as a trustee on the board of your local fire fighters' retirement fund.

However, you may have some questions about the scope of your role as a trustee. Often, it is not immediately clear what a trustee *actually does*—what the responsibilities are, and how boards can work most effectively. This section will provide guidance on how to execute your duties as a trustee of a TLFFRA plan.

#### 1.1.1 Roles performed by individual trustees

Consider a city council. The formal powers of a city council are only exercised by the **entire council** when voting on a particular policy proposal. Similarly, the powers of a TLFFRA board are exercised collectively, by the **board as a whole**.

However, there are numerous roles performed by trustees as individuals. These include *fiduciary*, *strategic thinker*, *advocate and representative*.

##### *Fiduciary*

As a trustee, you will individually act as a fiduciary for the plan. This charges you with specific legal responsibilities to act in the best interest of the plan and can even open you up to personal liability. This is an important topic, which will be described in detail later in this section.

##### *Strategic thinker*

Your key distinguishing role, aside from acting as a plan fiduciary, is to serve as a long-term strategic thinker. Plan sponsors, plan members, staff and consultants can easily become too focused on short-term thinking. As a trustee, you must think not just one year out, but five, ten, and fifty years out. It is your job to ensure the long-term stability of the pension plan, so that benefits earned by a new firefighter today can be paid out at the end of his or her career. You must always be willing to defend the plan and act in its long-term best interest, even when there is controversy over employer contributions, benefit levels, investment policy, actuarial assumptions, or the plan's solvency.

##### *Advocate and representative*

You may be called upon to represent the plan externally, including to other governmental agencies or to the public. When acting as a trustee, you must always represent the interests of plan members and beneficiaries, even if that may conflict with another position you hold. In other words, if you wear multiple hats, keep in mind which hat you are wearing in a particular context, and make that clear to the individual or group you are communicating with.

#### **New member transition**

Every TLFFRA board knows that you must diversify your assets to reduce volatility and risk. You need to have similar concerns when thinking about your board. The long-term reliance upon one or two members to keep your fund functioning is very risky. Do not allocate all your system's institutional knowledge with one or two members.

There are fewer tasks more important for a TLFFRA board than helping a new board member get up to speed with the issues they will face as a trustee. Think of your board like you think of a diversified asset allocation. A new member may be a drag on returns in the short term; however, with proper training and guidance the new member will provide dividends in the long term.

## 1. The Trustee

### 1.2 Stakeholders

TLFFRA plans have many stakeholders, including the plan members (both active and retired), the plan sponsor, other governmental agencies, and the public/taxpayers. As an individual trustee, you should expect to hear from any or all of them. Sometimes, the interests of different groups may diverge, complicating your decision-making process. While you may have been chosen to serve the TLFFRA board in positions designated for plan members, city representatives, or members of the public, you are charged to **act in the best interest of the fund as a whole** and not merely the group with which your position is associated.

#### *Plan members*

As might be expected, members will take a keen interest in the plan. Active members will be primarily focused on their employee contribution rate and their expected benefits. Retired members will likely be especially interested in the plan's ability to pay benefits on time and benefits keeping up with inflation. All members will take an interest in the performance of the fund's investments, since strong investment returns can reduce the amount of required contributions, while weak returns can impact the fund's ability to pay promised benefits.

#### *Plan sponsor*

The plan sponsor, or city, will be concerned about its contribution to the plan. In some cases, this is actuarially determined—more on this later—but in many cases the contribution amount is fixed. This can lead to challenges when the fixed contribution is not high enough to fully fund the promised benefits. Employers use retirement plans as a key selling point for potential employees, and any weakness may make the employer less attractive.

#### *Other governmental agencies*

Other governmental agencies have an interest in the plan. The Texas Pension Review Board (PRB) oversees public pension plans in the state; state law requires certain information be provided to PRB to further that mission. The Texas Legislature or Office of the Governor may inquire based on constituent requests or consider policy changes that would impact the plan.

#### *The public*

Ultimately, taxpayers fund the plan via employer contributions. Thus, the public may take an interest in the financial performance of the plan. Will it be necessary to raise taxes or cut services to fully fund the promised benefits? How will any benefit adjustments impact local firefighters? As a trustee, you should consider how your board interacts with the public and especially the media; in some cases, it may be appropriate to delegate that work to a specific trustee or to staff to ensure a consistent message.

## 1. The Trustee

### 1.3 What is a fiduciary?

As a trustee, you are a fiduciary because you exercise direct discretionary control over the fund's assets. Texas Statute establishes that the members of the governing body of a public retirement system are fiduciaries, and as such, must discharge their fiduciary duties.<sup>2</sup>

A simple definition of a fiduciary is a person who must act primarily for the benefit of the other in a particular activity.<sup>3</sup> **As fiduciaries, trustees are responsible for their decisions, even if they delegate duties or contract out the administration of the system to a third-party entity.**

While more detail is provided in this section, broadly speaking, trustees should follow these seven requirements, termed the **Global Fiduciary Precepts**.<sup>4</sup>

1. Know standards, laws, and plan provisions
2. Diversify assets to the specific risk/return profile of your plan
3. Prepare and follow the investment policy statement
4. Use "prudent experts" (for example, an investment consultant and investment managers)
5. Control and account for investment expenses
6. Monitor the activities of "prudent experts"
7. Avoid prohibited transactions and avoid or manage other conflicts of interest

#### 1.3.1 Duties

Statute defines fiduciary duty for public retirement systems. Fiduciaries are charged with the following duties:<sup>5</sup>

##### *Duty of Loyalty*

The duty of loyalty, also known as the **exclusive benefit rule**, states that while in service to a retirement system, **it is the duty of trustees to always act solely in the best interest of the participants and beneficiaries.** Fiduciaries should act for the exclusive purposes of providing benefits to participants and their beneficiaries while defraying reasonable expenses of administering the system. Members of the governing board of a system have an ethical duty to avoid conflicts of interest when fulfilling their duties to the board, as self-dealing violates the duty of loyalty.

Trustees should not place any other interest above that of the participants and their beneficiaries and should administer their duties solely in their interest. **A trustee's duty to serve the participants and their beneficiaries of the retirement system is greater than the duty to oneself, a plan sponsor, the Legislature, or members of an association or other group (constituency).** This is also called the "two hat" rule.

It is also the duty of trustees to **defray the reasonable expenses** of the administration of the retirement system. This means that it is the duty of the trustees to ensure the system is run as efficiently as possible,

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<sup>2</sup> Section 802.203, Texas Government Code

<sup>3</sup> <https://www.irs.gov/retirement-plans/retirement-plan-fiduciary-responsibilities>

<sup>4</sup> <https://financialgroup.com/wp-content/uploads/2020/02/Prudent-Practices-for-Investment-Advisors.pdf>

<sup>5</sup> Section 802.203, Texas Government Code

## 1. The Trustee

with only the **appropriate resources**.<sup>6</sup>

**Travel** is an example of balancing the needs of the retirement system with the appropriate resources. Members of the governing board of a retirement system may find that they need to travel to conduct the business of the board; however, such trips should be **carefully monitored** to ensure that they are **necessary** to fulfill the trustees' fiduciary duty. Also, care should be taken to ensure that travel costs are **reasonable**.

### *Duty of care*

The duty of care, also known as the **prudent person standard**, charges fiduciaries with knowing when they have sufficient experience and knowledge to make decisions. Fiduciaries do not necessarily need to be experts in investments, but **they should know when they need to delegate responsibility or seek expert advice**.

**Prudent persons** have a duty to educate themselves on investments. They also have a duty to ask questions of investment managers and review performance against benchmarks.

In practice, fiduciaries working with investments should:

- Identify and consider any pertinent information to assist in decision making.
- Ask experts questions about investments when clarification or additional information is needed.
- Determine **procedural** vs. **substantive** prudence, wherein **procedural** prudence refers to courts deferring to fiduciaries who engage in a prudent process even if decisions are wrong in hindsight. **Substantive** prudence is when courts expect thorough review of "expert advice" and informed educated and independent decisions.<sup>7</sup>
- Conduct **due diligence** to ensure comprehensive review.
- **Monitor investments** to determine performance.
- **Document** decisions made.
- **Obtain continuing education** on matters related to investments.

### *Duty to diversify*

It is the duty of the governing board of a retirement system to **ensure that investments are diversified across different asset classes** to mitigate any losses that may occur in any one type of asset.

**Diversification** is the act of spreading investments over several different asset classes to better reflect the market overall, so that losses in one asset will not cause the system to lose too much money, thus spreading out the risk involved in investing.<sup>8</sup>

**Diversification helps protect a fund's future valuations from being overly vulnerable** to the return on any one asset or asset class. By diversifying the portfolio with uncorrelated assets, which are assets that do not move up and down together as the market shifts, trustees and staff **lower the risk** of sudden shocks to a particular investment that would have a large negative impact on the portfolio.

### *Duty to follow plan documents*

In addition to the requirements of Texas statute, many public retirement systems' governing statutes

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<sup>6</sup> [https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=5816&context=journal\\_articles](https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=5816&context=journal_articles)

<sup>7</sup> Mary Kathryn Campion, "Fiduciary Matters and Ethics" (Presentation, TEXPERS Basic Trustee Training, San Antonio, TX, August 14, 2015)

<sup>8</sup> [Christopher P. Cline, \*The Law of Trustee Investments\*, \(Chicago, Il. American Bar Association, 2009\), P. 23](#)

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contain specific provisions that require trustees to take an oath to **administer the fund diligently and honestly and not knowingly violate or willingly permit a violation of the statute to occur**. To comply with these requirements, **trustees have a duty to administer the plan in accordance with the plan's governing documents**, such as statute or ordinance, a plan's bylaws, ethics policy, governance manual and investment policy.

One of the key measures that the governing board of a system should take as fiduciaries is to **adopt written policies and consistently follow them**. Policies and procedures should delineate authority and responsibility. The governing board should use governing documents to help decide which tasks should be delegated.

### 1.3.2 Co-fiduciary issues

A fiduciary may also be liable for the act of another fiduciary. Beyond the fiduciary duties laid out by statute, **trustees are legally obligated to bring to the attention of the board misconduct or breach of duty of other members**.

- Trustees have a duty to expose breaches made by other fiduciaries.
- A fiduciary may breach their duty by having actual knowledge of and not reporting wrongdoing by another fiduciary.
- A fiduciary who becomes aware that a co-fiduciary has breached his fiduciary duty to plan beneficiaries may not escape liability by simply looking the other way, casting a blind eye toward the breach.
- The board should establish a written process for raising, investigating, and addressing fiduciary breaches.

### 1.3.3 Fiduciary duties related to contracting for professional services

When choosing and contracting for professional investment management services, the board must act prudently and in the interest of the participants and beneficiaries of the retirement system. Systems should consider the following due diligence when hiring professionals:

- **Conflicts of interest** arise in situations in which the trustee or key employee's personal interest, be it financial, personal, or professional, interferes with their ability to make independent and objective decisions for the retirement system. Conflicts of interest should be avoided or resolved when contracting for services.
- **Fees** need to be scrutinized when hiring third-party service providers. The service provider should provide service and expertise that equals the value of the fee paid by the retirement system. The governing board should conduct due diligence to ensure that the trust funds allocated to the service are spent as effectively and efficiently as possible.
- **Performance** should be reviewed at reasonable intervals to ensure it meets the evolving needs of the system and complies with contractual terms and statutory requirements. Systems should, to the extent possible, conduct reviews on a regular schedule and evaluate performance against established standards.<sup>9</sup>

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<sup>9</sup> Eugene B. Burroughs, *Trustees and Their Professional Advisors*, (Brookfield, WI: International Foundation of Employee Benefit Plans, Inc., 1996), p.8.

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Delegation to contracted professionals should always be done according to **defined criteria** and with **mechanisms for review** of delegated functions. It is important that trustees are aware that even if tasks and responsibilities are delegated, **they remain fiduciaries and ultimately cannot delegate their fiduciary duty**.

However, in some circumstances, the contracted professionals themselves also become fiduciaries. The governing board must obtain acknowledgment, in writing, that an investment manager who is hired by the board has fiduciary responsibilities to the fund.<sup>10</sup>

### 1.3.4 Ethical issues

Trustees should always be aware that issues may arise between their personal interest and the interest of the system. Texas state law has specific rules that govern both conflicts of interest and standards of conduct for trustees, and best practices should be followed for dealing with prohibited transactions.

#### *Conflicts of interest*

Trustees and key staff have the potential for conflicts of interest between personal interests and their duty to the pension fund. Conflicts of interest may impair a trustee or key employee's ability to make balanced decisions and create a situation in which personal interests undermine his or her duty to the system. Texas Local Government Code, Chapter 171 establishes specific requirements that trustees and key staff of local public retirement systems must follow; trustees should review these requirements carefully.

Generally, members of the board who become aware of a personal conflict of interest have an obligation not only to disclose the conflict, but to resolve it. A person normally resolves a conflict of interest by promptly eliminating it.

A trustee or key employee can resolve a conflict by prudently withdrawing from action on a particular matter in which a conflict exists provided that:

- The person may be and is effectively separated from influencing the action taken;
- The action may properly be taken by others; and
- The nature of the conflict is not such that the person must regularly and consistently withdraw from decisions that are normally his or her responsibility with respect to the retirement system.

Trustees should disclose any conflicts-of-interest regarding matters which are before the board, make themselves absent from any relevant deliberations, and not vote on the matter. Such trustees may be required to disclose additional relevant information with respect to the matter in question.

#### *Prohibited Transactions*

It is considered a best practice for trustees and other fiduciaries to refrain from certain transactions because they may be considered conflicts-of-interest or self-enriching. Examples of such transactions include the:

- purchase, sale, exchange or leasing of property with the retirement system if the trustee or employee holds an interest in the property;
- purchase, sale, or exchange of any direct investment with the system if the trustee or employee holds an interest in the investment;

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<sup>10</sup> Section 802.203(d), Texas Government Code

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- lending of money or furnishing of other credit by the retirement system if the trustee or key employee has a direct or indirect interest in the loan or credit unless such loan or credit is generally available to members of the system, generates a reasonable return, provides adequate security, and is made in accordance with specific provisions of the plan;
- accepting offers by reason of a trustee's or key employee's position with the retirement system to trade in any security or other investment on terms more favorable than those available to the general investing public; and
- Soliciting business for a trustee's or key employee's own account or the account of an immediate relative or business associate.

### *Standards of Conduct*

The Texas Government Code provides explicit standards of conduct applicable to trustees of statewide retirement systems, but it is generally advisable that all trustees hold themselves to the same standards.<sup>11</sup>

A trustee should not:

- Accept or solicit any gift, favor, or service that might reasonably tend to influence him or her in the discharge of official duties or that the trustee or key employee knows or should know is being offered with the intent to influence his or her official conduct.
- Accept other employment or engage in a business or professional activity that he or she might reasonably expect would require or induce the trustee or key employee to disclose confidential information acquired by reason of his or her position with the retirement system.
- Accept other employment or compensation that could reasonably be expected to impair his or her independence of judgment in the performance of his or her official duties for the retirement system.
- Intentionally or knowingly solicit, accept, or agree to accept any benefit for having exercised his or her authority or performed his or her duties at the retirement system in favor of another.

### **1.3.5 Fiduciary liability**

Liability exists where there are unfulfilled responsibilities. A breach of fiduciary duty can result in lawsuits against the retirement system, civil action from the state or federal government, and criminal prosecution. Fiduciaries that do not follow basic standards of conduct may be **personally liable** to restore any losses to the fund, or to restore any profits made through improper use of the fund's assets resulting from their actions.

Fiduciaries and the governing board of the retirement system may take the following actions to reduce the likelihood of a lawsuit and minimize potential losses:

- Hold **fiduciary liability insurance**; however, insurance does not cover intentional criminal wrongdoing.
- Have written **policies and procedures** for both the administration and investments of the retirement system. This includes an investment policy, which is required by all Texas public retirement systems. An ethics policy may be used to outline both the legal and best practice expectations of the governing board.
- **Be engaged** in the investment process and ask relevant questions.

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<sup>11</sup> Section 572.051, Texas Government Code



## 1. The Trustee

- Engage in **risk management** and **strategic planning**.
- **Diversify** roles within the system.
- **Document** decision-making processes.
- **Monitor and benchmark** investments and services in addition to **auditing** systems to check for noncompliance.
- Obtain **continuing education**.
- **Seek advice** of independent professionals to assist with decision making.

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### 1.4 Education for trustees

TLFFRA trustees are granted enormous responsibilities in complex actuarial, investment and governance matters, however, they may not have a background in these subject areas. The Texas Legislature has established Minimum Educational Training (MET) requirements administered by the PRB.<sup>12</sup> Trustees should aim to build a solid educational foundation early in their service and continue to build on it with more advanced knowledge on a continuing basis.

The PRB has differentiated between “core” or “foundational” education, and “continuing” education. Often, continuing education offers a perspective on recent developments, the practice at a particular plan, or a deep dive on a particular subject. While often valuable, continuing education is not a replacement for foundational material, which covers the nuts and bolts of investments, actuarial matters, governance, and benefits administration.

#### 1.4.1 Minimum Educational Training (MET) requirements

**New trustees and administrators** are required to complete a minimum of seven hours of training within the first year of service, including training in all seven core content areas. No less than half a credit hour or more than two credit hours may be earned in any one core content area.

Core content areas include:

- Fiduciary Matters
- Governance
- Ethics
- Investments
- Actuarial Matters
- Benefits Administration
- Risk Management

**Continuing trustees and administrators** are required to complete a minimum of four hours of training every two years after the first year of service, which may be in either core content areas (above), or non-core content areas.

Non-core content areas include:

- Compliance
- Legal and regulatory matters
- Pension accounting
- Custodial issues
- Plan administration
- Texas Open Meetings Act
- Texas Public Information Act

Courses that meet the MET requirements are available from the PRB directly and from others listed on the agency’s website. Some systems also provide qualifying MET training directly, usually through their consultants (e.g., actuary, investment consultant, legal counsel).

#### 1.4.2 Building a strong educational foundation

Trustees should aim to build a strong educational foundation early in their service, as it will serve them throughout their tenure. There are many outside opportunities to build the skills and knowledge to serve effectively. The following may or may not be approved for MET compliance; please check the PRB sponsor list for the most up-to-date sponsor and course accreditation.

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<sup>12</sup> Section 801.211, Texas Government Code

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### *IFEBP/Wharton: Portfolio Concepts and Management*

The International Foundation of Employee Benefit Plans (IFEBP) offers several educational programs in conjunction with The Wharton School of the University of Pennsylvania, including a 3.5-day foundational course on Portfolio Concepts and Management.

Aimed at pension fund trustees, the course lays the groundwork for the core principles of portfolio theory and investment performance measurement. It offers the practical tools and experiences needed to make sound investment management decisions and is intended for those who have limited experience with investment-related course work.

<http://www.ifebp.org/portfolio>

### *NCPERS: Trustee Educational Seminar (TEDS)*

Offered by the National Council of Public Employee Retirement Systems (NCPERS), the TEDS program includes a beginner track that covers pension history, investments, performance measurement, and actuarial matters.

<https://www.ncpers.org/teds>

### **1.4.3 Conference opportunities**

Many educational opportunities are available at pension-related conferences, such as conferences provided by TLFRA and the Texas Association of Public Employee Retirement Systems (TEXPERS). Education offered at conferences often includes panel discussions or presentations on recent developments or best practices. While this can be a good way of staying up to date on recent developments and satisfying continuing education requirements, it may not provide the foundational content that is crucial for new trustees.

An additional benefit of attending conferences is the opportunity to build a network of peers. In some cases, it may be helpful to consult a more experienced colleague, perhaps from a different board of trustees.

### *Texas Local Fire Fighter's Pension Conference*

This conference is held annually in the fall and is hosted by the Texas Local Fire Fighters' Pension Conference, a nonprofit educational organization created to enhance the opportunities for education for trustees of TLFRA systems. These conferences provide MET program credits as required by the PRB.

The TLFRA Peer Review Trustee Training is an eight-hour course held annually and hosted by the TLFRA Peer Review Committee. The course is specifically for trustees and administrators of TLFRA systems, covering topics such as legal issues, governance policy, and administration. This course is taught by the TLFRA Peer Review Committee, certified speakers in fields of actuarial, investments, etc. This training meets the PRB MET requirements.

Check the TLFRA website at [www.tlffra.org](http://www.tlffra.org) to find out when and where the next conferences will be held.

### *Texas Association of Public Employee Retirement Systems (TEXPERS)*

TEXPERS offers the Basic Trustee Training class, which fulfills the MET program requirements, at least twice yearly prior to its conferences. TEXPERS conducts an Annual Conference each spring and a Summer Educational Forum each year. Along with the Basic Trustee Training class, TEXPERS offers additional focused workshops designed around the current topics or trends focused on public fund management and investment issues. Check the TEXPERS website for more information at [www.texpers.org](http://www.texpers.org).

## 1.5 Troubleshooting

At some point in your service as a trustee you will probably face challenges. Below are strategic means of addressing some of the common problems that trustees have encountered.

### 1.5.1 What to do when you lack knowledge on a topic?

Simply put—seek education and ask questions. Check with another trustee, the plan’s staff, your investment consultant, and/or your actuary. You can also consult the PRB on matters related to fulfilling your responsibilities under Texas law. It is vital to ask questions of the consultants. No question is too elementary: if you are wondering about something, chances are very good another trustee has a similar question. Consultants serve the board and should be able and willing to break technical concepts down to ensure trustees are able to make well-informed decisions.

You can also consult the PRB, which can provide technical assistance in a variety of areas including funding best practices, administrative issues, and actuarial matters.

Of course, keep in mind the requirements of the Texas Open Meetings Act (TOMA), which requires board meetings to be open to the public. If a majority of the board is discussing a matter privately, it may constitute a TOMA violation. More information on these requirements is presented in Section 3.6 of this manual.

### 1.5.2 How to ensure your priorities are considered by the board?

You probably started your board service with some ideas on how to improve your plan—that’s great! However, you’ll quickly learn that every idea has a season. Any topic being formally considered by the board must be on the noticed board agenda. Often key matters are only considered on a specific schedule. For example, investment reports should be reviewed quarterly while budgets may be addressed annually, and so on.

Consider checking with your board’s chair to determine an appropriate meeting to have your ideas considered by the board or to understand if a policy matter is typically discussed at a specific board meeting.

### 1.5.3 What to do if staff or consultants aren’t responsive?

Sometimes you may find that staff or consultants are not responsive to questions or concerns you raise, and you may be tempted to raise the matter at a board meeting. This is probably not the right approach. Instead, consider contacting an officer of the board, such as the chair, who may be able to address your concern directly. Certain topics may rise to the level of being discussed among the board during a closed (non-public) session.

## 2. The Board

## **2. THE BOARD**

## 2. The Board

### 2.1 The role of the board

The authority for a TLFRA pension system is clearly defined in the Texas Constitution and in state statute. Unlike private pension systems, your fire fighters' pension system is not subject to the federal oversight found in the Employees Retirement Income Security Act (ERISA). Each TLFRA trustee should read and become familiar with the pertinent articles of the Texas Constitution and state law governing pension systems.

In general, a board of trustees makes strategic decisions to ensure the longevity and actuarial soundness of their system. Consider a city council.<sup>13, 14</sup> This body decides the strategy for the city, making organization-wide decisions. For instance, a city council enacts the city's ordinances, hires the city manager, and oversees his or her management of the city government's day-to-day affairs.

Much the same, a pension plan's board of trustees decides the plan's investment strategy, hires investment professionals, and oversees their work. In other words, the work of the pension plan board of trustees is largely about establishing appropriate *governance*.

The board is responsible for developing and approving the plan's overall investment strategy, working with professional investment advisors. Specifically, the board develops and maintains an Investment Policy Statement (IPS) which guides investment decision-making, approves an asset allocation that aligns with the IPS and the plan's risk tolerance, and oversees the work of investment managers.

In addition to setting policy, the board is also responsible for plan administration. This means creating and maintaining a plan document; approving computations of service retirement, disability, and survivor benefits; and ensuring that benefits are actually paid correctly. While many stakeholders may have opinions, your role as trustee is to balance them and work for the overall good of the plan. In your role as administrator, you will also need to manage risk: you will face risks related to investments and funding, of course, but also risks to the security of IT systems and participant data, which must be proactively managed.

Another key role of the board is the hiring (and firing) of key staff and consultants, including those providing investment, actuarial and legal services. As a trustee, you will help prepare Requests for Proposal (RFPs), review resulting proposals, interview promising candidates, and oversee the work of staff or consultants—and, if needed, dismiss those who underperform. TLFRA trustees are encouraged to read *Boards That Make a Difference: A New Design for Leadership in Nonprofit and Public Organizations* and other books that will help to effectively serve as fiduciaries.

#### 2.1.1 What is governance?

In basic terms, **governance is the process used to make and implement decisions**. At a minimum, good governance generally means decisions are made through processes that are:

- **consistent and well-documented**,
- **in compliance** with relevant statutes and rules, and
- **open and accountable** to stakeholders.

For public retirement systems, good governance also means fiduciaries exercising their duties

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<sup>13</sup> <https://corporatefinanceinstitute.com/resources/careers/jobs/what-is-a-ceo-chief-executive-officer/>

<sup>14</sup> <https://www.tml.org/DocumentCenter/View/1289/2019HandbookforMayorsandCouncilmemberswebfinal>

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by **prudently** selecting and managing investments and **cost effectively** administering the system.

### 2.1.2 Why is governance important?

Why do formal, established processes matter? Can't we simply make decisions informally, as needed? If we are hiring staff and consultants, why can't we just trust them to make decisions?

Experience shows us why. The Enron collapse was largely a failure of governance—the company's board of directors failed to create appropriate oversight of the company's business practices.<sup>15,16</sup> The 2008-2009 financial collapse is also associated with governance and regulatory failures.

A body of literature and research on pension governance suggests that good governance can offer numerous benefits to a public retirement system, including:

- **establishing accountability** by defining roles and responsibilities for the board, plan administrator, plan staff, and contracted service providers;<sup>17</sup>
- **building stakeholder confidence** in the system;
- **reducing the likelihood of a fiduciary breach**, providing protection to the trustees and plan participants and possibly reducing the risk of litigation;<sup>18</sup> and
- **potentially improving long-term investment returns**, according to one study<sup>19</sup>

### 2.1.3 The board as policymaker

It is important for trustees to remember that a large aspect of board leadership is setting policies for their retirement system to follow. Acting collectively as a body, TLFRA boards develop the formal, written policies that guide the day-to-day management of the system. This is largely about *mindset*. TLFRA boards need to think of themselves as policy boards and understand that board leadership is largely a policy task.

**Policymaking means being proactive, rather than being reactive to issues of all sizes.** Governing by policy means that no plan activity takes place without reference to policies. Most resolutions in board meetings will be motions to amend the policy structure in some way. Policy development is not an occasional board chore, but its chief occupation. **Policymaking is an ongoing process of continuous improvement.**

From time to time, a board discovers that its values and perspectives have changed, that a previous statement was not fully cognizant of the range of options, or that the risks and opportunities in the external world have shifted. Even large shifts in board values can usually be accommodated more by altering existing language than by adding to it, thus changing the volume of policies very little. It is important that the collection of board policies not grow so large that it fails to remain a truly living document.

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<sup>15</sup> <https://www.govinfo.gov/content/pkg/CPRT-107SPRT80393/pdf/CPRT-107SPRT80393.pdf>

<sup>16</sup> [http://picker.uchicago.edu/Enron/PowersReport\(2-2-02\).pdf](http://picker.uchicago.edu/Enron/PowersReport(2-2-02).pdf)

<sup>17</sup> <http://www.afscme.org/news/publications/for-leaders/pdf/AFSCME-report-pension-best-practices.pdf>.

<sup>18</sup> Texas Municipal Retirement System Fiduciary Training Manual

<sup>19</sup> The Ambachtsheer Letter, How Much is Good Governance Worth?, June 2006, as referenced by: [http://www.ncpers.org/Files/2012\\_ncpers\\_best\\_governance\\_practices.pdf](http://www.ncpers.org/Files/2012_ncpers_best_governance_practices.pdf)

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If you ask most trustees to name the policies that they have adopted, the list will probably include policies concerning administration, budget, elections, ethics, travel, and investments, among others.

Several factors drive good policymaking. **Effective policy must be:**

- **Explicit.** Policies must exist in written form. This is the only way all parties (including the policymakers) can know just what the policy is. Some plans may try to govern by tradition or using institutional knowledge. This is a recipe for problems because it may obscure differences in interpretation or implementation. Plans should codify any such policies in writing to ensure they are consistently understood and implemented.
- **Current.** Up-to-date policies are the only ones that work. Boards must continually review their policies to ensure they match with best practices recommended by independent groups or peer organizations—and that they work given the current circumstances facing the plan.
- **Literal.** Policies must mean what they say. Policies should be clearly written and readily understood. The language should leave no ambiguity in meaning.
- **Central.** Board pronouncements should be kept in one place, to serve as a central resource for those charged with implementing the policies. They should not be scattered about, discoverable only by scouring years of meeting minutes and other documents.
- **Brief.** Organizations often seem impressed with complexity, but should focus instead on shorter, simpler directives. It is often more challenging to limit the length of a policy than to extend it. Boards should take the time to produce brief, clear policy.

The rest of this section will detail common policymaking engaged in by TLFRA boards, including key decisions and how those relate to the core policy documents produced by a board. It will also provide a checklist of administrative tasks a board must complete and a breakdown of compliance requirements under Texas law.



## 2. The Board

### 2.2 Key policy decisions

The board of trustees is tasked with making numerous policy decisions. Often, they relate and decisions in one sphere may impact the range of possibilities in another.

Many of these decisions deal with complex financial and actuarial matters, which are covered more in depth later in this manual.

#### 2.2.1 Plan design

The Texas Local Fire Fighters Retirement Act (TLFFRA) provides a basic framework for plans, but the individual boards of trustees are charged with establishing the details of their plan design. TLFFRA plans are **defined benefit** plans instead of defined contribution or hybrid plans. A defined benefit plan is funded by contributions from employers and employees and investment returns to the fund; **the employee is then guaranteed specified benefits**—regardless of whether contributions or investment returns actually cover the cost of those benefits.

All existing TLFFRA plans have a plan design in place, but boards of trustees can modify them to some extent. For instance, a plan may modify its benefit formula (which calculates the retirement benefit payment amount), provide a cost-of-living adjustment (COLA), or create a deferred retirement option plan (DROP). Any of these changes can have a significant impact on the ability of the plan to pay benefits.

Under Section 7 of TLFFRA, any changes to benefits or eligibility must be approved by both an actuary selected by the board and by a vote of the members of the plan. For current members, accumulated benefits may not be retroactively reduced; however, the benefit formula may be altered for accumulation of benefits moving forward. Also, be sure to consider Texas Attorney General Opinion GA-0615 and recent lawsuits regarding the constitutional protection of benefits.<sup>20</sup> Any change to your benefit design or structure that may impact current members should be analyzed to ensure it does not violate Section 66 of the Texas Constitution.

#### 2.2.2 Investment objectives

The plan design impacts the investment objectives. For public retirement systems, the main goal of investing is to ensure that sufficient assets are available to fund the retirement benefits promised to their members.

A key question is what level risk a plan is willing to tolerate. At its most basic level, investing involves **prudently taking risk** to achieve higher long-term rates of return than can be earned with risk-free investments such as cash or Treasury bills. If a plan is relatively “young,” with many active members, it may be willing to tolerate a higher level of risk in exchange for higher returns. If a plan has more retired members, it may need a lower level of risk.

A fundamental principle to remember is that some level of risk is inherent in all investments. That is, investors generally must expect to bear higher levels of risk to achieve higher levels of return. However, it is also important to note that riskier investments do not always ultimately turn out to have higher levels of return.

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<sup>20</sup> <https://www.texasattorneygeneral.gov/opinions/greg-abbott/ga-0615>

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### 2.2.3 Asset allocation

The board can determine the appropriate asset allocation once the investment objectives of a plan have been established. Assets may be divided and invested in specific asset classes to diversify the plan's investment portfolio. How a plan divides up assets is referred to as **asset allocation**. For instance, equities (i.e., stocks) tend to have higher returns but are also riskier. Bonds tend to have lower returns but lower risk. Boards of trustees determine how to allocate their investments between these asset classes, as well as cash, real estate, and alternative investments.

Boards of trustees adopt a **strategic asset allocation** in its investment policy statement (IPS), which defines which asset classes to include in the portfolio and the long-term allocation. Boards can also approve **tactical asset allocations**, wherein the asset allocation is temporarily adjusted to account for short-term risks or opportunities. For example, a board might believe, based on the advice of investment professionals, that a certain asset class is undervalued, and may choose to reallocate its investments on that basis.

Trustees should remember that the asset allocation is developed from the plan design and investment objectives. Boards of trustees also adopt an **assumed rate of return** as an actuarial assumption, and it may be tempting to allocate assets in to attempt to meet that assumption. This puts the cart before the horse; instead, *the assumed rate of return should be based on asset allocation.*<sup>21</sup>

### 2.2.4 Investment management guidelines

In addition to establishing the plan's asset allocation, the board is responsible for creating other guidelines for investment managers. Generally, they aim to mitigate risk by restricting certain investment practices.

For instance, investment management guidelines may limit the portion of the portfolio that can be invested in a single investment, might limit equity investments to high-quality and highly marketable stocks, and might restrict investors from engaging in short sales (borrowing an equity to sell it, hoping it can later be purchased for less and returned to the owner) or purchasing on margin (borrowing money from a broker to purchase a stock).

### 2.2.5 Actuarial assumptions

Based on the advice of actuarial professionals, boards adopt actuarial assumptions, which help assess whether the plan's assets will be sufficient to pay the promised benefits. These include both **economic** and **demographic** assumptions. The actuary is required to follow the Actuarial Standards of Practice (ASOPs) when developing and recommending assumptions.

**Economic assumptions** include the assumed rate of return, projected salary increases, and inflation. **Demographic assumptions** include the expected retirement age, and rates of turnover, disability, and mortality. More on assumptions will be covered in **Section 4** of this manual.

It may be tempting to make actuarial assumptions in response to other considerations. For instance, adopting unrealistic assumptions may make your plan appear more stable than it really is. On the contrary, it is important for boards to make **reasonable assumptions** (as recommended in the PRB's *Pension Funding Guidelines*), which will produce a more accurate view of the plan's current status.<sup>22</sup> If an actuarial valuation reveals problems based on reasonable assumptions, the solution is to make changes to the plan design or investment practices, not to change the assumptions themselves.

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<sup>21</sup> <https://www.actuary.org/node/13739>

<sup>22</sup> <https://www.prb.texas.gov/prb-pension-funding-guidelines/>

## 2. The Board

### 2.3 Hiring and evaluating staff and contracted service providers

Delegation is a key aspect of good governance. Boards of trustees should set the policy of the retirement system, while the staff carries out the policies and manages the system's operations. For example, the plan administrator is in charge of the **administrative management** of the plan and implementing the board's decisions. The governing board is charged with making policy and setting the mission and vision of the system.

As a result, the hiring and evaluation of staff and contracted professional services providers is an important responsibility for the board. Hiring a service provider in and of itself is a fiduciary function. When considering prospective service providers, provide them with complete and identical information about the plan and what services you are looking for so that you may make a meaningful comparison.

Some items a trustee needs to consider when selecting a service provider include:

- Information about the firm itself: financial condition and experience with retirement plans of similar size and complexity.
- Information about the quality of the firm's services: the identity, experience, and qualifications of professionals who will be handling the plan's account; any recent litigation or enforcement action that has been taken against the firm; and the firm's experience or performance record.
- A description of business practices: how plan assets will be invested if the firm will manage plan investments or how participant investment decisions will be handled, the proposed fee structure, and whether the firm has fiduciary liability insurance.

The fund should establish and **follow** a formal review process at reasonable intervals to decide if it wants to continue using the current service providers or look for replacements. When monitoring service providers, actions to ensure they are performing the agreed-upon services include:

- reviewing the service provider's performance,
- reading and comprehending any reports they provide,
- monitoring and reconciling actual fees charged,
- receiving continuing updates about policies and practices of the provider (i.e., trading, investment personnel turnover, proxy voting, soft money), and
- following up on participant inquires or complaints.

A system should document its selection and monitoring process and any actions the board takes on behalf of the service provider. It is important that members of the board are aware that **even if tasks and responsibilities are delegated, the trustees remain fiduciaries and ultimately cannot delegate their fiduciary duty.**

#### *Fees and Expenses*

Fees are just one of several factors that fiduciaries need to consider when deciding on service providers and plan investments. When the fees for services are paid out of plan assets, trustees will need to understand the fees and expenses charged and the services provided.

TLFFRA provides for fees for services to be paid for attorneys, actuaries, and certified public accountants, as well as for costs of investment management and/or consulting services. Currently, provisions for other payments from the system, excluding legal and medical fees, may not exceed one percent of the market value of the assets of the fund up to \$1 million in book value; and ¼ of one percent of the market value of the assets of the fund that exceeds \$1 million.

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In comparing estimates from prospective service providers, it is important to ask which services are covered for the estimated fees and which are not. Some providers offer several services for one fee, sometimes referred to as a “bundled” services arrangement. Others charge separately for individual services. Compare all services to be provided with the total cost for each provider. Consider whether the estimate includes services you did not specify or want.

Expenses are another area which should be closely monitored and accounted for. A board should have an annual budget for all expenses, including service provider fees, which should include expenditures such as board travel and training.

Section 25 of TLFRA states that “a board...may pay from assets of the fund all costs reasonably and lawfully incurred by the retirement system and the costs of actual expenses incurred by board members in the performance of their duties on the board.”

These fees and expenses, like any other cost, are assets of the fund and should be closely monitored and scrutinized. Again, this is not your money.

### 2.3.1 Investment professionals

While retirement system boards are fiduciaries and are directly responsible for investing the system's funds, most hire specialists to advise the board on particular investments and to actually invest the assets. Many boards, especially those that do not have in-house investment managers, typically hire outside investment consultants and investment managers. Importantly, any time a board hires investment professionals, the board is obligated to evaluate their performance.<sup>23</sup>

#### *Non-discretionary vs discretionary models*

If seeking investment management assistance, boards will either choose a **non-discretionary** or a **discretionary** manager model. Both models share many of the same responsibilities. However, the primary difference between the two models is the level of authority or responsibility granted to a manager and the governing body's involvement. The non-discretionary manager model is most commonly used by pension funds in Texas. It keeps final investment decisions with the board, while managers provide advice or other services to assist in the board's decision-making process.

If opting for a discretionary manager, the board gives significant authority to an outsourced chief investment officer or similar professional and must establish clear policies to guide the manager. The discretionary management model shifts more of the fiduciary and day-to-day obligations onto the selected manager. Effectively, a discretionary model changes the governing body's investment role to setting policy and monitoring portfolio effectiveness. While this model may allow the governing body to focus more time on other matters, the board members are still fiduciaries and have increased responsibility to thoroughly monitor all aspects of the investment decisions made. The primary benefit associated with the discretionary model is the ability of the selected manager to act more quickly to hire/fire any investment manager and capture investment opportunities within the parameters of the board's established policies. The primary tradeoff for the discretionary model is increased fees charged by the manager for the additional responsibilities.

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<sup>23</sup> Carol V. Calhoun, Cynthia L. Moore, Keith Brainard, Governmental Plans Answer Book, (Frederick, MD: Aspen Publishers, 2007), p. 2-13

## 2. The Board

### *Investment consultant*

Boards often hire investment consultants who have expertise in specific asset classes to assist in setting and meeting investment objectives, reviewing investment performance, and making portfolio adjustments over time. Typically, an investment consultant provides advice to the board, which has the discretion to accept or reject the recommendations.<sup>24</sup>

**A non-discretionary consultant does not execute investment decisions, but rather, provides strategic-level advice and may conduct periodic studies such as asset/liability studies.** Investment consultants may also assist the fund with investment manager selection and performance evaluation.

### *Investment manager*

Investment managers, or money managers, are responsible for investing a system's assets. Depending on the size and complexity of the retirement system, a plan may have multiple investment managers.

Statute specifies that managers must be<sup>25</sup>:

- (1) registered under the Investment Advisors Act of 1940 (15 U.S.C. Section 80b-1 et seq.);
- (2) a bank as defined by that Act; or
- (3) an insurance company qualified to perform investment services under the laws of more than one state.

Under state law, **investment managers hired by retirement systems are fiduciaries and must acknowledge such in writing.**<sup>26</sup>

### *Custodian bank*

Systems usually hire a custodian bank which maintains the system's funds and often performs account reconciliation, recordkeeping, and compliance activities. If a board has multiple asset managers, it will often require a master custodian to safeguard and reconcile the invested assets across managers. Custodian banks are responsible for:

- safeguarding or safekeeping financial assets, e.g., stocks, bonds, etc.;
- arranging the settlement of sales and purchases of such securities; and
- collecting information on income from the assets.

## 2.3.2 Other service providers

In addition to investment-related tasks, retirement systems frequently delegate certain other tasks to outside consultants and service providers. Some boards may also delegate certain duties, including asset management and/or benefit payments.

