MICHAEL S. RAWLINGS
Mayor of Dallas

April 7, 2017

Delivered via email: David.Erinakes@house.texas.gov

Dear Chairman Flynn:

Thank you again for your courtesy and professionalism at Monday's hearing and for following through on your word to continue to work with us over the past few days. I am hopeful that we are moving closer to a resolution that will provide us with the tools to save the Dallas Police & Fire Pension System. I have outlined changes below to the Committee Substitute for HB 3158 ("CS"), which, if included, will allow me to support the bill.

Based on conversations with our actuaries at Deloitte, and other considerations, I propose certain changes affecting: 1) taxpayer funds; 2) governance; and 3) a few clean-up items. These fiscally conservative changes will restore the fund's actuarial soundness to a 29-year amortization period.

1. <u>Taxpayer Funds</u>

We propose a floor of $135 million for the first two years and 34.5 percent of computation pay thereafter. This strikes a balance between the pension board's need for certainty for the first two years, and the city's need for flexibility by not locking itself into hard-wired payments indefinitely.

Utilizing conservative and reasonable assumptions, Deloitte analyzed the impact of the Committee Substitute, along with my proposal to replace the indefinite hard-wired payments (the "escalator clause") with a two-year period of hard-wired payments (the floor I mentioned at Monday's hearing). Analyzing that, and even factoring in our revised payroll assumptions, Deloitte concludes that the plan will be fully funded in 29 years. This is far better than the Pension Review Board's benchmark of 48 years, which you have adopted, for an acceptable plan. Deloitte continues to work with the Pension Review Board's actuaries, who, up to this point, have largely relied on assumptions that were given to them by the pension system staff. For your reference, we are also providing a letter from Deloitte confirming the 29-year amortization period.

In order to replace the escalator clause with a two-year floor, we suggest the following revisions:

"(d) Subject to Section 4.025 of this article, the city shall make contributions to the pension system equal to the sum of:

(1) for the period beginning on the first biweekly pay period after September 1, 2017, and ending on the last day of the first biweekly pay period after September 1, 2019, an amount equal to the greater of:
   (A) 34.5 percent of the aggregate computation pay paid to members during the period for which the contribution is made; or
   (B) $5,173,000 for the biweekly pay periods;
(2) for the periods immediately following the period described in Paragraph (1) of this subsection, an amount equal to 34.5 percent of the aggregate computation pay paid to members during the period for which the contribution is made; and
(3) except as provided by Subsection (e) of this section, an amount equal to 1/26th of $11 million.

(e) Beginning with the first biweekly pay period following the last biweekly pay period that ends on or after September 1, 2019, the city is only required to pay the contribution amount described by Subsection (d)(3) of this section if the board determines, based on the most recently completed actuarial valuation, that with the contribution, the unfunded actuarial accrued liabilities of the fund can be amortized within 35 years, as confirmed by the State Pension Review Board. The board and the State Pension Review Board shall annually make the determination required under this subsection."

-Amends 4.02(d) and 4.02(e) of the statute; Section 11, Page 35: Line 19 thru Page 37: Line 12 of the CS.

2. <u>Governance</u>

   A) Board composition

As a best practice in governance, the members and beneficiaries of the fund should not have representation on the board equal to the city's. One option is for the mayor to appoint the 11th trustee (currently jointly appointed by the city manager and nominations committee) if that position is vacant for more than 60 days. This is consistent with the city's larger share of contributions into the fund, as compared to employee contributions. As an alternative, the state comptroller or the governor shall select the 11th trustee if that seat is vacant after 60 days. We suggest the following options:

"If the city manager and nominations committee do not fill the vacancy under Subsection (b)(3) of this section within 60 days, then the mayor shall fill that vacancy."

-Amends Section 3.01(d-1) of the statute; Section 5, Page 18: Lines 11-14 of CS.

OR

"If the city manager and nominations committee do not fill the vacancy under Subsection (b)(3) of this section within 60 days, then the state comptroller [or the governor] shall fill that vacancy."

