Interview with Joe Newton

Hello and welcome to TRS Today, a communications initiative of the Teacher Retirement System of Texas. I'm your host, Rhonda Price, and our guest today is Joe Newton of Gabriel, Roeder, Smith and Company. Now, Joe you're firm conducts actuarial evaluations for TRS. And this work is very important to TRS, but not many people know what the term means. So, let's start with the basics.

Q: What is an actuarial valuation?

A: Thanks, Rhonda. Actuarial evaluation is the measurement of the health of the pension fund. A lot of attention is given to and a lot of resources made towards the assets of the fund, but the real reason for TRS is the benefits that are paid to the membership because it's a defined benefit plan. And in a defined benefit plan it's not a lump sum of assets that's promised to each individual, but it's a benefit annuity that will be paid for that person's life once they reach retirement. And so, what the evaluation does is try to attempt to measure that liability over time. It's similar to what an individual might do with an online calculator, where they go in and put in their own current age and they put in their current asset levels and they put in some target retirement age and how much money they want to have at retirement and the calculator tells them, ok well really, you should have this much money today or here's how much you need to contribute from now on or how much more money you need to earn in your investments to get to your goals. We are going to do that on a much grander scale. We are going to do it for all million TRS members and compare that to the current assets contribution expectations to make sure the fund is actuarially sound.

Q: Why do retirement systems conduct regular evaluations? And, why are they so important to TRS and our members?

A: Well, regular evaluation's important mostly because all the expectations will not be exactly right. Will Rogers once said that "Predictions are very difficult especially ones about the future". And so, you know, we're going to make very good educated guesses. We're going to come up with very strong economic forecasts, but most likely things are not going to quite be right. You can imagine if we did an evaluation in 2000 then didn't even touch the fund again until 2010, how much different the world is. I mean even from 2007 to 2010 how much different the world is. So, you want to make sure you're regularly measuring and making adjustments as needed to make sure that the fund is actuarially sound and expected to continue indefinitely.

Q: What do think are the most commonly held misconceptions about actuarial evaluations?

A: I would say a very common misconception is the focus on the past or maybe even the immediate present. When really the evaluation is focusing on the future. It's focused on future expectations. A lot of terms you'll hear, the unfunded accrued liability or funded ratio, and these are terms that are measurement as of today. But really, they are a means to an end, which is trying to make sure that the fund assets are going to be there to provide benefits to members for all time. And so, the funded ratio, for example, is a measurement of today's liabilities to today's assets. The accrued liability is the measurement of where we are, how many assets we have today compared to a target level of funding. For example, that online calculator, it may have told you that you need two hundred thousand dollars, well if you only have a hundred thousand dollars today, then does that mean the game is over? Well, no, it means that you need to contribute more in the future to make it to the same goal. And so, that's what the unfunded liability is telling us, is that we are a little behind according to our target, but we have time to make it up. We just need more contributions to do so. And currently the contributions is made up of cost for new benefits and for making up that unfunded liability.

Q: What is actuarial soundness?

A: Well, actuarial soundness is a term that could have various meanings, but really it's going to mean is the fund expected to be sustainable. Will it work? If you take the current level of assets and current expectations of contributions and then the current expectations of benefits that will pay out of a trust, will that all work? Will it balance over time? And, you know, the goal of the pension trust is for all generations of taxpayers to pay a similar cost for the benefit and for all generations of TRS members to get benefits that are of similar value. And so, what we are trying to do is make sure that's in balance and that the plan is expected to continue indefinitely. And if the evaluations show that it's maybe not, then that's when the contributions have to increase or maybe some other adjustments are being made.

Q: In general, how have public pension plans faired in recent years? And how does TRS compare to other large public funds?

A: Well, the last decade, but really since 2008 has been very difficult on public plans. The shock to the financial markets really lowered the asset levels, which means if your benefits are going to stay the same, the item that makes up the difference is contributions. So, contributions are going to have to come up to meet the same expected benefit levels. And across the country in lots of places, the contributions have begun to come up. Now, if there's a limit to how high those contributions can go, then the next step is for benefits and it's been pretty common recently for benefits for new hires to be adjusted in some way. But in some of the plans which are more mature, maybe not growing, have lots of retirees, there's had to been adjustments to current members as well. TRS is in a unique position because of the size, but also because of the growth aspect. Where the population of Texas is growing, the population of TRS is growing and even if, over the next couple of years, as we get through this budget you see the numbers of our teachers shrinking a little bit, over time we expect the number of teachers to grow as the population grows. And so, that provides a boost underneath and kind of a safety net to help make sure the plan is going to be sustainable.

Q: So, how has life expectancy changed over time? And how does that affect your projections?

A: Well, of course life expectancy is increased over time and it's probably increased well beyond anyone back in the thirties or forties would've ever dreamed it could've increased to, but our evaluation process does predict there's going to be certain levels of life expectancy increases in the future. And therefore it can be managed. You know the life expectancy is really the most valuable piece of the benefit that's provided to TRS members, even more so than the size of the annuity and it's because it provides protection against longevity. In case that the one member that makes it to one hundred and five, if they were in a defined contribution plan would have depleted their assets most likely long ago. Where as the pension fund and the aggregation of that risk allows that member to continue to provide a benefit throughout their remaining lifetime. So, we can make an adjustment at the fund level, which has a much longer timeframe and can manage that if there is a spike in life expectancy, much better than an individual can.

Rhonda: Thank you Joe. That's really done a lot to explain these terms to us all. Thank you for being with us Joe.

Joe: Well, thank you for having me Rhonda.

Rhonda: And before we go, we'd like to let our viewers know that TRS's current actuarial evaluations can be found on the TRS website.

Well that's our time for now. We appreciate your joining us and we hope you'll tune in for the next addition of TRS Today.