### *Actuary*

An actuary is a business professional who analyzes the financial consequences of risk using mathematics, statistics, and financial theory to study uncertain future events, mostly related to insurance and pension programs.<sup>27</sup>

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<sup>24</sup> [https://www.sec.gov/about/offices/oia/oia\\_investman/rplaze-042012.pdf](https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf)

<sup>25</sup> Section 802.204(b), Texas Government Code

<sup>26</sup> Section 802.203(d), Texas Government Code

<sup>27</sup> <https://www.soa.org/future-actuaries/what-is-an-actuary/>

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Professional designations of actuaries can vary, but the following designations are most common:

- F.S.A. = Fellow of the Society of Actuaries
- A.S.A. = Associate of the Society of Actuaries
- E.A. = Enrolled Actuary
- M.A.A.A. = Member of the American Academy of Actuaries

Statute **requires retirement systems in Texas to employ an actuary full-time, part-time, or as a consultant** for the purpose of creating an actuarial valuation of assets and liabilities at least once every three years.<sup>28</sup> The actuary must be a fellow of the Society of Actuaries, a member of the American Academy of Actuaries, or an enrolled actuary under the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.).

Actuaries estimate the future benefit payments expected to be paid from the plan by making assumptions about how long current employees will work and live, how much they will earn, and ultimately the distributions they will receive. The expected future payments are analyzed in various ways to:

- **Perform calculations required** by general and specific reporting requirements;
- **Determine if a plan's existing funding policy is sufficient** to meet the future benefit obligations of the plan based on the current plan design and funded status; and
- **Estimate the financial impact** of plan design, funding policy and/or investment policy changes.

A good resource for locating actuaries is the American Academy of Actuaries website at <http://www.actuary.org/>. They have a search engine that you can use to find actuaries to bid on your proposal. In your communications with prospective actuarial firms, be sure to clarify your expectations and the services you will need. Be sure to include:

- Description of your current plan design
- Statutory authority (TLFFRA)
- Latest actuarial valuation
- Audited financial statement
- A description of services required
- Expectations regarding delivery of reports and attendance at meetings

This process is a good task for a committee of board. A committee of three members (with additional outside assistance from the city) could draft the request for proposal and develop the evaluation criteria for the board to review and adopt. The committee could be also charged with narrowing the field of candidates to two or three firms for board presentation.

Although you should be concern with the cost of the proposed services, you should attempt to find the best value for your fund. A low-cost report may meet your statutory requirements but may not provide your board with the professional advice that you need to make the best long-term decisions.

### *Auditor*

An external auditor (or independent auditor) examines the books and accounts of the retirement system in accordance with generally accepted auditing standards for the purpose of issuing an opinion on a financial statement. This is called a financial audit and is required at least annually of all Texas systems

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<sup>28</sup> Section 802.101, Texas Government Code

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under state law.<sup>29</sup>

Some systems, given available resources, also hire internal auditors to monitor compliance and advise the board to avoid potential problems. Governance or fiduciary audits are other types of audits that systems may choose to have performed.

### *Legal counsel*

Many retirement systems seek the help of legal counsel. Legal counsel can provide guidance on statutory compliance as well as on issues not covered by statute. Legal counsel typically advises on fiduciary duty, governance, tax issues, contracts, and benefit decisions and other issues.<sup>30</sup> Legal counsel may also review proposed legislation. Depending on the services needed, systems may choose to hire internal counsel, outside counsel, or to seek the services of the sponsor government's counsel.

### **2.3.3 Selecting service providers**

An established selection process helps ensure a service provider has the necessary qualifications and that the process is fair and competitive, and free of conflicts-of-interest. Establishing an appropriate process to select service providers is another type of **policymaking**.

When contracting for investment management services, boards **should take particular care to employ due diligence**, given the importance of those decisions and their fiduciary duty. After the screening and interview process, systems should make a **reasoned decision** based on the information obtained and document that decision.

Below are some questions that the governing board should answer as part of the contracting process.<sup>31</sup> Answers to these questions will help boards develop requests for proposal (RFPs) and assess the proposals they subsequently receive.

#### *What are the specifications for the position?*

A board should have a clear view of the role the position will have within the system. The role and responsibilities of the position should be outlined and understood prior to the selection process.

#### *What qualifications should the candidate have?*

A board must determine what qualifications are required for the position, including those required by law such as Section 802.204(b), Texas Government Code.

#### *How can the system identify appropriate candidates?*

Systems usually have various resources they can use to help identify candidates including consulting with other funds in their area to obtain recommendations for service providers. Also, if the system already has an investment consultant, the consultant might conduct an initial search and screen of potential investment manager candidates.

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<sup>29</sup> Section 802.102, Texas Government Code

<sup>30</sup> Carol V. Calhoun, Cynthia L. Moore, Keith Brainard, Governmental Plans Answer Book, (Frederick, MD: Aspen Publishers, 2007), p. 2-12

<sup>31</sup> Eugene B. Burroughs, Trustees and Their Professional Advisors, (Brookfield, WI: International Foundation of Employee Benefit Plans, Inc., 1996), p.7.

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*Do bids and proposals from candidates meet expectations and align with the system's needs?*

Candidates' proposals should set forth their qualifications, proposed services and fees and provide references. The system's bidding processes should be transparent, open, and comply with applicable statutory requirements. TLFRA plans should consider drafting a procurement policy, which may be based on the state contracting laws applicable to statewide retirement systems.



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### 2.4 Governing documents, reports, and plans

Once a board of trustees makes its policy decisions, it works with the staff and contractors it hires to produce a series of core governing documents and reports, many of which are required under state law. In some cases, a plan may be required to develop additional documents if it meets certain requirements.

#### 2.4.1 Plan document

The plan document is a detailed description of the plan design, including benefits and eligibility requirements, as well as employee contributions. It will explicitly identify factors like the benefit formula, retirement age, disability eligibility, death benefits, deferred retirement option plan (DROP) provisions, etc.

Existing TLFRA plans have a plan document in place. Its provisions can be modified prospectively by the board of trustees, if approved by an actuary and by a vote of the plan's members.

#### 2.4.2 Investment policy statement (IPS)

TLFRA statute requires the board of trustees to **adopt formal investment policies that emphasize safety and diversity as well as liquidity for benefit payments**. Since 1993, all Texas plans have been required to develop a formal, written investment policy statement, which must be available to the public for review and filed with the PRB within 90 days of adoption. The IPS is a way of formalizing the investment-related policy decisions made by the board of trustees.

An investment policy should focus on the big picture, stating such things as asset allocation, types of allowable investments rather than specific investments, and other criteria such as standards of investment quality and rate of return objectives. If this is accomplished, the trustees can refer to their "business plan" and adjust on a quarterly or annual basis. Key policy decisions that should be included in an IPS include the investment objectives, risk tolerance, asset allocation, and investment manager review procedures.

Developing the IPS is among the most important duties of a board of trustees. The PRB has made available guidance for the development of an investment policy, and recommends the following "test" questions to assess the IPS; a trustee should be able to read the IPS and answer "yes" to each.<sup>32</sup>

1. Is the policy carefully designed to meet the real needs and objectives of the retirement plan?
2. Is the policy written so clearly and explicitly that a complete stranger could manage a portfolio and conform to the desired intentions?
3. Would the retirement fund have been able to sustain a commitment to the policies during the capital markets that have been experienced over the past ten, twenty, fifty, or even sixty years?
4. Would the investment managers have been able to maintain fidelity to the policy over the same periods?
5. Would the policy, if previously implemented, have achieved the objectives and results desired?

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<sup>32</sup> <https://www.prb.texas.gov/resource-center/trustees-administrators/developing-an-investment-policy/>

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### 2.4.3 Annual financial report

All public retirement systems must publish an annual financial report showing the financial condition of the system, as assessed by a certified public accountant (CPA) under generally accepted accounting standards. The goal of the annual financial report is to provide trustees and the public with an understanding of the current value of the plan's assets, and how that has changed since the prior year. The annual financial report must be filed with the PRB.

The report must include current financial statements and schedules, an opinion from the CPA stating that the statements and schedules are presented fairly, a listing of all investment fees and commissions paid by the plan, and the names of the plan's investment managers.<sup>33</sup>

Investment expenses must be broken down and detailed in annual financial reports. While there are many asset classes and internally the plan may have specific names they use for categorization purposes, the PRB has identified five broad asset classes that must be used when reporting investment fees and expenses.<sup>34</sup>

Asset classes per the PRB 2020 Asset Class Categorization Guide:

1. Cash
2. Fixed income
3. Public equity
4. Real assets
5. Alternative/other

### 2.4.4 Actuarial valuation report

The actuarial valuation report is completed by a certified actuary and reports on the system's total assets and liabilities using actuarial assumptions determined by the board of trustees in consultation with the actuary. Public requirement systems are required to submit an actuarial valuation at least once every three years.

The actuarial valuation allows trustees and the public to assess whether the plan's assets will be sufficient to pay benefits when due, given the chosen assumptions. The actuarial valuation must also include a recommendation from the actuary on a contribution rate that would allow any unfunded liability to be fully funded, or amortized, within thirty years. The actuarial valuation must be filed with the PRB.<sup>35</sup>

### 2.4.5 Actuarial experience study

Plans with assets valued at \$100 million or higher are required to complete an actuarial experience study once every five years.<sup>36</sup> This study reviews the actuarial assumptions considering relevant experience factors, important trends, and economic projections with the purpose of determining whether the assumptions require adjustment.

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<sup>33</sup> Section 802.102 and 802.103, Texas Government Code

<sup>34</sup> 40 Tex. Admin. Code §609.111(d) (2020)

<sup>35</sup> Section 802.101, Texas Government Code

<sup>36</sup> Section 802.1014, Texas Government Code

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### 2.4.6 Investment Practices and Performance Evaluation (IPPE)

Plans with assets of at least \$30 million are required to hire an independent firm to evaluate their investment practices and performance and make recommendations for improvement. Plans with assets between \$30 million and \$100 million must have an IPPE completed once every six years; plans with assets over \$100 million must have an IPPE completed once every three years.<sup>37</sup>

### 2.4.7 Funding policy

Plans are required to adopt a written funding policy, which describes the board’s plan to achieve a funded ratio of at least 100 percent—in other words, to ensure that assets are at least equal to projected liabilities. The policy serves as a “roadmap” to fully fund the plan’s long-term obligations.

A funding policy helps a system achieve the three fundamental goals of public pension funding: benefit security, contribution stability, and intergenerational equity. While different plans and their sponsors may prioritize these goals differently, the funding policy should seek to achieve **balance** in its funding policy. In particular, the funding policy should include:

1. Clear and concrete funding objectives
2. Actuarial methods
3. A roadmap to achieve the funding objectives
4. Actions that will be taken to address actual experience that diverges from assumptions.<sup>38</sup>

The funding policy and any subsequent changes must be filed with the PRB within 31 days.<sup>39</sup>

### 2.4.8 Funding Soundness Restoration Plan (FSRP)

If a defined benefit plan receives an actuarial valuation indicating the system’s actual contributions are not sufficient to pay off the unfunded actuarial accrued liability within 30 years over a few valuations, the plan and its associated governmental entity are required to formulate a Funding Soundness Restoration Plan (FSRP).<sup>40</sup>

Each FSRP shall:

- be designed to achieve a contribution rate sufficient to amortize the unfunded actuarially accrued liability (UAAL) within 30 years no later than two years after the triggering actuarial valuation (AV) or September 1, 2025, whichever is later,
- be adopted during open meetings of the governing bodies of both the system and sponsor, and
- be submitted to the PRB not later than the 31<sup>st</sup> day after the date on which the plan or any change is agreed to.

The system and sponsor are required to provide progress reports to the PRB no later than a year after the date of the triggering AV and each subsequent six-month period until the FSRP is submitted. The progress

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<sup>37</sup> <https://www.prb.texas.gov/txpen/wp-content/uploads/2019/10/Investment-Practices-and-Performance-Reports-Guidelines.pdf>

<sup>38</sup> <https://www.prb.texas.gov/txpen/wp-content/uploads/2019/11/Guidance-for-Systems-Developing-a-Funding-Policy.pdf>

<sup>39</sup> Section 802.2011, Texas Government Code

<sup>40</sup> Sections 802.2015 and 802.2016

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report shall include a draft of any plan and description of any changes under consideration.<sup>41</sup>

### **2.4.9 Ethics and Conflict-of-Interest Policy**

It is considered a best practice to develop a formal ethics and conflict-of-interest policy, which outlines standards of conduct expected of trustees as plan fiduciaries to act responsibly, honestly, and in the best interest of the fund, and to avoid creating even the appearance of impropriety. There are several things to consider when developing your policy, for example, the fund's ethics policy should outline the procedures and policies relating to the interactions with both potential and current vendors. The PRB has developed a Model Ethics and Conflict-of-Interest Policy for voluntary use by Texas public retirement systems.<sup>42</sup>

### **2.4.10 Domestic Relations Orders (DROs)**

In a divorce, a court may award a portion of a member's retirement benefits to a former spouse. A qualified domestic relations order (QDRO) is an order entered by the court in a divorce that directs the retirement system to make direct payment of a portion of a participant's benefits to his or her former spouse. In Texas, public pension plan QDROs are governed by Chapter 804, Texas Government Code. For the QDRO provisions of Chapter 804 to apply, your board of trustees must elect to adopt the provisions of this subchapter and Subchapter C. An election under this section must be by order or resolution and need not set out the text of this subchapter or Subchapter C. A board of trustees may not elect to adopt only this subchapter or Subchapter C. It is important to include proper procedures concerning QDROs in your plan document and/or handbook provided to members so they can easily understand how to proceed in that situation.

### **2.4.11 Appeals to the State Office of Administrative Hearings**

TLFFRA board trustees need to be aware that an aggrieved person may appeal their decision regarding a benefit award. If an appeal is filed, a trustee should review both the TLFFRA Section 22 and the Administrative Procedure Act (APA).<sup>43</sup>

#### **Step 1: Notify applicants of appeal process**

The board shall provide a Notice of Appeal/Complaint Form and a copy of the appeal procedures with every application for benefits (refund, retirement, disability, spouse benefit, correction of errors, etc.) that the board distributes. This should provide the applicant with sufficient notice to file an appeal if they wish to contest the benefit determination. The PRB has a Notice of Appeal form a person may use or retirement systems can provide to their members to initiate the process.<sup>44</sup>

#### **Step 2: Appellant must file appeal with board within 20 days**

The appellant should complete the form including a reference to the section(s) of the statute (Article 6243e.V.T.C.S.) or the section(s) of the fund's plan that forms the basis of the appeal. The aggrieved person initiates an appeal by delivering a notice of appeal with the chairman, secretary, or secretary-

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<sup>41</sup> Section 802.2015, Texas Government Code <https://www.prb.texas.gov/actuarial/funding-soundness-restoration-plan-fsrp/>

<sup>42</sup> [https://www.prb.texas.gov/txpen/wp-content/uploads/2019/11/prb\\_model\\_ethics\\_policy\\_2015.pdf](https://www.prb.texas.gov/txpen/wp-content/uploads/2019/11/prb_model_ethics_policy_2015.pdf)

<sup>43</sup> Section 2001.001, Texas Government Code

<sup>44</sup> <https://www.prb.texas.gov/txpen/wp-content/uploads/2019/11/TLFFRA-Appeal-Form-Web-Final.pdf>

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treasurer of the board of trustees that made the decision. The notice must be delivered not later than the 20th day after the date of the decision and contain a brief description of the reasons or grounds for appeal. The aggrieved person must file a copy of the notice with the PRB. Upon receipt of the notice of appeal, the PRB will immediately refer the matter to the State Office of Administrative Hearings (SOAH) by submitting the appeal to them. The sole function of the PRB with respect to an appeal under this section is to refer the appeal to SOAH. SOAH has exclusive authority to decide the appeal.

### **Step 3: Processing of appeal**

An appeal under this section is a contested case under the APA and is conducted as a de novo hearing by SOAH in Austin. Traditionally, the party seeking relief is the party with the burden of proof.

The board should be represented at the hearing and evidence submitted into the record supporting the board's decision. You should consult with your attorney; however, your local board should be prepared to submit into evidence the following documents:

- Notice of Appeal/Complaint Form
- Board order, if any, containing the board's decision
- Minutes of the meeting in which the board's decision was made
- Current plan document (plan design) for the fund
- Appellant's benefit form(s)
- Medical records
- Any other records pertaining to the case

Like for a QDRO, this procedure should be laid out for members so they can understand what is needed on their end to file an appeal, and then the process thereafter.

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### 2.5 Administrative checklist

The checklist below shows the tasks commonly performed by boards of trustees and staff of TLFRA plans, including their frequency. Use this as a guideline as you enter service as a trustee and ask incumbent trustees if they have a list like this specific to your plan.

#### *Ongoing Tasks*

1. Process pension applications.
2. Interface with city finance department, custodial bank, and investment contractors.
3. Process personnel records.
4. Prepare mechanism for reviewing retirement scenarios with member.
5. Update PRB when plan description changes are approved.
6. Update PRB when the fund's investment policy changes.

#### *Monthly Tasks*

1. Track benefit disbursements.
2. Reconcile investment trades.
3. Present cash flow report to board.
4. Track contributions for employed fund participants.
5. Post notice of monthly meeting.

#### *Quarterly Tasks*

1. Receive quarterly investment reports.

#### *Annual Tasks*

1. Create and store snapshot of benefit disbursements for the fiscal year.
2. Create and store snapshot of contribution payments for the fiscal year.
3. Send Membership Reconciliation Report annually to PRB.
4. Send Investment Policy to PRB 90 days after a change.
5. Send accepted audited annual financial report to PRB 210 days after fiscal year end.
6. Send accepted actuarial valuation to PRB every two years.
7. Report to participants (active and vested terminated) with benefit statements.

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### 2.6 Compliance requirements

TLFFRA plans are required to comply with Texas state law, including plan reporting requirements, Public Information Act requirements, and internet posting requirements. The basics are outlined below; review the actual requirements or consult with counsel or the PRB for any detailed questions.

#### 2.6.1 Filings with the Pension Review Board

Texas Government Code requires TLFFRA plans to submit certain documents and reports to the PRB as follows:

<b>Document/Report</b>	<b>Req'd Frequency</b>	<b>Deadline to PRB</b>
Annual Financial Report	Annually	
Membership Report	Annually	Within 210 days after end of previous fiscal year
Investment Returns and Assumptions Report	Annually	
Minimum Education Training compliance	Annually	September 1 of each year
Actuarial Valuation	Every 3 years	Upon adoption
Actuarial Experience Study		
Actuarial Audit <i>(Only plans with &gt;\$100 million in assets)</i>	Every 5 years	Within 30 days of adoption
Investment Practices and Performance Evaluation Report	Every 3/6 years	
Funding Policy		Within 31 days of adoption/receipt by the system
Funding Soundness Restoration Plan	If triggered	
Investment Policy		Within 90 days of adoption/amendment
Summary Plan Description		Changes reported within 30 days
Trustee and System Administrator Information		
Registration with the PRB (new plans)		Within 90 days of the plan's creation

TLFFRA plans for volunteer fire departments are only required to submit registration and summary plan description to the PRB.

Updated information on required PRB filings is maintained at the PRB website:

<https://www.prb.texas.gov/plan-reporting-and-compliance/>

#### 2.6.2 Texas Public Information Act

The Texas Public Information Act (PIA) recognizes that the work of public agencies, including public retirement systems, is a matter of public concern. As such, it provides that any member of the public generally has the right to access any information relating to the work of a public agency that pertains to official business.

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Public information includes any information that is collected, assembled, or maintained by or for a governmental entity. The PIA applies to records regardless of their format; it includes information that is maintained in paper, tape, microfilm, video, electronic data held in a computer memory, as well as other mediums specified under law.

- The PIA is only activated by a written request for information.
- The governmental body has a duty to respond to any written requests for records including those that are made through email or by fax.
- An open record request only requires a governmental body to provide copies of documents that relate to the information sought by the requestor.
- The PIA does not require a governmental body to calculate statistics, to perform legal research, or to prepare answers to questions.
- The PIA allows governmental bodies to set a charge for providing copies of public information. The Texas Attorney General's Office has a set charge of 10 cents per page for making simple photocopies or printouts. A governmental body may not charge more than 25 percent above the charges set by the Attorney General's Office without prior authorization from the Attorney General's Office.

Generally, there are only two permissible lines of inquiry that can be made of a requestor:

- First, the governmental body can ask a requestor for proper identification but may not inquire into the motives or use that a requestor may have for public information that has been requested. This inquiry for proper identification should be done only if needed—if the information can be given without any identification, then the inquiry is not necessary. This identification requirement is generally imposed by a governmental body when a state statute limits who may gain access to certain information.
- Second, a governmental body may ask the requestor for a clarification of what type of information is being requested. Often, an initial open records request may involve the production of more documents than the requestor intended. Similarly, many open records requests ask for information that is not kept by the governmental body in the requested format. In either case, the governmental body can ask the requestor whether a potential narrowing or variation of the request would meet the requestor's need.

There is often a misconception that the law requires copies of public information to be produced within 10 business days of the written request to the governmental body for the record. However, the PIA requires the governmental body to "promptly produce" the public information. Further, the PIA states that all open records requests must be handled with good faith and must be accomplished within a reasonable time period.

If it will take a governmental body longer than 10 business days to provide the records, the governmental body must certify that fact in writing to the requestor. In the notice to the requestor, the governmental body must indicate a set date and hour within a reasonable time that the information will be available for inspection or duplication.

There are specific provisions governing the release of records; your plan should act quickly in response to any request you receive. There are numerous exemptions for sensitive material. In some cases, a request may be forwarded to the Texas Attorney General's Open Records Division for review.

**Detailed information on the Public Information Act's requirements is maintained by the Attorney General online:**



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<https://www.texasattorneygeneral.gov/open-government/members-public/overview-public-information-act>

**The Texas Municipal League also maintains practical guides to the PIA:**

<https://www.tml.org/345/Public-Information-Act>

### **2.6.3 Making documents available online**

Retirement systems that maintain websites are required to prominently post the system administrator contact information, as well as the most recent reports and other required written information submitted to the PRB.<sup>45</sup>

Systems without their own website have the option of posting this information on the plan sponsor's website, or on a state agency website, such as the PRB.

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<sup>45</sup> Section 802.107(c), Texas Government Code

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### 2.7 Records retention

Records retention is part of an overall records management program that determines how long organizations should keep their records to comply with various legal requirements and operational needs, and what procedures should be followed to destroy them. It is a best practice to have a formalized records retention policy and process. Below are general guidelines for various types of records that your plan may produce or maintain.

Record	Details and Examples	Retention Period
Actuarial Valuations		Permanent, or follow Dept of Insurance, which is 7 years after end of fiscal year
Audits		
Reports		Permanent
Working Papers	Documents created for the purpose of conducting the audit	3 years after all questions arising from the audit have been resolved.
Annual Financial Reports		Permanent
Bank Records	Bank statements, cancelled checks, deposit slips, etc.	Fiscal Year End + 5 Years
Board Meeting Records		
Agendas	Both open and closed session	2 years
Meeting Notes	Notes taken during meetings from which minutes are prepared	90 days after approval of minutes
Meeting Minutes		Permanent
Supporting Documentation	Docs submitted to board for consideration/approval	2 years
Board Meeting Tapes		
Workshops	No actions/minutes	2 years
Open Meeting	With minutes	90 days after approval of minutes
Open Meeting	Without minutes	Permanent
Closed Meeting		2 years
Open Meeting Notices		2 years
Oaths of Office		Until superseded + 5 years
Plan Document		Permanent
Active and Inactive Member Records	Participant personnel file (forms submitted to plan; correspondence) HR personnel file (employment records)	Permanent
Retired Member Records	Participant personnel file (forms submitted to plan; correspondence)	Permanent

### 3. The Board Meeting

## **3. THE BOARD MEETING**

### 3. The Board Meeting

#### 3.1 The purpose of the board meeting

Board meetings are public events where trustees come together as one to decide the best path forward for the plan. The board meeting is an important, periodic event, and as a result, it uses specific procedures that may be unfamiliar to new members. For instance, there are formalized rules governing when and how topics are discussed, how proposals may be introduced, how officers of the board impact the board's work, and how the public is involved.

The goal of any board meeting is to **efficiently make good decisions**. Of course, a lot goes into making *good* decisions, and a lot into making them *efficiently*.

What does it mean to make good decisions? While some decisions may be easy and straightforward, many are not. Often, there are competing options, all of which have good arguments in support. How can we improve the quality of decisions? One way is to ensure trustees know what will be discussed during board meetings in advance to allow them to do research and talk with interested stakeholders. Another is to provide background information about the topic and details on the options. Boards also benefit from having trustees with a diversity of backgrounds and experiences; discussion between the board members in particular can help foster understanding of different views. And, of course, it is important to ensure access and input.

That's where rules and procedures come in. Properly formalized procedure, well-understood rules, and appropriately strong leadership come together to balance the need to engage in activities that help improve the quality of the decisions without leading to deep inefficiency.

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## 3.2 Composition, officers, and committees

Clearly designating roles and responsibilities, either externally or internally, is a key aspect of good governance. Boards often find it helpful to elect officers and form committees, which have specific duties and areas of focus.

Under the TLFFRA statute (Section 20), TLFFRA boards are required to **annually** elect a chair, vice-chair, and secretary. Committees are not required under law but are common and may help the board conduct its affairs.

### 3.2.1 Composition

Under the TLFFRA statute (Section 19), each board of trustees must have seven members:

- The chief operating officer (e.g., the mayor or board president) of the plan sponsor, or their appointee
- The chief financial officer of the plan sponsor, or his/her appointee
- Three members of the retirement system, elected by the members
- Two public trustees, who can be neither members of the plan nor officers or employees of the plan sponsor, elected by a majority of the city and plan trustees

### 3.2.2 Officers

Though every TLFFRA board must annually elect a chair, vice chair, and secretary, the specific duties of each are left to the board's discretion.

Serving as chair is largely about leadership. The chair must be someone able to lead the group fairly and firmly, to balance diverse opinions with the need for clear decision making, and to adhere to agreed-upon rules for board conduct. The best chairs help develop the leadership that lies dormant within the group.

The **vice chair** fills in for the chair when they are absent, and on many boards is the de facto "chair in waiting."

The **secretary** is generally responsible for documenting the official record of the board's activities, including vote records, meeting minutes, and adopted policy statements. A governing body must either keep minutes or make a tape recording of every open meeting. If the body chooses to keep minutes rather than make a tape, the minutes must indicate the subject of each deliberation and indicate every action that is taken. The minutes or tape recording of an open meeting are open to the public and must be available for inspection and/or for copying. The local unit must permanently retain copies of its minutes of its meetings. However, the unit is not required by state law to publicly post the minutes of an open meeting. Detailed narrative minutes of what individual trustees expressed are often counterproductive; instead, the secretary should focus on recording the "one voice" of the board, which acts only as a body. The secretary should be focused on correctness, accuracy, and appearance.

### 3.2.3 Committees

While some TLFFRA boards do not rely upon formal committees, many boards may find it helpful to delegate certain responsibilities. A smaller, more specialized committee can work more efficiently on

### 3. The Board Meeting

particular issues where members may have expertise. Committees advise the board and provide necessary information, helping inform the decisions the full board reaches.

**Note that if a committee's size constitutes a quorum of the board, its meetings must comply with the Open Meetings Act—see details on this later in this section.**

#### Common committees

**Investment committee.** An investment committee is typically charged with the review of investment actions for the board. Generally, responsibilities of the committee include:

- Establishing and reviewing the system's investment policy
- Recommending and/or approving investments for the plan
- Researching current investment trends, policies, and laws
- Recommending or approving service provider contracts, such as investment consultants and managers

**Nominations committee.** Each TLFFRA board has two public members, which are elected by majority vote of the sponsor and member trustees. A nominations committee can help identify candidates to fill these seats, ensuring high-quality trustees join the board.

**Benefits committee.** A benefits committee is typically formed to assist the board in carrying out its duty to administer benefits to eligible participants. The benefits committee generally makes recommendations for plan design changes.

**Risk management committee.** A risk management committee generally develops and reviews the system's risk management strategy. This committee identifies potential risks, develops processes and procedures to mitigate those risks, and may create a written risk management plan.

**Budget committee.** A budget committee is typically tasked with developing and monitoring the system's budget. The committee may advise the board on the development of the annual budget and strategic plan and monitoring the budget throughout the fiscal year.

**Audit committee.** An audit committee is typically created to oversee a system's internal and external audit function.

**Disability committee.** A disability committee can assist the board in overseeing the evaluation of disability applicants.

**Ethics committee.** Typically, a system's ethics committee helps to develop and review the board's ethics policy, which is the document that outlines the standards of conduct expected of board members (and sometimes staff and service providers).

### 3. The Board Meeting

## 3.3 Agenda development and publication

Under the TLFRA statute, boards are required to meet at least monthly. Those twelve meetings form the backbone of the board's yearly work, and boards must carefully plan the content of each meeting to effectively meet their obligations. In developing the annual meeting calendar, each board should first plan their fiscal year and the quarterly cycle of investment reporting. Your board should be formally reviewing investment reports quarterly. Financial quarters end on the last day of March, June, September, and December.

### 3.3.1 Development

Once new board members are sworn in the board should meet and draft a tentative plan for the year outlining what should be discussed when. Trustees are most effective when they are proactive rather than reactive. Boards should invest time in advance to determine the best time to discuss the numerous topics facing the board.

Boards should plan their schedules taking into consideration reporting deadlines and allow themselves time to review all reports. Investment managers and consultants typically need 30-45 days to prepare and distribute performance reports to boards. If a meeting is set too early, the reports may not yet be ready until a later meeting. This could result in necessary actions, such as rebalancing a portfolio's asset allocation, being delayed. If the plan will be conducting an actuarial valuation, the actuary will need access to financial reports. Your annual contribution rates may be affected by results of the actuarial valuation, and you will want to have enough time to support your case to the city. Thus, the board meeting dates and topics flow from these considerations.

The board should also monitor educational opportunities for trustees or staff and ensure they are added to agendas as needed to approve the expenses.

### 3.3.2 Publication

Because TLFRA boards are subject to the Texas Open Meetings Act, agendas for board meetings must **clearly describe the business to be discussed** and be posted publicly for at least **72 hours prior to the meeting**. More details on the Open Meetings Act are at the end of this section.

The posted notice of an open meeting must contain the date, hour, and place of the meeting and a description of each subject to be discussed at the meeting.

Descriptions such as "old business," "new business," "other business," "personnel," and "litigation matters" are usually not sufficiently detailed to meet the requirements of the Act.

Finally, a local unit must be sure that its postings are not misleading. For example, a Texas court has ruled that a notice calling for "discussion" of a certain item was not sufficient to allow a board to take action on that item when the board's previous notices had always explicitly stated when an action might be taken.

A governing body may not change the date, time, or location of its meeting without posting a corrected notice for 72 hours.

A governmental body that recesses an open meeting to the following regular business day need not post notice of the continued meeting if the action is taken in good faith and not to circumvent the Act. If a meeting continued to the following regular business day is then continued to another day, the governmental body must give notice of the meeting's continuance to the other day.

### 3. The Board Meeting

## 3.4 Rules of Order

Board meeting processes are governed by certain “rules of order,” which codify parliamentary procedure. This is where terms like “**motion**,” “**second**,” and “**quorum**” come into play. The goal is to establish a structured means of receiving input from trustees and the public, without getting bogged down. Each TLFRA board should formally adopt a set of rules to govern its meetings.

The best known set of rules are **Robert’s Rules of Order**. First published in 1876, Robert’s Rules are widely considered the standard.<sup>46</sup> Robert’s Rules provides for constructive and democratic meetings, to help, not hinder, the business of the assembly. Under no circumstances should “undue strictness” be allowed to intimidate members or limit full participation.

Recently, **Rosenberg’s Rules of Order** have gained popularity among smaller boards. Written by a Superior Court judge with extensive experience on state boards and commissions, they retain the most familiar elements of Robert’s Rules while reducing their complexity. The entirety of Rosenberg’s Rules is less than 10 pages in length.<sup>47</sup> Rosenberg’s Rules generally empower the chair to run meetings, rather than those with detailed knowledge of the rules. Since the rules are simpler, they are often better understood by members.

Basic elements of parliamentary procedure are below; these exist under either Robert’s Rules or Rosenberg’s Rules. For more detailed information on each, consult the rules themselves:

Robert’s Rules of Order: [www.robertsrules.org](http://www.robertsrules.org), [www.robertsrules.com](http://www.robertsrules.com)

Rosenberg’s Rules of Order: [https://www.cacities.org/Resources/Open-Government/RosenbergText\\_2011.aspx](https://www.cacities.org/Resources/Open-Government/RosenbergText_2011.aspx)

### 3.4.1 Starting the meeting

The chair calls the meeting to order and takes roll of the trustees present. A **quorum** of the trustees is necessary for the board to conduct business; generally, this is more than half the members, but in some cases board bylaws may specify a higher threshold.

Typically, a board will start by considering approval of the **minutes** from the prior meeting, which serve as the official record of actions considered and taken by the board.

### 3.4.2 Working through the agenda

The chair will then proceed to the primary agenda items. The usual process is to announce the agenda item, call for a presentation from the appropriate person or persons (trustees, staff, or service providers), allow an opportunity for questions from trustees, and then entertain motions.

If a report is being presented during the meeting, consider allowing a draft to be circulated prior to the board presentation. This will provide you time to review the report and possibly identify issues before formal presentation and additional expense of binding reports.

Also be sure to give consultants adequate time to present reports and be sure to cover in detail any

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<sup>46</sup> Henry M. Robert III et al, Robert’s Rules of Order: Newly Revised 12<sup>th</sup> edition, (New York, NY: PublicAffairs, 2020)

<sup>47</sup> [https://www.cacities.org/Resources/Open-Government/RosenbergText\\_2011.aspx](https://www.cacities.org/Resources/Open-Government/RosenbergText_2011.aspx)



### 3. The Board Meeting

changes, such as if during an actuarial valuation report, the actuary discusses assumption changes.

**A motion is the process by which the board acts on an agenda item.** At the beginning of an agenda item that has a motion, the chair may mention that there is an upcoming motion. For instance, a trustee might say, “I move that we reduce our actuarial assumed rate of return by 0.25%, to 7%.” To proceed, another trustee would need to **second** the motion, simply by saying “Second.” Then, the chair makes sure everyone understands the motion by repeating it or asking the maker of the motion to repeat it.

**Amendments** may be offered (which tweak the motion), **substitute motions** can be made (which replace the motion with something entirely different), and motions can be made to **limit debate** (which usually requires a supermajority vote). How these are handled varies depending on the specifics of the rules a board is operating under.

After discussion has ended the chair ends the discussion. He or she restates the motion and asks for a vote. Voting process varies, but the two primary means are to ask for the “ayes” and “noes” together, or to ask for a roll call vote wherein trustees vote one by one.

The chair then reports the result of the vote, including whether it passes or fails based on the threshold for passage.

#### 3.4.3 Ending the meeting and other actions

A trustee may make a **motion to adjourn**. If it passes, the meeting immediately ends.

There are numerous other motions that are distinct from the business at hand. For instance, a trustee might raise a **point of privilege** to make an urgent point—perhaps the air conditioning makes it difficult to hear. A trustee might make a **motion to recess** if he or she wishes to break from the meeting before returning (perhaps for a meal). Check the rules adopted by your board for more detail; often, a “cheat sheet” is available to trustees, or can be found online.

### 3. The Board Meeting

#### 3.5 Executive/closed session

Under Texas law, the general rule is that all meetings of TLFRA boards must be open to the public. However, there are some topics which may be discussed in a closed meeting, also called an executive session. A governing body may generally hold an executive session for one or more of the following nine reasons:

1. Consideration of specific personnel matters;
2. Certain consultations with the board's attorney;
3. Discussions about the value or transfer of real property;
4. Discussions about security personnel or devices;
5. Discussions about a prospective gift or donation to the city;
6. Discussions by a governing body of potential items on tests that the governing body conducts for purposes of licensing individuals to engage in an activity;
7. Discussions of certain economic development matters;
8. Discussions of certain competitive matters relating to a city-owned electric or gas utility for which the city council is the governing body; and
9. Certain information relating to the subject of emergencies and disasters.

The rules for posting executive session items are the same as the general rules for posting issues that will be considered in open session. Most local units indicate on the posted agenda that the governmental body may be going into executive session on a particular topic and the statutory section that allows such an item to be considered in a closed meeting. However, the Act does not require the agenda to state which items will be discussed in closed session.

If a governing body chooses to discuss an item in executive session, it must follow the statutory procedures required for such sessions.

- The body must first convene in a properly posted open session.
- During that open session, the presiding officer must announce that a closed meeting will be held and identify the section or sections of the law that authorize such a closed meeting.

*Example:* "Pursuant to Texas Government Code Sections 551.001 to discuss any item on its open meeting in accordance with the Texas Open Meetings Act, including, without limitation, Sections 551.071-551.088 of the Act. Any final action, decision, or vote on a matter deliberated in a closed meeting will only be taken in an open meeting that is held in compliance with Texas Government Code, Chapter 551."

- Once an executive session has begun, the presiding officer must announce the date and time the session started. At the end of that executive session, the presiding officer must again announce the date and time.

A tape recording or certified agenda must be made. Any final action, decision, or vote on a matter deliberated in a closed meeting can only be taken in an open meeting. The certified agenda must include a statement of the subject of each deliberation and a record of any further action taken. The certified agenda or tape recording is confidential and may not be released absent court action. A *sitting member* of the Board may review the certified agenda or tap recording. After discussing an item in executive session, boards will return to open session to take the vote.

*Example minutes:* Chair recessed the regular board meeting at X o'clock to enter executive session. .... Chair reconvened the regular board meeting at Y o'clock.

### 3. The Board Meeting

**Executive sessions involving medical records of individuals.** Under state statute, a benefits appeals committee for a public self-funded health plan or a governmental body that administers a public insurance, health, or retirement plan may conduct an executive session to deliberate the medical records or psychiatric records of an individual applicant for a benefit from the plan; or a matter that includes a consideration of information in the medical or psychiatric records of an individual applicant for a benefit from the plan.<sup>48</sup>

**Executive sessions for consultations with an attorney.** The law allows a governmental body to meet with its attorney to receive legal advice about pending or contemplated litigation or about settlement offers.<sup>49</sup> The Texas Attorney General has also concluded that a governmental body may meet with its attorney to receive legal advice on any matter. However, the Attorney General has warned that discussions in an executive session under consultations with an attorney must only relate to legal matters. The governing body may not discuss general policy matters that are unrelated to receiving legal advice from the attorney while in executive session under this exception.

A governing body may consult with its attorney in executive session to receive advice on legal issues raised by a proposed contract. However, the body may not discuss the merits of a proposed contract, financial considerations, or other non-legal matters related to the contract simply because its attorney is present. General discussion of policy unrelated to legal matters is not permitted in executive session under the Act merely because an attorney is present.

**Executive session to discuss the acquisition of real estate.** The Act allows a governmental body to hold an executive session to discuss the purchase, exchange, lease or value of real estate. However, such an executive session is only allowed if discussion of the real estate in an open meeting would have a detrimental effect on the ability of the governmental body to negotiate with a third party. For example, an executive session may in certain cases, be permitted to discuss that the local unit is willing to pay for real property that it plans to acquire. The unit should not use this exception when the other side for the transaction is present, as discussed below. There is no comparable authority for a governing body to go into an executive session to discuss the acquisition of items of personal property such as the purchase of a new computer system

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<sup>48</sup> Section 551.0785, Texas Government Code

<sup>49</sup> Section 551.0785, Texas Government Code

### 3. The Board Meeting

## 3.6 Open Meetings Act

The Texas Open Meetings Act (TOMA) makes governmental entities' decision-making processes accessible to the public. The Open Meetings Act applies to the decision-making body when a **quorum**, or majority, of the members are present and discuss or deliberate the business or policies of the governmental entity. **To emphasize this point: four members of a seven-member pension board cannot privately go to dinner and discuss the plan.** There are exceptions, most notably executive session, but these are specific situations that must be dealt with carefully (and even executive session must be properly noticed).

It is crucial that all the requirements of the Act are fulfilled **before** a meeting takes place. These requirements include the posting of notice and the agenda of the meeting, the minimum time that the notice must be posted and the location of the posting, the contents of the posting, and ensuring that the location in which the meeting is held is adequate.

**All public officials are required to complete training on the Open Meetings Act no more than 90 days after they have either taken the oath of office or have assumed official responsibilities to the governmental entity.**<sup>50</sup>

The Attorney General's Office provides Open Meetings Act training via the following link: <https://texasattorneygeneral.gov/og/oma-training>

The Texas Municipal League maintains various Open Meetings Act resources, including the *Texas Open Meetings Act Made Easy* guide and a one-page *Texas Open Meetings Act At-a-Glance*:

<https://www.tml.org/343/Open-Meetings-Act>

The following are some common questions regarding the Open Meetings Act requirements.

#### **May less than a quorum of members of the governing body talk over the phone without violating the Act?**

The mere fact that two members visit over the phone does not in itself constitute a violation of state law. However, if members are using individual telephone conversations to poll all the members on an issue or are making such telephone calls to conduct their deliberations about public business, there may be a potential criminal violation. Physical presence in one place is not necessary to violate the Act. It would remain a fact issue whether certain phone conversations between less than a quorum of members would be a violation of the Act. Such interactions could amount to meeting in numbers less than a quorum to circumvent the Act.

#### **What right does the public have to speak on a particular agenda item?**

The Act allows the public to observe the open portion of a meeting. However, the Attorney General has concluded that the Act does not give members of the public a right to speak on items considered at an open meeting. Such a right only exists if a specific state law requires a public hearing on an item or if state law requires that public comment be allowed on an issue. If a local entity allows members of the public to speak on an item at a meeting, the governing body may adopt reasonable rules regulating the number

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<sup>50</sup> Section 551.005, Texas Government Code

### 3. The Board Meeting

of speakers on a particular subject and the length of time allowed for each presentation. However, the body must apply its rules equally to all members of the public.