-Amends Section 3.01(d-1) of the statute; Section 5, Page 18: Lines 11-14 of CS.

B) New management

It is imperative that the new board be given every chance to succeed in steering the fund towards solvency. To that end, the bill must require that the new board appoint a management team of its choice within a specified timeframe. We suggest the following language:

"Not later than January 1, 2018, the board of trustees established under Section 3.01, Article 6243a-1, Revised Statutes, as amended by this Act, shall (a) establish the ethics policy required by Subsection (r) of that section, as added by this Act; and (b) appoint an executive director, deputy executive director, chief investment officer, and chief legal officer, as those terms are defined in Article 6243a-1, Revised Statutes, as amended by this Act."

-Amends Section 52, Page 183: Lines 20-23 of the CS.

C) Nominations Committee

In order to eliminate a conflict of interest, the executive director should not serve as the presiding officer of the nominations committee. This creates a conflict of interest because the board, including trustees appointed by the nominations committee, hires and supervises the executive director. Instead, once convened, the nominations committee shall select a presiding officer. Suggested language is as follows:

"The nominations committee, at its first meeting, which the executive director shall call, shall select a presiding officer from among its members."

-Amends Section 3.011(d) of the statute; Section 5, Page 26: Lines 24-25 of the CS.

3. Clean-up items

A) Definition of "Eligible Back Pay"

In order to minimize litigation and not interfere with the numerous and ongoing pay referendum lawsuits affecting Dallas police officers and firefighters, it is necessary that any eligible back pay granted by the pension board exclude compensation based on the lawsuits. We suggest adding a new Subsection (C) to the existing definition of "eligible back pay":

"(C) Eligible back pay does not include any additional compensation based wholly or partly, or directly or indirectly, as a result of litigation instituted to recover back pay or monies based on a referendum election held before January 1, 1980, or an ordinance or resolution implementing the referendum."

-Adds a new (C) to Section 2.01(27) of the statute; Section 2, Page 8: Line 17 thru Page 9: Line 14 of the CS.

B) Clarifying the Executive Director's role

"The executive director means the person designated by the board to supervise the operation of the pension system and is the 'plan administrator,' as that term is defined in 414(g) of the Code, as amended."

-Amends Section 2.01(28) of the statute; Section 2, Page 9: Lines 15-16 of the CS.

C) Board rules

-Delete 3.01(j-6)(2) of the statute; Section 5, Page 22: Lines 13-14 of the CS, regarding a board rule having to comply with federal law. This is superfluous as the board must follow federal law anyway.

In order for the board to enact certain rules, it must have approval from the Pension Review Board. However, in the event that the agency does not act within a specified period, it is imperative to the fund's efficient operation that the board not be hampered by the delay. Thus, if, after 90 days from receipt of the proposed rule, the Pension Review Board has not acted, then the proposed rule is presumed approved. The following language would achieve that:

"If the State Pension Review Board does not make a finding 90 days after receipt of the proposed rule, then the proposed rule is presumed approved."

-Amends Section 3.01(j-7) of the statute; Section 5, Page 22: Lines 15-18 of CS.

D) Suit by the Board

In order to avoid a conflict with other laws, including the Texas Trust Code, it should be clarified that, except as otherwise provided by other law, the board is the body that brings suit on behalf of the pension system.

"(p) ... Except as allowed by other law, the board has sole authority to litigate matters on behalf of the pension system."

-Amends Section 3.01(p) of the statute; Section 5, Page 23: Lines 10-11 of the CS.

We look forward to hearing back from you soon. Our staff and attorneys will be available through the weekend. Thank you again for your consideration.

Best regards,

Michael S. Rawlings
Mayor of Dallas

cc: Honorable Members of the Texas House Dallas Delegation
Council member Lee Kleinman, Chairman of the City Council Ad-Hoc Legislative Committee

Encl.

Deloitte.

