Retirement Plan for Employees

Of the Guadalupe-Blanco River Authority

"Defined Benefit Pension Plan"

FUNDING POLICY

DEFINED BENEFIT PENSION PLAN BACKGROUND

The Defined Benefit Pension Plan (DB Plan) was established and became effective January 1, 1966 for eligible employees. The DB Plan was amended a number of times through the years and was restated in 2013. Effective December 31, 2010, the DB Plan was closed to new participants. On December 31, 2018, the DB Plan was fully frozen. Beginning January 1, 2019, all employees were enrolled in the Texas County and District Retirement System (TCDRS).

As part of the freezing of the DB Plan, a supplemental benefit was authorized for participants in the DB Plan in recognition that the total combined benefit that a participant would receive from both the DB Plan and the TCDRS retirement plan may be less than the benefit the participant would have received had the DB Plan not been frozen.

PURPOSE OF FUNDING POLICY

The purpose of a funding policy is to establish goals toward funding for the DB Plan in order to meet current and future benefit payments as well as provide flexibility in the face of budgetary challenges, market conditions, and actuarial estimates. A funding policy helps to provide reasonable assurance that the cost of benefits will be funded in an equitable and sustainable manner.

In order to provide assistance to public retirement systems, the Texas Pension Review Board published pension funding guidelines for meeting long-term pension obligations, most recently amended in 2017, adding a recommendation that organizations develop a funding policy. The Government Finance Officers Association also recommends that every governmental entity that offers defined benefit pension plans formally adopt a funding policy.

In addition, Texas state law now requires the governing board of a public retirement system to adopt a funding policy. For more information, see the Legal Requirement section later in this Policy.

COMPONENTS OF FUNDING POLICY

Risk Management

A retirement system faces many types of risk. While risk cannot be completely eliminated, measures should be in place to mitigate risk to the extent possible. Included below is a listing of risks facing the Plan, followed by the measures that are currently in place for mitigation. Risk definitions are courtesy of the Texas Pension Review Board's Risk Management training course.

- *Governance/fiduciary risk* – risk of breach of fiduciary responsibility including poor decision-making resulting from a failure to follow established and reasonable processes, fraud, or conflicts of interest; also, insufficient authority given to boards to make decisions
    - Oversight by Board of Directors
    - Acknowledgement and prioritization by Board of Directors and management of the importance of sufficient funding and engaged monitoring
    - Establishment and ongoing oversight by Retirement and Benefit Committee
    - Education and training of Committee members
    - Completion of pension plan financial audit by independent accounting firm
    - Providing transparency into the affairs of the retirement plan
- *Investment risk* – risk of underperformance of invested assets
    - Adoption of investment policy
    - Diversification of investment portfolio
    - Establishment of target allocations for investment classes
    - Contracting with qualified and experience investment consulting firm
    - Oversight by and decision making of Retirement and Benefit Committee
- *Funding risk* – risk of insufficient assets to meet liabilities, including risk of non-payment or underpayment of contributions
    - Oversight by Retirement & Benefit Committee
    - Ongoing reviews by management of investments and cash position
    - Scrutinizing investment options; due diligence in selection process; advice and monitoring by investment consultant
    - Full evaluation of benefit options and changes
    - Adoption and implementation of Funding Policy
    - Establishment of funding target and liability amortization period
- *Actuarial risk* – risk of relying on inappropriate actuarial methods and assumptions
    - Contracting with actuarial firm with solid reputation for accuracy and adherence to professional standards
    - Documenting the actuarial methods and assumptions used
    - Continual review and evaluation of actuarial methods and assumptions employed

- *Liquidity risk* – risk of being unable to sell an asset quickly enough to avert a loss, which can result in the inability to make benefit distributions or other payments when they come due, or to employ the asset in a desired manner
    - Oversight by Retirement & Benefit Committee
    - Ongoing reviews by management of investments and cash position
    - Involvement and advice from investment consultant
- *Operational risk* – risk related to the failure of internal or outsourced processes including benefits calculation, recordkeeping, information technology systems, etc.
    - Contracting with qualified and experienced designated trustee and actuarial firms
    - Management oversight of contracts
    - Completion of pension plan financial audit by independent accounting firm
    - Staying informed of changes in legal and regulatory environments as well as investment markets & the economic landscape
- *Data security risk* – risk related to storing electronic information including data breaches, hacks, etc.
    - Inclusion of clauses within contracts related to data protection systems
    - Validation by management that contracted firms have sufficient systems in place to prevent internal and external cyber threats
    - Insurance coverage for cybersecurity

In addition to the measures detailed above, employing the practices outlined in this Policy will serve to further reduce these risks.