#### **What may members of a governing body do if an unposted issue is raised at an open meeting?**

Members of the governmental body may not deliberate or make any decision about an unposted issue at a meeting of the governmental body. If an unposted item is raised by member or the general public, the governing body has four options:

- First, an official may respond with a statement of specific factual information or recite the governmental body's existing policy on that issue.
- Second, an official may direct the person making the inquiry to visit with staff.
- Third, the governing body may offer to place the item on the agenda for discussion at a future open meeting.
- Finally, the governing body may offer to post the matter as an emergency item if it meets the criteria for an emergency posting.

#### **Walking quorums**

On occasion, a governmental body has tried to avoid complying with TOMA by deliberating about public business without a quorum being physically present in one place and claiming that this was not a "meeting" under the Open Meetings Act. Conducting secret deliberations and voting over the telephone, when no statute authorized this, was one such method.

A member of a governing body commits a crime if that official conspires to circumvent TOMA by meeting in numbers of less than a quorum for the purpose of secret deliberations. A violation of this sort is a misdemeanor punishable by a fine of between \$100 and \$500, one to six months in jail, or both.

As stated earlier, a gathering of less than a quorum of the governing body is not generally subject to the Act. However, if a standing committee or subgroup of the governmental body meets and the discussion of public business occurs, it is advisable that such gatherings should also be posted and conducted as open meetings. State law also provides that if less than a quorum of the governing body gathers with the intent of circumventing the law, criminal penalties can be imposed against the participating officials. In other words, if members are holding their discussion of public business in numbers less than a quorum to avoid having to meet the requirements of the law, prosecution can be pursued.

4. Financial and Actuarial Basics

**4. FINANCIAL AND ACTUARIAL BASICS**

## 4.1 Financial objectives of a defined benefit fund

Your TLFRA pension system is a **defined benefit (DB) retirement plan** in which the amount of the benefit is set by a formula established through your plan. These types of plans may present specific challenges for trustees.

### 4.1.1 Defined benefit plans

Defined benefit plans, like those operated by TLFRA boards, are very different from defined contribution plans. While working, generally both employees and employers make contributions to the fund and there are no individual accounts. Employees receive a **defined benefit** at retirement based on a particular formula. Benefits are calculated based upon age, length of service, and final salary. The benefit is payable as a lifetime annuity and possibly for the lifetime of the designated beneficiary. For instance, a plan might offer a benefit formula that provides [Final Salary x Years of Service x 2.5 percent]. To use round numbers, if a firefighter finished at a salary of \$100,000 after 30 years of service in this plan, they would be eligible for an annual retirement benefit of \$75,000 under that formula. There are many details that may be in place, including eligibility requirements, the way final salary is calculated, and whether the plan includes cost-of-living adjustments.

Defined benefit plans take the employer and employee contributions and invest them in stocks, bonds, and other vehicles. Contributions, combined with investment returns, *must* be enough to pay all promised benefits. Employees are promised a certain benefit at retirement—period. The risk has been borne by the plan, not by the individual employee.

### 4.1.2 Challenges of defined benefit plans

DB plans must estimate how much money will be needed to pay promised benefits. This is a function of projected employment patterns, salary patterns, life expectancy, and other factors. This question is further complicated by the fact that funds are needed at different times in the future. Actuaries revalue future benefits into present-value dollars because it is a fundamental aspect of finance that a dollar today is worth more than a dollar in the future. These matters are addressed using **actuarial methods**.

The second challenge is to ensure that employer and employee contributions are invested in a way that best balances the competing goals of high returns with limited risk. Riskier investments may produce higher rates of return in the long-term but may also have significant variance in the short-term. These matters are addressed via an **investment management** program.

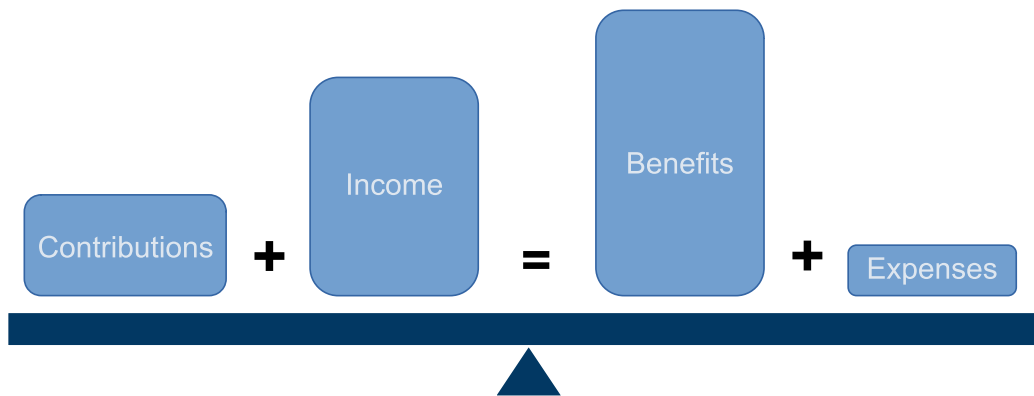
Actuarial and investment matters are closely linked. When considering the cost to pay future benefits, actuaries incorporate a **discount** which adjusts for the fact that the value of current contributions will grow overtime due to investment returns. For example, \$500 in hand now may be able to cover a \$1,000 payment due in twenty years, since that \$500 is expected to grow via investment returns (this assumes a 3.5 percent annual rate of return). Actuaries convert the value of future benefits to its present value, based on the number of years until due and the assumed rate of return on investments when evaluating a fund's finances. That rate of return assumption is a function of investment management decisions by the plan.

Conversely, many pension plans often do the reverse: they select an actuarial rate of return assumption that makes their plan appear to be in good shape, and then try to design an investment program to meet that rate of return. While it may be tempting to do so, it may lead to plan funding deficits in the future. To be effective, trustees should understand the fundamentals of actuarial and investment matters, and how each impacts the other.

## 4.2 Pension financing basics

### 4.2.1 Basic equation of pension financing

Pensions are funded by contributions and investment income, which must equal or exceed the costs associated with benefits and expenses. This is considered the core equalities of pension plan financing.



Generally, employers and employees regularly contribute to a pension fund. The fund invests these **contributions** and earns a return on investment. Returns from investments (fixed income, equity, etc.) are considered **income**. Contributions and income combine to add to the fund over time.

Retirement plans pay **benefits** to members who have met plan requirements. Retirement plans also pay **expenses** for maintaining the plan including administrative, investment fees, auditing costs, etc. Benefit payments and expenses combine to decrease the amount in the fund.

The two types of financing for a defined benefit retirement plan are **pay-as-you-go** and **pre-funding**.

### 4.2.2 Pay-as-you-go vs. pre-funding

The two types of financing center on when benefits are funded; pay-as-you-go or pre-funding.

Under pay-as-you-go funding, the retirement plan makes contributions as benefit payments become due. The cost of the plan is completely paid for by contributions.

Pre-funding retirement benefits allows for assets to be built up to pay future benefits. Contributions are made to the trust by the participants and their employer before the benefits are paid, the money is invested, and the plan has a funding structure in place.

Pre-funding helps balance three common, but sometimes competing, policy goals: providing **benefit security**, ensuring **intergenerational equity** between generations of taxpayers and employees, and producing a **stable contribution** from year to year.

**As a result, public defined benefit pension plans generally aim to pre-fund their benefits.** However, in some cases, plans can become so underfunded that they effectively become pay-as-you-go plans, with current contributions going to pay current benefits.



## 4.3 Actuarial methods

Pension obligations are complex and at times difficult to understand. In the simplest sense, the goal is to be able to compare “what the plan has” with “what the plan owes.” However, what the plan owes is subject to considerable uncertainty (e.g., we do not know what salary today’s employees will retire at, how many years of service with which they will retire, and at what age they will die).

Further, even if we arrived at a reasonable estimate of those matters, it would be further complicated by the fact that the payments are due in the future: we know that funds in hand now are more valuable than future funds, so it would not be accurate to compare the nominal amount of resources today with the nominal amount of resources needed in the future—we need to “convert” those future needs into their value in present dollars.

Actuaries use formal methods to arrive at an understanding of these matters.

### 4.3.1 Present value of future benefits

Trustees must be aware of how much money a pension fund will need to pay future benefits. To do this, they work with actuaries who calculate the present value of future benefits, or PVFB. Money in trust funds is expected to grow over time due to interest accumulation; this is a financial concept called the **time value of money**. The rate of expected interest growth used to calculate PVFB is called the discount rate.

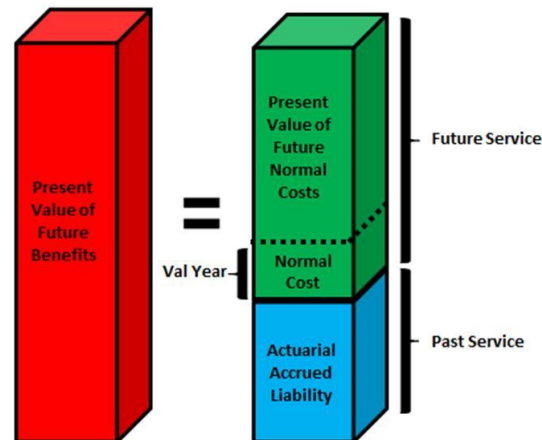
Conceptually, calculating PVFB involves two steps. First, actuaries project all expected future benefit payments for each participant. In doing so, they consider both benefits already earned from past service and expected future service and pay. They also make assumptions about the timing and likelihood of payment—for instance, employees retire at different ages and die at different ages. More information on these assumptions is later in this document.

Second, actuaries discount each expected future payment to the valuation date using the discount rate, as described above. Most plans set the discount rate to equal their plan’s expected investment rate of return (often in the range of 6-8 percent).

PVFB is broken into the following categories, which you may hear referred to in isolation:

- The current value of benefits accrued in past years is called the **actuarial accrued liability** or **AAL**. This is compared with the assets currently held by the plan to determine if the plan is underfunded or overfunded.
- The current value of benefits accruing for the present year is called the **normal cost** or **NC**. This is the amount that employers and employees must contribute in that year to cover the expected cost of benefits earned.
- The current value of benefits for the present year and future years is called the **present value of future normal costs** or **PVFNC** (includes the normal cost as the first year).
- Since the AAL includes all past service and the PVFNC includes all future service, **they sum to equal the PVFB** ( $AAL + PVFNC = PVFB$ ). This is the total expected cost of all future benefits, converted to its present value.

#### 4. Financial and Actuarial Basics



#### 4.3.2 Asset valuation and asset smoothing

Actuaries compare the **actuarial accrued liability (AAL)**—which counts benefits already earned—with the fund’s current assets—the result of contributions and investment income intended to pay these benefits. In pre-funded defined benefit plans, the value of the plan’s current assets is calculated using different methodologies:

- The **market value of assets (MVA)** is generally the value at which assets could be traded on the market. For instance, if a plan has a stock with an MVA of \$2,000, the plan could sell that stock on the open market for \$2,000.
- The **actuarial value of assets (AVA)** is the value of assets used for the actuarial valuation. The AVA can be either the market value (MVA) or a smoothed value of assets, as explained below.

Actuaries often use **asset smoothing** techniques in determining a plan’s AVA. This concept is designed to recognize the long-term nature of pension obligations and reduce the volatility of assets, which may sharply increase or decrease in market value due to short-term changes in market conditions. Asset smoothing helps keep contributions more stable and predictable for the plan sponsor over time.

Under smoothing, asset gains and losses are generally recognized over a period of years rather than immediately. The most frequent method of smoothing used by Texas public pension plans is a five-year phase-in of actuarial gains and losses, where 20 percent of any gain or loss is recognized in each subsequent year. To say it a different way, 8 percent% of the most recent year's gain or loss is deferred and 20 percent is recognized, 60 percent of the year immediately prior has been deferred and 40 percent has been recognized, etc.

#### 4.3.3 Funded status and ratio

Plan assets consist of all contributions and income which therefore must be sufficient to cover all distributions (i.e., benefits and expenses). However, at any point in time, the assets (AVA) and current liabilities (AAL) are rarely exactly equal. When the difference between the AAL and AVA is positive (i.e., the AAL > assets), the plan has an **unfunded actuarial accrued liability (UAAL)**. Thus, the UAAL is the amount that is still "owed" to the fund for past obligations. If the difference is negative (i.e., AAL < assets) the plan has a surplus.

#### 4. Financial and Actuarial Basics



To determine the plan's funded ratio, you simply divide the plan's asset value by its AAL. For instance, if a plan has an AVA of \$800,000 and an AAL of \$1,000,000, its funded ratio is 80 percent.



The goal is for each plan's funded ratio to be exactly 100 percent.

Addressing this funding gap impacts two of the policy goals identified previously: intergenerational equity and the desire for a stable contribution from one year to another. This makes it all the more important for plans to adopt reasonable (if not conservative) assumptions up front, and to work with employees and employers to secure contributions that will actually cover the promised benefits. Making up ground later is much more difficult.

#### 4.3.4 Amortization policy

Plans use amortization policies to determine how to address their UAAL. The amortization policy defines the length of time the plan is allocating to pay off the UAAL and the structure of payments applied to it.

The specified length of time used when calculating the amortization payment is known as the **amortization period**. The PRB recommends a target amortization period of 10-25 years, but not to exceed 30 years.<sup>51</sup>

Plans typically use either a **closed amortization period** or an **open amortization period**, which defines how the amortization period changes from one year to the next:

- Under a **closed amortization period**, the annual amortization payment towards the UAAL is calculated using a fixed schedule based on a specified starting and ending date.
  - Example: If a plan's amortization period is a closed 30 years, the ADC will be calculated using a 30-year period in the first year and decrease by one year at each subsequent year's valuation (29, 28, etc. down to 1, after which the plan would be fully funded).
  - This is similar to a fixed period home mortgage with a known beginning and ending date (in this case, a 30-year mortgage)
- Under an **open amortization period**, the annual amortization payment towards the UAAL is calculated using the same period from one year to the next.

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<sup>51</sup> <https://www.prb.texas.gov/prb-pension-funding-guidelines/>

#### 4. Financial and Actuarial Basics

- Example: If a plan's amortization period is an open 30 years, the ADC will be calculated at each valuation using a 30-year period.
- This is like refinancing a home mortgage every single year, and typically results in lower amortization payments.
- **In theory, however, if an open amortization period is always used, the UAAL will never be fully funded.**

Plans also choose from different **amortization methods**, which define how the UAAL is split among the chosen amortization period. The two most common amortization methods are the **level dollar** and **level percent of payroll** methods.

- **Level dollar amortization** is like a standard fixed-rate mortgage: the annual payment towards the UAAL is assumed to be the same dollar amount every year.
- Under the **level percent of payroll** calculation, the amortization amount is set as a percentage of the sponsor's payroll, and thus is assumed to increase as the sponsor's payroll increases.

## 4.4 Actuarial assumptions

Pension funding requires making assumptions about future events. These assumptions are called **actuarial assumptions**. Actuarial assumptions, along with current plan participant data and the benefit formula are used to project future benefit obligations. Actuarial assumptions can be split into two broad categories: **demographic** and **economic**. Tables describing key assumptions are presented below.

<b><i>Demographic Assumptions</i></b>			
<b>Assumption</b>	<b>Description</b>	<b>Why It's Important</b>	<b>Cost Impact</b>
Expected retirement age, or rates of retirement by age or service	The age (or ages) when employees are expected to retire	Impacts the normal cost and actuarially accrued liability for active employees; thus, also the PVFB	Earlier assumed retirement usually increases estimated cost
Turnover (rate of withdrawal – i.e., pre-retirement termination of employment)	The annual rate of employment termination of employees at various stages of their careers	Impacts the normal cost and actuarially accrued liability for active employees; thus, also the PVFB	Greater assumed turnover decreases liability and cost
Mortality	The probability of dying within one year at each age	Impacts the normal cost and actuarially accrued liability for active employees; thus, also the PVFB	Lower mortality increases liability and cost
Disability	The probability of disablement from active employment within one year at each age	Impacts the normal cost and actuarially accrued liability for active employees; thus, also the PVFB	With a high disability benefit, a high assumed rate of disability can increase liability and cost
Percent married, spouse age difference, and optional form of benefit elected	Assumptions regarding the payment of a subsidized form of benefit	Affects costs in plans where spousal survivor benefits are subsidized.	Correctly applied, these assumptions account for the cost of subsidized benefits
<i>Guidance for selecting demographic assumptions is provided in Actuarial Standard of Practice (ASOP) No. 35, Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations<sup>52</sup></i>			

<sup>52</sup> <http://www.actuarialstandardsboard.org/asops/selection-of-demographic-and-other-noneconomic-assumptions-for-measuring-pension-obligations/>

## 4. Financial and Actuarial Basics

### *Economic Assumptions*

<b>Assumption</b>	<b>Description</b>	<b>Why It's Important</b>	<b>Cost Impact</b>
Discount rate	Usually a single rate; often, the rate of return on plan assets (below) serves as the discount rate	This assumption allows the conversion of expected future payments into present values	A higher rate results in lower reported liability and cost
Rate of return on plan assets	Reflects the anticipated returns on the plan's current assets and, if appropriate for the measurement, future assets	Commonly used as the discount rate (above)	A higher rate results in lower reported liability and cost
Salary increases	The expected rate of future salary increases for employees at various stages of their careers	Impacts the normal cost and actuarially accrued liability for active employees; thus, also the PVFB	Higher salary assumptions result in higher reported liability and cost
Inflation	The expected rate at which price levels which rise, and purchasing power will fall	A component of both rate of return on plan assets and salary increases. Also used for plans with an automatic indexed COLA	For plans with an automatic indexed COLA, higher inflation assumptions result in higher reported liability and cost
Payroll growth	The projected overall annual rate of increase in the plan sponsor's covered payroll	Used only for calculating the amortization of the unfunded actuarial accrued liability	Higher payroll growth assumptions result in lower reported initial cost but higher ultimate cost

*Guidance for selecting demographic assumptions is provided in Actuarial Standard of Practice (ASOP) No. 27, Selection of Economic Assumptions for Measuring Pension Obligations<sup>53</sup>*

The assumptions that have the most significant impact on the statement of plan liabilities used by most actuaries include the rate of interest earnings on investments (the interest assumption, or assumed rate of return), the rate of anticipated salary increases for plan members (the salary assumption), and the anticipated increase in the size of the covered payroll of the plan (the payroll assumption).

The actuarial assumptions are **not** considered independently of one another and should be reasonable when considered as a group. For example, a very high assumed salary growth, and a very low payroll growth assumption would be unlikely, since similar factors influence both numbers. The distance between interest and salary growth rates assumed in valuation is called the spread.

#### **4.4.1 The key assumption: discount rate**

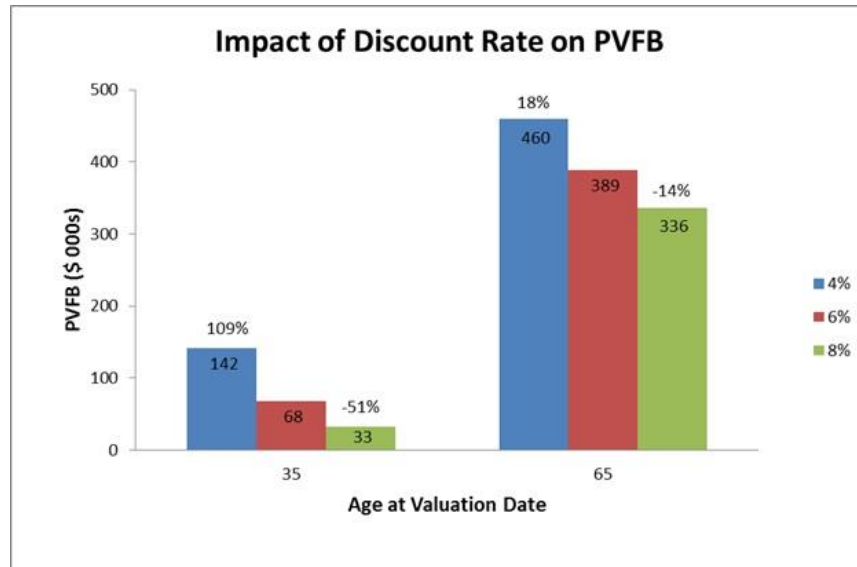
The **discount rate** is the assumption that typically has the largest single impact on the determination of the AAL and PVFB. As previously mentioned, the discount rate is an interest rate used to calculate the

<sup>53</sup> <http://www.actuarialstandardsboard.org/asops/selection-economic-assumptions-measuring-pension-obligations/>

#### 4. Financial and Actuarial Basics

PVFB. A deferred payment with a higher discount rate will produce a lower present value, due to the higher interest that is expected to accumulate in the future (and vice versa).

To illustrate the impact the discount rate can have, the graph below shows the change in PVFB when the discount rate is increased or decreased by **two percent** starting from an assumed six percent rate (and holding all other assumptions equal). Note the further away from assumed retirement, the larger the impact of the change in discount rate.



Most pension systems use their assumed rate of return as the discount rate; this is typically in the range of 6-8 percent. The median discount rate among TLFRA plans was 7.5 percent as of 2019.<sup>54</sup>

#### 4.4.2 Monitoring and adjusting assumptions

Assumptions are not permanent. As new information becomes available, plans should adjust their assumptions to better match observed reality. ASOPs Nos. 27 and 35 require pension plan actuaries to determine whether the selected assumptions continue to be reasonable at each valuation date. Two additional tools can help plans and their sponsoring governmental entities to monitor assumptions: **experience studies** and **actuarial audits**.

##### *Experience Studies*

To prepare an actuarial valuation, the actuary must **make assumptions about the future**. While the actuarial assumptions may not exactly match future reality, if actual plan experience is significantly different than the selected assumptions over several years, the long-term funding of the plan can be negatively impacted. In addition, ASOPs require that all selected assumptions be "**reasonable**," considering relevant current and historical data as well as expected future experience of the plan.

Experience studies are a tool to compare the selected assumptions to the events that actually occur. This allows the actuary and the retirement system to determine the reasonableness of the selected assumptions and to make decisions regarding the selection of future assumptions.

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<sup>54</sup> <https://www.prb.texas.gov/txpen/wp-content/uploads/2020/03/2020-TLFFRA-Report.pdf>

#### 4. Financial and Actuarial Basics

State law requires a public retirement system with assets of at least \$100 million to conduct an actuarial experience study at least once every five years.<sup>55</sup> For purposes of this requirement, actuarial experience study means a study in which actuarial assumptions are reviewed considering relevant factors, important trends, and economic projections with the purpose of determining whether actuarial assumptions require adjustment.

Statute further requires a public retirement system that conducts an experience study to file a copy with the PRB, regardless of whether the study is required by statute or is completed at the will of the retirement system or its sponsoring governmental entity.<sup>56</sup>

Even if a retirement system does not conduct a full experience study they should still monitor, review, and report the impact of actual plan experience on actuarial assumptions at least once every five years. This can be accomplished through regular actuarial valuations.

##### *Actuarial Audits*

An **actuarial audit** is a tool used by retirement systems to monitor the quality of the retirement system's actuarial services. Actuarial audits are completed by an outside reviewing actuary; they aim to:

- **Boost the integrity** of the retirement system's actuarial valuation process.
- Help trustees and system administrators with **making decisions** and **ensuring that funding goals are being met**.
- **Find errors** so they can be remedied to improve public trust of the retirement system.

The sponsoring governmental entity of a public retirement system with assets of at least \$100 million is required to hire an independent actuary to conduct an audit of the most recent actuarial valuations, studies and reports prepared for the retirement system at least once every five years.<sup>57</sup> The public retirement system is provided an opportunity to submit comments that must be presented by the sponsoring governmental entity along with the final version of the audit. The sponsoring governmental entity is required to file a copy of the audit with the PRB.

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<sup>55</sup> Section 802.1014(b-1), Texas Government Code

<sup>56</sup> Section 802.1014(b), Texas Government Code

<sup>57</sup> Section 802.1012, Texas Government Code



## 4.5 Contributions

Contributions come from two sources: the **employer** and the **employee**. In public pension plans, the employer is the sponsoring governmental entity, which would be the fire department for TLFFRA plans. Contribution rates vary from plan to plan, however TLFFRA law has established a minimum employer contribution of twelve percent or equal to the employee contribution, whichever is lower.<sup>58</sup> Usually, the benefit provided by the plan is a function of the employee's compensation; therefore, both the employer and employee contributions are typically expressed as a **percentage of payroll**.

Generally, the total contribution each year consists of two pieces:

- **normal cost**, which was previously defined as the current value of benefit accruing for the present year
- **amortization of the UAAL**, which is basically the contributions applied to past years' obligations if the AAL is not fully funded

How the total contribution rate is calculated for a given year can be classified into two broad categories, **fixed rate** or **actuarially determined contributions** (ADC).

### 4.5.1 Fixed rate contributions

Having fixed rate contributions is the most common contribution approach used by Texas public pension plans. Under this methodology, the total contribution rate is the same from year to year and is known in advance. The fixed rate may be set by state statute, city ordinance or simply as the funding policy agreed upon by the system and its sponsoring governmental entity.

Fixed rate contributions come with additional risk. The stability and consistency of fixed contributions makes it easier to budget; however, there is the risk that the contribution will be insufficient to cover expenses and promised benefits.

### 4.5.2 Actuarially determined contributions

Under an ADC plan, the contribution rate is calculated to ensure it is an adequate amount to fully fund normal cost and the amortization payment, as assessed by the plan's actuary.

To determine the total contribution rate, the actuary calculates both the normal cost rate and the amortization rate, as shown below. As a result, the contribution rate is not known in advance, but by ensuring that both the full normal cost and amortization payment are included in the contribution, the methodology improves benefit security.

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<sup>58</sup> Vernon's Texas Civil Statutes, Article 6243e, Section 29(b)

## 4.6 Actuarial and Financial Documents and Other Financial Health Measures

Ultimately, actuarial tools result in the development of the actuarial valuation and other key documents. Together, these can provide valuable insights into your plan's health.

### 4.6.1 Actuarial valuations

Determining the lifetime cost of your plan is very complex and requires the skill of an actuary. The most important role of the actuary is to figure what level of contributions, when combined with expected investment income, is needed over the long term. This is called the advanced funding schedule or schedule of contributions.

An actuarial valuation provides information regarding the current financial health of the plan under a specified set of actuarial assumptions and methods. In other words, a valuation is a "snapshot" taken at a single moment in time. The results of the valuation should be expected to change on future measurement dates.

Actuarial valuations can be prepared for a wide variety of reasons such as making decisions regarding appropriate contribution levels, plan design changes including benefit enhancements, and assessing funding progress, as well as for required financial disclosures. The purpose and intended audience of the valuation determines what set of actuarial assumptions and methods are appropriate. Regardless of the purpose, **all actuarial valuations performed by a qualified actuary are required to be prepared in accordance with the Actuarial Standards of Practice (ASOPs).**

The two most common type of valuations for Texas public retirement systems are:

- **Funding** - Helps the plan and the sponsoring governmental entity determine appropriate contribution levels and measure the current progress towards funding the expected future benefit payments.
- **Accounting** - Provides the required disclosures for financial reporting purposes for the system or the sponsoring governmental entity.

**Section 802.101, Texas Government Code requires public retirement systems to conduct a funding valuation at least once every three years and to file a copy of any valuation or other actuarial study performed with the PRB.** The valuation must include a recommended contribution rate necessary for the system to have an expected amortization period that does not exceed 30 years.

Board trustees must try to understand the actuarial process because they will ultimately be called upon to approve the actuarial valuation report. Plan design decisions (such as retirement age, benefit eligibility, and benefit formula) are based upon the findings of the actuary and the board must understand enough about the process to make informed decisions.

### 4.6.2 Funding policy and related documents

Statute requires Texas public retirement systems to adopt written funding policies.<sup>59</sup> The funding policy is intended to be used as the retirement system's roadmap to fully fund its long-term obligations.

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<sup>59</sup> Section 802.2011, Texas Government Code

## 4. Financial and Actuarial Basics

### *Key Components of the Funding Policy*

Per guidance from the PRB, funding policies should include:

- Clear and concrete funding objectives
- Actuarial methods
- A roadmap to achieve funding objectives
- Actions that will be taken to address actual experience that diverges from assumptions

### **4.6.3 Funding Soundness Restoration Plan**

State law requires certain public retirement systems to prepare a Funding Soundness Restoration Plan (FSRP) to help address potential funding challenges. A public retirement system is required to notify its associated governmental entity if it receives an actuarial valuation indicating the system's actual contributions are insufficient to achieve an amortization period of 30 years or less. If the system's amortization period exceeds 30 years over several valuations, the public retirement system and its associated governmental entity are required to formulate an FSRP. After September 1, 2025, additional **immediate** triggers take effect:

- Amortization period exceeds 40 years
- Amortization period exceeds 30 years AND funded ratio below 65 percent

Each FSRP shall:

- be designed to achieve a contribution rate sufficient to amortize the unfunded actuarially accrued liability (UAAL) within 30 years no later than two years after the triggering actuarial valuation (AV) or September 1, 2025, whichever is later
- be adopted during open meetings of the governing bodies of both the system and sponsor
- be submitted to the PRB not later than the 31<sup>st</sup> day after the date on which the plan or any change is agreed to.

The system and sponsor are required to provide progress reports to the PRB no later than a year after the date of the triggering AV and each subsequent six-month period until the FSRP is submitted. The progress report shall include a draft of any plan and description of any changes under consideration.<sup>60</sup>

### **4.6.4 Pension financial health measures**

For a retirement system to meet its long-term obligations, sufficient assets are needed to pay for benefits accrued by and owed to system members. The two most frequently used measures to assess a system's ability to meet its long-term obligations are the **amortization period** and the **funded ratio**.

A plan's **amortization period** is the time it would theoretically take to fully fund any unfunded liability. The **funded ratio** is the ratio of assets to accrued liability: Assets/AAL. Funded ratios are reported based on the actuarial value of assets (AVA or smoothed value) and market value of assets (MVA). Generally, the closer the funded ratio is to 100%, the more secure the current accrued benefits. However, if a plan is currently underfunded, the attempt to achieve a funded ratio of 100 percent will impact the other policy goals, intergenerational equity, and the desire for a stable contribution from one year to another.

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<sup>60</sup> Texas Government Code Section 802.2015, <https://www.prb.texas.gov/actuarial/funding-soundness-restoration-plan-fsrp/>

5. Introduction to Investments

**5. INTRODUCTION TO INVESTMENTS**

## 5.1 Public pension investment objectives

As previously discussed, having a pre-funded pension system means that plan contributions can grow over time through investments. Plans must make strategic investments to maximize their returns. Estimating the investment's rate of return is essential when developing an investment policy. The rate of return is a key actuarial assumption described in the prior section. While it is important to not "chase" that assumption by attempting to design an investment policy to achieve it, it is also important to remember the stakes. **If investment earnings are inadequate, either employer and member contributions must cover the shortfall, or the full benefits promised cannot be paid.**

Plans are presented with a bad set of options when investment earnings are inadequate. They must either:

- increase employer contributions (possibly reducing funding for other crucial public services),
- increase current employee contributions (meaning current employees pay for the benefits of past employees), or
- cut benefits (even though employees earned them through their service).

Therefore, the best option is to adopt realistic assumptions and investment methodologies early on to prevent having to be faced with these options.

Investing is all about risk. Riskier investments tend to produce higher rates of return in the long-term but can also have significant variance in the short-term. This dependence on financial market returns was demonstrated by the negative impact of the 2008-2009 stock market decline on the financial condition of many public retirement systems. Many have never fully recovered. Thus, one of the key tasks of a retirement system trustee is to strike a balance between investing the assets in a way that provides sufficient investment returns to fund future benefit payments while avoiding the risk of large losses that might jeopardize the payment of those benefits.

## 5.2 Understanding risk and return

Investing involves prudently taking risk to achieve returns. **A fundamental principle to remember is that some level of risk is inherent in all investments.** Furthermore, to achieve higher levels of return, investors generally must expect to bear higher levels of risk. However, it is also important to note that riskier investments do not always achieve higher levels of return.

One of the most commonly used measures of risk is volatility. **Volatility** calculates how much an asset's return has fluctuated over a historical time period; it measures the rise and fall of investment returns over time. It is a simple measure of risk that seeks to capture most types of investment risk over a long period of time into a single number.<sup>61</sup>

Different types of investments have different degrees of volatility. In general, **there tends to be a strong correlation between the volatility of an investment and the returns expected by investors as compensation for the associated risk.** That is, the higher the degree of risk/volatility, the greater the expected return should be and vice versa. This view is based on the fundamental concept that an investor should expect to be rewarded for assuming greater amounts of risk, because otherwise the investor would opt for less risky or entirely risk-free investments.

In the short term, the actual return of an investment is heavily dependent on its volatility and may diverge significantly from the investor's initial expectation. In the long term, there is a greater chance that expected and actual returns will be more similar regardless of the level of volatility.

### 5.2.1 Specific vs. systematic risk

The total risk of an individual asset can be split into two categories: specific risk and systematic risk. That is, there is a degree of risk **specific** to particular investments—for example, the risk that a particular company fails; there is also a degree of risk that is **systematic** to investments generally—the risk of a broad recession, for instance.

Portfolio managers address specific risk via diversification. For instance, if an investor wants to invest in tech, they might avoid investing entirely in Apple. Instead, they could diversify their portfolio by also purchasing Amazon, Alphabet (Google), Cisco, IBM, Microsoft, Oracle, and others. Further, ideally the investor would diversify further, not only investing in a single sector (such as tech) but in all sectors. However, the systematic risk of downturn to the entire economy would remain, as seen following the 2008 financial collapse.

More information on diversification and portfolio construction is provided later in this section.

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<sup>61</sup> Russell L. Olson, *Investing in Pension Funds & Endowments*. (New York, NY: The McGraw-Hill Companies, Inc., 2003), p.28.

## 5.3 Understanding asset classes and types

**Capital markets** are the part of the financial system concerned with raising capital through dealings in stocks, bonds, and other investments. Capital markets are primarily made up of stocks and bonds, but other markets such as futures, options, and foreign exchange also play an important role. Large pension funds have increasingly turned to alternative investments, like venture capital and private equity, over the past two decades in search of higher returns, but these add a degree of risk and illiquidity that may not be appropriate for smaller funds.<sup>62, 63</sup>

The following chart provides examples of each asset class:

Asset Class	Example
Cash	Money Market Securities
Fixed Income	U.S. Treasury Securities, Treasury Inflation Protected Securities (TIPS), Corporate Bonds, Mortgage-Backed Securities (MBS)
Public Equities (Stocks)	Domestic Stocks, International Stocks, Emerging Market Stocks
Real Assets	Real Estate Investment Trusts (REITs), Private Real Estate Funds, Direct Investment in Property, Natural Resources
Alternatives	Hedge Funds, Private Equity, Venture Capital, Real Assets, Private Credit, Commodities, Absolute Return

### 5.3.1 Asset class descriptions

#### 1. Cash

Cash and cash equivalents such as money market securities are very liquid and stable (that is, they have very low volatility).

#### 2. Fixed income

Fixed income generally comprises debt securities such as municipal or corporate bonds that provide returns in the form of fixed, periodic payments (e.g., interest or coupon payments) and the return of principal at maturity. Other examples include private debt, Treasury Inflation-Protected Securities (TIPS), US Treasury securities held for longer than one-year, fixed income mutual funds and mortgage-backed securities.

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<sup>62</sup> <https://reason.org/commentary/opaque-alternative-investments-add-uncertainty-to-public-pension-fund-reporting/>

<sup>63</sup> <https://www.institutionalinvestor.com/article/b1k8kysvmr8vy1/Pensions-Love-Alternative-Investments-More-Than-Ever>

## 5. Introduction to Investments

The term bond is commonly used to refer to any securities that are founded on debt. When investing in a bond, it is lending out your money to a company or government. In return, they agree to pay interest on the investment and eventually pay you back the amount lent out. Unlike a variable-income security, where payments change based on some underlying measure such as short-term interest rates, the payments of a fixed income security are known in advance.

### 3. Public equity

Equity securities are shares representing an ownership interest in a corporation. Examples of equities include domestic, international, and emerging market stocks, as well as equity mutual funds.

The investment in stocks, or equities, as the asset class defines them, means there is ownership of a part of the business. This entitles voting privileges at the shareholders' meeting and allows a pension fund to receive any profits that the company allocates to its owners. These profits are referred to as dividends.

While bonds provide a steady stream of income, stocks are volatile. That is, they fluctuate in value daily, so when you buy a stock, you aren't guaranteed anything. Many stocks don't even pay dividends, in which case, the only way that you can make money is if the stock increases in value.

Compared to bonds, stocks provide relatively high potential returns. Of course, there is a price for this potential: the risk of losing some or all of the investment.

### 4. Real assets

Real assets are physical assets. They can include natural resources, commodities, and real estate investments such as real estate investment trusts (REITs), private real estate funds and direct investment in property.

### 5. Alternative/other

Investments that do not fit into any of the categories above may be classified as an alternative or other investment. Some alternative investments may include private equity, hedge funds, derivatives and venture capital. All investments in this class must be listed by type in a footnote or table.

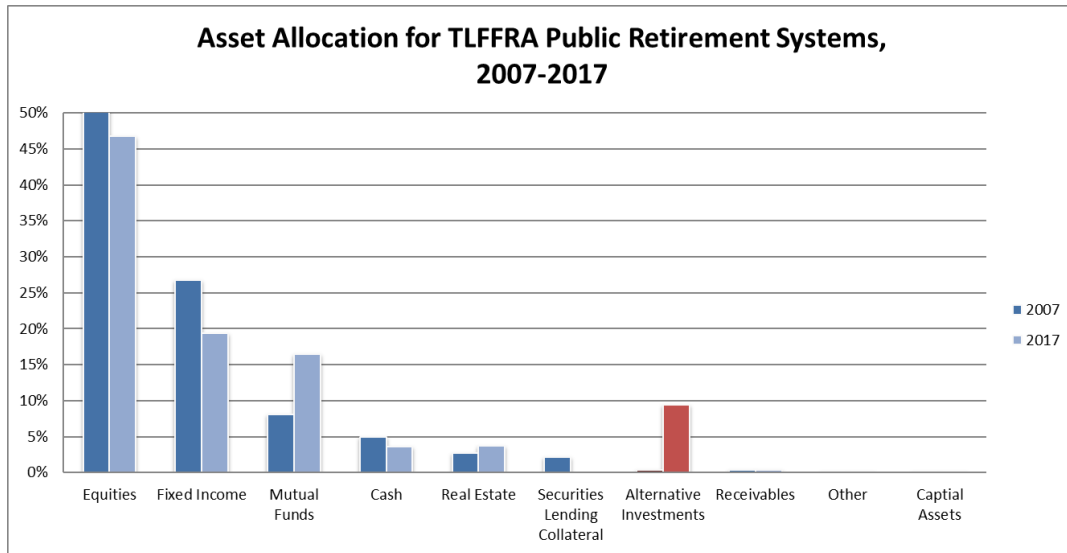
In addition to the two basic securities: equity and debt, better known as stocks and bonds, there are numerous alternative vehicles, which represent the most complicated types of securities and investing strategies.

These are generally high-risk securities that are much more speculative than plain old stocks and bonds. Yes, there is the opportunity for big profits, but they require some specialized knowledge. So, if you don't understand what is being recommended, ask questions. Experts and professionals generally agree that new investors should focus on building a financial foundation before speculating with alternative investments. If your investment consultant is recommending adding this asset class, they may also provide an asset/liability study to explain all risks and rewards expected and how it may affect the plan actuarially.

In recent years, many pension funds have been diversifying by adding alternative investments to their portfolios. Between 2007 and 2017, the category jumped from nearly-zero to about 10 percent of TLFRA plan assets. This shift was even higher among other plans—alternatives moved from less than 5 percent in 2007 to over 30 percent in 2017.



## 5. Introduction to Investments



The primary attraction of alternative investments is the potential for higher returns compared to traditional stock and bond investments. However, with these higher potential returns come increased risks such as high fees and lack of liquidity and transparency. Alternative investments include a wide variety of investments with many different characteristics, such as hedge funds, commodities, derivatives, private equity, venture capital, partnerships, and foreign currency.<sup>64</sup>

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<sup>64</sup> [http://www.ncpers.org/files/Conference%20Docs/Annual%20Conference/2016%20PPTs/Investments%20201\\_Don%20Fehrs.pdf](http://www.ncpers.org/files/Conference%20Docs/Annual%20Conference/2016%20PPTs/Investments%20201_Don%20Fehrs.pdf)

## 5.4 Asset allocation, investment risk, diversification, and portfolio management

Previously we discussed the two characteristics of investments: risk and return. While individual assets have those characteristics, so do portfolios comprised of numerous assets. Investors aim to create a portfolio that maximizes the return per unit of risk accepted. In practice, this means, first, selecting an asset allocation that aligns with the plan's level of risk tolerance, and second, intelligently diversifying within the asset classes.

### 5.4.1 Asset allocation

Asset allocation is the most important tool used in meeting the pension's investment objectives and goals; it is the primary determinant of the portfolio's long-run investment returns. It is also the key factor in determining the portfolio's volatility and risk, and as such, warrants the bulk of time spent by trustees on managing the investments of the system. Every asset allocation decision should be made to enhance the portfolio's return, reduce the portfolio's risk, or a mixture of both.

Most public retirement systems establish their asset allocation in their **investment policy statement**. The plan's strategic allocation defines the asset classes to include in the portfolio and the long-term allocation to each.

Every asset class chosen should serve a specific role. For example, equities could be used as a tool to generate long-term growth of capital while fixed income is used as a tool to gain diversification and reduce the volatility of the portfolio. The ideal strategy is to choose a mix of investments that provide a reasonable return and are driven by different market factors such that they have a low correlation with one another.