Deloitte Consulting LLP
2200 Ross Avenue
Suite 1600
Dallas, TX 75701
USA

Tel: 612-397-4024
Fax: 612-692-4024
www.deloitte.com

April 7, 2017

Ms. Mary Elizabeth Reich
Chief Financial Officer
City of Dallas
1500 Marilla Street
Dallas, TX 75201

Re: Analysis of Committee Substitute for House Bill 3158

Dear Ms. Reich:

As you requested, we have analyzed the committee substitute to House Bill 3158. We analyzed the impact of replacing the contribution floor in Section 4.02(d) of the statute for all years with only a two-year floor on the City's contribution. Based on the assumptions and methods summarized below, we have projected the plan to be fully-funded in 29 years.

These projections rely significantly on the actuarial assumptions and methods used to develop those projections. The actuarial assumptions and methods were approved by the City. We believe these assumptions and methods are reasonable for the purpose of the measurements. There will be differences between forward-looking information and actual results because actual experience will almost certainly be different than assumed, and those differences may be material.

The participant data, methods and assumptions we used for this analysis are consistent with those described in the actuarial impact statement of HB 3158 dated April 2, 2017 (http://www.capitol.state.tx.us/tlodocs/85R/impactstmts/html/HB03158IA.htm) except as noted below. We based our understanding of the Committee Substitute to House Bill 3158 on the summary of provisions documented in Segal Consulting's letter dated March 31, 2017.

- Rate of return on assets of 7.25% in all years
- Retirement Rates
    - Active non-DROP Participants
        - 2017: Segal's 1/1/2016 valuation assumption increased by 10 percentage points at all ages
        - 2018+: Segal's 1/1/2016 valuation assumption increased by 25 percentage points at age 58 (unchanged at other ages)
    - Active DROP Participants
        - 2017: 50 percent (regardless of age)
        - 2018+: Segal's 1/1/2016 valuation assumption
- Cost of Living Adjustment (COLA) of 0% in all future years
- DROP Distribution
    - 60% of the January 1, 2016 retiree balance was assumed to be paid out in 2016
    - Remaining DROP accounts are assumed to be paid out over the expected lifetime of the participant

- DROP Account Interest of 2.75%
- Projected payroll stream provided by the City based on revised hiring expectations. Payroll of $364 million in 2018 growing to $581 million in 2031 and increasing by 2.75% thereafter
- 1/1/2017 asset value of $2,144 million
- All plan provision and contribution changes were valued as if they had occurred on 1/1/2017
- Contribution floor of $135.24 million (plus $11 million) for the first two years

Participant information as of January 1, 2016 was provided by Segal Consulting, and was used as the basis for these actuarial estimates and was assumed to be complete and accurate for purposes of the projections contained in this document. Preliminary December 31, 2016 asset information received January 13, 2017, historical aggregate annual DROP withdrawal information from 1994-2015, and weekly aggregate DROP withdrawal information between January 1, 2016 and December 2, 2016 were provided by the DPFP Fund and assumed to be accurate.

Future actuarial measurements may differ significantly from the current measurements presented in this analysis due to such factors as the following: actual plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operations of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's actual future funded status); and changes in plan provisions or applicable law. Our scope did not include analyzing the potential range of such future measurements based on potential impacts of these factors; therefore we did not perform such an analysis.

The undersigned with actuarial credentials collectively meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinions contained herein.

This analysis was prepared solely for the benefit and internal use of the City of Dallas. This analysis is not intended for the benefit of any other party and may not be relied upon by any third party for any purpose, and Deloitte Consulting accepts no responsibility or liability with respect to any party other than the City of Dallas.

To the best of our knowledge, no employee of the Deloitte U.S. Firms is an officer or director of the employer. In addition, we are not aware of any relationship between the Deloitte U.S. Firms and the employer that may impair or appear to impair the objectivity of the work included in this analysis.

Sincerely,

Deloitte Consulting LLP

By: Judy K. Stromback

Judy K. Stromback, FSA, FCA, EA, MAAA
Managing Director

Michael de Leon, FCA, ASA, EA, MAAA
Specialist Leader