Plans must also consider both the long-term nature of pension investing, as well as short-term distribution needs. The long-term time horizon may justify a fairly aggressive asset allocation than an individual might select for a personal portfolio, since a "buy and hold" approach increases the probability that asset classes will achieve their expected returns.<sup>65</sup> Yet a plan must also remember it needs access to cash to pay benefits, which should dissuade a plan from adopting a highly aggressive and illiquid portfolio.

Questions to answer when determining the fund's asset allocation include:

- What level of risk is the fund willing to accept?
- Which allocation to each asset class will produce the highest expected return at the level of risk the fund is willing to accept?
- Is any short-term, tactical reallocation permissible and, if so, how and when?
- Which management strategies should be used within asset classes?

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<sup>65</sup> Eugene B. Burroughs, *Investment Policy Guidebook for Trustees*, 5th ed. (Brookfield, WI: International Foundation of Employee Benefit Plans, Inc., 2005), p.10.

## 5. Introduction to Investments

### 5.4.2 Portfolio risk

In addition to the risk of individual assets described previously, portfolios comprised of numerous assets also have risk. Different risks present depending on a system's **investment strategy** (i.e., active vs. passive management, discussed later). The key sources of risk to a portfolio include:

### 5.4.3 Portfolio management and the importance of fees

There are two major styles of investing: active and passive management. With an **active management strategy**, the plan pays fees to an investment manager who tries to outperform the asset's benchmark. For instance, a large cap fund might try to outperform the returns of the S&P 500 as a whole. In contrast, a **passive management strategy** instead tries to match the performance of a benchmark—often by mirroring the assets that make up the benchmark. For instance, a S&P 500 index fund would aim to mirror the composition of the S&P 500 index itself, thereby performing nearly-identically. **Crucially, fees charged by passive managers are typically far lower than those charged by active managers.**

**Manager selection risk** is the risk trustees incur as they grant discretionary supervision of assets to investment professionals. Most of the available evidence suggests that investors tend to hire managers with strong past performance—a phenomenon known as "**performance chasing**"—only to witness a long period of weak performance after the hire is made. As a result, many systems find that they spend a significant amount of time and effort to identify managers but see little improvement in overall performance. Performing adequate due diligence on the underlying process when selecting investment managers can help mitigate (but will not entirely eliminate) this type of risk.

The available evidence indicates that active managers cannot consistently outperform the returns of passively managed funds in highly efficient markets, like large cap US equities. Thus, active management is most commonly employed in markets of small-cap domestic equity, high-yield bonds, private real estate, and emerging markets.

### 5.4.4 Rebalancing

Rebalancing is bringing a portfolio back to an original asset allocation mix, or back within target allocation minimum and maximum percentages established in the written investment policy. This is necessary because over time some investments may become out of alignment with Board established investment goals. Some investments will grow faster than others, some may have lost value. Rebalancing helps ensure that a portfolio does not overemphasize one or more asset categories and returns a portfolio to an intended level of risk and reward. These measures are important to not only the portfolio, but also to actuarial valuations.

For example, an asset allocation might be established to hold 60 percent in equities of your portfolio, but after a recent stock market increases, stock investments represent 80 percent of your portfolio. The boards' annual calendar review with an investment consultant may show a need to either sell some of the equity holdings or purchase investments from an under-weighted asset class to bring the portfolio back to the targeted asset allocation mix.

There are basically three different ways to rebalance a portfolio:

1. Sell off investments from over-weighted asset categories and use the proceeds to purchase investments for under-weighted asset categories.
2. Purchase new investments for under-weighted asset categories.

## 5. Introduction to Investments

3. If making continuous contributions to the portfolio, alter where these are allocated so that more investments go to under-weighted asset categories until the portfolio is back into balance.

Before rebalancing a portfolio, trustees should consider whether the method of rebalancing used will trigger transaction fees or other (gains/losses) consequences. Contracted financial professionals can help identify ways to minimize these potential costs.

## **6. APPENDIX**

## 6.1 Developing an investment policy

*The guidance below was developed by the Texas Pension Review Board. For the latest guidance, visit the PRB's website: <https://www.prb.texas.gov>.*

### Written Investment Policies for Public Pension Systems

State law adopted in 1993 requires all Texas public retirement systems to adopt a written investment policy. The law does not mandate the type or ratio of investments. The written investment policy must be available to the public for review, and a copy must be filed with the Pension Review Board within 90 days of adoption.

For many years, the Pension Review Board has stressed the importance of written investment policies. Having written investment policies in place is a basic minimum requirement for funds to follow. Not only does having a written policy focus on a board's investment goals, it also provides an objective framework in which investment managers can operate and allows the board of trustees checkpoints for seeing that their policy is being carried out properly.

There are two clear benefits of a carefully considered written investment policy:

1. A public fund will develop a standard by which to monitor the professionals in achieving results.
2. A method for the client who has established realistic long-term investment goals to communicate those goals to the investment community.

### Investment Policy Test

An investment policy should focus on the big picture, stating such things as asset allocation, types of allowable investments rather than specific investments, and other criteria such as standards of investment quality and rate of return objectives. If this is accomplished, the Trustees can refer to their "business plan" and make adjustments on a quarterly or annual basis. As a "test" a Trustee should be able to read investment policies and answer yes to the following questions.

1. Is the policy carefully designed to meet the real needs and objectives of the retirement plan?
2. Is the policy written so clearly and explicitly that a complete stranger could manage a portfolio and conform to the desired intentions?
3. Would the retirement fund have been able to sustain a commitment to the policies during the capital markets that have been actually experienced over the past ten, twenty, fifty, or even sixty years?
4. Would the investment managers have been able to maintain fidelity to the policy over the same periods?
5. Would the policy, if previously implemented, have achieved the objectives and results desired?

### Asset Allocations

One of the basic tenets of an investment policy is asset allocation. Asset allocation is simply a decision to expose certain percentages of total Fund assets to segments of the investment markets. In order to achieve higher returns, generally one must be willing to accept higher volatility. Volatility is one way to measure risk.

## 6. Appendix

### **Rates of Return**

To increase one's understanding, one can also look at the actual rates of return and volatility for the past 25 years. This places the spectrum of anticipated investment returns and risk in focus. Obviously, Trustees who take positions that are either 100% in bonds or 100% in stocks are at the extreme end. Most fiduciaries prefer to be some place in between. That point that offers the greatest return with the least amount of risk is called the optimum asset allocation. Many Trustees through common sense have determined how their own portfolios should be structured based on the philosophy that one does not put all his or her eggs in one basket.

### **Risk**

By now, as a Public Fund Trustee you may have a thought in mind as to how much risk you are willing to incur. The key then is what is the minimum required rate of return that must be achieved? This is often expressed in terms of an actuarial interest assumption, an assumed rate of earnings that the retirement fund will realize over a long period of time. Another factor in a plan's funding is INFLATION. Because defined benefit plans provide a benefit as a percentage of wages, the variable of inflation and its impact on wages can be substantial. Earnings, when combined with contributions, should allow the Fund to pay promised benefits by a specific date.

### **Three points to keep in mind**

1. What is my minimum required rate of return expressed in terms of percentage growth?
2. How should I mix assets so as reasonably to assure the achievement of those returns without taking undue risk?
3. How do I offset inflation?

## 6.2 Trustee outline for developing an investment policy

*The Pension Review Board is providing the following basic outline for a trustee to consider in developing a written investment policy. For the latest guidance, visit PRB's website: <https://www.prb.texas.gov>.*

### Written investment policy introduction

- Who is my fund?
- Who are my beneficiaries?
- What are their needs?
- How is the fund governed?
- What are the variety of legal statutes that constrain the fund operation?
- Who do people talk to when they want to know more?
- What are we trying to achieve in this statement?

### Investment objectives (should be expressed as a percentage)

- What are the actuarial assumptions or other minimum earnings rate that we must make in this plan to assure long-term growth?
- What is our overall asset allocation?
- How much will we have in government obligations?
- How much in corporate bonds?
- How much in stock, etc.?

### What are the objectives of the total fund as measured in the following ways?

- Absolute rate of return
- Relative rate of return
- Risk adjusted rate of return
- Real rate of return (measured against inflation)
- What time series do we assign for achieving these objectives?

### Investment policy

Describe the investment policy as it relates to each of the specific assets in your allocation. For example, if you have stocks do you believe in a growth philosophy or a conservative income philosophy? For bonds, do you believe in long-term, intermediate bonds, or comparing the bonds against a recognized index? Other issues in investment guidelines: What are my concerns and needs for:

- liquidity
- diversification
- preservation of principle



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- risk of loss
- restrictions (such as South Africa and other prohibited transactions)
- legislation

### **Investment manager review procedure**

- How often is the manager to be measured?
- Against what indices?
- In the event of extreme circumstances in the investment markets, what should the manager do?
- How will the performance be measured?
- Who will do it?

Contact the Texas Pension Review Board at (512) 463-1736 if you any questions or if you would like a copy of a written investment policy that is on file.

### 6.3 Questions the SEC Wants You to Ask

To encourage the disclosure and review of more and better information about potential conflicts of interest, the Department of Labor and the SEC have developed the following set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant.

**1. Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?**

You can check yourself—and view Part I of the firm’s Form ADV—by searching the SEC’s Investment Adviser Public Disclosure website. Your investment adviser must furnish you with a copy of Part II of Form ADV. At present, the IAPD database contains Forms ADV only for investment adviser firms that register electronically using the Investment Adviser Registration Depository. In the future, the database will expand to encompass all registered investment advisers—individuals as well as firms—in every state. If you can’t locate an investment adviser in IAPD, be sure to contact your state securities regulator or the SEC’s Public Reference Branch.

**2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, describe those relationships?**

When pension consultants have alliances or financial or other relationships with money managers or other service providers, the potential for material conflicts of interest increases, depending on the extent of the relationships; knowing what relationships, if any, your pension consultant has with money managers may help you assess the objectivity of the advice the consultant provides.

**3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of these payments in relation to your other income (revenue)?**

Payments from money managers to pension consultants could create material conflicts of interests. You may wish to assess the extent of potential conflicts.

**4. Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being considered when you provide advice to your clients?**

Probing how the consultant addresses these potential conflicts may help you determine whether the consultant is right for your plan.

**5. If you allow plans to pay your consulting fees using the plan’s brokerage commissions, do you monitor the amount of commissions paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not over-pay its consulting fees?**

You may wish to avoid any payment arrangements that could cause the plan to pay more than it should in pension consultant fees.

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**6. If you allow plans to pay your consulting fees using the plan's brokerage commissions, what steps do you take to ensure that the plan receives best execution for its securities trades?**

Where and how brokerage orders are executed can impact the overall costs of the transaction, including the price the plan pays for the securities it purchases.

**7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?**

As noted above, you may wish to explore the consultant's relationships with other service providers to weigh the extent of any potential conflicts of interest.

**8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the plan while providing the consulting services we are seeking?**

All investment advisers (whether registered with the SEC or not) owe their advisory clients a fiduciary duty. Among other things, this means that advisers must disclose information to their clients about material conflicts of interest.

**9. Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?**

If the consultant is a fiduciary under ERISA and receives fees from third parties as a result of their recommendations, a prohibited transaction under ERISA occurs unless the fees are used for the benefit of the plan (e.g., offset against the consulting fees charged the plan) or there is a relevant statutory or class exemption permitting the receipt of such fees.

**10. What percentage of your plan clients utilize money managers, investment funds, brokerage services or other service providers from whom you receive fees?**

The answer may help in evaluating the objectivity of the recommendations or the fiduciary status of the consultant under ERISA.

## 6.4 Model ethics and conflict-of-interest policy

*The Pension Review Board published the model ethics and conflict-of-interest policy below in 2015. For the latest guidance, visit PRB's website: <https://www.prb.texas.gov>.*

### Background

Pursuant to Section 801.210, Texas Government Code, the State Pension Review Board (PRB) has developed the following Model Ethics and Conflict-of-Interest Policy for voluntary use by public retirement systems in Texas. Texas public retirement systems are not required to utilize the model policy when developing and/or adopting their own policies.

Adoption of ethics and conflict-of-interest policies may help public retirement systems to outline standards of conduct expected of their board of trustees, as plan fiduciaries, to act responsibly, honestly and in the best interest of the fund, and to avoid creating even the appearance of impropriety. The PRB developed the model ethics and conflict-of-interest policy to function as a general policy that can be used as a guide for minimum levels of ethical and conflict-of-interest requirements for public retirement systems.

The provisions below are intended to aid retirement systems in identifying ethical standards, conflicts-of-interest, and properly avoiding, disclosing and managing conflicts. This model is a guide, not a complete statement of all ethical standards, conflict of interest requirements, or legal requirements that may apply to a retirement system. It also is not offered and should not be interpreted as legal advice.

The model policy has been created for the trustees of retirement systems; however, systems may adopt a similar policy for their key employees as well. Additionally, systems may include relevant attachments to their policy, such as applicable statutory section language and required conflict-of-interest disclosure forms and statements.

### Statutory requirements for Texas public retirement systems

Public retirement systems should be aware as they develop ethics and conflict-of-interest policies that certain requirements exist in law that may apply to system trustees. Many of the ethical standards and conflict-of-interest and disclosure requirements that may apply to public retirement systems can be found in various Texas statutes as outlined below:

- a. Article 16, Section 67 of the Texas Constitution contains provisions regarding fiduciary duties applicable to state and local retirement systems' board of trustees.
- b. Texas Government Code Section 802.203 outlines the fiduciary responsibilities of the governing body of a public retirement system and states that the governing body shall discharge its duties solely in the interest of the participants and beneficiaries.
- c. Chapter 572 of the Texas Government Code contains provisions relating to standards of conduct, and conflict-of-interest and disclosure requirements for state officers and employees.
- d. Chapters 171 and 176 of the Texas Local Government Code contain provisions relating to conflict-of-interest and disclosure requirements applicable to officers of municipalities, counties, and certain other local governments.
- e. Governing statutes of public retirement systems could also contain fiduciary, ethics, conflict-of-interest and/or disclosure requirements. Texas statewide and local retirement systems' governing statutes can be found in the Texas Government Code, Vernon's Texas Civil Statutes, or Local

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Ordinances adopted by a city. A retirement system should refer to its governing statute to ensure all ethics-related requirements are included in their policy.

- f. The Texas Trust Code contained under the Texas Property Code also governs pension trusts in Texas. Chapter 113 of the Code states that a trustee shall administer the trust in good faith and shall perform all of the duties imposed on trustees by the common law. The Uniform Prudent Investor Act, Chapter 117 of the Texas Trust Code provides information on the duties of trustees including the standard of care, loyalty, impartiality, and the prudent investor rule in managing trust assets.
- g. Retirement systems may also be subject to federal laws, such as the Internal Revenue Service's fiduciary-related requirements and the Securities and Exchange Commission's Pay to Play Regulations.

### **Document layout**

This model policy is divided into the following sections: Overview, Code of Ethics, General Standards of Conduct, Fiduciary Duties, Conflicts-of-Interest, Prohibited Transactions and Interests, Disclosure, Confidential Information, Nepotism, Gifts, Enforcement, Training, and Definitions.

Where applicable, requirements set out in the Texas statutes are included in each section. Sections also may contain examples of additional non-statutory guidelines for systems that may wish to adopt policies beyond the statutory minimum standards.

Some of the non-statutory guidelines contained in this model policy have been designed after provisions contained in ethics policies of Teacher Retirement System of Texas (TRS), Employee's Retirement System of Texas (ERS), Texas County and District Retirement System (TCDRS), and Houston Municipal Employees Pension System (HMEPS).

The following material contains the Model Ethics and Conflict-of-Interest Policy that retirement systems may use to create their own policy.

## **[RETIREMENT SYSTEM] BOARD OF TRUSTEES ETHICS POLICY**

### **I. Overview**

The [retirement system] promulgates the following ethics and conflict-of-interest policy that sets forth the basic principles, guidelines and standards of conduct for trustees of the [retirement system].

This policy does not supersede any applicable federal and Texas law or administrative rule. [Retirement system] trustees must abide by all applicable federal and Texas laws, and [retirement system] policies, including this ethics and conflict-of-interest policy.

The purpose of this document is to outline the specific standards of conduct expected of [retirement system] trustees. This policy is a guide, not a complete statement of all legal and fiduciary responsibilities of the trustees; therefore, compliance with this policy does not necessarily ensure compliance with all legal requirements.

### **II. Code of Ethics**

Trustees of the [retirement system] shall abide by the Texas Constitution, Texas statutes, and federal laws applicable to the [retirement system] and will also abide by the code set forth below:

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- A. Act solely in the best interest of the fund and the [retirement system] members, retirees, and beneficiaries.
- B. Act with integrity, competence, dignity, and in an ethical manner when dealing with participants, beneficiaries, the public, employees, vendors, and fellow members.
- C. Use reasonable care and prudence.
- D. Exercise independent professional judgment.
- E. Remain independent from conflicts-of-interest.
- F. Deal fairly, objectively, and impartially in all matters relating to the [retirement system].
- G. Maintain confidentiality of the [retirement system], participant, and beneficiary information.
- H. Not have a direct or indirect interest, including financial or other interests, or engage in a personal business activity that could conflict with the proper discharge of the trustee's duties or management of the [retirement system] investments.

### III. General Standards of Conduct

- A. A trustee must abide by the following statutory standards of conduct and shall not:<sup>66</sup>
  - 1. Accept or solicit any gift, favor, or service that might reasonably tend to influence the trustee in the discharge of official duties or that the trustee knows or should know is being offered with the intent to influence the trustee's official conduct;
  - 2. Accept other employment or engage in a business or professional activity that the trustee might reasonably expect would require or induce the trustee to disclose confidential information acquired by reason of his or her position with the [retirement system];
  - 3. Accept other employment or compensation that could reasonably be expected to impair the trustee's independence of judgment in the performance of his or her official duties for the [retirement system]; or
  - 4. Intentionally or knowingly solicit, accept, or agree to accept any benefit for having exercised the trustee's authority or performed the trustee's duties at the [retirement system] in favor of another.
- B. A trustee must abide by the following additional standards of conduct.<sup>67</sup>
  - 1. Trustees must be honest in the exercise of their duties and must not take actions which will discredit the [retirement system].
  - 2. Trustees should avoid personal, employment, or business relationships that create conflicts of interest. Should trustees become aware of any conflict of interest, they have an affirmative duty to disclose and to cure the conflict in a manner provided for in this policy.

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<sup>66</sup> Section 572.051(a), Texas Government Code

<sup>67</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum. Source: TCDRS Code of Ethics and HMEPS Ethics Policy.

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3. Trustees may not use their relationship with [retirement system] to seek or obtain personal gain. This should not be interpreted to forbid properly authorized expense reimbursements from the [retirement system] to a Trustee for valid expenses incurred in the performance of duties or the use of the [retirement system] as a reference or the communication to others of the fact that a relationship with the public retirement system exists, provided that no misrepresentation is involved.
4. Solicit, accept, or agree to accept any benefit from a person the trustee knows is interested in or is likely to become interested in any contract, purchase, payment, claim, or transaction involving the exercise of the trustee's discretion.

### IV. Fiduciary Duties

- A. A trustee must abide by the following statutory fiduciary responsibility.
  1. In the administration of the [retirement system] and in making and supervising investments of assets of the system, a trustee shall discharge his or her duties solely in the interest of the participants and beneficiaries:
    - a. For the exclusive purposes of:
      - i. providing benefits to participants and their beneficiaries; and
      - ii. defraying reasonable expenses of administering the system;
    - b. with the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with matters of the type would use in the conduct of an enterprise with a like character and like aims;
    - c. by diversifying the investments of the system to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
    - d. in accordance with the documents and instruments governing the system.<sup>68</sup>
  2. In choosing and contracting for professional investment management services and in continuing the use of an investment manager, a trustee must act prudently and in the interest of the participants and beneficiaries of the [retirement system].<sup>69</sup>
  3. The board of trustees when appointing an investment manager for the system shall obtain an acknowledgement in writing stating that the manager has fiduciary responsibility to the fund.<sup>70</sup>
  4. A trustee shall invest and manage the trust assets solely in the interest of the beneficiaries and, if the trust has two or more beneficiaries, the trustee shall act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries.<sup>71</sup>

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<sup>68</sup> Section 802.203(a), Texas Government Code

<sup>69</sup> Section 802.203(b), Texas Government Code

<sup>70</sup> Section 802.203(d), Texas Government Code

<sup>71</sup> Sections 117.007 and 117.008, Texas Trust Code

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5. In making investments, a trustee shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital.<sup>72</sup>
  6. A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.<sup>73</sup>
- B. A trustee must abide by the following additional fiduciary duties.<sup>74</sup>
1. In making or participating in decisions, trustees shall give appropriate consideration to those facts and circumstances reasonably available to the trustee, which are relevant to the particular decision, and shall refrain from using facts or circumstances which are not relevant to the decision.<sup>75</sup>
  2. Trustees shall ensure that [retirement system] business transactions are based on professional integrity and competence, financial merit and benefit to [retirement system] and on a competitive basis.
  3. Review on a regular basis the efficiency and effectiveness of the [retirement system's] success in meeting its goals, including assessing the performance and actions of system service providers, such as investment managers, consultants, and actuaries.
  4. Trustees shall use reasonable care to prevent other trustees from committing a breach and shall not participate in concealing such a breach, or knowingly or negligently permit such a breach to occur.<sup>76</sup>

## V. Conflicts-of-Interest

- A. Statutory conflict-of-interest provisions governing state officials.
1. A trustee may not have a direct or indirect interest, including financial and other interests, or engage in a business transaction or professional activity, or incur any obligation of any nature that is in substantial conflict with the proper discharge of the trustee's duties.<sup>77</sup>
  2. Make personal investments that could reasonably be expected to create a substantial conflict between the trustee's private interest and the interest of [retirement system].<sup>78</sup>
  3. A trustee may not solicit or accept from the [retirement system], or any third party a commission, fee, bonus, retainer, or rebate that is compensation for the trustee's

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<sup>72</sup> Article 16, Section 67(a)(3), Texas Constitution

<sup>73</sup> Section 117.004(a), Texas Trust Code

<sup>74</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum.

<sup>75</sup> HMEPS Ethics Policy

<sup>76</sup> HMEPS Ethics Policy

<sup>77</sup> Section 572.001(a), Texas Government Code

<sup>78</sup> Section 572.051(a)(4), Texas Government Code



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personal solicitation for the award of a contract for investment services or sale of goods to the [retirement system].<sup>79</sup>

### B. Statutory conflict-of-interest provisions governing local officials.<sup>80</sup>

1. If a trustee has a substantial interest in a business entity or in real property, the trustee shall file, before a vote or decision on any matter involving the business entity or the real property, an affidavit stating the nature and extent of the interest and shall abstain from further participation in the matter if:
  - a. In the case of a substantial interest in a business entity the action on the matter will have a special economic effect on the business entity that is distinguishable from the effect on the public; or
  - b. In the case of a substantial interest in real property, it is reasonably foreseeable that an action on the matter will have a special economic effect on the value of the property, distinguishable from its effect on the public.
2. The board of trustees of the [retirement system] shall take a separate vote on any budget item specifically dedicated to a contract with a business entity in which a trustee has a substantial interest. The affected trustee may not participate in that separate vote. The trustee may vote on a final budget if the trustee has complied with Texas Local Government Code, Chapter 171; and the matter in which the trustee is concerned has been resolved.<sup>81</sup>

### C. Trustees must abide by the following additional conflict-of-interest guidelines.<sup>82</sup>

1. Trustees should make reasonable efforts to avoid conflicts of interest and appearances of conflicts of interest.<sup>83</sup>
2. Trustees may not under any circumstances accept offers, by reason of their service, relationship or employment with the [retirement system], to trade in any security or other investment on terms more favorable than those available to the general investing public or, in the case of private market investments, a similarly situated investor.<sup>84</sup>
3. A conflict of interest exists for a trustee whenever the trustee has a personal or private commercial or business relationship that could reasonably be expected to diminish the trustee's independence of judgment in the performance of the trustee's responsibilities to the [retirement system].<sup>85</sup>
4. Curing Conflicts-of-Interest<sup>86</sup>

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<sup>79</sup> Section 572.056, Texas Government Code

<sup>80</sup> Section 171.004(a), Texas Local Government Code

<sup>81</sup> Section 171.005, Texas Local Government Code

<sup>82</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum.

<sup>83</sup> TRS Board of Trustees Ethics Policy

<sup>84</sup> ERS Code of Ethics and Personal Investment Activities

<sup>85</sup> TCDRS Ethics Policy

<sup>86</sup> TCDRS Ethics Policy

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- a. All trustees who become aware of a personal conflict of interest have an obligation not only to disclose that conflict, but to cure it. A person normally cures a conflict of interest by promptly eliminating it.
- b. A trustee can cure a conflict by prudently withdrawing from action on a particular matter in which a conflict exists provided that:
  - i. the person may be and is effectively separated from influencing the action taken;
  - ii. the action may properly be taken by others; and
  - iii. the nature of the conflict is not such that the person must regularly and consistently withdraw from decisions that are normally his or her responsibility with respect to the [retirement system].
- c. Trustees must disclose any conflicts-of-interest regarding matters which are before the board, absent themselves from any relevant deliberations, and not vote on the matter. Such trustees may be required to disclose additional relevant information with respect to the matter in question.

## VI. Prohibited Transactions and Interests

- A. Statutory conflict-of-interest provisions governing state officials.<sup>87</sup>
  1. Certain transactions by trustees are prohibited, including:<sup>88</sup>
    - i. The purchase, sale, exchange or leasing of property with the [retirement system] if that trustee holds an interest in the property;
    - ii. The purchase, sale, or exchange of any direct investment with the system if that trustee holds an interest in the investment; and
    - iii. The lending of money or furnishing of other credit by the [retirement system] if the trustee has a direct or indirect interest in the loan or credit unless such loan or credit is generally available to members of the system, generates a reasonable return, provides adequate
  2. Trustees shall not under any circumstance accept offers by reason of their position with the [retirement system] to trade in any security or other investment on terms more favorable than those available to the general investing public.
  3. Trustees shall not use their position with the [retirement system] to solicit business for their own account or the account of an immediate relative or business associate.
  4. Trustees shall not borrow from investment managers, outside service providers, professional advisors or consultants, banks or other financial institutions with which the [retirement system] has a business relationship , unless such entities are normally engaged in such lending in the usual course of their business.

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<sup>87</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum.

<sup>88</sup> TCDRS Ethics Policy and HMEPS Ethics Policy

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5. No trustee shall serve as a placement agent in connection with any [retirement system] investment. A former trustee may be prohibited from serving as a placement agent in connection with any system investment for a certain period of time. A placement agent is any person or entity hired, engaged, or retained by or acting on behalf of an external investment manager or investment fund or on behalf of another placement agent as a finder, solicitor, consultant, broker or other intermediary to raise investments from or to obtain access to the system, directly or indirectly.
  6. Trustees shall not cause the system to engage in any prohibited transactions outlined above with any immediate relative or business associate of the trustee, any other trustee, employee, custodian, vendor or consultant to the system, or any person providing services to the system.
- B. Trustees may buy or sell a publicly traded security of an issuer which is held by the [retirement system] but may not engage in a personal securities transaction when the trustees have actual knowledge that the [retirement system] is trading such securities.<sup>89</sup>
- C. Statutory requirements for former state officials:
1. Trustees may not for two years after ceasing to be in their respective positions at the [retirement system] make any communication to or appearance before, an officer or employee of [retirement system], with the intent to influence [retirement system] action to benefit the person seeking such action. This restriction does not apply to the act of providing information as long as such communication is done without the intent to influence any actions by the [retirement system].<sup>90</sup>
  2. A former trustee may not represent any person or receive compensation for services rendered on behalf of any person regarding a particular matter in which the former trustee participated during the period of his/her service or employment, either through personal involvement or because the matter was within the trustee's official responsibility.<sup>91</sup>

## VII. Disclosure

### A. Statutory disclosure provisions governing state officials.

A trustee who has a personal or private interest in a measure, proposal, or matter pending before the [retirement system] shall publicly disclose the fact to the system. The trustee may not vote or otherwise participate in the decision. The disclosure shall be entered in the minutes of the meeting.<sup>92</sup>

### B. Statutory disclosure requirements governing local officials.

1. Trustees shall file a conflicts disclosure statement with respect to a vendor who enters into a contract with the [retirement system] or the system is considering entering into a contract with the vendor; and

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<sup>89</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum.

<sup>90</sup> Section 572.054(a), Texas Government Code

<sup>91</sup> Section 572.054(b), Texas Government Code

<sup>92</sup> Section 572.058, Texas Government Code

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- a. the vendor has an employment or other business relationship with the trustee or a family member of the trustee that results in the trustee or family member receiving certain taxable income exceeding \$2,500.
  - b. the vendor has given one or more gifts with an aggregate value of greater than \$100 to the trustee or a family member; or
  - c. the vendor has a family relationship with the trustee<sup>93</sup>
2. A trustee is not required to file a conflicts disclosure statement in relation to a gift accepted by the trustee or a family member of the trustee if the gift is a political contribution as defined by Title 15, Election Code; or food, accepted as a guest.<sup>94</sup>
  3. A trustee is not required to file a conflicts disclosure statement under Subsection (B1) if the local governmental entity or vendor described by that subsection is an administrative agency created under Section 791.01, Government Code.<sup>95</sup>

### VIII. Confidential Information<sup>96</sup>

- A. Trustees must not disclose confidential information, except when duly authorized personnel determine such disclosure is required by law.
- B. Trustees may be provided or have access to confidential information, including material, nonpublic information. It is the duty of trustees to maintain the confidentiality of information and not misuse confidential information, including material, nonpublic information, belonging to or relating to the [retirement system]. Trustees who come into possession of material, nonpublic information must not communicate it intentionally or inadvertently to any third party, including but not limited to relatives and friends, unless the person has the need to know for legitimate reasons and such communication is consistent with their responsibilities to the system.<sup>97</sup>

### IX. Nepotism

Statutory Nepotism provisions:

A trustee must not appoint, confirm the appointment of, or vote for the appointment or confirmation of the appointment of an individual to a position that is to be directly or indirectly compensated from public funds or fees of office if:<sup>98</sup>

1. The individual is related to the trustee within the third degree by consanguinity or within the second degree by affinity; or

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<sup>93</sup> Section 176.003(a), Texas Local Government Code

<sup>94</sup> Section 176.003(a-1), Texas Local Government Code

<sup>95</sup> Section 176.003 (a-2), Texas Local Government Code

<sup>96</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum.

<sup>97</sup> AFSCME *Best Practices for Trustees and Pension Systems, Ethical and Fiduciary Conduct*. The Best Practices section included in this publication has additional provisions relating to prohibition on insider trading that the retirement systems could consider including in their policy.

<sup>98</sup> Section 573.041, Texas Government Code. Computation of degree of consanguinity and determination of affinity provisions can be found under Sections 573.023 and 573.024, respectively.

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2. The trustee holds the appointment or confirmation authority as a member of the [retirement system] board and the individual is related to another member of that board within the third degree by consanguinity or within the second degree by affinity.
3. The ending of a marriage by divorce or the death of a spouse ends relationships by affinity created by that marriage unless a child of that marriage is living, in which case the marriage is considered to continue as long as a child of that marriage lives.

### **X. Gifts<sup>99</sup>**

- A. Barring any statutory exception, a trustee is prohibited from soliciting or accepting a gift from any donor because of or through use of the trustee's position with the [retirement system]. Such gifts cannot be accepted by trustees themselves or for their families or business partners.
- B. Under no circumstances may trustees accept a gift if the source of the gift is not identified or if the trustee knows or has reason to know that the gift is being offered through an intermediary.
- C. If a prohibited gift is received by a trustee, he or she should return the gift to its source. If that is not possible or feasible, the gift should be donated to charity.
- D. Statutory exceptions regarding acceptance of gifts are allowed under this policy as long as the trustee is not influenced by the gift.

### **XI. Enforcement<sup>100</sup>**

- A. The Board will enforce this policy. A complaint or allegation of a Trustee's potential violation of the policy must be in writing and submitted to the Executive Director. The Executive Director will promptly notify the chair of the alleged violation. If the potential violation involves the chair, the executive director will notify the vice-chair, or secretary or other Board Trustee, as applicable. The Executive Director may have Legal Counsel review the claim and related information. No retaliatory action will be taken against the reporting person for any such report involving another person made in good faith.
- B. The chair, or vice-chair, or secretary or other Board Trustee, as applicable, shall present the recommendations to the Board for resolution of the matter. The Board has final decision-making authority with respect to Trustee violations of the policy, and such decision shall be binding on the Trustee. A Trustee who is a subject of the alleged violation may not deliberate or vote on such Board action
- C. If the Board finds a violation occurred, the Board may issue a resolution of reprimand, censure, or other appropriate measure, including a request for resignation.

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<sup>99</sup> TCDRS Ethics Policy. Chapter 36, Section 36.10 of the Texas Penal Code and Chapter 176 of the Texas Local Government Code contain specific provisions relating to acceptance of gifts, benefits and entertainment and applicable statutory exceptions for state and local officials, respectively.

<sup>100</sup> Additional non-statutory guidelines for systems that wish to adopt standards beyond the statutory minimum. Please note that specific enforcement procedures in an ethics policy can play an important role in consistent application of the policy. A retirement system can tailor its enforcement procedures to best address its specific needs.

## 6. Appendix

- D. A violation of this policy may be reported to applicable regulatory or law enforcement agencies when appropriate or required.

### **XII. Training**

- A. Every trustee shall attend periodic ethics training and acknowledge in writing that he or she understands the ethical standards, has abided by them, and will continue to abide by them. New trustees are to make this written acknowledgment when they take office.

### **XIII. Definitions**

In this policy the following definitions apply:

- A. "Board" means the board of trustees of the [retirement system].
- B. "Trustee" means a member of the Board of Trustees of the [retirement system].
- C. "Fiduciary" means any person who exercises any discretionary control over the management of the public retirement system or any authority or control over the management or disposition of its assets.
- D. "Executive Director" means the Director or Administrator of the [retirement system].
- E. "Legal Counsel" means the lawyer or firm of lawyers designated from time to time as the Legal Counsel of the [retirement system].
- F. "Gift" means anything of tangible value given without consideration and includes any payment of cash, receipt of goods or services, or other benefit.

## 6.5 Texas Local Fire Fighters Retirement Act (TLFFRA)

*Article 6243e, Vernon's Texas Civil Statutes, 45th Legislature, 1937*

*Current through the 87th Legislature, 2021*

Note: Great effort has been made to reproduce the provisions in this publication as the provisions are found in the official laws of the State of Texas. However, the main purpose is to provide a convenient source of reference. The laws and constitutional provisions as published in the official laws of the state will prevail in all questions of interpretation and application. In addition, this book, while providing general information, is not intended to be a substitute for independent legal research or the advice of an attorney.

### Section 1 – Short title

This Act may be cited as the Texas Local Fire Fighters Retirement Act.

### Section 2 – Definitions

*In this Act:*

- (1) "Contribution" means an amount of money paid by a municipality or other political subdivision to a retirement system or required to be paid periodically to a retirement system by or on behalf of a member of the retirement system for the purpose of financing benefits payable by the system.
- (2) "Employee" means a person who regularly performs services for a fire department, who is a member of the retirement system that includes the fire department, and who regularly receives compensation for those services of at least \$200 a month. The term includes a person described by Subsection (d) of Section 9 of this Act who regularly receives compensation by the municipality or other political subdivision of at least \$200 a month.
- (3) "Fund" means a trust fund established in conjunction with a fire fighters' retirement system for the purpose of holding assets to be used to finance benefits payable by the system.
- (4) "Participating member" means an employee who is required to make periodic contributions to a retirement system or a volunteer who meets the requirements of Subsection (b) of Section 10 of this Act.
- (5) "Regularly organized fire department" means a unit that is responsible primarily for fighting fires and responding to other emergencies each day and that has specialized equipment for use in performing those tasks.
- (6) "Retiree" means a person who receives a benefit, other than a return of contributions, from a retirement system for services the person performed as a member.
- (7) "Retirement system" means a fire fighters' retirement system established as provided by Section 4 of this Act.
- (8) "Volunteer" means a person who regularly performs services for a fire department, who is a member of the retirement system that includes the fire department, and who either receives no compensation for those services or regularly receives compensation for those services of less than \$200 a month. The term includes a person described by Subsection (d) of Section 9 of this Act who either receives no compensation for service to a municipality or other political subdivision or regularly receives compensation for that service of less than \$200 a month.

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(9) "Compensation" includes amounts of workers' compensation benefits received by an employee and by which the employee's salary is reduced.

(10) "Determination date" means:

(A) the day before the effective date of an addition or change adopted by the board of trustees of a retirement system under Section 7 of this Act; or

(B) the date of divorce for a member or retiree whose benefits under this Act are subject to a qualified domestic relations order.

(11) "Vested accrued benefit" means the amount of the monthly benefit that a person is entitled to receive based on the person's service credit and compensation history as of the determination date under the benefit formula and other terms established by a retirement system, including a vested percentage where applicable, as those terms exist on the determination date. The vested accrued benefit of a member is calculated without regard to any optional form of payment the member may select at retirement. The term does not include cost-of-living increases that may be applied to a benefit after the determination date.

### **Section 3 – Application of Act**

(a) This Act applies to each municipality in the state that has a regularly organized fire department not consisting exclusively of volunteers, except:

(1) a municipality all of whose fire department personnel participate in the Texas Municipal Retirement System;

(2) a municipality whose fire department is governed by another state law providing for retirement benefits for fire department personnel; and

(3) a municipality that has in effect a program providing retirement benefits for fire department personnel that was established by charter or ordinance before September 1, 1989.

(b) This Act also applies to each municipality in the state that has a fire department that:

(1) consists exclusively of volunteers;

(2) was organized before September 1, 1989, and remains a regularly organized department; and

(3) does not participate in the statewide program provided by Chapter 269, Acts of the 65th Legislature, Regular Session, 1977 (Article 6243e.3, Vernon's Texas Civil Statutes).

(c) If a municipality's fire department consists partly of employees participating in the Texas Municipal Retirement System and partly of employees or volunteers not participating in that retirement system, this Act applies to the persons who are not participating in the Texas Municipal Retirement System. In that circumstance, a provision of this Act that applies to members of a retirement system or to members of a fire department applies only to those members who are participating in a retirement system under this Act.

(d) If a municipality's fire department consists partly of volunteers participating in the statewide program provided by Chapter 269, Acts of the 65th Legislature, Regular Session, 1977 (Article 6243e.3, Vernon's Texas Civil Statutes), and partly of employees not participating in that program, this Act applies to the fire department personnel who are employees. In that circumstance, a provision of this Act that applies to members of a retirement system or to members of a fire department applies only to those members who are employees.



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(e) In addition to the other applicability of this Act, this Act applies to a political subdivision that has a regularly organized fire department not consisting exclusively of volunteers, except a political subdivision whose fire department is governed by another state law providing for retirement benefits for full-time paid fire department personnel. If the political subdivision's fire department consists partly of volunteers eligible to participate in the program provided by Subtitle H, Title 8, Government Code, and partly of employees, this Act applies to fire department personnel who are employees.

### **Section 4 – Retirement System and Trust Fund**

A fire fighters' retirement system and trust fund are established in each municipality or other political subdivision to which this Act applies. The board of trustees of each retirement system established by this Act shall hold or cause to be held in trust the assets appropriated or dedicated to the system or fund, separate from other money or accounts administered by the board of trustees or the municipality or other political subdivision, for the exclusive benefit of the members and retirees of the system and their beneficiaries.

### **Section 5 – Exemption from Judicial Process**

All amounts in a trust fund of a retirement system subject to this Act and all rights accrued or accruing under this Act to any person are exempt from garnishment, attachment, execution, state and municipal taxation, sale, levy, and any other process and are unassignable.

### **Section 6 – Social Security**

Provisions of a retirement system may not be integrated with social security as otherwise permitted under Sections 401(a)(4), (a)(5), and (l) of the Internal Revenue Code of 1986 (26 U.S.C. Section 401).

### **Section 7 – Modification of Benefits and Eligibility**

(a) The board of trustees of a retirement system may change the benefits or eligibility requirements for benefits payable from the retirement system, may provide for reinstatement by a member of service credit previously forfeited, and may adopt or change other requirements for the payment of benefits, except as otherwise prohibited by this Act.

(b) Before a board of trustees chooses to adopt or change a benefit or requirement for payment of benefits under this section, the proposed addition or change must be approved by:

- (1) an eligible actuary selected by the board; and
- (2) a majority of the participating members of the retirement system voting on the addition or change by secret ballot at an election held for that purpose at which at least 50 percent of all participating members of the retirement system vote.

(c) To be eligible to approve an addition or change under this section, an actuary must be either a fellow of the Society of Actuaries or a member of the American Academy of Actuaries.

(d) Except as provided by Subsection (e) of this section, if a board chooses to adopt an addition or change after it has been approved as provided by this section, the addition or change applies to all persons who are participating members of the retirement system on the effective date of the addition or change and all persons who became participating members during the time the addition or change remains in effect. The addition or change also may apply to:

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(1) persons receiving monthly benefits; or

(2) former members of the fire department who meet an applicable length-of-service requirement for service retirement.

(e) An addition or change adopted under this section may not, without the written consent of the member, retiree, or eligible survivor under Section 15 of this Act, deprive a member of the retirement system, a retiree, or an eligible survivor of a right to receive a vested accrued benefit.

(f) The effective date of a change or addition adopted under this section is a date specified by the board of trustees that is not earlier than the date of adoption by the board. A change or addition may not be applied retroactive to its effective date unless required to maintain a plan's tax qualification status.

### **Section 8 – Recovery of Amounts Wrongfully Obtained**

The board of trustees of a retirement system subject to this Act may initiate or cause to be initiated a suit against any appropriate person to recover amounts paid or obtained from the trust fund through fraud, misrepresentation, theft, or other misapplication or by mistake. The board of trustees shall deposit amounts recovered under this section in the trust fund for the retirement system.

### **Section 9 – Membership**

(a) Except as otherwise provided by this section, a person who is an employee of a fire department included within the coverage of a retirement system is a member of the retirement system if the person is younger than 36 years old on the date the person is certified under civil service as eligible for a beginning position with the department.

(b) Except as provided by Subsections (c), (d), (e), and (g) of this section, a person who performs services as a volunteer of a fire department included within the coverage of a retirement system is a member of the retirement system.

(c) A board of trustees established under this Act may, in accordance with Section 7 of this Act:

(1) require a waiting period before retirement system membership begins;

(2) include within the required membership of the retirement system categories of personnel, other than personnel performing services for the fire department, who perform emergency medical or fire department-related services; or

(3) exclude from membership categories of fire department personnel not regularly directly engaged in the fighting of fires.

(d) If a board of trustees, under Subdivision (2) of Subsection (c) of this section, includes categories of personnel within the membership of a retirement system, for purposes of this Act, the personnel are considered employees or volunteers, as applicable, of the fire department and their service is considered as if it were performed for the fire department included within the coverage of the retirement system.

(e) As a condition of membership in a retirement system, a board of trustees may by order require persons to pass a physical examination given by a physician of the board's choice but may not require the persons to pay the cost of the examination.

(f) A board of trustees of a retirement system for a fire department may by order authorize membership in the retirement system for employees of the department who are 36 years old or older at the time they become employees but who first became fire fighters at an age younger than 36. Membership under an

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authorization is optional with each employee, except that an employee must, before beginning membership, pass any physical examination requirement established under Subsection (e) of this section.

(g) A service retiree of a retirement system may not rejoin or receive credit in the system for any postretirement service performed for the fire department included within the coverage of the system.

### **Section 10 – Service Credit**

(a) Service credit is earned in a retirement system for each month for which an employee makes the contribution required under this Act.

(b) Service credit is earned in a retirement system for each calendar year in which a volunteer answers at least 25 percent of all fire alarms determined by the board of trustees and attends at least 40 percent of all drills held by the fire department.

(c) A retirement system shall also grant service credit to a member who leaves the service of a fire department and later returns, if the break in service is attributable to service for any period as a member of the armed forces of the United States during a war or national emergency.

(d) Absence from service by an employee does not forfeit service credit accrued before the absence begins, unless membership is terminated. Absence from service by a volunteer does not forfeit service credit accrued before the absence begins.

(e) A board of trustees established under this Act may, in accordance with Section 7 of this Act, expand the circumstances under which service credit is earned.

### **Section 11 – Previous Fire Department Service**

(a) Except as provided by Subsection (c) of this section, a person who elects to become a member of a retirement system under an authorization adopted under Subsection (f) of Section 9 of this Act may establish credit in the retirement system for previous service performed for another fire department included within the coverage of a retirement system under this Act. To establish credit for the previous service, the person must deposit with the retirement system an amount determined by the board of trustees that is equal to the sum of:

- (1) the amount that the person would have contributed to the system if the person's previous fire department service had been performed for the department by which the person is employed, computed on the member contribution rate in effect in the retirement system at the time the service was performed and on the person's compensation for the previous service; and
- (2) interest on the amount described by Subdivision (1) of this subsection at the rate of eight percent, compounded annually, from the date the service was performed to the date of deposit.

(b) If a person makes the deposit described by Subsection (a) of this section, the municipality or other political subdivision served by the fire department that employs the person shall deposit with the retirement system an amount determined by the board that is equal to the sum of:

- (1) the amount that the municipality or other political subdivision would have contributed to the system if the person's previous fire department service had been performed for the department by which the person is employed, computed on the contribution rate of the municipality or other political subdivision in effect in the retirement system at the time the service was performed and on the person's compensation for the previous service; and

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(2) interest on the amount described by Subdivision (1) of this subsection at the rate of eight percent, compounded annually, from the date the service was performed to the date of deposit.

(c) A person may not establish credit under this section for service that is credited in another public retirement system, including another retirement system subject to this Act.

### **Section 12 – Service Retirement**

(a) A member of a retirement system is eligible for retirement for service if the member is at least 55 years old and has performed at least 20 years of service that is credited in the retirement system.

(b) Except as provided by Subsection (c) of this section, monthly benefits payable for service retirement are \$100 to a retiree whose service was not exclusively as a volunteer and \$25 to a retiree whose service was exclusively as a volunteer.

(c) A board of trustees established under this Act may, in accordance with Section 7 of this Act:

(1) decrease the age or service requirements for service retirement from a particular retirement system; or

(2) determine formulas for computing benefits, classes of permissible beneficiaries, and other requirements for payment of service retirement benefits, as long as the minimum benefits payable to a retiree are not less than the amounts provided by Subsection (b) of this section.

### **Section 13 – Certificate of Service**

(a) A member of a retirement system who meets an applicable length-of-service requirement for service retirement benefits but does not meet the applicable age requirement for service retirement benefits may terminate employment with or otherwise discontinue service for the fire department and remain eligible to receive service retirement benefits from the retirement system on attaining the applicable age, as long as the member does not withdraw contributions in the retirement system.

(b) A member who terminates employment or otherwise discontinues service after meeting an applicable length-of-service requirement for service retirement may not be required to pay to the retirement system contributions that become due after the date of termination or discontinuance.

### **Section 14 – Disability Retirement**

(a) A member of a retirement system is eligible for retirement for disability if the member becomes physically or mentally disabled, except as the result of a condition the member had on the date the member became an employee or volunteer, in or in consequence of the performance of the member's duties as an employee or volunteer of the fire department included within the coverage of the retirement system.

(b) An application for disability retirement must be filed with the board of trustees of the retirement system of which the applicant is a member. The application must contain a sworn statement of the member's medical condition, signed by a physician attending the member, and a sworn statement of the circumstances under which the disability arose, signed by the member or another person who has reason to know those circumstances. The application also may contain other pertinent information to enable the board to determine whether the member is eligible for disability retirement.

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(c) A board of trustees may require an applicant for disability retirement to be medically examined by one or more physicians of the board's choice but may not require the applicant to pay the cost of a medical examination required under this subsection.

(d) If a board of trustees determines that an applicant for disability retirement meets the eligibility requirements for disability retirement from the retirement system, the board shall retire the member.

(e) Except as provided by Subsection (f) of this section, monthly benefits payable for disability retirement are \$100 to a retiree whose service was not exclusively as a volunteer and \$25 to a retiree whose service was exclusively as a volunteer.

(f) A board of trustees established under this Act may, in accordance with Section 7 of this Act:

- (1) expand the circumstances under which disability retirement benefits become payable;
- (2) require periodic medical examinations of, periodic vocational rehabilitation examinations of, or periodic financial information from disability retirees to determine whether the retiree remains eligible to receive disability retirement benefits; or
- (3) determine formulas for computing benefits, classes of permissible beneficiaries, and other requirements for payment of disability retirement benefits, as long as the minimum benefits payable to a retiree who remains eligible for disability retirement resulting from the performance of duty are not less than the amounts provided by Subsection (e) of this section.

(g) The vested accrued benefit of a retiree under this section who is retired as of the determination date is subject to the terms established by the retirement system as those terms exist on the determination date and is payable to the retiree only if the retiree meets the eligibility requirements established by the board of trustees under this section.

(h) Notwithstanding any other provision of this Act, a disability retirement benefit is not a vested accrued benefit until a member becomes disabled under the terms of the retirement system.

### **Section 15 – Death Benefits**

(a) A death benefit is payable as provided by this section on the death:

- (1) of a member of a retirement system that occurs in or in consequence of the performance of the member's duties as an employee or volunteer of the fire department included within the coverage of the retirement system;
- (2) of a member of a retirement system for any reason if the member met the applicable length-of-service requirement for service retirement at the time of death; or
- (3) of a retiree of a retirement system.

(b) Except as otherwise provided by this section, monthly benefits payable on the death of a member or retiree are:

- (1) \$100 to an eligible surviving spouse of a member or retiree whose service was not exclusively as a volunteer and \$16.67 to an eligible surviving spouse of a member or retiree whose service was exclusively as a volunteer;
- (2) if there is an eligible surviving spouse and a minor child, \$20 to the guardian of each minor child of a member or retiree whose service was not exclusively as a volunteer and \$6 to the guardian of each minor child of a member or retiree whose service was exclusively as a volunteer;

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(3) if there is no eligible surviving spouse at the time of death of the member or retiree or if the surviving spouse dies or becomes ineligible to receive benefits during the minority of a surviving child, \$40 to the guardian of each minor child of a member or retiree whose service was not exclusively as a volunteer and \$12 to the guardian of each minor child whose service was exclusively as a volunteer; and

(4) if there is no eligible surviving spouse or minor child at the time of death of the member or retiree, a total of \$100 to one or more surviving dependent parents of a member or retiree whose service was not exclusively as a volunteer and a total of \$16.67 to one or more dependent parents of a member or retiree whose service was exclusively as a volunteer.

(c) To be eligible to receive benefits as a surviving spouse under this section, a person must remain unmarried after the death of the member or retiree. To be eligible to receive benefits as a surviving spouse of a deceased retiree, a person also must have married the deceased before the deceased's retirement. To be eligible to receive benefits as a surviving spouse of a deceased member who had terminated employment with or otherwise discontinued service for the fire department, a person also must have married the deceased before the termination or discontinuance.

(d) If a member or retiree for whom death benefits are payable under this section is survived by a child who is totally disabled as a result of physical or mental illness, injury, or retardation, the guardian of the child is entitled to receive for the benefit of the child and the duration of the child's disability any benefit that would be payable to the guardian of a surviving minor child.

(e) A board of trustees established under this Act may, in accordance with Section 7 of this Act:

(1) expand the circumstances under which death benefits become payable; or

(2) determine formulas for computing benefits, classes of permissible beneficiaries, exclusions from payment of benefits for certain causes of death, and other conditions for payment of death benefits.

(f) The vested accrued benefit that an eligible survivor receives under this section as the result of the death of a member or retiree on or before the determination date is subject to the terms established by the retirement system as those terms exist on the determination date.

(g) Notwithstanding any other provision of this Act, a death benefit is not a vested accrued benefit until the member or retiree for whom death benefits are payable dies.

### **Section 16 – Reduction of Benefits During Deficiency**

If money available for benefits currently payable by a retirement system is insufficient to pay the full amount of those benefits, a board of trustees may proportionately reduce all benefit payments for the time necessary to prevent payments from exceeding money available to pay the benefits.

### **Section 17 – Person Causing Death of Member or Annuitant**

(a) A benefit payable on the death of a member or annuitant may not be paid to a person convicted of causing that death but instead is payable to a person who would be entitled to the benefit had the convicted person predeceased the decedent. If no person would be entitled to the benefit, the benefit is payable to the decedent's estate.

(b) A retirement system is not required to pay a benefit under Subsection (a) of this section unless it receives actual notice of the conviction of the person who would have been entitled to the benefits. However, a retirement system may delay payment of a benefit payable on the death of a member or

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annuitant pending the results of a criminal investigation and of legal proceedings relating to the cause of death.

(c) For the purposes of this section, a person has been convicted of causing the death of a member or annuitant if the person:

- (1) has pleaded guilty or nolo contendere to or has been found guilty by a court of an offense at the trial of which it is established that the person's intentional, knowing, or reckless act or omission resulted in the death of a person who was a member or annuitant, regardless of whether sentence is imposed or probated; and
- (2) has no appeal of the conviction pending and the time provided for appeal has expired.

### **Section 18 – Provisions Applicable to Boards of Trustees Generally**

(a) A board of trustees established under this Act may receive, handle, control, manage, and disburse the fund for the retirement system, hear and determine all applications for retirement and claims for disability, either partial or total, and designate beneficiaries and participants as provided by this Act. The chairman and vice chairman of a board may swear witnesses for the purpose of taking testimony before the board on any matter related to the fund. A board may issue a subpoena addressed to a sheriff or constable to require the attendance of a witness or the production of books, records, or other documents that may be necessary and proper for the purposes of a proceeding before the board.

(b) A member of a board of trustees established under this Act takes office on the first meeting of the board that occurs after the member is elected or designated a member or assumes the position that makes the person a member ex officio. At the time a person takes office as a member of a board of trustees established under this Act, the person shall take an oath of office that the person will diligently and honestly administer the affairs of the retirement system and fund and will not knowingly violate or willingly permit to be violated any provision of this Act.

(c) A board of trustees established under this Act shall meet monthly at such times and places as the board by resolution designates and at other times at the call of the chairman. A majority of the trustees of a board is a quorum.

(d) A board established under this Act shall keep accurate minutes and records of its proceedings and a record of all claims, receipts, and disbursements relating to the fund. An order of a board must be made by vote recorded in the minutes of its proceedings.

(e) A board established under this Act may make a disbursement from the fund only on a regular voucher signed by one or more persons designated by the board. Subject to the approval of a majority of the participating members voting by secret ballot at an election at which at least 50 percent of the participating members of the retirement system vote, a board established under this Act shall determine whether the signatures of one, two, or three persons are required for vouchers.

(f) A board of trustees established under this Act may designate a bank or, as applicable, the chief financial officer of the municipality or other political subdivision or the secretary-treasurer of the board to be custodian of the assets of the retirement system. If the chief financial officer or the secretary-treasurer of the board is designated custodian, the person's official bond and oath of office are conditioned additionally on the faithful performance of the person's duties as custodian of the assets of the retirement system.

**(g) Repealed by Acts 2013, 83rd Leg., R.S.**

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(h) A vacancy in the office of a trustee of a board established under this section shall be filled for the remainder of the unexpired term in the manner that the office was previously filled.

### **Section 18A – Enforcement of Act**

**Repealed under Acts 2013, 83rd Leg., R.S.**

### **Section 18B – Technical Assistance, Training, and Information for Boards of Trustees**

(a) The State Pension Review Board shall provide technical assistance, training, and information to members of the boards of trustees established under this Act. The training required by this section must be designed to meet the specific needs of members of boards of trustees administering benefit plans for local fire fighters, including small-to-medium-sized benefit plans.

(b) To the extent resources are available, the board shall designate one person who specializes in providing the technical assistance, training, and information required under Subsection (a).

### **Section 19 – Board of Trustees for Paid or Part-Paid Fire Department**

(a) In each municipality and other political subdivision to which this Act applies and that has a fire department that does not consist exclusively of volunteers, the fire fighters' retirement system is governed by a board of trustees consisting of:

(1) in a municipality, the mayor or the mayor's designated representative; in an emergency services district, the president of the board of emergency services commissioners; or in another political subdivision, the chief operating officer or the chief operating officer's designated representative, as applicable;

(2) the chief financial officer of the municipality or other political subdivision or, if there is no officer denominated as chief financial officer, the person who performs the duties of chief financial officer or a person designated by the chief financial officer or by the person performing the duties of chief financial officer;

(3) three members of the retirement system elected by participating members as provided by Subsection (b) of this section; and

(4) two persons who reside in this state, who are not officers or employees of the municipality or other political subdivision, and who are elected by a majority vote of the members of the board of trustees determined as provided by Subdivisions (1), (2), and (3) of this subsection.

(b) During each period that begins on December 1 of one year and ends on January 31 of the following year, the participating members of a fire fighters' retirement system in a municipality or other political subdivision subject to this section shall elect by secret ballot and certify to the governing body of the municipality or other political subdivision a member to the board of trustees to serve a term of three years. To be elected a member of a board of trustees under this subsection, a person must be a participating member of the retirement system and receive a majority of the votes cast in the election, and at least 50 percent of all participating members of the retirement system must vote in the election. Provided, however, that if only a single person is nominated for the board of trustees position being filled, that person may be elected by acclamation by those participating members present for the election meeting, without the necessity of a secret ballot.



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(c) Annually, at a meeting in March, the members of a board of trustees determined as provided by Subdivisions (1), (2), and (3) of Subsection (a) of this section shall elect a member to the board, as provided by Subdivision (4) of Subsection (a) of this section, to serve a term of approximately two years that expires on the day before the date of the first board meeting that occurs after the meeting at which a successor is elected.

(d) A board of trustees established under this section annually shall elect a chairman, vice-chairman, and secretary.

**(e) Repealed by Acts 2013, 83rd Leg., R.S.**

### **Section 20 – Board of Trustees for Volunteer Fire Department**

(a) In each municipality to which this Act applies and that has a fire department consisting exclusively of volunteers, the fire fighters' retirement system is governed by a board of trustees consisting of:

(1) the mayor of the municipality or the mayor's designated representative;

(2) the municipal treasurer or, if there is no officer denominated as treasurer, the person who performs the duties of municipal treasurer; and

(3) three members of the retirement system elected by participating members as provided by Subsection (b) of this section.

(b) During each period that begins on December 1 of one year and ends on January 31 of the following year, the participating members of a fire fighters' retirement system in a municipality subject to this section shall elect by secret ballot and certify to the governing body of the municipality a member to the board of trustees to serve a term of approximately three years that expires on the day before the date of the first board meeting that occurs after the election of a successor. To be elected a member of a board of trustees under this subsection, a person must be a member of the retirement system and receive a majority of the votes cast in the election, and at least 50 percent of all participating members of the retirement system must vote in the election.

(c) The municipal treasurer is the secretary-treasurer of a board of trustees established under this section. A board of trustees established under this section annually shall elect a chairman and a vice-chairman to preside in the absence or disability of the chairman.

### **Section 21 – Fire Fighters' Pension Commissioner**

**Repealed by Acts 2013, 83rd Leg., R.S.**

### **Section 21A – General Duties of Fire Fighters' Pension Commissioner**

**Repealed by Acts 2013, 83rd Leg., R.S.**

### **Section 22 – Appeals from Local Board Decisions**

(a) A person aggrieved by a decision of a board of trustees relating to eligibility for or amount of benefits payable by a retirement system may appeal the decision to the State Office of Administrative Hearings.

(b) An appeal under this section is begun by delivering a notice of appeal with the chairman, secretary, or secretary-treasurer of the board of trustees that made the decision. The notice must be delivered not

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later than the 20th day after the date of the decision and contain a brief description of the reasons or grounds for appeal. The aggrieved person must file a copy of the notice with the State Pension Review Board.

(b-1) As soon as practicable after receiving a notice of appeal under Subsection (b) of this section, the State Pension Review Board shall refer the matter to the State Office of Administrative Hearings by submitting notice of the appeal to that office.

(c) An appeal under this section is held in Austin and is a contested case under Chapter 2001, Government Code, conducted as a de novo hearing by the State Office of Administrative Hearings.

(d) The sole function of the State Pension Review Board with respect to an appeal under this section is to refer the appeal to the State Office of Administrative Hearings, and that office has exclusive authority to decide the appeal.

### **Section 22A – Attorney**

A board of trustees may employ an attorney to represent the board in one or all legal matters, including a hearing on appeal to the State Office of Administrative Hearings. At the request of a board of trustees, the city attorney of the municipality of which the board is a part shall, without additional compensation, represent the board in one or all legal matters.

### **Section 23 – Actuary**

(a) A board of trustees established under this Act may employ an actuary to provide actuarial services.

(b) The cost of actuarial services may be paid from assets of the fund.

### **Section 24 – Certified Public Accountant**

(a) A board of trustees established under this Act may employ a certified public accountant or a firm of certified public accountants to perform an audit of the fund in accordance with Section 12.102, Title 110B, Revised Statutes.

(b) The cost of an audit may be paid by the municipality or other political subdivision or from the assets of the fund.

### **Section 25 – Other Expenses**

(a) Except as provided by Subsection (b) of this section, a board of trustees established under this Act may pay from assets of the fund all costs reasonably and lawfully incurred by the retirement system and the costs of actual expenses incurred by board members in the performance of their duties on the board. A member of the board may not receive compensation for service on the board.

(b) The annual amount of payments from a fund under this section, excluding legal and medical fees, may not exceed:

(1) 1 percent of the market value of the assets of the fund for the first \$1 million in market value; and

(2) 1/4 of 1 percent of the market value of the assets of the fund that exceeds \$1 million.

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### **Section 26 – Gifts Accepted from any Source**

The board of trustees of a retirement system established under this Act is authorized to accept and receive for the use and benefit of the fund, in addition to member contributions and contributions of the municipality or other political subdivision, gifts of money from any source.

### **Section 27 – Investment of Assets**

(a) A board of trustees established under this Act shall keep a sufficient amount of cash on hand to make payments as they become due under the retirement system. If a board determines that the fund of its retirement system contains an amount in excess of the amount needed to make payments as they become due, the board may invest any portion of the excess.

(b) In making investments for a retirement system, its board of trustees shall exercise the judgment and care, under the circumstances prevailing at the time of the investment, that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in speculation but when making a permanent disposition of their funds, considering the probable income from the disposition and the probable safety of their capital.

(c) A board of trustees established under this Act may not invest in the stock or bonds of one corporation more than five percent of the book value of the assets of a fund. A retirement system may not own more than five percent of the voting stock of one corporation.

(d) A board of trustees established under this Act shall adopt formal investment policies that emphasize safety and diversity as well as liquidity for benefit payments. In developing those policies, the board of trustees shall give special consideration to the preferred investment practices of the Government Financial Officers Association.

### **Section 28 – Investment Manager and Counseling Service**

(a) The board of trustees of a retirement system established under this Act may appoint investment managers for the system by contracting for professional investment management services with one or more organizations, which may include a bank if it has a trust department, that are in the business of managing investments.

(b) To be eligible for appointment under Subsection (a) of this section, an investment manager must be:

- (1) registered under the Investment Advisors Act of 1940 (15 U.S.C. Section 80b-1 et seq.);
- (2) a bank as defined by that Act; or
- (3) an insurance company qualified to perform investment services under the laws of more than one state.

(c) In a contract made under this section, the board of trustees shall specify policies, requirements, and restrictions, including criteria for determining the quality of investments and for the use of standard rating services that the board of trustees adopts for investments of the system.

(d) In choosing and contracting for professional investment management services and in continuing the use of an investment manager, the board of trustees must act prudently and in the interest of the participants and beneficiaries of the retirement system.

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(e) A trustee is not liable for the acts or omissions of an investment manager appointed under this section, nor is a trustee obligated to invest or otherwise manage any asset of the system subject to management by the investment manager.

(f) A board of trustees established under this Act may employ professional investment counselors to assist and advise the board in the investment of the assets of the fund or to evaluate the performance of an investment manager appointed under this section. The investment counseling service must be provided by an organization whose business functions include performing continuous investment advisory service to public retirement systems.

(g) The cost of investment managing or counseling services may be paid by the municipality or other political subdivision or from the assets of the fund.

(h) A retirement system established under this Act is exempt from Subchapter C, Chapter 802, Government Code, except Sections 802.2011, 802.2015, 802.202, 802.205, and 802.207.

### **Section 29 – Contributions**

(a) Each person who is a member of a retirement system as a current fire department employee shall make contributions to the system. Except as provided by Subsection (d) of this section, a contribution required under this subsection is computed on the employee's periodic compensation at a rate determined by majority vote of the employees of the department who are members, at an election by secret ballot at which at least 50 percent of those employees vote. Except as provided by Section 30 of this Act, the payroll officer of the municipality or other political subdivision shall deduct the contributions required under this subsection each payroll period and submit them to the retirement system.

(b) A municipality or other political subdivision that has employees who are participating members of a retirement system shall make contributions to the system each payroll period. Except as provided by Subsection (d) of this section; contributions required under this subsection are computed on the total compensation paid to the employees who are participating members of the system. A municipality or other political subdivision is required to make contributions under this subsection at the same rate paid by employees or 12 percent, whichever is the smaller rate. The governing body of a municipality or other political subdivision by ordinance may adopt a rate of employer contributions that is greater than the rate required by this subsection.

(c) Contributions by a municipality or other political subdivision determined under Subsection (b) or (d) of this section are payable each payroll period to the retirement system.

(d) Contributions required under Subsections (a) and (b) of this section are computed on the average compensation of all employees of the department for the preceding year, if this method of computation is adopted by majority vote of the employees of the department who are members, at an election by secret ballot at which at least 50 percent of the participating members vote, and is also adopted by ordinance of the governing body of the municipality or other political subdivision. The average compensation of department employees shall be computed for each 12-month period as determined by the board of trustees.

(e) Each person who is a member of a retirement system as a current fire department volunteer shall contribute to the system an annual amount determined by majority vote by secret ballot of the volunteers of the department who are participating members of the retirement system. A municipality may at any time make the member contributions required under this subsection on behalf of its volunteers and any other contributions the municipality chooses to make to the retirement system.

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(f) Payment of member contributions required under this Act are conditions of employment and participation in the retirement system to which the contributions are due.

(g) Except as otherwise provided under Section 7 of this Act, a member of a retirement system may withdraw all of the member's accumulated contributions to the system if the member terminates service for the fire department included within the coverage of the system for a reason other than service or disability retirement. The estate of a deceased member may withdraw all of the deceased member's accumulated contributions if a survivor or alternative monthly benefit is not payable as a result of the death. A withdrawal of contributions cancels a person's membership and credit in the retirement system.

### **Section 30 – Pick up of Employee Contributions**

(a) A municipality or other political subdivision may pick up the employee contributions required by Subsection (a) of Section 29 of this Act for all compensation that is earned by participating members of the retirement system on or after the effective date of the pick up. Employee contributions picked up as provided by this section are in lieu of deductions of employee contributions from paychecks or warrants and shall be paid by the municipality or other political subdivision to the retirement system from the same source of funds that is used in paying compensation to the members. A pick up of employee contributions shall be accompanied by a reduction in the compensation of members, an offset against a future increase in member compensation, or a combination of compensation reduction and offset against a compensation increase. Unless otherwise determined by the governing body of the municipality or other political subdivision and approved by majority vote of the participating members at an election by secret ballot, a pick up of contributions results in a corresponding reduction in compensation.

(b) Contributions picked up as provided by this section shall be treated as employer contributions in determining tax treatment of the amounts under the Internal Revenue Code of 1986. Employee contributions picked up as provided by this section shall be deposited to the credit of the individual account of each affected member and shall be treated for all other purposes of this Act as if the contributions had been deducted from the compensation of members. Picked up contributions are not includable in a computation of contribution rates of the municipality or other political subdivision.

(c) A pick up of employee contributions takes effect in a municipality or other political subdivision on January 1 of the year following the year in which:

(1) the governing body of the municipality or other political subdivision by ordinance has adopted the pick up; and

(2) the pick up has been approved by majority vote of the participating members of the retirement system at an election by secret ballot at which at least 50 percent of the participating members vote.

#### **(3) Repealed by Acts 2013, 83rd Leg., R.S.**

(d) A pick up of employee contributions is terminated in a municipality or other political subdivision on January 1 of the year following the year in which:

(1) the termination has been approved by a two-thirds vote of the participating members of the retirement system at an election by secret ballot at which at least 50 percent of the participating members vote; and

(2) the governing body of the municipality or other political subdivision has repealed the ordinance that adopted the pick up of employee contributions.

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### **Section 31 – Termination of Participation in Act**

(a) A retirement system for a fire department not consisting exclusively of volunteers may not be terminated or merged into another retirement system without the approval of the board of trustees of the retirement system and the approval of the participating members of the system in the manner described by Subdivision (2) of Subsection (b) of Section 7 of this Act provided 51 percent of the volunteers first petition the board for such change.

(b) The board of trustees of a retirement system for a fire department consisting partly of employees and partly of volunteers may transfer assets actuarially attributable to the volunteers from the retirement system under this Act to the statewide program provided by the Texas Statewide Volunteer Fire Fighters Retirement Act (Article 6243e.3, Vernon's Texas Civil Statutes), if the board obtains approval as provided by Section 7 of this Act provided 51 percent of the volunteers first petition the board for such change.

**(c) Repealed by Acts 2013, 83rd Leg., R.S.**

### **Section 31A – Authority of Certain Retirement Systems to Exclude Certain Persons from Coverage**

(a) In this section, "closure effective date" means the first day of the second month after the month in which the Texas Municipal Retirement System receives retirement system plan documents under Subsection (f)(2) of this section.

(b) This section applies only to a municipality:

(1) with a population of less than 200,000;

(2) that is located in a county with a population of not less than 2 million and not more than 4 million;

(3) that has a regularly organized fire department for which a retirement system and fund have been established under Section 4 of this Act; and

(4) that before January 1, 2017, has one or more departments participating in the Texas Municipal Retirement System.

(c) Subject to the requirements of this section, the governing body of a municipality subject to this section may adopt one or more ordinances to exclude from participation in the retirement system employees of the fire department first hired on or after the closure effective date.

(d) If the governing body of a municipality adopts an ordinance under Subsection (c) of this section, the governing body shall concurrently adopt an ordinance to allow the employees described by the ordinance to participate in the Texas Municipal Retirement System.

(e) Not later than the 60th day after the date an ordinance is adopted under Subsection (c) of this section, the municipality shall submit the ordinance to an election of the participating members of the retirement system established in the municipality. To be approved at the election, a majority of the participating members must vote in favor of the ordinance.

(f) If the voting members approve an ordinance under Subsection (e) of this section, as soon as practicable after the date of election:

(1) the board of trustees of the retirement system shall amend the retirement system plan documents as necessary to be consistent with the approved ordinance; and

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(2) the municipality shall give written notice of the results of the election to the Texas Municipal Retirement System and include copies of the relevant ordinances and any amended retirement system plan documents.

(g) If a municipality adopts ordinances under Subsections (c) and (d) of this section, all subsequent actions authorized or required by this section must be completed before October 1, 2018. If all subsequent actions are not completed before October 1, 2018:

(1) as soon as practicable after that date, the Texas Municipal Retirement System shall publish notice to that effect in the Texas Register; and

(2) Section 851.0011, Government Code, this section, and the ordinances adopted under Subsections (c) and (d) of this section expire on October 1, 2018.

### **Section 32 – Confidentiality of Information about Members, Retirees, Annuitants, or Beneficiaries**

(a) Information contained in records that are in the custody of a retirement system established under this Act concerning an individual member, retiree, annuitant, or beneficiary is confidential under Section 3(a)(1), Chapter 424, Acts of the 63rd Legislature, Regular Session, 1973 (Article 6252-17a, Vernon's Texas Civil Statutes), and may not be disclosed in a form identifiable with a specific individual unless:

(1) the information is disclosed to:

(A) the individual;

(B) the individual's attorney, guardian, executor, administrator, conservator, or other person who the board of trustees of the retirement system determines is acting in the interest of the individual or the individual's estate;

(C) a spouse or former spouse of the individual if the board of trustees determines that the information is relevant to the spouse's or former spouse's interest in member accounts, benefits, or other amounts payable by the retirement system; or

(D) a person authorized by the individual in writing to receive the information; or

(2) the information is disclosed under an authorization of the board of trustees that specifies the reason for the disclosure.

(b) This section does not prevent the disclosure of the status or identity of an individual as a member, former member, retiree, deceased member or retiree, or beneficiary of the retirement system.

(c) A determination and disclosure under Subsection (a) of this section may be made without notice to the individual member, retiree, annuitant, or beneficiary.

## 6.6 Pertinent provisions of the Texas Constitution

### Article XVI, Sec. 17.

#### SERVICE OF PUBLIC OFFICER PENDING QUALIFICATION OF SUCCESSOR.

(a) Except as provided by Subsection (b) of this section, all officers of this State shall continue to perform the duties of their offices until their successors shall be duly qualified.

(b) Following the expiration of a term of an appointive office that is filled by appointment of the Governor with the advice and consent of the Senate and that is not an office for which the officer receives a salary, the period for which the officer shall continue to perform the duties of office under Subsection (a) of this section ends on the last day of the first regular session of the Legislature that begins after the expiration of the term.

(Amended Nov. 7, 2017.)

### Article XVI, Sec. 66.

#### PROTECTED BENEFITS UNDER CERTAIN PUBLIC RETIREMENT SYSTEMS.

(a) This section applies only to a public retirement system that is not a statewide system and that provides service and disability retirement benefits and death benefits to public officers and employees.

(b) This section does not apply to a public retirement system that provides service and disability retirement benefits and death benefits to firefighters and police officers employed by the City of San Antonio.

(c) This section does not apply to benefits that are:

(1) health benefits;

(2) life insurance benefits; or

(3) disability benefits that a retirement system determines are no longer payable under the terms of the retirement system as those terms existed on the date the retirement system began paying the disability benefits.

(d) On or after the effective date of this section, a change in service or disability retirement benefits or death benefits of a retirement system may not reduce or otherwise impair benefits accrued by a person if the person:

(1) could have terminated employment or has terminated employment before the effective date of the change; and

(2) would have been eligible for those benefits, without accumulating additional service under the retirement system, on any date on or after the effective date of the change had the change not occurred.

(e) Benefits granted to a retiree or other annuitant before the effective date of this section and in effect on that date may not be reduced or otherwise impaired.

(f) The political subdivision or subdivisions and the retirement system that finance benefits under the retirement system are jointly responsible for ensuring that benefits under this section are not reduced or otherwise impaired.



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(g) This section does not create a liability or an obligation to a retirement system for a member of the retirement system other than the payment by active members of a required contribution or a future required contribution to the retirement system.

(h) A retirement system described by Subsection (a) and the political subdivision or subdivisions that finance benefits under the retirement system are exempt from the application of this section if:

- (1) the political subdivision or subdivisions hold an election on the date in May 2004 that political subdivisions may use for the election of their officers;
- (2) the majority of the voters of a political subdivision voting at the election favor exempting the political subdivision and the retirement system from the application of this section; and
- (3) the exemption is the only issue relating to the funding and benefits of the retirement system that is presented to the voters at the election.

(Former Sec. 66 repealed Nov. 2, 1999; current Sec. 66 added Sept. 13, 2003.)

### **Article XVI, Sec. 67.**

#### **STATE AND LOCAL RETIREMENT SYSTEMS.**

(a) General Provisions.

(1) The legislature may enact general laws establishing systems and programs of retirement and related disability and death benefits for public employees and officers. Financing of benefits must be based on sound actuarial principles. The assets of a system are held in trust for the benefit of members and may not be diverted.

(2) A person may not receive benefits from more than one system for the same service, but the legislature may provide by law that a person with service covered by more than one system or program is entitled to a fractional benefit from each system or program based on service rendered under each system or program calculated as to amount upon the benefit formula used in that system or program. Transfer of service credit between the Employees Retirement System of Texas and the Teacher Retirement System of Texas also may be authorized by law.

(3) Each statewide benefit system must have a board of trustees to administer the system and to invest the funds of the system in such securities as the board may consider prudent investments. In making investments, a board shall exercise the judgment and care under the circumstances then prevailing that persons of ordinary prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income therefrom as well as the probable safety of their capital. The legislature by law may further restrict the investment discretion of a board.

(4) General laws establishing retirement systems and optional retirement programs for public employees and officers in effect at the time of the adoption of this section remain in effect, subject to the general powers of the legislature established in this subsection.

(b) State Retirement Systems.

(1) The legislature shall establish by law a Teacher Retirement System of Texas to provide benefits for persons employed in the public schools, colleges, and universities supported wholly or partly by the state. Other employees may be included under the system by law.

(2) The legislature shall establish by law an Employees Retirement System of Texas to provide

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benefits for officers and employees of the state and such state-compensated officers and employees of appellate courts and judicial districts as may be included under the system by law.

(3) The amount contributed by a person participating in the Employees Retirement System of Texas or the Teacher Retirement System of Texas shall be established by the legislature but may not be less than six percent of current compensation. The amount contributed by the state may not be less than six percent nor more than 10 percent of the aggregate compensation paid to individuals participating in the system. In an emergency, as determined by the governor, the legislature may appropriate such additional sums as are actuarially determined to be required to fund benefits authorized by law.

### (c) Local Retirement Systems.

(1) The legislature shall provide by law for:

(A) the creation by any city or county of a system of benefits for its officers and employees;

(B) a statewide system of benefits for the officers and employees of counties or other political subdivisions of the state in which counties or other political subdivisions may voluntarily participate; and

(C) a statewide system of benefits for officers and employees of cities in which cities may voluntarily participate.

(2) Benefits under these systems must be reasonably related to participant tenure and contributions.

### (d) Judicial Retirement System.

(1) Notwithstanding any other provision of this section, the system of retirement, disability, and survivors' benefits heretofore established in the constitution or by law for justices, judges, and commissioners of the appellate courts and judges of the district and criminal district courts is continued in effect. Contributions required and benefits payable are to be as provided by law.

(2) General administration of the Judicial Retirement System of Texas is by the Board of Trustees of the Employees Retirement System of Texas under such regulations as may be provided by law.

(e) Anticipatory Legislation. Legislation enacted in anticipation of this amendment is not void because it is anticipatory.

(f) Retirement Systems Not Belonging to a Statewide System. The board of trustees of a system or program that provides retirement and related disability and death benefits for public officers and employees and that does not participate in a statewide public retirement system shall:

(1) administer the system or program of benefits;

(2) hold the assets of the system or program for the exclusive purposes of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the system or program; and

(3) select legal counsel and an actuary and adopt sound actuarial assumptions to be used by the system or program.

(g) If the legislature provides for a fire fighters' pension commissioner, the term of office for that position is four years.

(Added April 22, 1975; Subsec. (f) added Nov. 2, 1993; Subsec. (g) added Nov. 6, 2001.)

## 6.7 Pertinent provisions of the Texas Government Code

Key provisions of the Texas Government Code pertinent to TLFRA plans are below but should not be considered exhaustive. The PRB maintains a pamphlet of Government Code provisions generally applicable to retirement systems at <https://www.prb.texas.gov/statute-and-rules/>.

### **Title 8. Public Retirement Systems**

#### **Subtitle A. Provisions Generally Applicable to Public Retirement Systems**

#### **Chapter 802. Administrative Requirements**

#### **Subchapter B. Studies and Reports**

##### **Sec. 802.101. ACTUARIAL VALUATION.**

(a) The governing body of a public retirement system shall employ an actuary, as a full-time or part-time employee or as a consultant, to make a valuation at least once every three years of the assets and liabilities of the system on the basis of assumptions and methods that are reasonable in the aggregate, considering the experience of the program and reasonable expectations, and that, in combination, offer the actuary's best estimate of anticipated experience under the program. The valuation must include a recommended contribution rate needed for the system to achieve and maintain an amortization period that does not exceed 30 years.

(b) On the basis of the valuation, the actuary shall make recommendations to the governing body of the public retirement system to ensure the actuarial soundness of the system. The actuary shall define each actuarial term and enumerate and explain each actuarial assumption used in making the valuation. This information must be included either in the actuarial study or in a separate report made available as a public record.

(c) The governing body of a public retirement system shall file with the State Pension Review Board a copy of each actuarial study and each separate report made as required by law.

(d) An actuary employed under this section must be a fellow of the Society of Actuaries, a member of the American Academy of Actuaries, or an enrolled actuary under the Employee Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.).

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Amended by Acts 1981, 67th Leg., 1st C.S., p. 196, ch. 18, Sec. 4, eff. Nov. 10, 1981; Acts 1985, 69th Leg., ch. 143, Sec. 4, eff. Sept. 1, 1985. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.101 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 2015, 84th Leg., R.S., Ch. 940 (H.B. 3310), Sec. 3, eff. June 18, 2015.

##### **Sec. 802.1012. AUDITS OF ACTUARIAL VALUATIONS, STUDIES, AND REPORTS.**

(a) In this section, "governmental entity" means a unit of government that is the employer of active members of a public retirement system.

(b) Except as provided by Subsection (k), this section applies only to a public retirement system with total assets the book value of which, as of the last day of the preceding fiscal year, is at least \$100 million.

(c) Every five years, the actuarial valuations, studies, and reports of a public retirement system most

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recently prepared for the retirement system as required by Section 802.101 or other law under this title or under Title 109, Revised Statutes, must be audited by an independent actuary who:

- (1) is engaged for the purpose of the audit by the governmental entity; and
  - (2) has the credentials required for an actuary under Section 802.101(d).
- (d) Before beginning an audit under this section, the governmental entity and the independent actuary must agree in writing to maintain the confidentiality of any nonpublic information provided by the public retirement system for the audit.
- (e) Before beginning an audit under this section, the independent actuary must meet with the manager of the pension fund for the public retirement system to discuss the appropriate assumptions to use in conducting the audit.
- (f) Not later than the 30th day after completing the audit under Subsection (c), the independent actuary shall submit to the public retirement system for purposes of discussion and clarification a preliminary draft of the audit report that is substantially complete.
- (g) The independent actuary shall:
- (1) discuss the preliminary draft of the audit report with the governing body of the public retirement system; and
  - (2) request in writing that the retirement system, on or before the 30th day after the date of receiving the preliminary draft, submit to the independent actuary any response that the retirement system wants to accompany the final audit report.
- (h) The independent actuary shall submit to the governmental entity the final audit report that includes the audit results and any response received from the public retirement system:
- (1) not earlier than the 31st day after the date on which the preliminary draft is submitted to the retirement system; and
  - (2) not later than the 60th day after the date on which the preliminary draft is submitted to the retirement system.
- (i) At the first regularly scheduled open meeting after receiving the final audit report, the governing body of the governmental entity shall:
- (1) include on the posted agenda for the meeting the presentation of the audit results;
  - (2) present the final audit report and any response from the public retirement system; and
  - (3) provide printed copies of the final audit report and the response from the public retirement system for individuals attending the meeting.
- (j) The governmental entity shall:
- (1) maintain a copy of the final audit report at its main office for public inspection;
  - (2) submit a copy of the final audit report to the public retirement system and the State Pension Review Board not later than the 30th day after the date the final audit report is received by the governmental entity; and
  - (3) pay all costs associated with conducting the audit and preparing and distributing the report under this section.
- (k) This section does not apply to the Employees Retirement System of Texas, the Teacher Retirement

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System of Texas, the Texas County and District Retirement System, the Texas Municipal Retirement System, or the Judicial Retirement System of Texas Plan Two.

Added by Acts 2007, 80th Leg., R.S., Ch. 733 (H.B. 2664), Sec. 1, eff. September 1, 2007.

### **Sec. 802.1014. ACTUARIAL EXPERIENCE STUDY.**

(a) In this section, "actuarial experience study" means a study in which actuarial assumptions are reviewed in light of relevant experience factors, important trends, and economic projections with the purpose of determining whether actuarial assumptions require adjustment.

(b) Except as provided by Subsection (c), a public retirement system that conducts an actuarial experience study shall submit to the board a copy of the actuarial experience study before the 31st day after the date of the study's adoption.

(b-1) Except as provided by Subsection (c), a public retirement system that has assets of at least \$100 million shall conduct once every five years an actuarial experience study and shall submit to the board a copy of the actuarial experience study before the 31st day after the date of the study's adoption.

(c) This section does not apply to the Employees Retirement System of Texas, the Teacher Retirement System of Texas, the Texas County and District Retirement System, the Texas Municipal Retirement System, or the Judicial Retirement System of Texas Plan Two.

Added by Acts 2013, 83rd Leg., R.S., Ch. 1152 (S.B. 200), Sec. 10, eff. September 1, 2013.

Amended by Acts 2015, 84th Leg., R.S., Ch. 940 (H.B. 3310), Sec. 4, eff. June 18, 2015.

### **Sec. 802.102. AUDIT.**

The governing body of a public retirement system shall have the accounts of the system audited at least annually by a certified public accountant in accordance with generally accepted auditing standards. A general audit of a governmental entity, as defined by Section 802.1012, does not satisfy the requirement of this section.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Amended by Acts 1985, 69th Leg., ch. 143, Sec. 5, eff. Sept. 1, 1985. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.102 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 2013, 83rd Leg., R.S., Ch. 1152 (S.B. 200), Sec. 11, eff. September 1, 2013.

### **Sec. 802.1024. CORRECTION OF ERRORS.**

(a) Except as provided by Subsection (b), if an error in the records of a public retirement system results in a person receiving more or less money than the person is entitled to receive under this subtitle, the retirement system shall correct the error and so far as practicable adjust any future payments so that the actuarial equivalent of the benefit to which the person is entitled is paid. If no future payments are due, the retirement system may recover the overpayment in any manner that would be permitted for the collection of any other debt.

(a-1) On discovery of an error described by Subsection (a), the public retirement system shall as soon as practicable, but not later than the 90th day after the date of discovery, give written notice of the error to the person receiving an incorrect amount of money. The notice must include:

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- (1) the amount of the correction in overpayment or underpayment;
- (2) how the amount of the correction was calculated;
- (3) a brief explanation of the reason for the correction;
- (4) a statement that the notice recipient may file a written complaint with the retirement system if the recipient does not agree with the correction;
- (5) instructions for filing a written complaint; and
- (6) a payment plan option if no future payments are due.

(a-2) Except as provided by this subsection and Section 802.1025, the public retirement system shall begin to adjust future payments or, if no future payments are due, institute recovery of an overpayment of benefits under Subsection (a) not later than the 90th day after the date the notice required by Subsection (a-1) is delivered by certified mail, return receipt requested. If the system does not receive a signed receipt evidencing delivery of the notice on or before the 30th day after the date the notice is mailed, the system shall mail the notice a second time by certified mail, return receipt requested. Except as provided by Section 802.1025, not later than the 90th day after the date the second notice is mailed, the system shall begin to adjust future payments or, if no future payments are due, institute recovery of an overpayment of benefits.

(b) Except as provided by Subsection (c), a public retirement system:

- (1) may correct the overpayment of benefits to a person entitled to receive payments from the system by the method described by Subsection (a) only for an overpayment made during the three years preceding the date the system discovers or discovered the overpayment;
- (2) may not recover from the recipient any overpayment made more than three years before the discovery of the overpayment; and
- (3) may not recover an overpayment if the system did not adjust future payments or, if no future payments are due, institute recovery of the overpayment within the time prescribed by Subsection (a-2) or Section 802.1025.

(c) Subsection (b) does not apply to an overpayment a reasonable person should know the person is not entitled to receive.

Added by Acts 2003, 78th Leg., ch. 416, Sec. 1, eff. June 20, 2003. Amended by Acts 2007, 80th Leg., R.S., Ch. 1164 (H.B. 155), Sec. 1, eff. June 15, 2007.

### **Sec. 802.1025. COMPLAINT PROCEDURE.**

(a) Not later than the 20th day after the date of receiving notice under Section 802.1024(a-1) or, if applicable, the second notice under Section 802.1024(a-2), the notice recipient may file a written complaint with the retirement system. The recipient shall include any available supporting documentation with the complaint.

(b) Not later than the 30th day after the date of receiving a complaint under Subsection (a), the retirement system shall respond in writing to the complaint by confirming the amount of the proposed correction or, if the retirement system determines the amount of the proposed correction is incorrect, by modifying the amount of the correction. If the retirement system modifies the amount of the correction, the response must include:

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- (1) how the modified correction was calculated;
- (2) a brief explanation of the reason for the modification; and
- (3) a payment plan option if no future payments are due.

(c) Subject to Subsection (d), if a complaint is filed under this section, the retirement system may not adjust future payments or recover an overpayment under Section 802.1024 until:

- (1) the 20th day after the date the notice recipient receives the response under Subsection (b), if the recipient does not file an administrative appeal by that date; or
- (2) the date a final decision by the retirement system is issued, if the recipient files an administrative appeal before the date described by Subdivision (1).

(d) If the retirement system has begun the adjustment of future payments or the recovery of an overpayment under Section 802.1024(a-2), the system shall discontinue the adjustment of future payments or the recovery of the overpayment beginning with the first pay cycle occurring after the date the complaint is received by the system. The system may not recommence the adjustment of future payments or the recovery of an overpayment until the date described by Subsection (c)(1) or (2), as applicable. If a complaint is resolved in favor of the person filing the complaint, not later than the 30th day after the date of the resolution, the system shall pay the person the appropriate amount.

(e) A person whose complaint is not resolved under this section must exhaust all administrative procedures provided by the retirement system. Not later than the 30th day after the date a final administrative decision is issued by the retirement system, a person aggrieved by the decision may appeal the decision to an appropriate district court.

Added by Acts 2007, 80th Leg., R.S., Ch. 1164 (H.B. 155), Sec. 2, eff. June 15, 2007.

### **Sec. 802.103. ANNUAL FINANCIAL REPORT.**

(a) The governing body of a public retirement system shall publish an annual financial report showing the financial condition of the system as of the last day of the fiscal year covered in the report. The report must include:

- (1) the financial statements and schedules examined in the most recent audit performed as required by Section 802.102;
- (2) a statement of opinion by the certified public accountant as to whether or not the financial statements and schedules are presented fairly and in accordance with generally accepted accounting principles;
- (3) a listing, by asset class, of all direct and indirect commissions and fees paid by the retirement system during the system's previous fiscal year for the sale, purchase, or management of system assets; and
- (4) the names of investment managers engaged by the retirement system.

(b) The governing body of a public retirement system shall, before the 211th day after the last day of the fiscal year under which the system operates, file with the State Pension Review Board a copy of each annual financial report it makes as required by law.

(c) Repealed by Acts 2013, 83rd Leg., R.S., Ch. 1152 (S.B. 200), Sec. 17, eff. September 1, 2013, and Ch. 1316 (S.B. 220), Sec. 4.01(1), eff. June 14, 2013.

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(d) A general audit of a governmental entity, as defined by Section 802.1012, does not satisfy the requirement of this section.

(e) The board may adopt rules necessary to implement this section.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Amended by Acts 1981, 67th Leg., 1st C.S., p. 196, ch. 18, Sec. 5, 6, eff. Nov. 10, 1981; Acts 1985, 69th Leg., ch. 143, Sec. 5, eff. Sept. 1, 1985; Acts 1987, 70th Leg., ch. 126, Sec. 1, eff. May 20, 1987. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.103 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

Amended by Acts 2013, 83rd Leg., R.S., Ch. 1152 (S.B. 200), Sec. 12, eff. September 1, 2013; Acts 2013, 83rd Leg., R.S., Ch. 1152 (S.B. 200), Sec. 17, eff. September 1, 2013; Acts 2013, 83rd Leg., R.S., Ch. 1316 (S.B. 220), Sec. 4.01(1), eff. June 14, 2013; Acts 2019, 86th Leg., R.S., Ch. 578 (S.B. 322), Sec. 2, eff. June 10, 2019.

### **Sec. 802.104. REPORT OF MEMBERS AND RETIREES.**

Each public retirement system annually shall, before the 211th day after the last day of the fiscal year under which the system operates, submit to the board a report containing the number of members and number of retirees of the system as of the last day of the immediately preceding fiscal year.

Added by Acts 1981, 67th Leg., 1st C.S., p. 196, ch. 18, Sec. 7, eff. Nov. 10, 1981. Amended by Acts 1985, 69th Leg., ch. 143, Sec. 5, eff. Sept. 1, 1985. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.104 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1991, 72nd Leg., ch. 624, Sec. 12, eff. Sept. 1, 1991.

### **Sec. 802.105. REGISTRATION.**

(a) Each public retirement system shall, before the 91st day after the date of its creation, register with the State Pension Review Board.

(b) A registration form submitted to the board must include:

- (1) the name, mailing address, and telephone number of the public retirement system;
- (2) the names and occupations of the chairman and other members of its governing body;
- (3) a citation of the law under which the system was created;
- (4) the beginning and ending dates of its fiscal year; and
- (5) the name of the administrator of the system and the person's business mailing address and telephone number if different from those of the retirement system.

(c) A public retirement system shall notify the board of changes in information required under Subsection (b) before the 31st day after the day the change occurs.

Added by Acts 1981, 67th Leg., 1st C.S., p. 196, ch. 18, Sec. 7, eff. Nov. 10, 1981. Amended by Acts 1985, 69th Leg., ch. 143, Sec. 5, eff. Sept. 1, 1985. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.105 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

### **Sec. 802.106. INFORMATION TO MEMBER OR ANNUITANT.**



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(a) When a person becomes a member of a public retirement system, the system shall provide the person:

- (1) a summary of the benefits from the retirement system available to or on behalf of a person who retires or dies while a member or retiree of the system;
- (2) a summary of procedures for claiming or choosing the benefits available from the retirement system; and
- (3) a summary of the provisions for employer and employee contributions, withdrawal of contributions, and eligibility for benefits, including any right to terminate employment and retain eligibility.

(b) A public retirement system shall distribute to each active member and retiree a summary of any significant change that is made in statutes or ordinances governing the retirement system and that affects contributions, benefits, or eligibility. A distribution must be made before the 271st day after the day the change is adopted.

(c) A public retirement system annually shall provide to each active member a statement of the amounts of the member's accumulated contributions and total accumulated service credit on which benefits may be based and to each annuitant a statement of the amount of payments made to the annuitant by the system during the preceding 12 months.

(d) A public retirement system shall provide to each active member and annuitant a summary of the financial condition of the retirement system, if the actuary of the system determines, based on a computation of advanced funding of actuarial costs, that the financing arrangement of the system is inadequate. The actuarial determination must be disclosed to members and annuitants at the time annual statements are next provided under Subsection (c) after the determination is made. An actuary who makes a determination under this subsection must have at least five years of experience working with one or more public retirement systems and be a fellow of the Society of Actuaries, a member of the American Academy of Actuaries, or an enrolled actuary under the Employees Retirement Income Security Act of 1974 (29 U.S.C. Section 1001 et seq.).

(e) A member not currently contributing to a particular public retirement system is entitled on written request to receive from that system a copy of any document required by this section to be furnished to a member who is actively contributing.

(f) The governing body of a public retirement system composed of participating subdivisions or municipalities may provide one copy of any document it prepares under this section to each affected participating subdivision or municipality. Each participating subdivision or municipality shall distribute the information contained in the document to its employee members and annuitants, as applicable.

(g) Information required by this section may be contained, at the discretion of the public retirement system providing the information, in one or more separate documents. The information must be stated to the greatest extent practicable in terms understandable to a typical member of the public retirement system.

(h) A public retirement system shall submit to the board copies of the summarized information required by Subsections (a) and (b) before the 31st day after the date of publication or the date a change is adopted, as appropriate.

Added by Acts 1981, 67th Leg., 1st C.S., p. 196, ch. 18, Sec. 7, eff. Nov. 10, 1981. Amended by Acts 1985, 69th Leg., ch. 143, Sec. 6, eff. Sept. 1, 1985. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.106 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

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Amended by Acts 2013, 83rd Leg., R.S., Ch. 1152 (S.B. 200), Sec. 13, eff. September 1, 2013.

### **Sec. 802.107. GENERAL PROVISIONS RELATING TO REPORTS AND CONTACT INFORMATION.**

(a) A public retirement system shall maintain for public review at its main office and at such other locations as the retirement system considers appropriate copies of the most recent edition of each type of report or other information required by this chapter to be submitted to the State Pension Review Board.

(b) Information required by this chapter to be submitted to the State Pension Review Board may be contained in one or more documents but must be submitted within the period provided by the provision requiring the information.

(c) A public retirement system shall post on a publicly available Internet website:

(1) the name, business address, and business telephone number of a system administrator of the public retirement system; and

(2) a copy of the most recent edition of each report and other written information that is required by this chapter or Chapter 801 to be submitted to the board.

(d) A public retirement system that maintains a website or for which a website is maintained shall prominently post a link on that website to the information required by Subsection (c). All other public retirement systems shall:

(1) prominently post the information required by Subsection (c) on a website that is maintained by the governing body of the political subdivision of which members of the public retirement system are officers or employees; or

(2) post the information required by Subsection (c) on a publicly available website that is maintained by a state agency.

(e) A report or other information posted under Subsection (c) must remain posted until replaced with a more recently submitted edition of the report or information.

Added by Acts 1985, 69th Leg., ch. 143, Sec. 7, eff. Sept. 1, 1985. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.1061 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

Amended by Acts 2013, 83rd Leg., R.S., Ch. 140 (H.B. 13), Sec. 4, eff. May 24, 2013; Acts 2013, 83rd Leg., R.S., Ch. 140 (H.B. 13), Sec. 5, eff. May 24, 2013.

### **Sec. 802.108. REPORT OF INVESTMENT RETURNS AND ASSUMPTIONS.**

(a) A public retirement system shall, before the 211th day after the last day of its fiscal year, submit to the board an investment returns and actuarial assumptions report that includes:

(1) gross investment returns and net investment returns for each of the most recent 10 fiscal years;

(2) the rolling gross and rolling net investment returns for the most recent 1-year, 3-year, and 10-year periods;

(3) the rolling gross and rolling net investment return for the most recent 30-year period or the gross and net investment return since inception of the system, whichever period is shorter;

(4) the assumed rate of return used in the most recent actuarial valuation; and

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(5) the assumed rate of return used in each of the most recent 10 actuarial valuations.

(b) For purposes of this section, "net investment return" means the gross investment return minus investment expenses. The net investment return may be calculated as the money-weighted rate of return as required by generally accepted accounting principles. The period basis for each report of investment returns under this section must be the fiscal year of the public retirement system submitting the report.

(c) If any information required to be reported by a public retirement system under Subsection (a) is unavailable, the governing body of the public retirement system shall, before the 211th day after the last day of the public retirement system's fiscal year, submit to the board a letter certifying that the information is unavailable, providing a reason for the unavailability of the information, and agreeing to timely submit the information to the board if it becomes available.

Added by Acts 2013, 83rd Leg., R.S., Ch. 140 (H.B. 13), Sec. 6, eff. May 24, 2013.

### **Sec. 802.109. INVESTMENT PRACTICES AND PERFORMANCE REPORT.**

(a) Except as provided by Subsection (e) and subject to Subsections (c) and (k), a public retirement system shall select an independent firm with substantial experience in evaluating institutional investment practices and performance to evaluate the appropriateness, adequacy, and effectiveness of the retirement system's investment practices and performance and to make recommendations for improving the retirement system's investment policies, procedures, and practices. Each evaluation must include:

(1) a summary of the independent firm's experience in evaluating institutional investment practices and performance and a statement that the firm's experience meets the experience required by this subsection;

(2) a statement indicating the nature of any existing relationship between the independent firm and the public retirement system and confirming that the firm and any related entity are not involved in directly or indirectly managing the investments of the system;

(3) a list of the types of remuneration received by the independent firm from sources other than the public retirement system for services provided to the system;

(4) a statement identifying any potential conflict of interest or any appearance of a conflict of interest that could impact the analysis included in the evaluation due to an existing relationship between the independent firm and:

(A) the public retirement system; or

(B) any current or former member of the governing body of the system; and

(5) an explanation of the firm's determination regarding whether to include a recommendation for each of the following evaluated matters:

(A) an analysis of any investment policy or strategic investment plan adopted by the retirement system and the retirement system's compliance with that policy or plan;

(B) a detailed review of the retirement system's investment asset allocation, including:

(i) the process for determining target allocations;

(ii) the expected risk and expected rate of return, categorized by asset class;

(iii) the appropriateness of selection and valuation methodologies of alternative and illiquid assets; and

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- (iv) future cash flow and liquidity needs;
  - (C) a review of the appropriateness of investment fees and commissions paid by the retirement system;
  - (D) a review of the retirement system's governance processes related to investment activities, including investment decision-making processes, delegation of investment authority, and board investment expertise and education; and
  - (E) a review of the retirement system's investment manager selection and monitoring process.
- (b) The governing body of a public retirement system may determine additional specific areas to be evaluated under Subsection (a) and may select particular asset classes on which to focus, but the first evaluation must be a comprehensive analysis of the retirement system's investment program that covers all asset classes.
- (c) In selecting an independent firm to conduct the evaluation described by Subsection (a), a public retirement system:
  - (1) subject to Subdivision (2), may select a firm regardless of whether the firm has an existing relationship with the retirement system; and
  - (2) may not select a firm that directly or indirectly manages investments of the retirement system.
- (d) A public retirement system shall conduct the evaluation described by Subsection (a):
  - (1) once every three years, if the total assets of the retirement system as of the last day of the preceding fiscal year were at least \$100 million; or
  - (2) once every six years, if the total assets of the retirement system as of the last day of the preceding fiscal year were at least \$30 million and less than \$100 million.
- (e) A public retirement system is not required to conduct the evaluation described by Subsection (a) if the total assets of the retirement system as of the last day of the preceding fiscal year were less than \$30 million.
- (e-1) Not later than the 30th day after the date an independent firm completes an evaluation described by Subsection (a), the independent firm shall:
  - (1) submit to the public retirement system for purposes of discussion and clarification a substantially completed preliminary draft of the evaluation report; and
  - (2) request in writing that the system, on or before the 30th day after the date the system receives the preliminary draft, submit to the firm:
    - (A) a description of any action taken or expected to be taken in response to a recommendation made in the evaluation; and
    - (B) any written response of the system that the system wants to accompany the final evaluation report.
- (f) The independent firm shall file the final evaluation report, including the evaluation results and any response received from the public retirement system, with the governing body of the system:
  - (1) not earlier than the 31st day after the date on which the preliminary draft is submitted to the system; and
  - (2) not later than the later of:

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(A) the 60th day after the date on which the preliminary draft is submitted to the system;  
or

(B) May 1 in the year following the year in which the system is evaluated under Subsection (a).

(g) Not later than the 31st day after the date the governing body of a public retirement system receives a report of an evaluation under this section, the governing body shall submit the report to the board.

(h) A governmental entity that is the employer of active members of a public retirement system evaluated under Subsection (a) may pay all or part of the costs of the evaluation. The public retirement system shall pay any remaining unpaid costs of the evaluation.

(i) The board shall submit an investment performance report to the governor, the lieutenant governor, the speaker of the house of representatives, and the legislative committees having principal jurisdiction over legislation governing public retirement systems in the biennial report required by Section [801.203](#). The report must compile and summarize the information received under this section by the board during the preceding two fiscal years.

(j) Repealed by Acts 2021, 87th Leg., R.S., Ch. 141 (H.B. [1585](#)), Sec. 20(1), eff. May 26, 2021.

(k) The following reports may be used by the applicable public retirement systems to satisfy the requirement for a report of an evaluation under this section:

(1) an investment report under Section 10A, Article 6243g-4, Revised Statutes;

(2) an investment report under Section 2D, Chapter 88 (H.B. 1573), Acts of the 77th Legislature, Regular Session, 2001 (Article [6243h](#), Vernon's Texas Civil Statutes); and

(3) a report on a review conducted on the retirement system's investments under Section 2B, Article 6243e.2(1), Revised Statutes.

(l) The board may adopt rules necessary to implement this section.

Added by Acts 2019, 86th Leg., R.S., Ch. 578 (S.B. [322](#)), Sec. 3, eff. June 10, 2019.

Amended by Acts 2021, 87th Leg., R.S., Ch. 141 (H.B. [1585](#)), Sec. 20(1), eff. May 26, 2021; Acts 2021, 87th Leg., R.S., Ch. 1033 (H.B. [3898](#)), Sec. 2, eff. September 1, 2021.

### **Subchapter C. Administration of Assets**

#### **Sec. 802.201. ASSETS IN TRUST.**

The governing body of a public retirement system shall hold or cause to be held in trust the assets appropriated or dedicated to the system, for the benefit of the members and retirees of the system and their beneficiaries.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.201 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

#### **Sec. 802.2011. FUNDING POLICY.**

(a) In this section:

(1) "Funded ratio" means the ratio of a public retirement system's actuarial value of assets divided by the system's actuarial accrued liability.

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(2) "Governmental entity" has the meaning assigned by Section 802.1012.

(3) "Statewide retirement system" means:

(A) the Employees Retirement System of Texas, including a retirement system administered by that system;

(B) the Teacher Retirement System of Texas;

(C) the Texas County and District Retirement System;

(D) the Texas Emergency Services Retirement System; and

(E) the Texas Municipal Retirement System.

(b) The governing body of a public retirement system and, if the system is not a statewide system, its associated governmental entity shall:

(1) jointly, if applicable:

(A) develop and adopt a written funding policy that details a plan for achieving a funded ratio of the system that is equal to or greater than 100 percent; and

(B) timely revise the policy to reflect any significant changes to the policy, including changes required as a result of formulating and implementing a funding soundness restoration plan, including a revised funding soundness restoration plan, under Section 802.2015 or 802.2016;

(2) maintain for public review at its main office a copy of the policy;

(3) file a copy of the policy and each change to the policy with the board not later than the 31st day after the date the policy or change, as applicable, is adopted; and

(4) post a copy of the most recent edition of the policy on a publicly available Internet website in accordance with Section 802.107(c)(2).

Added by Acts 2019, 86th Leg., R.S., Ch. 453 (S.B. 2224), Sec. 1, eff. September 1, 2019.

Amended by Acts 2021, 87th Leg., R.S., Ch. 1033 (H.B. [3898](#)), Sec. 3, eff. September 1, 2021.

### **Sec. 802.2015. FUNDING SOUNDNESS RESTORATION PLAN.**

(a) In this section:

(1) "Funded ratio" has the meaning assigned by Section [802.2011](#).

(2) "Governmental entity" has the meaning assigned by Section [802.1012](#).

(b) This section applies to a public retirement system and its associated governmental entity other than a public retirement system and its associated governmental entity subject to Section [802.2016](#).

(c) A public retirement system shall notify the associated governmental entity in writing if the system receives an actuarial valuation indicating that the system's actual contributions are not sufficient to amortize the unfunded actuarial accrued liability within 30 years. The governing body of the public retirement system and the governing body of the associated governmental entity shall jointly formulate a funding soundness restoration plan under Subsection (e) if the system's actuarial valuation shows that the system's expected funding period:

(1) has exceeded 30 years for three consecutive annual actuarial valuations, or two consecutive

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annual actuarial valuations in the case of a system that conducts the valuations every two or three years; or

(2) effective September 1, 2025:

(A) exceeds 40 years; or

(B) exceeds 30 years and the funded ratio of the system is less than 65 percent.

(d) Except as provided by Subsection (d-1), the governing body of a public retirement system and the governing body of the associated governmental entity that have an existing funding soundness restoration plan under Subsection (e) shall formulate a revised funding soundness restoration plan under Subsection (e-1) if the system becomes subject to Subsection (c) before the 10th anniversary of the date prescribed by Subsection (e)(2)(A) or (B), as applicable.

(d-1) The governing body of a public retirement system and the governing body of the associated governmental entity are not subject to Subsection (d) if:

(1) the system's actuarial valuation shows that the system's expected funding period exceeds 30 years but is less than or equal to 40 years; and

(2) the system is:

(A) adhering to an existing funding soundness restoration plan that was formulated before September 1, 2025; or

(B) implementing a contribution rate structure that uses or will ultimately use an actuarially determined contribution structure and the system's actuarial valuation shows that the system is expected to achieve full funding.

(e) A funding soundness restoration plan formulated under this section must:

(1) be developed by the public retirement system and the associated governmental entity in accordance with the system's governing statute;

(2) be designed to achieve a contribution rate that will be sufficient to amortize the unfunded actuarial accrued liability within 30 years not later than the later of:

(A) the second anniversary of the valuation date stated in the actuarial valuation that required formulation of the plan under this subsection; or

(B) September 1, 2025;

(3) be based on actions agreed to be taken by the system and entity that were approved by the respective governing bodies of both the system and the entity before the plan was adopted; and

(4) be adopted at open meetings of the respective governing bodies of the system and the entity not later than the second anniversary of the date the actuarial valuation that required application of this subsection was adopted by the governing body of the system.

(e-1) A revised funding soundness restoration plan formulated under this section must:

(1) be developed by the public retirement system and the associated governmental entity in accordance with the system's governing statute;

(2) be designed to achieve a contribution rate that will be sufficient to amortize the unfunded actuarial accrued liability within 25 years not later than the second anniversary of the valuation date stated in the actuarial valuation that required formulation of a revised plan under this subsection;

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(3) be based on actions, including automatic risk-sharing mechanisms, an actuarially determined contribution structure, and other adjustable benefit or contribution mechanisms, agreed to be taken by the system and entity that were approved by the respective governing bodies of both the system and the entity before the plan was adopted; and

(4) be adopted at open meetings by the respective governing bodies of the system and the entity not later than the second anniversary of the date the actuarial valuation that required application of this subsection was adopted by the governing body of the system.

(e-2) Not later than the 90th day after the date on which the plan is adopted by both the governing body of the system and the governing body of the associated governmental entity, a system may submit to the board an actuarial valuation required under Section [802.101\(a\)](#) or other law that shows the combined impact of all changes to a funding soundness restoration plan adopted under this section, including a revised funding soundness restoration plan adopted under Subsection (e-1). If a system does not provide an actuarial valuation to the board in accordance with this subsection, the board may request that the system provide a separate analysis of the combined impact of all changes to a funding soundness restoration plan adopted under this section not later than the 90th day after the date the board makes the request. An actuarial valuation or separate analysis conducted under this subsection must include:

(1) an actuarial projection of the public retirement system's expected future assets and liabilities between the valuation date described by Subsection (e)(2)(A) or (e-1)(2), as applicable, and the date at which the plan is expected to achieve full funding; and

(2) a description of all assumptions and methods used to perform the analysis which must comply with actuarial standards of practice.

(e-3) The associated governmental entity may pay all or part of the costs of the separate analysis required under Subsection (e-2). The public retirement system shall pay any costs for the analysis not paid by the associated governmental entity.

(e-4) A funding soundness restoration plan adopted under this section, including a revised funding soundness restoration plan adopted under Subsection (e-1), may not include actions that are subject to future approval by the governing bodies of either the public retirement system or the associated governmental entity.

(f) A public retirement system and the associated governmental entity required to formulate a funding soundness restoration plan under this section, including a revised funding soundness restoration plan, shall provide a report to the board on progress made by the system and entity in formulating the plan, including a draft of any plan and a description of any changes under consideration for inclusion in a plan, not later than the first anniversary of the date of the actuarial valuation that required formulation of the plan under Subsection (e) or (e-1) and each subsequent six-month period until the plan is submitted to the board under this section.

(g) Each public retirement system that formulates a funding soundness restoration plan as provided by this section shall submit a copy of that plan to the board and any change to the plan not later than the 31st day after the date on which the plan is adopted by both the governing body of the system and the governing body of the associated governmental entity or the date the change is agreed to.

(h) The board may adopt rules necessary to implement this section.

Added by Acts 2015, 84th Leg., R.S., Ch. 940 (H.B. [3310](#)), Sec. 5, eff. June 18, 2015.

Amended by Acts 2021, 87th Leg., R.S., Ch. 1033 (H.B. [3898](#)), Sec. 4, eff. September 1, 2021.



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### **Sec. 802.202. INVESTMENT OF SURPLUS.**

- (a) The governing body of a public retirement system is responsible for the management and administration of the funds of the system.
- (b) When, in the opinion of the governing body, a surplus of funds exists in accounts of a public retirement system over the amount needed to make payments as they become due within the next year, the governing body shall deposit all or as much of the surplus as the governing body considers prudent in a reserve fund for investment.
- (c) The governing body shall determine the procedure it finds most efficient and beneficial for the management of the reserve fund of the system. The governing body may directly manage the investments of the system or may choose and contract for professional investment management services.
- (d) The governing body of a public retirement system shall:
  - (1) develop and adopt a written investment policy;
  - (2) maintain for public review at its main office a copy of the policy;
  - (3) file a copy of the policy with the State Pension Review Board not later than the 90th day after the date the policy is adopted; and
  - (4) file a copy of each change to the policy with the State Pension Review Board not later than the 90th day after the change is adopted.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.202 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989; Acts 1993, 73rd Leg., ch. 373, Sec. 1, eff. Aug. 30, 1993.

### **Sec. 802.203. FIDUCIARY RESPONSIBILITY.**

- (a) In making and supervising investments of the reserve fund of a public retirement system, an investment manager or the governing body shall discharge its duties solely in the interest of the participants and beneficiaries:
  - (1) for the exclusive purposes of:
    - (A) providing benefits to participants and their beneficiaries; and
    - (B) defraying reasonable expenses of administering the system;
  - (2) with the care, skill, prudence, and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with matters of the type would use in the conduct of an enterprise with a like character and like aims;
  - (3) by diversifying the investments of the system to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
  - (4) in accordance with the documents and instruments governing the system to the extent that the documents and instruments are consistent with this subchapter.
- (b) In choosing and contracting for professional investment management services and in continuing the use of an investment manager, the governing body must act prudently and in the interest of the participants and beneficiaries of the public retirement system.
- (c) A trustee is not liable for the acts or omissions of an investment manager appointed under Section

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802.204, nor is a trustee obligated to invest or otherwise manage any asset of the system subject to management by the investment manager.

(d) An investment manager appointed under Section 802.204 shall acknowledge in writing the manager's fiduciary responsibilities to the fund the manager is appointed to serve.

(e) The investment standards provided by Subsection (a) and the policies, requirements, and restrictions adopted under Section 802.204(c) are the only standards, policies, or requirements for, or restrictions on, the investment of funds of a public retirement system by an investment manager or by a governing body during a 90-day interim between professional investment management services. Any other standard, policy, requirement, or restriction provided by law is suspended and not applicable during a time, and for 90 days after a time, in which an investment manager is responsible for investment of a reserve fund. If an investment manager has not begun managing investments of a reserve fund before the 91st day after the date of termination of the services of a previous investment manager, the standards, policies, requirements, and restrictions otherwise provided by law are applicable until the date professional investment management services are resumed.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Amended by Acts 1981, 67th Leg., 1st C.S., p. 198, ch. 18, Sec. 8, 9, eff. Nov. 10, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.203 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

### **Sec. 802.204. INVESTMENT MANAGER.**

(a) The governing body of a public retirement system may appoint investment managers for the system by contracting for professional investment management services with one or more organizations, which may include a bank if it has a trust department, that are in the business of managing investments.

(b) To be eligible for appointment under this section, an investment manager must be:

- (1) registered under the Investment Advisors Act of 1940 (15 U.S.C. Section 80b-1 et seq.);
- (2) a bank as defined by that Act; or
- (3) an insurance company qualified to perform investment services under the laws of more than one state.

(c) In a contract made under this section, the governing body shall specify any policies, requirements, or restrictions, including criteria for determining the quality of investments and for the use of standard rating services, that the governing body adopts for investments of the system.

(d) A political subdivision of which members of the public retirement system are officers or employees may pay all or part of the cost of professional investment management services under a contract under this section. Any cost not paid directly by a political subdivision is payable from funds of the public retirement system.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Amended by Acts 1981, 67th Leg., 1st C.S., p. 199, ch. 18, Sec. 10, eff. Nov. 10, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.204 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

### **Sec. 802.205. INVESTMENT CUSTODY ACCOUNT.**

(a) If the governing body of a public retirement system contracts for professional investment management services, it also shall enter into an investment custody account agreement designating a

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bank, depository trust company, or brokerage firm to serve as custodian for all assets allocated to or generated under the contract.

(b) Under a custody account agreement, the governing body of a public retirement system shall require the designated custodian to perform the duties and assume the responsibilities for funds under the contract for which the agreement is established that are performed and assumed, in the absence of a contract, by the custodian of system funds.

(c) A political subdivision of which members of the retirement system are officers or employees may pay all or part of the cost of custodial services under a custody account agreement under this section. Any cost not paid directly by a political subdivision is payable from funds of the public retirement system.

(d) If the governing body enters into a contract under Subsection (a) with a brokerage firm, the firm must:

- (1) be a broker-dealer registered with the Securities and Exchange Commission;
- (2) be a member of a national securities exchange;
- (3) be a member of the Securities Investor Protection Corporation;
- (4) be registered with the State Securities Board; and
- (5) maintain net regulatory capital of at least \$200 million.

(e) A brokerage firm contracted with for custodial services under this section may not have discretionary authority over the retirement system's assets in the firm's custody.

(f) A brokerage firm that provides custodial services under Subsection (a) must provide insurance against errors, omissions, mysterious disappearance, or fraud in an amount equal to the amount of the assets the firm holds in custody.

(g) A brokerage firm that provides consulting advice, custody of assets, or other services to a public retirement system under this chapter shall discharge its duties solely in the interest of the public retirement system in accordance with Section 802.203.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.205 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989. Amended by Acts 1991, 72nd Leg., ch. 621, Sec. 1, eff. Sept. 1, 1991; Acts 2003, 78th Leg., ch. 916, Sec. 1, eff. June 20, 2003.

### **Sec. 802.206. EVALUATION OF INVESTMENT SERVICES.**

(a) The governing body of a public retirement system may at any time and shall at frequent intervals monitor the investments made by any investment manager for the system. The governing body may contract for professional evaluation services to fulfill this requirement.

(b) A political subdivision of which members of the retirement system are officers or employees may pay all or part of the cost of professional evaluation services under a contract under this section. Any cost not paid directly by a political subdivision is payable from funds of the public retirement system.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.206 by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

### **Sec. 802.207. CUSTODY AND USE OF FUNDS.**

(a) An investment manager other than a bank having a contract with a public retirement system under

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Section 802.204 may not be a custodian of any assets of the reserve fund of the system.

(b) When demands of the public retirement system require, the governing body shall withdraw from a custodian of system funds money for use in paying benefits to members and other beneficiaries of the system and for other uses authorized by this subchapter and approved by the governing body.

Acts 1981, 67th Leg., p. 1876, ch. 453, Sec. 1, eff. Sept. 1, 1981. Renumbered from Vernon's Ann.Civ.St. Title 110B, Sec. 12.207 and amended by Acts 1989, 71st Leg., ch. 179, Sec. 1, eff. Sept. 1, 1989.

## **Title 8. Public Retirement Systems**

### **Subtitle A. Provisions Generally Applicable to Public Retirement Systems**

#### **Chapter 804. Domestic Relations Orders and Spousal Consent**

##### **Subchapter A. Qualified Domestic Relations Orders**

###### **Sec. 804.001. DEFINITIONS.**

In this chapter:

(1) "Alternate payee" means a spouse, former spouse, child, or other dependent of a member or retiree who is recognized by a domestic relations order as having a right to receive all or a portion of the benefits payable by a public retirement system with respect to such member or retiree.

(2) "Domestic relations order" means any judgment, decree, or order, including approval of a property settlement agreement, which relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of a member or retiree, and is made pursuant to a domestic relations law, including a community property law of the State of Texas or of another state.

(3) "Public retirement system" means the Employees Retirement System of Texas, the Judicial Retirement System of Texas Plan One, the Judicial Retirement System of Texas Plan Two, the Teacher Retirement System of Texas, the Texas County and District Retirement System, the Texas Municipal Retirement System, and any other continuing, organized program of service retirement, disability retirement, or death benefits for officers or employees of the state or a political subdivision or of an agency or instrumentality of the state or a political subdivision and includes the optional retirement program governed by Chapter 830. Public retirement system does not include:

(A) a program, other than the optional retirement program, for which benefits are administered by a life insurance company;

(B) a program providing only workers' compensation benefits;

(C) a program administered by the federal government;

(D) an individual retirement account or individual retirement annuity within the meaning of Section 408, or a retirement bond within the meaning of Section 409, of the Internal Revenue Code of 1986;

(E) a plan described by Subsection (d) of Section 401 of the Internal Revenue Code of 1986;

(F) a group or an individual account plan consisting of an annuity contract described by Subsection (b) of Section 403 of the Internal Revenue Code of 1986, other than a 403(b) contract or plan under the optional retirement program;

(G) an eligible state deferred compensation plan described by Subsection (b) of Section 457 of the Internal Revenue Code of 1986; or

(H) the program established by Chapter 615.

(4) "Qualified domestic relations order" means a domestic relations order which creates or recognizes the existence of an alternate payee's right or assigns to an alternate payee the right to receive all or a portion of the benefits payable with respect to a member or retiree under a public retirement system, which directs the public retirement system to disburse benefits to the alternate payee, and which meets the requirements of Section 804.003.

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(5) "Statewide retirement system" means the Employees Retirement System of Texas, the Judicial Retirement System of Texas Plan One, the Judicial Retirement System of Texas Plan Two, the Teacher Retirement System of Texas, the Texas County and District Retirement System, or the Texas Municipal Retirement System.

Added by Acts 1991, 72nd Leg., ch. 16, Sec. 11.02(a), eff. Aug. 26, 1991. Amended by Acts 1995, 74th Leg., ch. 76, Sec. 5.95(32), eff. Sept. 1, 1995.

### **Sec. 804.002. APPLICATION OF CHAPTERS.**

This subchapter and Subchapter C apply to each statewide retirement system and to the optional retirement program governed by Chapter 830. This subchapter and Subchapter C also apply to each other public retirement system for which the board of trustees of the system elects to adopt the provisions of this subchapter and Subchapter C. An election under this section must be by order or resolution and need not set out the text of this subchapter or Subchapter C. A board of trustees may not elect to adopt only this subchapter or Subchapter C.

Added by Acts 1991, 72nd Leg., ch. 16, Sec. 11.02(a), eff. Aug. 26, 1991.

### **Sec. 804.003. QUALIFIED DOMESTIC RELATIONS ORDERS.**

(a) Sections 811.005, 821.005, 831.004, 836.004, 841.006, and 851.006 and any similar antialienation provisions contained in any other public retirement system shall apply to the creation, assignment, recognition, or enforcement of a right to any benefit payable with respect to a member or retiree of a public retirement system to which the section applies pursuant to a domestic relations order unless the order is determined to be a qualified domestic relations order.

(b) Except as provided in Subsection (d), the administrative head of a public retirement system to which this chapter applies and to which a domestic relations order is submitted or his designee has exclusive authority to determine whether a domestic relations order is a qualified domestic relations order. A determination by the administrative head or his designee under this section may be appealed only to the board of trustees of the public retirement system. An appeal to the board of trustees of a statewide retirement system is a contested case under Chapter 2001. However, the board of a statewide retirement system by rule may waive the requirement of an appeal to the board. On appeal of a decision made by the board of trustees or by the administrative head if there is no appeal to the board under this section, the standard of review is by substantial evidence.

(c) Except as provided in Subsection (d), a court does not have jurisdiction over a public retirement system to which this chapter applies with respect to a divorce or other domestic relations action in which an alternate payee's right to receive all or a portion of the benefits payable to a member or retiree under the public retirement system is created or established. A party to such an action who attempts to make a public retirement system a party to the action contrary to the provision of this subsection shall be liable to the public retirement system for its costs and attorney's fees.

(d) Under the optional retirement program, applicable carriers shall determine whether a domestic relations order is a qualified domestic relations order. If a dispute arises over the determination of whether a domestic relations order is a qualified domestic relations order which cannot be resolved by the procedure described in Subsection (g), the court which issued the order or which otherwise has jurisdiction over the matter shall resolve the dispute with respect to a divorce or other domestic relations action in which an alternate payee's right to receive all or a portion of the benefits payable to a member

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or retiree under the optional retirement program is created or established.

(e) For the purposes of this section, benefits payable with respect to a member or retiree under the retirement system include the types of benefits payable by a public retirement system and a withdrawal of contributions from a public retirement system.

(f) A domestic relations order is a qualified domestic relations order only if such order:

(1) clearly specifies the:

(A) name and last known mailing address of:

(i) the member or retiree; and

(ii) each alternate payee covered by the order; and

(B) social security number, or an express authorization for the parties to use an alternate method acceptable to the public retirement system to verify the social security number, of the member or retiree and each alternate payee covered by the order;

(2) clearly specifies the amount or percentage of the member's or retiree's benefits to be paid by a public retirement system to each such alternate payee or the manner in which such amount or percentage is to be determined;

(3) clearly specifies the number of payments or the period to which such order applies;

(4) clearly specifies that such order applies to a designated public retirement system;

(5) does not require the public retirement system to provide any type or form of benefit or any option not otherwise provided under the plan;

(6) does not require the public retirement system to provide increased benefits determined on the basis of actuarial value;

(7) does not require the payment of benefits to an alternate payee which are required to be paid to another alternate payee under another order previously determined to be a qualified domestic relations order; and

(8) does not require the payment of benefits to an alternate payee before the retirement of a member, the distribution of a withdrawal of contributions to a member, or other distribution to a member required by law.

(g) A public retirement system may reject a domestic relations order as a qualified domestic relations order unless the order:

(1) provides for a proportional reduction of the amount awarded to an alternate payee in the event of the retirement of the member before normal retirement age;

(2) does not purport to require the designation of a particular person as the recipient of benefits in the event of a member's or annuitant's death;

(3) does not purport to require the selection of a particular benefit payment plan or option;

(4) provides clearly for each possible benefit distribution under plan provisions;

(5) does not require any action on the part of the retirement system contrary to its governing statutes or plan provision other than the direct payment of the benefit awarded to an alternate payee;

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(6) does not make the award of an interest contingent on any condition other than those conditions resulting in the liability of a retirement system for payments under its plan provisions;

(7) does not purport to award any future benefit increases that are provided or required by the legislature;

(8) provides for a proportional reduction of the amount awarded to an alternate payee in the event that benefits available to the retiree or member are reduced by law; and

(9) if required by the retirement system, conforms to a model order adopted by the retirement system.

(h) The administrative head of a public retirement system to which this chapter applies or his designee (or applicable carrier, if under the optional retirement program), upon receipt of a certified copy of a domestic relations order, shall determine whether such order is a qualified domestic relations order and shall notify the member or retiree and each alternate payee of such determination. If the order is determined to be a qualified domestic relations order, the public retirement system (or applicable carrier, if under the optional retirement program), shall pay benefits in accordance with the order. If the order is determined not to be a qualified domestic relations order, the member or retiree or any alternate payee named in the order may appeal the administrative head's determination in the manner specified in Subsection (b) or the optional retirement program carrier's determination in the manner specified in Subsection (d) and may petition the court which issued the order to amend the order so that it will be qualified. The court which issued the order or which would otherwise have jurisdiction over the matter has jurisdiction to amend the order so that it will be qualified even though all other matters incident to the action or proceeding have been fully and finally adjudicated.

(i) During any period in which the issue of whether a domestic relations order is a qualified domestic relations order is being determined by the agency administrative head, his designee, the board of trustees, a court of competent jurisdiction, optional retirement program carrier, or otherwise, the public retirement system shall separately account for the amounts, in this section referred to as the "segregated amounts," which would have been payable to the alternate payee during such period if the order had been determined to be a qualified domestic relations order.

(j) If a domestic relations order is determined to be a qualified domestic relations order, then the public retirement system (or applicable carrier, if under the optional retirement program) shall pay the segregated amounts without interest to the person or persons entitled thereto and shall thereafter pay benefits pursuant to the order.

(k) If a domestic relations order is determined not to be a qualified domestic relations order or if within 18 months of the date a domestic relations order is received by the public retirement system (or applicable carrier, if under the optional retirement program) the issue as to whether such order is a qualified domestic relations order is not resolved, then the public retirement system (or applicable carrier, if under the optional retirement program) shall pay the segregated amounts without interest and shall thereafter pay benefits to the person or persons who would have been entitled to such amounts if there had been no order. This subsection shall not be construed to limit or otherwise affect any liability, responsibility, or duty of a party with respect to any other party to the action out of which the order arose.

(l) Any determination that an order is a qualified domestic relations order which is made after the close of the 18-month period shall be applied prospectively only.

(m) The public retirement system, the board of trustees, and officers and employees of the public retirement system (or applicable carrier, if under the optional retirement program) shall not be liable to any person for making payments of any benefits in accordance with a domestic relations order in a cause



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in which a member or a retiree was a party or for making payments in accordance with Subsection (k).

(n) The board of trustees of a public retirement system may promulgate rules it deems necessary to implement the provisions of this section.

(o) Except as specifically provided in this subtitle or by any other statute, public employment does not confer special privileges or immunities on a public employee. An ownership or beneficial interest in any retirement, pension, or other financial plan not included in the definition of "public retirement system" as set forth in Section 804.001 held in whole or in part by an officer or employee of the state or a political subdivision or of an agency or an instrumentality of either, whether obtained in connection with that employment or otherwise, shall be subject to the requirements of the federal laws governing qualified domestic relations orders.

(p) A public retirement system may assess administrative fees on a party who is subject to a domestic relations order for the review of the order under this subchapter and, as applicable, for the administration of payments under an order that is determined to be qualified. In addition to other methods of collecting fees that a retirement system may establish, the retirement system may deduct fees from payments made under the order.

Added by Acts 1991, 72nd Leg., ch. 16, Sec. 11.02(a), eff. Aug. 26, 1991. Amended by Acts 1995, 74th Leg., ch. 76, Sec. 5.95(50), eff. Sept. 1, 1995.

Amended by Acts 2011, 82nd Leg., R.S., Ch. 455 (S.B. 1667), Sec. 5, eff. September 1, 2011.

### **Sec. 804.004. LIFE ANNUITY OR LUMP-SUM PAYMENT IN LIEU OF BENEFITS AWARDED BY A QUALIFIED DOMESTIC RELATIONS ORDER.**

(a) The board of trustees of a public retirement system to which this chapter applies may by rule provide that, in lieu of paying an alternate beneficiary the interest awarded by a qualified domestic relations order, the system may pay the alternate beneficiary an amount that is the actuarial equivalent of such interest in the form of:

- (1) an annuity payable in equal monthly installments for the life of the alternate payee; or
- (2) a lump sum.

(b) The determination of whether to pay an amount authorized by this section in lieu of the interest awarded by the qualified domestic relations order shall be at the sole discretion of the public retirement system.

(c) If a public retirement system elects to pay the alternate payee pursuant to this section, the benefit payable by the system to the member, retiree, or beneficiary shall be reduced by the interest in the benefit awarded to the alternate payee by the qualified domestic relations order.

(d) If the public retirement system pays the alternate payee pursuant to this section, the retirement system shall be entitled to rely on a beneficiary designation or benefit option selection made or changed pursuant to its plan without regard to any domestic relations order.

Added by Acts 1991, 72nd Leg., ch. 16, Sec. 11.02(a), eff. Aug. 26, 1991.

### **Sec. 804.005. PAYMENT IN CERTAIN CIRCUMSTANCES IN LIEU OF BENEFITS AWARDED BY QUALIFIED DOMESTIC RELATIONS ORDER.**

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(a) This section applies only to the Employees Retirement System of Texas and the Teacher Retirement System of Texas.

(b) A public retirement system to which this section applies shall pay an alternate payee of a member of the retirement system who is described by Subsection (c), if the alternate payee so elects and in lieu of the interest awarded by a qualified domestic relations order on or after January 1, 1985, an amount that is the alternate payee's portion of the actuarial equivalent of the accrued retirement benefit of the member of the retirement system, determined as if the member retired on the date of the alternate payee's election. The amount becomes payable at the time the actuarial equivalent is determined, and the amount is payable in the form of an annuity payable in equal monthly installments for the life of the alternate payee.

(c) A member whose benefits are subject to partial payment under this section is one who has not retired from the retirement system, has attained the greater of the age of 62 or normal retirement age and the service requirements for service retirement, and retains credit and contributions in the retirement system attributable to that service.

(d) If an alternate payee elects to be paid under this section, the retirement system shall reduce the benefit payable by the system to the member or the member's beneficiary by the alternate payee's portion of the actuarial equivalent determined under Subsection (b).

(e) In determining under Subsection (b) the actuarial equivalent of an accrued retirement benefit, the system shall consider the member's benefit as a normal age standard service retirement annuity, without regard to any optional annuity chosen or beneficiary designated by the member.

(f) The beginning of monthly payments under this section terminates any interest that the alternate payee who receives the payment might otherwise have in benefits that accrue to the account of the member after the date the initial payment to the alternate payee is made.

(g) A public retirement system may adopt rules for administration of this section.

Added by Acts 1993, 73rd Leg., ch. 867, Sec. 1, eff. Sept. 1, 1993.

### **Subchapter B. Spousal Consent Requirements**

Sec. 804.051. AUTHORITY TO REQUIRE SPOUSAL CONSENT.

A public retirement system may adopt rules to require spousal consent for the selection of a service retirement annuity other than a joint and survivor annuity that pays benefits to the member's spouse on the death of the member or for the selection of a death benefits plan that pays benefits in the form of an annuity to a person other than the member's spouse on the death of the member.

Added by Acts 1991, 72nd Leg., ch. 16, Sec. 11.02(a), eff. Aug. 26, 1991.

### **Subchapter C. Termination of Interest in Public Retirement System**

Sec. 804.101. TERMINATION OF INTEREST IN PUBLIC RETIREMENT SYSTEM.

The death of an alternate payee as defined in Section 804.001 or the death of a spouse of a member or retiree of a public retirement system to which this chapter applies shall terminate the interest of the alternate payee or spouse in that public retirement system. This section shall not affect an interest in a public retirement system accrued to an individual as a member of the public retirement system.

Added by Acts 1991, 72nd Leg., ch. 16, Sec. 11.02(a), eff. Aug. 26, 1991.

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## 6.8 Pertinent provisions of the Texas Local Government Code

Key provisions of the Texas Government Code pertinent to TLFRA plans are below, but should not be considered exhaustive. The PRB maintains a pamphlet of Government Code provisions generally applicable to retirement systems at <https://www.prb.texas.gov/about/statutesrules/>.

### **Title 5. Matters Affecting Public Officers and Employees**

#### **Subtitle C. Matters Affecting Public Officers and Employees of More than One type of Local Government**

#### **Chapter 171. Regulation of Conflicts of Interest of Officers of Municipalities, Counties, and Certain Other Local Governments**

##### Sec. 171.001. DEFINITIONS.

In this chapter:

(1) "Local public official" means a member of the governing body or another officer, whether elected, appointed, paid, or unpaid, of any district (including a school district), county, municipality, precinct, central appraisal district, transit authority or district, or other local governmental entity who exercises responsibilities beyond those that are advisory in nature.

(2) "Business entity" means a sole proprietorship, partnership, firm, corporation, holding company, joint-stock company, receivership, trust, or any other entity recognized by law.

Acts 1987, 70th Leg., ch. 149, Sec. 1, eff. Sept. 1, 1987.

##### Sec. 171.002. SUBSTANTIAL INTEREST IN BUSINESS ENTITY.

(a) For purposes of this chapter, a person has a substantial interest in a business entity if:

(1) the person owns 10 percent or more of the voting stock or shares of the business entity or owns either 10 percent or more or \$15,000 or more of the fair market value of the business entity;  
or

(2) funds received by the person from the business entity exceed 10 percent of the person's gross income for the previous year.

(b) A person has a substantial interest in real property if the interest is an equitable or legal ownership with a fair market value of \$2,500 or more.

(c) A local public official is considered to have a substantial interest under this section if a person related to the official in the first degree by consanguinity or affinity, as determined under Chapter 573, Government Code, has a substantial interest under this section.

Acts 1987, 70th Leg., ch. 149, Sec. 1, eff. Sept. 1, 1987. Amended by Acts 1989, 71st Leg., ch. 1, Sec. 40(a), eff. Aug. 28, 1989; Acts 1991, 72nd Leg., ch. 561, Sec. 37, eff. Aug. 26, 1991; Acts 1995, 74th Leg., ch. 76, Sec. 5.95(27), eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 849, Sec. 1, eff. Sept. 1, 1997.

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### **Sec. 171.003. PROHIBITED ACTS; PENALTY.**

(a) A local public official commits an offense if the official knowingly:

- (1) violates Section 171.004;
- (2) acts as surety for a business entity that has work, business, or a contract with the governmental entity; or
- (3) acts as surety on any official bond required of an officer of the governmental entity.

(b) An offense under this section is a Class A misdemeanor.

Acts 1987, 70th Leg., ch. 149, Sec. 1, eff. Sept. 1, 1987. Amended by Acts 1989, 71st Leg., ch. 1, Sec. 40(a), eff. Aug. 28, 1989.

### **Sec. 171.004. AFFIDAVIT AND ABSTENTION FROM VOTING REQUIRED.**

(a) If a local public official has a substantial interest in a business entity or in real property, the official shall file, before a vote or decision on any matter involving the business entity or the real property, an affidavit stating the nature and extent of the interest and shall abstain from further participation in the matter if:

- (1) in the case of a substantial interest in a business entity the action on the matter will have a special economic effect on the business entity that is distinguishable from the effect on the public; or
- (2) in the case of a substantial interest in real property, it is reasonably foreseeable that an action on the matter will have a special economic effect on the value of the property, distinguishable from its effect on the public.

(b) The affidavit must be filed with the official record keeper of the governmental entity.

(c) If a local public official is required to file and does file an affidavit under Subsection (a), the official is not required to abstain from further participation in the matter requiring the affidavit if a majority of the members of the governmental entity of which the official is a member is composed of persons who are likewise required to file and who do file affidavits of similar interests on the same official action.

Acts 1987, 70th Leg., ch. 149, Sec. 1, eff. Sept. 1, 1987. Amended by Acts 1989, 71st Leg., ch. 1, Sec. 40(a), eff. Aug. 28, 1989.

### **Sec. 171.005. VOTING ON BUDGET.**

(a) The governing body of a governmental entity shall take a separate vote on any budget item specifically dedicated to a contract with a business entity in which a member of the governing body has a substantial interest.

(b) Except as provided by Section 171.004(c), the affected member may not participate in that separate vote. The member may vote on a final budget if:

- (1) the member has complied with this chapter; and
- (2) the matter in which the member is concerned has been resolved.

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Acts 1987, 70th Leg., ch. 149, Sec. 1, eff. Sept. 1, 1987. Renumbered from Sec. 171.006 and amended by Acts 1989, 71st Leg., ch. 1, Sec. 40(a), eff. Aug. 28, 1989.

### **Sec. 171.006. EFFECT OF VIOLATION OF CHAPTER.**

The finding by a court of a violation under this chapter does not render an action of the governing body voidable unless the measure that was the subject of an action involving a conflict of interest would not have passed the governing body without the vote of the person who violated the chapter.

Acts 1987, 70th Leg., ch. 149, Sec. 1, eff. Sept. 1, 1987. Renumbered from Sec. 171.008 by Acts 1989, 71st Leg., ch. 1, Sec. 40(a), eff. Aug. 28, 1989.

### **Sec. 171.007. COMMON LAW PREEMPTED; CUMULATIVE OF MUNICIPAL PROVISIONS.**

(a) This chapter preempts the common law of conflict of interests as applied to local public officials.

(b) This chapter is cumulative of municipal charter provisions and municipal ordinances defining and prohibiting conflicts of interests.

Amended by Acts 1989, 71st Leg., ch. 1, Sec. 40(a), eff. Aug. 28, 1989.

### **Sec. 171.009. SERVICE ON BOARD OF CORPORATION FOR NO COMPENSATION.**

It shall be lawful for a local public official to serve as a member of the board of directors of private, nonprofit corporations when such officials receive no compensation or other remuneration from the nonprofit corporation or other nonprofit entity.

Added by Acts 1989, 71st Leg., ch. 475, Sec. 2, eff. Aug. 28, 1989.

### **Sec. 171.010. PRACTICE OF LAW.**

(a) For purposes of this chapter, a county judge or county commissioner engaged in the private practice of law has a substantial interest in a business entity if the official has entered a court appearance or signed court pleadings in a matter relating to that business entity.

(b) A county judge or county commissioner that has a substantial interest in a business entity as described by Subsection (a) must comply with this chapter.

(c) A judge of a constitutional county court may not enter a court appearance or sign court pleadings as an attorney in any matter before:

(1) the court over which the judge presides; or

(2) any court in this state over which the judge's court exercises appellate jurisdiction.

(d) Upon compliance with this chapter, a county judge or commissioner may practice law in the courts located in the county where the county judge or commissioner serves.

Added by Acts 2003, 78th Leg., ch. 227, Sec. 21, eff. Sept. 1, 2003; Acts 2003, 78th Leg., ch. 1206, Sec. 3, eff. June 20, 2003.

## **Chapter 176. Disclosure of Certain Relationships with Local Government Officers; Providing Public Access to Certain Information**

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### **Sec. 176.001. DEFINITIONS.**

In this chapter:

(1) "Agent" means a third party who undertakes to transact some business or manage some affair for another person by the authority or on account of the other person. The term includes an employee.

(1-a) "Business relationship" means a connection between two or more parties based on commercial activity of one of the parties. The term does not include a connection based on:

(A) a transaction that is subject to rate or fee regulation by a federal, state, or local governmental entity or an agency of a federal, state, or local governmental entity;

(B) a transaction conducted at a price and subject to terms available to the public; or

(C) a purchase or lease of goods or services from a person that is chartered by a state or federal agency and that is subject to regular examination by, and reporting to, that agency.

(1-b) "Charter school" means an open-enrollment charter school operating under Subchapter D, Chapter 12, Education Code.

(1-c) "Commission" means the Texas Ethics Commission.

(1-d) "Contract" means a written agreement for the sale or purchase of real property, goods, or services.

(2) "Family member" means a person related to another person within the first degree by consanguinity or affinity, as described by Subchapter B, Chapter 573, Government Code.

(2-a) "Family relationship" means a relationship between a person and another person within the third degree by consanguinity or the second degree by affinity, as those terms are defined by Subchapter B, Chapter 573, Government Code.

(2-b) "Gift" means a benefit offered by a person, including food, lodging, transportation, and entertainment accepted as a guest. The term does not include a benefit offered on account of kinship or a personal, professional, or business relationship independent of the official status of the recipient.

(2-c) "Goods" means personal property.

(2-d) "Investment income" means dividends, capital gains, or interest income generated from:

(A) a personal or business:

(i) checking or savings account;

(ii) share draft or share account; or

(iii) other similar account;

(B) a personal or business investment; or

(C) a personal or business loan.

(3) "Local governmental entity" means a county, municipality, school district, charter school, junior college district, water district created under Subchapter B, Chapter 49, Water Code, or other political subdivision of this state or a local government corporation, board, commission, district, or authority to which a member is appointed by the commissioners court of a county, the mayor of a municipality, or the governing body of a municipality. The term does not include an association, corporation, or organization of governmental entities organized to provide to its members education, assistance, products, or services or to represent its members before the legislative, administrative, or judicial branches of the state or

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federal government.

(4) "Local government officer" means:

- (A) a member of the governing body of a local governmental entity;
- (B) a director, superintendent, administrator, president, or other person designated as the executive officer of a local governmental entity; or
- (C) an agent of a local governmental entity who exercises discretion in the planning, recommending, selecting, or contracting of a vendor.

(5) "Records administrator" means the director, county clerk, municipal secretary, superintendent, or other person responsible for maintaining the records of the local governmental entity or another person designated by the local governmental entity to maintain statements and questionnaires filed under this chapter and perform related functions.

(6) "Services" means skilled or unskilled labor or professional services, as defined by Section 2254.002, Government Code.

(7) "Vendor" means a person who enters or seeks to enter into a contract with a local governmental entity. The term includes an agent of a vendor. The term includes an officer or employee of a state agency when that individual is acting in a private capacity to enter into a contract. The term does not include a state agency except for Texas Correctional Industries.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

Amended by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 1, eff. May 25, 2007; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 1, eff. September 1, 2015.

### **Sec. 176.002. APPLICABILITY TO VENDORS AND OTHER PERSONS.**

(a) This chapter applies to a person who is:

- (1) a vendor; or
- (2) a local government officer of a local governmental entity.

(b) A person is not subject to the disclosure requirements of this chapter if the person is:

- (1) a state, a political subdivision of a state, the federal government, or a foreign government; or
- (2) an employee or agent of an entity described by Subdivision (1), acting in the employee's or agent's official capacity.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

Amended by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 2, eff. May 25, 2007; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 2, eff. September 1, 2015; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 3, eff. September 1, 2015.

### **Sec. 176.003. CONFLICTS DISCLOSURE STATEMENT REQUIRED.**

(a) A local government officer shall file a conflicts disclosure statement with respect to a vendor if:

- (1) the vendor enters into a contract with the local governmental entity or the local governmental entity is considering entering into a contract with the vendor; and



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(2) the vendor:

(A) has an employment or other business relationship with the local government officer or a family member of the officer that results in the officer or family member receiving taxable income, other than investment income, that exceeds \$2,500 during the 12-month period preceding the date that the officer becomes aware that:

(i) a contract between the local governmental entity and vendor has been executed; or

(ii) the local governmental entity is considering entering into a contract with the vendor;

(B) has given to the local government officer or a family member of the officer one or more gifts that have an aggregate value of more than \$100 in the 12-month period preceding the date the officer becomes aware that:

(i) a contract between the local governmental entity and vendor has been executed; or

(ii) the local governmental entity is considering entering into a contract with the vendor; or

(C) has a family relationship with the local government officer.

(a-1) A local government officer is not required to file a conflicts disclosure statement in relation to a gift accepted by the officer or a family member of the officer if the gift is:

(1) a political contribution as defined by Title 15, Election Code; or

(2) food accepted as a guest.

(a-2) A local government officer is not required to file a conflicts disclosure statement under Subsection (a) if the local governmental entity or vendor described by that subsection is an administrative agency created under Section 791.013, Government Code.

(b) A local government officer shall file the conflicts disclosure statement with the records administrator of the local governmental entity not later than 5 p.m. on the seventh business day after the date on which the officer becomes aware of the facts that require the filing of the statement under Subsection (a).

(c) Repealed by Acts 2015, 84th Leg., R.S., Ch. 989, Sec. 9(1), eff. September 1, 2015.

(d) Repealed by Acts 2015, 84th Leg., R.S., Ch. 989, Sec. 9(1), eff. September 1, 2015.

(e) The commission shall adopt the conflicts disclosure statement for local government officers for use under this section. The conflicts disclosure statement must include:

(1) a requirement that each local government officer disclose:

(A) an employment or other business relationship described by Subsection (a)(2)(A), including the nature and extent of the relationship; and

(B) gifts accepted by the local government officer and any family member of the officer from a vendor during the 12-month period described by Subsection (a)(2)(B) if the aggregate value of the gifts accepted by the officer or a family member from that vendor exceeds \$100;

(2) an acknowledgment from the local government officer that:

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- (A) the disclosure applies to each family member of the officer; and
- (B) the statement covers the 12-month period described by Subsection (a)(2)(B); and
- (3) the signature of the local government officer acknowledging that the statement is made under oath under penalty of perjury.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

Amended by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 3, eff. May 25, 2007; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 4, eff. September 1, 2015; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 5, eff. September 1, 2015; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 9(1), eff. September 1, 2015.

### **Sec. 176.006. DISCLOSURE REQUIREMENTS FOR VENDORS AND OTHER PERSONS; QUESTIONNAIRE.**

(a) A vendor shall file a completed conflict of interest questionnaire if the vendor has a business relationship with a local governmental entity and:

- (1) has an employment or other business relationship with a local government officer of that local governmental entity, or a family member of the officer, described by Section 176.003(a)(2)(A);
- (2) has given a local government officer of that local governmental entity, or a family member of the officer, one or more gifts with the aggregate value specified by Section 176.003(a)(2)(B), excluding any gift described by Section 176.003(a-1); or
- (3) has a family relationship with a local government officer of that local governmental entity.

(a-1) The completed conflict of interest questionnaire must be filed with the appropriate records administrator not later than the seventh business day after the later of:

- (1) the date that the vendor:
  - (A) begins discussions or negotiations to enter into a contract with the local governmental entity; or
  - (B) submits to the local governmental entity an application, response to a request for proposals or bids, correspondence, or another writing related to a potential contract with the local governmental entity; or
- (2) the date the vendor becomes aware:
  - (A) of an employment or other business relationship with a local government officer, or a family member of the officer, described by Subsection (a);
  - (B) that the vendor has given one or more gifts described by Subsection (a); or
  - (C) of a family relationship with a local government officer.

(b) The commission shall adopt a conflict of interest questionnaire for use under this section that requires disclosure of a vendor's business and family relationships with a local governmental entity.

(c) The questionnaire adopted under Subsection (b) must require, for the local governmental entity with respect to which the questionnaire is filed, that the vendor filing the questionnaire:

- (1) describe each employment or business and family relationship the vendor has with each local government officer of the local governmental entity;
- (2) identify each employment or business relationship described by Subdivision (1) with respect

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to which the local government officer receives, or is likely to receive, taxable income, other than investment income, from the vendor;

(3) identify each employment or business relationship described by Subdivision (1) with respect to which the vendor receives, or is likely to receive, taxable income, other than investment income, that:

(A) is received from, or at the direction of, a local government officer of the local governmental entity; and

(B) is not received from the local governmental entity; and

(4) describe each employment or business relationship with a corporation or other business entity with respect to which a local government officer of the local governmental entity:

(A) serves as an officer or director; or

(B) holds an ownership interest of one percent or more.

(d) A vendor shall file an updated completed questionnaire with the appropriate records administrator not later than the seventh business day after the date on which the vendor becomes aware of an event that would make a statement in the questionnaire incomplete or inaccurate.

(e) A person who is both a local government officer and a vendor of a local governmental entity is required to file the questionnaire required by Subsection (a)(1) only if the person:

(1) enters or seeks to enter into a contract with the local governmental entity; or

(2) is an agent of a person who enters or seeks to enter into a contract with the local governmental entity.

(f) Repealed by Acts 2015, 84th Leg., R.S., Ch. 989, Sec. 9(3), eff. September 1, 2015.

(g) Repealed by Acts 2015, 84th Leg., R.S., Ch. 989, Sec. 9(3), eff. September 1, 2015.

(h) Repealed by Acts 2015, 84th Leg., R.S., Ch. 989, Sec. 9(3), eff. September 1, 2015.

(i) The validity of a contract between a vendor and a local governmental entity is not affected solely because the vendor fails to comply with this section.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

Amended by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 6, eff. May 25, 2007; Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 9, eff. May 25, 2007; Acts 2009, 81st Leg., R.S., Ch. 87 (S.B. 1969), Sec. 15.005, eff. September 1, 2009; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 6, eff. September 1, 2015; Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 9(3), eff. September 1, 2015.

### **Sec. 176.0065. MAINTENANCE OF RECORDS.**

A records administrator shall:

(1) maintain a list of local government officers of the local governmental entity and shall make that list available to the public and any vendor who may be required to file a conflict of interest questionnaire under Section 176.006; and

(2) maintain the statements and questionnaires that are required to be filed under this chapter in accordance with the local governmental entity's records retention schedule.

Added by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 8, eff. May 25, 2007.

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Redesignated and amended from Local Government Code, Section 176.011 by Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 7, eff. September 1, 2015.

### **Sec. 176.008. ELECTRONIC FILING.**

The requirements of this chapter, including signature requirements, may be satisfied by electronic filing in a form approved by the commission.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

### **Sec. 176.009. POSTING ON INTERNET.**

(a) A local governmental entity that maintains an Internet website shall provide access to the statements and to questionnaires required to be filed under this chapter on that website. This subsection does not require a local governmental entity to maintain an Internet website.

(b) Repealed by Acts 2013, 83rd Leg., R.S., Ch. 847, Sec. 3(b), eff. January 1, 2014.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

Amended by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 7, eff. May 25, 2007; Acts 2011, 82nd Leg., R.S., Ch. 1163 (H.B. 2702), Sec. 76, eff. September 1, 2011; Acts 2013, 83rd Leg., R.S., Ch. 847 (H.B. 195), Sec. 3(b), eff. January 1, 2014.

### **Sec. 176.010. REQUIREMENTS CUMULATIVE.**

The requirements of this chapter are in addition to any other disclosure required by law.

Added by Acts 2005, 79th Leg., Ch. 1014 (H.B. 914), Sec. 1, eff. June 18, 2005.

### **Sec. 176.012. APPLICATION OF PUBLIC INFORMATION LAW.**

This chapter does not require a local governmental entity to disclose any information that is excepted from disclosure by Chapter 552, Government Code.

Added by Acts 2007, 80th Leg., R.S., Ch. 226 (H.B. 1491), Sec. 8, eff. May 25, 2007.

### **Sec. 176.013. ENFORCEMENT.**

(a) A local government officer commits an offense under this chapter if the officer:

- (1) is required to file a conflicts disclosure statement under Section 176.003; and
- (2) knowingly fails to file the required conflicts disclosure statement with the appropriate records administrator not later than 5 p.m. on the seventh business day after the date on which the officer becomes aware of the facts that require the filing of the statement.

(b) A vendor commits an offense under this chapter if the vendor:

- (1) is required to file a conflict of interest questionnaire under Section 176.006; and
- (2) either:

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(A) knowingly fails to file the required questionnaire with the appropriate records administrator not later than 5 p.m. on the seventh business day after the date on which the vendor becomes aware of the facts that require the filing of the questionnaire; or

(B) knowingly fails to file an updated questionnaire with the appropriate records administrator not later than 5 p.m. on the seventh business day after the date on which the vendor becomes aware of an event that would make a statement in a questionnaire previously filed by the vendor incomplete or inaccurate.

(c) An offense under this chapter is:

(1) a Class C misdemeanor if the contract amount is less than \$1 million or if there is no contract amount for the contract;

(2) a Class B misdemeanor if the contract amount is at least \$1 million but less than \$5 million; or

(3) a Class A misdemeanor if the contract amount is at least \$5 million.

(d) A local governmental entity may reprimand, suspend, or terminate the employment of an employee who knowingly fails to comply with a requirement adopted under this chapter.

(e) The governing body of a local governmental entity may, at its discretion, declare a contract void if the governing body determines that a vendor failed to file a conflict of interest questionnaire required by Section 176.006.

(f) It is an exception to the application of Subsection (a) that the local government officer filed the required conflicts disclosure statement not later than the seventh business day after the date the officer received notice from the local governmental entity of the alleged violation.

(g) It is an exception to the application of Subsection (b) that the vendor filed the required questionnaire not later than the seventh business day after the date the vendor received notice from the local governmental entity of the alleged violation.

Added by Acts 2015, 84th Leg., R.S., Ch. 989 (H.B. 23), Sec. 8, eff. September 1, 2015.

## 6.9 Pertinent Rules – MET and Investment Expense Reporting

### Texas Administrative Code

#### TITLE 40 SOCIAL SERVICES AND ASSISTANCE

#### PART 17 STATE PENSION REVIEW BOARD

#### CHAPTER 607 PUBLIC RETIREMENT SYSTEM MINIMUM EDUCATIONAL TRAINING PROGRAM

#### SUBCHAPTER A GENERAL PROVISIONS

##### **RULE §607.101 Authority**

This chapter is promulgated under the authority of Texas Government Code, §801.201, relating to rulemaking, and §801.211, relating to a public retirement system educational training program.

##### **RULE §607.103 Purpose**

(a) The Public Retirement System Educational Training Program, as mandated by §801.211 of the Texas Government Code, is intended to ensure that every trustee and system administrator of a public retirement system in Texas pursues the necessary education relating to public pension matters throughout his or her tenure to successfully discharge their duties.

(b) This chapter will establish Minimum Educational Training requirements for Trustees and Administrators to help ensure that these trustees and administrators participate in training activities that maintain and improve their core competencies, and keep them abreast of recent developments in public pension matters and issues impacting their respective duties.

(c) This chapter is not intended to dictate that trustees and system administrators pursue only the Minimum Educational Training, but to set a minimum standard for training/education. Trustees and system administrators are encouraged to pursue additional educational opportunities in public pension-related areas.

##### **RULE §607.104 Definitions**

The following words and terms, for the purposes of this chapter, shall have the following meanings, unless the rule indicates otherwise.

(1) "Board" means the State Pension Review Board.

(2) "Credit hour" means the actual amount of instruction time for an MET activity expressed in terms of hours. The number of MET credit hours shall be based on sixty (60) minutes of instruction per hour.

(3) "First year of service" means the twelve-month period beginning from the date of assuming one's position on the governing body or hiring date.

(4) "Governing body of a PRS" means, as provided in Texas Government Code §802.001(2).

(5) "Minimum Educational Training" shall have the same meaning as assigned by §607.110 of this chapter.

(6) "MET" means Minimum Educational Training.

(7) "MET activity" means any organized in-person or online pension-related educational activity, which may include, but is not limited to, organized seminars, courses, conferences, lectures, panel discussions,

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audio, teleconference, video, and digital media presentations, question-and-answer periods, and in-house education.

(8) "Net actual instruction time" means time spent on instruction, not including any breaks, or other non-educational activities including promotion of particular products or services as prescribed by §607.120(a)(3) of this chapter (relating to Program Standards for All Sponsors).

(9) "Public retirement system" shall have the same meaning as assigned by §801.001(2) and §802.001(3) of the Texas Government Code, but shall not include defined contribution plans as defined by Texas Government Code, §802.001(1-a) and retirement systems consisting exclusively of volunteers organized under the Texas Local Fire Fighters' Retirement Act as defined by Texas Government Code, §802.002(d).

(10) "PRS" means public retirement system.

(11) "Sponsor" means an individual or organization offering training programs to trustees and system administrators. The sponsor may or may not have developed the program materials. However, the sponsor is responsible for ensuring the program materials present the necessary learning objectives and for maintaining the documentation required by this chapter.

(12) "Statutorily authorized designee" means an individual other than the trustee, designated by the trustee as authorized under the governing statute of the PRS or any other statute.

(13) "System administrator" means as defined by Texas Government Code §801.001(3) and §802.001(4).

(14) "Trustee" means as provided in Texas Government Code §801.001(4).

### **RULE §607.105 Applicability**

This chapter is promulgated to establish the MET requirements for the following.

(1) Trustees, as defined in Texas Government Code, §801.001(4), in their capacity as members of the governing body of a PRS, as that term is defined in Texas Government Code §802.001(2). However, this chapter does not apply to:

(A) members of a PRS's sponsoring entity board that is only responsible for the creation, termination and amendment of the PRS; and

(B) members of a committee appointed by a PRS's sponsoring entity board to act in an advisory or oversight capacity only by providing guidance or recommendations.

(2) Statutorily authorized designees serving as members of the governing body of a PRS.

(3) System administrators, as defined by Texas Government Code, §801.001(3) and §802.001(4).

### **RULE §607.107 Exemption for Certain System Administrators**

(a) The Board may grant an exemption to a PRS for certain types of system administrators from the MET requirements on a case-by-case basis if:

(1) the PRS designates an outside entity (a bank or a financial institution) as the system administrator, and the PRS board of trustees or its designee completes and forwards to the Board a request for exemption on a form provided by the Board indicating the same; or

(2) the PRS does not have a system administrator that meets the statutory definition as contained in the Texas Government Code, §801.001(3) and §802.001(4) and the governing body of the PRS or its designee completes and forwards to the Board a request for exemption, on a form provided by the Board, certifying that the PRS does not have a system administrator. The request shall include a statement affirming that

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one or more trustees of the PRS are responsible for the duties of the system administrator and are already subject to the MET requirements.

(b) If the Board granted an exemption to a PRS under subsection (a) of this section and the exemption is no longer applicable, the PRS shall report the same to the Board, and the exemption shall be revoked.

### **SUBCHAPTER B MINIMUM EDUCATIONAL TRAINING REQUIREMENTS FOR TRUSTEES AND SYSTEM ADMINISTRATORS**

#### **RULE §607.110 Minimum Educational Training Requirements**

(a) First year of service. A new trustee and a new system administrator shall complete at least seven (7) credit hours of training in the core content areas within the first year of service. The seven credit hours shall include training in all of the core content areas. A trustee or system administrator must earn no less than half a credit hour in each content area. No more than two credit hours earned in any one core content area shall be applied toward meeting the 7-hour minimum requirement contained in this subsection.

The core content areas are:

- (1) fiduciary matters;
- (2) governance;
- (3) ethics;
- (4) investments;
- (5) actuarial matters;
- (6) benefits administration; and
- (7) risk management.

(b) Subsequent years of service. A trustee and a system administrator shall complete at least four (4) credit hours of continuing education in either the core content areas in subsection (a) or non-core content areas, or any combination thereof, within each two-year period after the first year of service as a new trustee or new system administrator.

(1) The non-core content areas include:

- (A) compliance;
- (B) legal and regulatory matters;
- (C) pension accounting;
- (D) custodial issues;
- (E) plan administration;
- (F) Texas Open Meetings Act; and
- (G) Texas Public Information Act.

(2) The Board may allow continuing education credit for courses not specifically covered under the non-core content areas on a case-by-case basis.

(c) MET completed up to six months before the trustee's date of assuming position on the governing body or system administrator's hiring date may be counted for the first-year-of-service requirement in



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subsection (a).

(d) If a trustee's term will expire before the end of the trustee's two-year continuing education cycle, such trustee will be exempt from the continuing education requirement in subsection (b) of this section for that two-year period; provided, however, that the trustee shall be subject to the continuing education requirements of subsection (b) of this section and as prescribed by §607.113(b) of this chapter upon the trustee's re-election or reappointment.

(e) A trustee serving concurrently on multiple PRS boards and a system administrator employed concurrently by multiple PRSs shall only be required to complete the MET requirements in this section for service with one PRS.

(f) Credit hours for attending MET activities shall be based on net actual instruction time. Credit hours for viewing or listening to audio, video, or digital media shall be based on the running time of the recordings, and credit hours for attending in-person educational programs shall be based on actual instruction time.

(g) The Board hereby adopts by reference the Curriculum Guide for Minimum Educational Training to provide further direction on core and non-core content areas as contained in subsections (a) and (b)(1) of this section. Trustees and system administrators are encouraged to review the Curriculum Guide for content area guidance.

(h) The Board shall make the Curriculum Guide for Minimum Educational Training available to the PRSs. A PRS can obtain the most current version of the Curriculum Guide for Minimum Educational Training from the offices of the State Pension Review Board and from its web site at <http://www.prb.state.tx.us>.

### **RULE §607.113 Minimum Educational Training Requirements for Reappointed and Re-elected Trustees and Rehired System Administrators**

(a) The following provisions shall apply to:

(1) A trustee who is reappointed or re-elected to a subsequent term of service for the same PRS or who leaves one PRS and is appointed as a trustee to another PRS;

(2) A trustee who serves on multiple PRS boards;

(3) A trustee who is subsequently hired by a PRS to serve as system administrator;

(4) A system administrator who is rehired to a subsequent term of employment by the same PRS or who leaves one PRS and is hired as system administrator by another PRS;

(5) A system administrator who is employed by multiple PRSs; and

(6) A system administrator who is subsequently appointed or elected to a PRS board.

(b) Unless more than two years have passed since the last date of the most recent term of service or employment, a person under subsection (a) of this section shall not be required to repeat the core training requirement already completed under §607.110(a) of this chapter (relating to Minimum Educational Training Requirements) but shall complete the continuing education requirement in §607.110(b) of this chapter within each two-year period served. The two-year period shall begin on the first day of assuming or resuming one's position on a governing body or the first day of employment.

(c) If more than two years have passed since the last date of most recent term of service or employment, a person under subsection (a) of this section shall be subject to both the core training requirement within the first year of service as contained in §607.110(a) of this chapter and the continuing education requirement within each two-year period after the first year of service as contained in §607.110(b) of this chapter.

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### **SUBCHAPTER C MINIMUM EDUCATIONAL TRAINING PROGRAM SPONSORS**

#### **RULE §607.120 Program Standards for All Sponsors**

(a) MET activities offered by sponsors must comply with the following standards.

(1) An MET activity shall constitute an organized program of learning dealing with matters related to public pensions, including the MET's core or non-core content areas in §607. 110 of this chapter (relating to Minimum Educational Training Requirements). Sponsors are encouraged to review the Curriculum Guide as referenced in §607. 110 of this chapter for content area guidance.

(2) An MET activity shall be conducted in a suitable facility by an individual or group qualified by professional or academic experience.

(3) An MET activity shall be educational in nature and shall not include the promotion of particular products or services.

(4) An MET activity shall be conducted in person, online via the internet, or by teleconference.

(5) An MET activity shall meet all of the other requirements contained in this chapter.

(b) An MET activity sponsor shall determine, and inform participants, in advance of the course, of the course's learning or content objectives, any necessary prerequisites, the credit hours the course provides for each core and non-core content area, and the total credit hours the course provides.

(c) An MET activity sponsor is responsible for ensuring the participants register their attendance during the MET activity. Sponsors are responsible for assigning the appropriate number of credit hours for participants, including reduced hours for those participants who arrive late or leave early.

(d) An MET activity sponsor conducting online or other electronically-delivered courses including via pre-recorded audio or video shall, at a minimum, provide a completion code to the participant upon successful completion of the course. The participant shall provide the completion code to the sponsor to demonstrate attendance and completion. Without receiving such code, the sponsor shall not issue a certificate of completion to the participant.

(e) Staff meetings and other settings cannot be claimed for fulfilling the MET requirements if they do not meet the provisions of this chapter.

#### **RULE §607.122 MET Credit Hour Computation for Sponsors**

(a) Credit hours for attending MET activities shall be based on net actual instruction time. Sponsors shall calculate the number of credit hours that should be given for an MET activity offered based on the net actual instruction time to be spent, and shall indicate the number on the MET activity materials. Fractional credit hours should be stated as decimals.

(b) Credit hours for viewing or listening to audio, video, or digital media shall be based on the running time of the recordings.

(c) Credit hours for attending in-person educational programs shall be based on actual instruction time.

#### **RULE §607.124 Sponsor Accreditation**

(a) The Board may allow any sponsor of MET to become Board accredited if the sponsor, in the opinion of the Board, demonstrates that it will comply with its obligations to the Board and that its programs will conform to the Board's standards as outlined in:

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- (1) §607.120 of this chapter (relating to Program Standards for All Sponsors); and
- (2) §607.122 of this chapter (relating to MET Credit Hour Computation for Sponsors).

(b) The Board will also require that each organization or individual applying to become a Board-accredited MET sponsor agree that in the conduct of its business it will:

- (1) Not commit fraud, deceit or engage in fiscal dishonesty of any kind;
- (2) Not misrepresent facts or make false or misleading statements;
- (3) Not make false statements to the Board or to the Board's agents; and
- (4) Comply with the laws of the United States and the State of Texas.

(c) Each organization or individual applying to become a Board accredited MET sponsor must submit an application on a form provided by the Board. The Board will consider for approval only applications that are complete. As part of the application process, the Board may require the sponsor to submit information regarding its organization, purpose, history of providing educational training activities, course outlines, or such additional information that the Board may deem relevant.

(d) The Board shall review each application and notify the sponsor of its acceptance or rejection. Approval of accredited sponsor status will be based upon information received with the application, and such other information the Board shall deem relevant including, but not limited to, course offering and attendance history, approvals and denials of accreditation by other governmental entities, and complaints concerning past programs or the marketing thereof. An acceptance in any given year shall not bind the Board to accept a sponsor in any future year.

(e) Upon accreditation a sponsor will be assigned a sponsor number and can represent that it is a Board accredited MET sponsor. An accredited sponsor shall include in promotional materials the following language: "We are accredited by the State Pension Review Board as a Minimum Educational Training (MET) sponsor for Texas public retirement systems. This accreditation does not constitute an endorsement by the Board as to the quality of our MET program."

(f) An accredited sponsor is not required to comply with provisions contained in §607.128 of this chapter (relating to Accreditation of MET Activities from Non-Accredited Sponsors).

(g) The Board may accredit a sponsor to offer MET activities in the core content areas under §607.110(a) of this chapter (relating to Minimum Educational Training Requirements), the non-core content areas under §607.110(b)(1) of this chapter, or both.

(h) An accredited sponsor shall be reviewed for renewal of accredited sponsor status after an initial two-year period of accreditation, and again after each subsequent four-year period of accreditation, or at such other times as the Board deems reasonable. To be considered for renewal, an accredited sponsor must submit a renewal application on a form provided by the Board. Review for renewal shall be based on the criteria stated in subsection (d) of this section.

(i) Complaints concerning accredited sponsors and MET activities may be directed to the Board. If the Board determines that a response is necessary from the sponsor, the sponsor shall be notified in writing and provided a copy of the complaint. The Board shall respond to all complaints within a reasonable time.

(j) The Board, in its sole and exclusive discretion, may determine that an accredited sponsor is not in compliance with the registration requirements, MET standards, or applicable Board rules. The Board will provide the accredited sponsor reasonable notice of such a determination and shall provide the accredited sponsor a reasonable opportunity to become compliant. If the Board determines the sponsor is not in compliance, the Board may require the sponsor to take corrective action and/or may terminate

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the sponsor's accreditation. A sponsor that has had its accreditation terminated or that has voluntarily surrendered its accreditation may apply for reinstatement no sooner than six months after the effective date of the termination or surrender.

(k) A sponsor that requests reinstatement may do so by submitting a completed application as required in subsection (c) of this section. The applicant will be subject to all the requirements of this section.

(l) Board decisions under this chapter are final and are not appealable. No portion of this chapter shall be interpreted or construed to create a right to a hearing, or to acknowledge or create any private right or interest.

### **RULE §607.126 Obligations of Accredited Sponsors**

(a) In order to support the reports required of PRSs, a sponsor accredited under §607.124 of this chapter (relating to Sponsor Accreditation) shall retain the following records for five years following the date the program is completed:

- (1) an agenda or outline that describes the course content;
- (2) the name and title of each instructor for each topic;
- (3) time devoted to each topic;
- (4) each date and location of the presentation; and
- (5) record of participation that reflects:
  - (A) the credit hours earned by each trustee and system administrator participant; and
  - (B) the number of non-trustee and non-administrator attendees.

(b) The accredited sponsor, upon request of the Board, shall immediately submit any of the records retained in subsection (a) of this section for review.

(c) An accredited sponsor shall at any reasonable time allow a member of the Board or Board staff, as part of a review of the sponsor, to inspect the sponsor's teaching facilities, examine the sponsor's records, attend its courses or seminars at no charge, and review its program to determine compliance with the sponsor accreditation requirements, MET standards, and all applicable Board rules.

(d) An accredited sponsor shall not use advertising that is false or misleading, or use any communication that, in the sponsor's effort to promote its services, is coercive.

(e) An accredited sponsor, promptly upon the conclusion of the activity, but not later than 30 calendar days after the conclusion activity, shall provide to each trustee or system administrator participant a certificate of completion, reflecting the following information:

- (1) Name of participant;
- (2) Activity title;
- (3) Date and location of the activity;
- (4) Total accredited MET hours; and
- (5) Sponsor name and contact information.

(f) An accredited sponsor shall include in each MET activity a process for participants and instructors to evaluate the quality of the activity, including whether:

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- (1) Course Objectives were met;
- (2) Facilities and technology were satisfactory;
- (3) Each instructor was effective; and
- (4) Program content was timely and effective.

(g) Sponsors shall inform Instructors of the results of their performance evaluation in subsection (f) of this section, and should systematically review the evaluation process to ensure its effectiveness.

### **RULE §607.128 Accreditation of MET Activities from Non-Accredited Sponsors**

(a) MET activities may be accredited, on a case-by-case basis, upon the written application of a sponsor or public retirement system on behalf of its own trustees or system administrator. All applications for accreditation of an MET activity by a non-accredited sponsor shall:

(1) be submitted at least 30 days in advance of the activity, although the Board, at its discretion, may approve applications filed less than 30 days in advance of the activity, or may approve applications filed after the activity, in exceptional cases;

(2) be submitted on a form provided by the Board;

(3) contain all information requested on the form;

(4) be accompanied by a sample agenda or course outline that describes the course content, designates the courses sought to be accredited as an MET activity, identifies the instructors, lists the time devoted to each topic, and shows each date and location at which the program will be offered; and

(5) include a detailed calculation of the total MET hours for the course and the hours that correspond to each core and non-core topic the course covers.

(b) A separate application is required for each activity unless the activity is being repeated in exactly the same format but on different dates and/or locations. Repeat presentations may be added to an existing application for a twelve month period following the effective date of accreditation.

(c) The Board shall review each application and notify the applicant of acceptance or rejection of the activity. An acceptance in any given year shall not bind the Board to accept a sponsor or activity in any future year.

### **RULE §607.130 Accreditation of In-House Training Activities**

(a) MET activities provided by public retirement systems or their hired consultants primarily for the education of their trustees and/or system administrators are considered in-house training, and may be accredited for MET credit. Education provided in-house must meet the standards in §607.120 of this chapter (relating to Program Standards for all Sponsors) and §607.122 of this chapter (relating to MET Credit Hour Computation for Sponsors).

(b) Public retirement systems that conduct in-house training may apply to become accredited sponsors under §607.124 of this chapter (relating to Sponsor Accreditation).

(c) Public retirement systems that conduct in-house training may submit individual courses for accreditation under §607.128 of this chapter (relating to Accreditation of MET Activities from Non-Accredited Sponsors).

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### **SUBCHAPTER D COMPLIANCE WITH THE MINIMUM TRAINING REQUIREMENTS**

#### **RULE §607.140 PRS Reporting**

(a) By September 1 of each year, a PRS shall accurately report to the Board on behalf of its trustees and system administrator the MET credit hours completed, as required by subchapter B. A PRS shall submit the report on a form provided by the Board.

(b) In the September 1 report, a PRS shall submit the MET credit hours completed between August 1 of the previous year and July 31 of the current year and any previously unreported training hours. A PRS shall be responsible for providing the following information to the Board on an ongoing basis. A PRS shall notify the Board of any changes in such information within 30 days after the date of the changes. A PRS shall submit this information on a form provided by the Board.

(1) For each trustee: the name, mailing address, phone number, e-mail, position (such as Chair, Vice-Chair, Secretary, etc.), trustee type (such as Active, Retired, Citizen, etc.), term start date, the term length, and the term end date.

(2) For a system administrator: the name, title, phone number, e-mail, and date of hire.

#### **RULE §607.142 PRS Records**

(a) For each trustee and system administrator, a PRS shall retain the following records for five years following the date an MET activity is completed:

(1) the sponsor's name and identification number, if applicable;

(2) the location of the MET activity;

(3) date(s) of completion; and

(4) the credit hours earned by the trustee or system administrator participant.

(b) The PRS, upon request of the Board, shall immediately submit a copy of any of the records retained in subsection (a) of this section for review.

### **CHAPTER 609 PUBLIC RETIREMENT SYSTEM INVESTMENT EXPENSE REPORTING**

#### **RULE §609.101 Authority**

These rules are promulgated under the authority of Texas Government Code, §801.201, relating to rulemaking, and §802.103, relating to an annual financial report and the Board's authority to adopt rules necessary to implement that section.

#### **RULE §609.103 Purpose**

(a) The governing body of a public retirement system, as mandated by §802.103 of the Texas Government Code, is required to publish an annual financial report showing the financial condition of the system as of the last day of the fiscal year covered in the report.

(b) Texas Government Code §802.103(a)(3) requires within the annual financial report, a listing, by asset class, of all direct and indirect commissions and fees paid by the retirement system during the system's previous fiscal year for the sale, purchase or management of system assets.

(c) This chapter implements these reporting requirements to help ensure consistency in investment

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expense reporting by public retirement systems, which will benefit those systems, the Board, policymakers, and the public, through the ability to make enhanced comparisons and allow for the better analysis, policymaking, and understanding of investment expenses paid by public retirement systems.

(d) This chapter is not intended to contradict generally accepted auditing standards, governmental accounting standards, or widely recommended best practices for financial reporting by governmental entities. It is also not intended to prevent systems from making additional disclosures beyond those listed in this chapter.

### **RULE §609.105 Definitions**

The following words and terms, for the purposes of this chapter, shall have the following meanings, unless the rule indicates otherwise.

- (1) "Annual financial report" means as defined by §802.103 of the Texas Government Code.
- (2) "Asset class" means a group of securities that share similar characteristics, perform comparably in the marketplace, and are generally governed by the same laws and regulations.
- (3) "Board" means the State Pension Review Board.
- (4) "Direct and indirect fees and commissions" means amounts paid to investment managers for managing assets; commissions paid to brokers for trading securities on a per share basis; and profit share as defined by §815.3015(a)(2) of the Texas Government Code.
- (5) "Fees netted from returns" means an amount that an investment manager collects or retains from earned investment returns rather than from the pension trust fund.
- (6) "Governing body of a public retirement system" means as provided by Texas Government Code §802.001(2).
- (7) "Investment expense" means direct and indirect fees and commissions and amounts retained or paid for investment services.
- (8) "Investment manager" means as defined by §802.204 of the Texas Government Code.
- (9) "Investment service" means a service provided to a public retirement system for general purposes of administering its investment program such as custodial, investment consulting, investment-related legal services, and research.
- (10) "Public retirement system" means as defined by §801.001(2) and §802.001(3) of the Texas Government Code, but shall not include defined contribution plans as defined by Texas Government Code, §802.001(1-a) or retirement systems consisting exclusively of volunteers organized under the Texas Local Fire Fighters' Retirement Act as defined by Texas Government Code, §802.002(d).

### **RULE §609.107 Applicability**

This chapter applies to every public retirement system.

### **RULE §609.109 Investment Expense Reporting**

For the first reporting period:

- (1) A public retirement system with 180 days or more remaining in its current fiscal year as of the effective date of this section shall include the required investment expense disclosures per this chapter in

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its annual financial report that covers that fiscal year.

(2) A public retirement system with fewer than 180 days remaining in its current fiscal year as of the effective date of this section shall include the required investment expense disclosures per this chapter during the first fiscal year that begins after the effective date of this chapter, as part of its regularly scheduled annual financial report.

(3) The provisions of this section shall expire on April 1, 2022.

### **RULE §609.111 Investment Expense Reporting Structure**

(a) Public retirement systems shall:

(1) report direct and indirect fees and commissions:

(A) in the fiscal year they are incurred;

(B) by asset class;

(C) in a supplemental schedule as part of the system's annual financial report; and

(2) identify amounts netted from returns separately from those paid from the trust.

(b) Investment services provided to the system shall be reported in a supplemental schedule contained in the notes to the financial statements that are part of a public retirement system's annual financial report.

(c) A retirement system shall report expenses incurred for investment services by type of service provided, even if multiple investment services are provided by a single firm. Those expenses should not be reported by asset class.

(d) The asset classes are:

(1) Cash;

(2) Public Equity;

(3) Fixed Income;

(4) Real Assets;

(5) Alternative/Other.

(e) The Board hereby adopts by reference the 2020 Asset Class Categorization Guide (2020 ACC Guide) to assist in categorizing items by asset class.

(f) The Asset Class Categorization Guide is available to all public retirement systems. A public retirement system may obtain the most current version of the Asset Class Categorization Guide from the offices of the State Pension Review Board and from its website at <http://www.prb.texas.gov>.

(g) For an investment product containing investments in more than one asset class, a public retirement system shall report fees according to the corresponding asset class.

(h) For a fund of funds, reported fees must include the top-layer management fees charged by the fund-of-fund manager and the fees charged by all subsidiary fund managers, and all profit share, reported as a single amount.

(i) A public retirement system must list the types of investment included in the "Alternative/Other" asset class as described in the 2020 ACC Guide.



## 6.10 Glossary

**Absolute Return** - The percentage change in value of an asset or portfolio over a given period; the portfolios or assets absolute return can be compared with that of a benchmark to derive relative return.

**Absolute Return Strategy** - An investment strategy that seeks to generate the highest possible absolute return within specified, often multiple, asset classes without construction limitations imposed when managing against a specific benchmark. By separating itself from a benchmark, an absolute return strategy seeks to generate a positive return regardless of the positive or negative performance of relevant markers.

**Active Return** - The performance difference between a portfolio and a benchmark that is attributable to an investment manager's decisions to construct a portfolio of securities that differs from the benchmark's construction. For example, if a portfolio of securities selected by an investment manager returned 5% while the benchmark returned 3%, the portfolio's active return is 2%. Active return is only possible when a manager takes on active risk.

**Actuarial Accrued Liability** - That portion, as determined by a particular actuarial cost method, of the actuarial present value of pension plan benefits and expenses which is not provided for by future normal costs.

**Actuarial Assumptions** - Assumptions of the occurrence of future events affecting pension costs, such as mortality, withdrawal, disablement, and retirement; changes in compensation and Social Security benefits; rates of investment earnings and asset appreciation or depreciation; and other relevant items.

**Actuarial Cost Method** - A procedure for determining the actuarial present value of pension plan benefits and expenses and for developing an actuarially equivalent allocation of such value to time periods, in the form of a normal cost and actuarial accrued liability.

**Actuarial Gain (Loss)** - A measure of the difference between actual experience and that expected based upon a set of actuarial assumptions, during the period between two actuarial valuation dates, as determined in accordance with a particular actuarial cost method. Actuarial gains are due to favorable experience, e.g., the fund's assets earn more than projected, salaries do not increase as fast as assumed, members retire later than assumed, etc. Favorable experience means actual results produce actuarial liabilities not as large as projected by the actuarial assumptions. On the other hand, actuarial losses are the result of unfavorable experience, i.e., actual results that produce actuarial liabilities which are larger than projected. Actuarial gains will shorten the time required for funding of the actuarial balance sheet deficiency while actuarial losses will lengthen the funding period.

**Actuarial Present Value** - The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions.

**Actuarial Soundness** - A public retirement system is considered actuarially sound if an actuary determines that the fund has sufficient money to pay ongoing normal cost and amortize the unfunded actuarial accrued liability over a period not to exceed 30 years, preferably 10 to 25 years.

**Actuarial Value of Assets** - The value of cash, investments and other property belonging to a pension plan, as used by the actuary for the purpose of an actuarial valuation.

**Actuarial Valuation** - The determination, as of a valuation date, of the normal cost, actuarial accrued liability, actuarial value of assets, and related actuarial present values for a pension plan.

**Actuarially Equivalent** - Of equal actuarial present value, determined as of a given date with each value based on the same set of actuarial assumptions.

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**Actuary** - Business professionals who analyze the financial consequences of risks and study uncertain future events using mathematics, statistics, and financial theory.

**Agency Issues** - Federally sponsored agencies are privately owned, publicly chartered entities that raise funds to provide credit to borrowers, such as farmers, homeowners, and students at a lower cost than would otherwise be available. Although there are no federal guarantees of most of these issues, the general market perceives that the government would "cover" any defaults on these issues, giving them virtually no credit risk.

**Alpha** - Alpha is a beta-adjusted measure of return. Positive alpha indicates that an investment portfolio has earned, on average, a premium above what is expected for the level of market variability (beta). A negative alpha indicates that the investment portfolio has received, on average, a premium lower than that expected for the level of market variability.

**American Depository Receipts** - These are domestically traded securities representing claims to shares of foreign stocks. They provide a way for investors to take advantage of foreign investment opportunities without the risks associated with overseas markets.

**Amortization Payment** - That portion of the pension plan contribution which is designed to pay interest on and to amortize the unfunded actuarial accrued liability or the unfunded frozen actuarial accrued liability.

**Annual Pension Cost** - A measure of the periodic cost of an employer's participation in a defined benefit pension plan the employer's periodic required contributions to a defined benefit pension plan, calculated in accordance with the Parameters. A vehicle created to facilitate commercial trade transactions. They are called "bankers' acceptances" because a bank accepts the responsibility to repay a loan to the holder of the vehicle created in a commercial transaction.

**Basis point** - One hundredth of one percentage point (0.01%).

**Benchmark** - A standard barometer against which investments can be measured in terms of performance, characteristics, construction, and similar criteria; sometimes widely recognized instruments (e.g., US Treasuries) or interest rates (e.g., the US fed funds rate or LIBOR) serve as benchmarks. More commonly, a benchmark is composed of an unmanaged group of securities with the same general characteristics as the portfolio being measured against it. Stock indices such as the S&P 500, the FTSE 100, and the Nikkei 225 are commonly used for equities, while indices such as the Lehman Aggregate or the Nomura Bond Performance Index are commonly used in fixed income.

**Beta** - A measure of the expected change of a security's or portfolio's return relative to that of the market. The beta of a benchmark index is 1.00. A security with a beta of more than 1.00 tends to rise or fall more than the market; a security with a beta of less than 1.00 tends to rise or fall less.

**Bond** - A security that pays interest. The issuer agrees to pay the bondholder a regular set sum based on the amount borrowed and the bond's coupon, and to repay the principal amount of the loan at a future date. Many variations exist on this basic format, including bonds with no coupon and with variable coupons; bonds may also contain call or put provisions. The price of a bond is quoted assuming a par value of 100. A bond selling above 100 is said to be trading at a premium; at 100, at par; and below 100, at a discount. The price varies over the life of the bond as interest rates, perceived credit quality and other factors fluctuate, and as the bond approaches its maturity date. A bond's price is inversely related to its yield: it rises when the bond's yield falls and declines when the yield rises. Bonds belong to the fixed-income asset class.

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**Book Value** - An accounting term that defines the net value of an asset as it appears on a company's balance sheet; a company's book value is equal to its total assets minus its total liabilities.

**Call Option** - A contract that gives an investor the right to buy a specified asset at a predetermined price and date prior to the security's stated maturity, if any (common stock doesn't have a maturity), or the date that the issuer makes the final payment to the security holder.

**Call Provision** - A bond feature that allows the issuer to retire the debt, in full or in part, prior to the bond's stated maturity date. Such a feature is favorable to the borrower, who can retire the bond and replace it with a lower-coupon issue if market rates fall. Conversely, such a feature is detrimental to the investor, who risks losing the higher-coupon bond when rates fall. Because of this disadvantage to the investor, callable bonds typically yield more than otherwise comparable bonds without a call provision.

**Cap-Weighted Index** - An index weighted by the market capitalization of each security in the index. Larger-cap companies thus account for a greater portion of the index. For example, if a company's market capitalization is \$1 billion and the market capitalization of all securities in the index is \$100 billion, the company would be 1% of the index. An index may also be fixed weighted, with each security, sector or country having a specified weight; fixed-weight indices are often equal weighted.

**Contribution Deficiencies (Excess Contributions)** - The difference between the annual required contributions of the employer (ARC) and the employer's actual contributions in relation to the ARC.

**Convertible Bond** - A bond that, at the option of the issuer or the investor, can be exchanged for common stock of the issuing company, at a predetermined conversion ratio and at predetermined dates. Some convertible bonds are convertible throughout their lives. Although a convertible bond is chiefly a fixed-income instrument, its price tends to be highly influenced by the stock price.

**Corporate Issues ("A" minimum rating)** - Corporate bonds are sold by corporations to dealers called underwriters and then to the public to raise long-term funds for investment. Corporate bonds are the alternative to issuing stock for raising funds. Corporate bonds are also rated according to the ability of a firm to pay its debt. The rating scale ranges from AAA to D.

**Cost-of-Living Adjustment (COLA)** - An increase in pension benefits after retirement that offsets the effects of inflation in the economy.

**Debt-to-Equity Ratio** - A company's debt (borrowings) divided by the market value of its shareholder equity.

**Decrements** - Those types of activities by members of a pension system which cause them to no longer remain members, i.e., death, retirement, disability, and withdrawal. Decrements is a general term referring to any or all these membership terminating events.

**Defined Benefit Plan** - In a retirement plan, benefits which are defined by a specific formula applied to a specific member compensation and/or specific years of service. The amount of the benefit is not a function of contributions or actual earnings on those contributions.

**Defined Contribution Plan** - A system providing pension benefits equal to the combined employer and employee contributions plus interest and minus administrative expenses.

**Derivative** - A tradable financial instrument that derives its value from underlying assets-such as stocks, bonds, market indices, commodities, and livestock. It is typically a contract based on the buyer's/seller's assumptions regarding the future price of the underlying assets. Given the uncertainty of future prices, participants often hedge their bets by entering into a contract for a future sale or purchase at a specified price. This contract, or financial instrument, is the derivative.

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**Domestic Equities** - Commonly referred to as "stock," equity issues are the most important source of capital for firms, representing a claim on assets and earnings of a business. Stock owners are owners of the firm. Domestic equities are stocks of companies incorporated in the United States.

**Duration** - A measure of a bond's price sensitivity to changes in interest rates, expressed in years. Duration approximates how much a bond's price will change if interest rates change by a given amount. For each year of duration, a bond's price will fall (or rise) roughly one percentage point for each one-percentage-point increase (or decrease) in yield. Thus, a bond with a longer duration will perform worse when rates rise than a bond with a shorter duration; conversely, it will perform better when rates fall. Technically, duration is the weighted average term to maturity of the bond's cash flows. Thus, it is shorter than maturity for coupon-bearing bonds, which make annual or semiannual payments throughout the life of the bond. Duration is an excellent approximation of price sensitivity when interest-rate changes are small, but it becomes less accurate when rate changes are large.

**Earnings Per Share (Eps)** - A company's net profit divided by the number of common shares outstanding.

**Equal-Weighted Index** - An index in which all the securities are given equal weight. As soon as the price of one security changes, it is no longer equal weighted. Therefore, such indices are rebalanced on a quarterly, semiannual, or annual basis.

**Equity** - Ownership of a company in the form of shares that represent a claim on the corporation's earnings and assets. Common stockholders have the right to vote on directors and other key matters. While preferred stockholders lack voting rights, they have priority in dividend payments. A corporation can authorize additional classes of stock, each with its own set of contractual rights.

**Equity Risk Premium** - A forward-looking estimate of how much equities are likely to outperform bonds. Equity investors typically demand a higher return due to their greater risk of not receiving cash flows for their investments.

**Excess Return** - Difference between returns, which may be applied to managers or sectors. When referring to a manager or portfolio, the excess return is typically the same as the active return—the difference between the manager's/portfolio's return and the benchmark. A fixed-income sector's excess return is the difference between its return and that of a comparable-duration government bond: If short-term government security returns 4%, the excess return is 2%.

**Exchange-Trade Fund (ETF)** - An instrument that provides exposure to an index and is traded on a stock exchange. The price of these units depends on the prevailing market prices of the underlying index components. ETFs offer investors a low-cost, liquid means to invest in indices; they are essentially an alternative to an index portfolio.

**Experience Study** - A periodic review and analysis of the actual experience of the system which may lead to a revision of one or more actuarial assumptions. Actual rates of decrement and salary increases are compared to the actuarially assumed values and modified as deemed appropriate by the actuary.

**Fair Value** - A price deemed to accurately reflect the value of a company, asset or financial instrument and thought to be equitable for both buyer and seller. Fair value is generally calculated based on measurable financial performance and potential. In the futures market, fair value refers to the relationship between the futures contract on a market index and the actual value of the index. When futures are above fair value, traders are betting that the market index will go higher. The converse is true when futures fall below fair value.

**Fiscal Note** - Estimate prepared by an independent actuary regarding the cost of pension legislation and policy changes.

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**Frozen Actuarial Accrued Liability** - The portion of the actuarial present value of projected benefits which is separated as of a valuation date and frozen under certain actuarial cost methods. Generally, this separated portion is the sum of an initial unfunded actuarial accrued liability and any increments or decrements in the actuarial accrued liability established subsequently as a result of changes in pension plan benefits or actuarial assumptions.

**Funding Period** - The number of years in the future that will be required to fully fund (i.e., pay off or eliminate) the unfunded actuarial accrued liability, based on the actuarial assumptions and assuming no future actuarial gains or losses.

**Future Benefits** - Benefits specified in the law which will become payable at some time in the future when the member satisfies the requirement to receive pension benefits.

**Future Contributions** - Contributions to be made by the member or the employer in the future, as required by law.

**Growth Stock** - A company that is expected to generate above-average revenue and earnings growth relative to its industry or the overall market. Such companies usually pay little or no dividend, preferring to use excess cash to finance expansion. However, because of the company's rapid earnings growth, investors typically expect the stock's price appreciation over time to more than compensate for the lack of short-term dividends.

**Hedging** - A trading practice aimed at limiting financial loss in an asset due to unexpected price changes. For example, cross-border securities investors need to exchange their home currencies for the local currencies of the markets in which they're investing to make the purchases. Through hedging instruments such as forwards or futures contracts, they can arrange to re-exchange the currencies at fixed prices at specified points in the future. This arrangement allows an investor to gain exposure to price changes in the underlying security without having to risk depreciation of the home currency relative to the local currency, which would lower the total value of the transaction when the proceeds are brought back home. There are many forms of hedging, which, in effect, seeks to neutralize a specific risk.

**High Yield Bonds** - Bond that has a rating of BB or lower and that pays a higher yield to compensate for its higher level of default risk when compared to investment-grade bonds.

**Hybrid Security** - A security that combines characteristics of two or more financial instruments, generally debt and equity. The most common type of hybrid is a so-called convertible bond, which is a fixed-income security that can be exchanged for common stock. Another popular type of hybrid is a Basket D. Basket Ds, which are issued by banks and insurance companies, are considered 75% equity and 25% debt. Hybrid securities are typically lower in the capital structure than senior corporate bonds, so recovery rates in times of corporate financial stress tend to be lower; however, debt-equity hybrids usually rank ahead of common stock.

**Information Ratio** - The ratio of a portfolio's excess return, or premium, to its tracking error, or the standard deviation of the premium over the period being measured. It is designed to measure how much excess return a manager delivers for each unit of risk. A higher number indicates a more favorable balance of reward to risk than a lower number. A positive number indicates that the portfolio outperformed, and a negative number indicates underperformance.

**Investment Contracts** - Issued by insurance companies, these pooled investment products have a limited guarantee of principal and a predetermined interest rate to be credited over the investment's life. Although the guarantee may imply the protection of principal, that guarantee is only as good as the insurer's claims-paying ability.

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**Investment Return Assumption (Discount Rate)** - The rate used to adjust a series of future payments to reflect the time value of money.

**Level Percentage of Projected Payroll Amortization Method** - Amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given number of years. The dollar amount of the payments generally will increase over time as payroll increases due to inflation; in dollars adjusted for inflation, the payments can be expected to remain level.

**Leverage** - In a financial context, the degree to which a business or asset is financed by borrowing. High financial leverage is generally regarded as a negative for a company, since it increases the risk of bankruptcy in the event of a financial squeeze and can make future borrowing more difficult and/or expensive. However, leverage to finance highly profitable new ventures, for example, can result in higher returns to shareholders. “Leveraged investing” is when investors borrow money to purchase more securities or other assets than they could with cash. This allows an investor to capture more of the upside if a security appreciates but increases the loss if the security depreciates.

**Liability** - A legal obligation to pay a specific amount within a defined time frame. For businesses, this typically includes debt payments, accounts payable, taxes, wages and similar pending expenses recorded on a company’s balance sheet. Short-term liabilities are those payable within the next year, and long-term liabilities are those payable over a longer time frame.

**LIBOR (London Interbank Offered Rate)** - The interest rate that banks charge one another in the short-term international interbank market. It applies to loans borrowed anywhere from one day to five years. LIBOR is officially fixed each day by a handful of large London banks, although the actual rate changes throughout the day. It is also used as a benchmark to set other short-term interest rates, which are sometimes set as specific increments relative to LIBOR (e.g., LIBOR plus 2%).

**Liquidity** - The ease with which an asset can be bought or sold quickly. High liquidity means that an asset can easily be exchanged for currency, and low liquidity means that supply and demand are somewhat constrained. Highly liquid assets tend to have narrower bid-ask spreads; illiquid assets tend to have wide bid-ask spreads.

**Long-Duration Assets** - Securities or other assets whose cash flows to investors tend to be further out in the future. In equity markets, these are typically companies that pay little or no dividends, often because they are reinvesting most of their earnings. The term is most typically used in conjunction with growth stocks but may also apply to emerging market stocks and other assets.

**Market Capitalization** - Also referred to as market cap, it reflects the total equity of a company. A company’s market capitalization is determined by multiplying the number of shares outstanding by the current stock price. Stock markets are frequently subdivided in terms of capitalization, with typical groups often including large-cap (those with the largest capitalizations), mid-cap (medium-size companies) and small-cap (the smallest publicly traded companies). Each group has distinct attributes and performance patterns and spreading investments across the various groups tends to diversify risk.

**Market-Related Value of Plan Assets** - A term used with reference to the actuarial value of assets. A market-related value may be market value (or estimated market value) or a calculated value that recognizes changes in market value over a period of, for example, three to five years.

**Market Value** - The current price of a security in the market, as reflected by the last reported price on an exchange, or the current bid-ask price if the security is traded over the counter.

**Market Weight** - When a portfolio allocates the same percentage of assets to a specific security or group of securities as its benchmark. Also known as a “neutral weight.”

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**Mark to Market** - To record the value of open positions in a security, a portfolio or an account based on current prices, not the purchase price or “cost basis.” This technique allows any interim gain or loss to be recognized for tax or accounting purposes even though the positions have not yet been closed out.

**Maturity** - The date when, or the remaining time until, an issuer is obligated to deliver the final coupon and principal payments owed to a bondholder. Bonds with a remaining term to maturity of one to five years are generally considered short-term; those maturing between six and 12 years out are considered intermediate-term; and those with maturities beyond 12 years are considered long-term. Bonds maturing in less than one year are categorized as cash equivalents.

**Measurement Date** - The date as of which plan assets and obligations are measured.

**Money Market Funds** - Customers pool their money into a fund that then purchases short-term debt such as Treasury bills and commercial paper in order to earn a high rate of return while maintaining liquidity.

**Mortgage-Backed Securities** - A fixed income type investment whose cash flow depends on the cash flow from an underlying pool of mortgages. Examples include mortgage pass-through securities and mortgage-backed bonds.

**Net Asset Value (NAV)** - The dollar value of a mutual-fund share, calculated by dividing the fund’s total net assets (assets minus liabilities) by the total number of shares outstanding. NAV, which is typically calculated at the end of each day, can change constantly to reflect changes in the value of a fund’s holdings.

**Net Pension Obligation** - The cumulative difference since the effective date of this statement between annual pension cost and the employer's contributions to the plan, including the pension liability (asset) at transition, and excluding short-term differences and unpaid contributions that have been converted to pension-related debt.

**Normal Cost** - Generally represents the current value of benefits attributed to the present year. Calculated differently under different funding methods. The employer normal cost equals the total normal cost of the plan reduced by employee contributions.

**Open Group/Closed Group** - Terms used to distinguish between two classes of actuarial cost methods. Under an open group actuarial cost method, actuarial present values associated with expected future entrants are considered; under a closed group actuarial cost method, actuarial present values do not consider the impact of future entrants.

**Option** - A contract that provides the right to buy or sell a specific asset such as a stock, a commodity, or a currency at a particular price during a defined period of time. The right to buy is referred to as a “call option,” while the right to sell is known as a “put option.” Although option holders have the right to buy or sell, they are not obligated to do so.

**Over the Counter (OTC)** - Securities not listed on an established exchange such as the London Stock Exchange, Tokyo Stock Exchange, or New York Stock Exchange, but rather traded by broker-dealers who negotiate directly with one another over computer networks and by telephone. Stocks traded over the counter may be more speculative since these companies have often not yet met the size or stability requirements for listing on an established exchange and have less accurate pricing data and other information readily available. Still, these trades tend to fall under the oversight of relevant regulatory bodies. Many bonds trade over the counter rather than on an exchange. Also known as “unlisted securities.”

**Overweight** - When a portfolio allocates a larger percentage of assets to a specific security or group of securities than its benchmark does.

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**Parameters** - The set of requirements for calculating actuarially determined pension information included in financial reports.

**Par or Face Value** - The amount of principal that the issuer must pay the bondholder at maturity. Although an individual bond typically has a par value of \$1,000, the term “par” is often used interchangeably with 100 in the context of a bond’s price.

**Payroll Growth Rate** - An actuarial assumption with respect to future increases in total covered payroll attributable to inflation; used in applying the level percentage of projected payroll amortization method.

**Portability** - Relates to an employee's ability to move pension credit and years of vesting when changing jobs.

**Preferred Stock** - A type of equity ownership in a corporation that is senior to common stock. For example, the firm may pay a specified dividend to preferred stock before any common stock dividends are paid. Also, preferred owners have a prior claim on any assets of the firm in the event of a liquidation.

**Premium Coupon** - A rate above current coupon. Bonds with premium coupons are typically priced above par.

**Prepaid Pension Cost** - Cumulative employer contributions in excess of accrued net pension cost.

**Present Value** - The actuarially determined lump sum value as of the valuation date of a series of payments to be made in the future, where the lump sum value is equal to the sum of the discounted value of each future payment. The discounted value of each payment is the product of a) the amount of the payment, (b) the probability that the payment will be made (based on the current actuarial assumptions as to future experience), and (c) the time value of money based on the Investment Return Assumption.

**Price-To-Book Ratio (P/B)** - A comparison of a stock’s market value with its book value, calculated by dividing the current closing price of the stock by the latest quarter’s book value per share.

**Price-To-Growth Ratio (PEG)** - A ratio used to determine a stock’s current value, calculated by dividing the price/earnings ratio by the annual earnings-per-share growth and indicates a stock’s potential value. A lower PEG means that the company’s growth is priced more attractively than its peers.

**Projected Benefits** - Those pension plan benefits which are expected to be paid at various times under a particular set of Actuarial Assumptions, taking into account such items as the effect of advancement in age and past and anticipated future compensation and service credits.

**Put Option** - A Put Option is a financial contract that gives the holder the right, but not the obligation, to sell an asset at a predetermined price on or before a particular date.

**Put Provision** - A bond feature that allows the investor to redeem the bond at par value before the bond’s stated maturity date. A put provision is typically valid only for predetermined dates and would only be attractive to the investor if the bond’s market value declined below par. Such a feature is favorable to the investor and detrimental to the issuer. Because of their potential advantage to the investor, puttable bonds typically yield less than otherwise comparable bonds without a put provision.

**Reciprocity** - Reciprocity relates to an employee's ability to move pension credit when changing jobs from one public sector to another under conditions that force the employee to change pension plan membership. Reciprocity provisions allow such employees to move pension credit between systems.

**Relative Return** - An asset’s or a portfolio’s return over a period of time relative to that of a chosen benchmark. It is calculated as the difference between the asset’s absolute return and the benchmark’s performance.



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**Return on Equity (ROE)** - A measure of how much profit a company is able to generate with the capital provided by shareholders. It is calculated by dividing after-tax income for a specified time period (e.g., trailing 12 months, trailing five years, and forward 12 months) by the book value. ROE is expressed as a percentage.

**Risk** - Risk means in common parlance, the chance of loss or of something bad occurring. In financial parlance, it usually means the uncertainty of outcomes due to one or many causes; it can be positive as well as negative. Return is usually measured by the standard deviation of returns-in other words, the extent to which returns may vary from the norm. Volatile assets tend to have a wider range of possible returns and thus are said to be higher risk.

**Risk-Free Rate** - Risk-Free Rate is an investment with a predictable rate of return. An example is a short-term government bond. A short-term government bond has the explicit backing of a government, and the time period before the bond matures is short enough to minimize the risks of inflation and market interest-rate changes. Its yield is therefore considered risk-free.

**Risk Premium** - Risk Premium is the expected return above the risk-free rate that investors demand to compensate for the volatility of returns or the possibility of default of risky assets.

**Securitizations** - Securitizations are the process of creating a tradable financial instrument from a pool of underlying assets, such as loans or mortgages, which generate an income stream for the issuers. Securitization allows issuers to remove assets from their balance sheets, thereby freeing up capital for other uses. It also allows investors to better diversify risk.

**Spread** - The term spread means the difference between two variables, such as a security's bid and ask prices (bid-ask spread). In the bond market, the "yield spread" is the difference in yield between bonds, most often between the yield of a bond and a benchmark such as a government bond, swap or LIBOR. Valuation spreads measure the difference between expensive and cheap segments of the market.

**Standard Deviation** - A statistical measure of risk that shows how aligned or at variance the returns of an asset, industry or fund are relative to their historical performance.

**Style Drift** - Style drift means the tendency of a portfolio manager to stray from its investment philosophy and process to boost short-term returns.

**Swap** - A contract between two parties to exchange future cash flows based on a set principal amount. An interest-rate swap normally involves swapping fixed-rate and floating-rate payments in the same currency. Other common types include currency swaps and credit default swaps.

**Systemic Risk** - A risk or event that affects an entire financial market or system, such as a stock market crash or banking-system failure Systemic risks cannot be avoided through diversification.

**Total Return** - The return on an investment, including price appreciation and depreciation, as well as income from dividends or interest

**Tracking Error** - The variance of a portfolio's investment returns relative to those of its benchmark or index.

**Tranche** - When a bond's cash flows are repackaged as a collateralized debt obligation (CDO) or a portfolio of mortgage securities is repackaged as a collateralized mortgage obligation (CMO), the various securities constituting the CDO or CMO are called tranches. Each tranche within a deal has a different risk/return profile, and the tranches trade separately from one another.

**Transaction Costs** - The costs incurred when buying or selling an asset security, such as commission, fees and any indirect taxes.

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**Underweight** - Underweight means when a portfolio allocates a smaller percentage of assets to a specific security or group of securities than its benchmark does.

**Unfunded Accrued Pension Cost** - Cumulative net pension cost accrued more than the employer's contributions.

**Unfunded Actuarial Accrued Liability (UAAL)** - The excess of the actuarial accrued liability over the actuarial value of assets.

**Unfunded Frozen Actuarial Accrued Liability** - The portion of the frozen actuarial accrued liability remaining after the addition of interest and the deduction of amortization payments.

**U.S. Government Issues** - These debt instruments are backed by the full faith and credit of the U.S. Government. They are viewed by market participants as having no credit risk and their interest rates are used as benchmarks throughout the U.S. and international capital markets.

**Valuation** - Valuation is the worth of an asset or a company using various techniques or the value of an investment portfolio's holdings at a specific date.

**Value Risk Premium** - The anticipated return premium of value stocks versus the broader market.

**Value Stock** - A stock that is underpriced by the market relative to its long-term fundamentals, such as dividends, earnings, and sales; such stocks tend to have a high dividend yield, low price-to-book ratio and/or low price-to-earnings ratio.

**Vesting Requirements** - Requirements that employees work a specific length of time before receiving the right to a pension benefit.

**Volatility** - The extent to which the price of a financial asset or market fluctuates, measured by the standard deviation of its returns; volatility is a commonly cited risk measure.

**Yield** - Yield means a component of the return on an investment. In the equity market, a share's dividend yield is its annual dividend payment as a percentage of the share's market price. In the fixed-income market, a bond's yield is its annual interest payment as a percentage of the bond's market price. Various measures of yield exist; most notably, current yield, which considers only coupon interest; and yield to maturity, which is the rate that will make the present value of the bonds expected cash flows equal to the bond's market price.

**Yield Curve** - A line connecting the yields of bonds from one end of the maturity spectrum to the other; because yields typically rise sharply at the short end of the maturity spectrum and rise more gradually at longer maturities, the plotted line usually forms a curve. However, depending on a host of factors, yield curves may be steeply upward-sloping, flat, inverted, straight, bowed or even kinked.