Prioritization of DB Plan Contributions

The mission of GBRA is "to support responsible watershed protection and stewardship, provide quality operational service, and a commitment to promote conservation and educational opportunities in order to enhance quality of life for those we serve".

During any budgetary process, there are many elements that, in some cases, compete for the same dollars within the budget. However, in providing high quality services to customers and in order to fulfill GBRA's mission, investment in the company's greatest assets, its employees, is essential. Therefore, contributions to the DB Plan will have the same budget priority as other salaries and wages.

Plan Costs & Fees

In addition to the governance of the DB Plan by the Retirement & Benefit Committee, the management and oversight of a pension plan requires the hiring of external companies having expertise in several areas. These services come at a cost and are borne either by the DB Plan itself or paid for through GBRA's annual operating budget.

It will be GBRA's practice to fund administrative & trustee services, investment consulting, and legal fees through GBRA's annual operating budget. Investment management fees will be paid by the DB Plan.

Actuarial Methodologies, Assumptions, & Amortization

Generally speaking, it will be GBRA's practice to implement conservative methodologies and assumptions to proactively plan for and address the obligations of the DB Plan. The following represents a summary. More details are available in the annual actuarial valuation performed by Rudd & Wisdom, GBRA's contracted actuarial firm.

<u>Actuarial Cost Method</u>

An actuarial cost method is a procedure that identifies a series of annual contributions that will fund anticipated plan payments. However, for a frozen plan, no actuarial cost method is required. The primary calculations are the actuarial present value of future benefits for benefits currently in pay status and benefits not yet taken (deferred). The unfunded actuarial liability (UAL) is the amount by which the present value of future benefits exceeds the current plan assets. The UAL is recalculated each time a valuation is performed. Experience gains and losses, which represent deviations of the UAL from its expected value based on the prior valuation, are determined at each valuation and are amortized as part of the newly calculated UAL.

<u>Actuarial Value of Assets & Smoothing of Gains and Losses</u>

Assets are valued at market value as determined by the DB Plan directed trustee, with an adjustment made to uniformly spread actuarial gains or losses over a five year period (as measured by actual market value investment return vs. assumed market value investment return). Principal Retirement & Income Solutions (formerly Wells Fargo Institutional Retirement & Trust) currently serves as the directed trustee.

<u>Assumptions</u>

The following actuarial assumptions will be used but may be changed from time to time based on updated information and changes in trends:

- Salary increases - 2.75%
- Investment rate of return - 6.75%
- Employee payroll growth – 2.75%
- Mortality rates - PubG-2010 (general employees of public retirement systems) using the projection scale MP-2018

<u>Amortization Method & Period</u>

A closed amortization period will be used for the DB Plan. This means the UAL will be amortized by the end of the designated period as opposed to resetting the amortization over the same designated period each time the liability is recalculated.

Amortization periods for public pension plans generally range from 15 to 30 years. In a Standard & Poor's publication, *Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings*, Standard & Poor's suggests that the goal of pension plans should be to amortize the pension liability over 20 years or less.

It is GBRA's plan to amortize the total liability of the DB Plan over the 10 year period that began January 1, 2019.

Contribution Amount

Participants in the DB Plan do not make individual contributions - GBRA is the sole contributor. The Plan has been closed to new participants since 2010 and the Plan was frozen in 2018 eliminating the accrual of additional benefits, with the exception of the supplemental benefit. Therefore, neither a level dollar contribution nor a level percent of payroll contribution would prove helpful in determining recommended annual contribution levels. Instead, the determination of the annual contribution will be based upon the remaining years of amortization of the liability. In addition to the annual contribution, supplemental contributions are recommended when funds are available and deemed appropriate.

Actuarial Valuation Frequency

It has been GBRA's procedure, and considered best practice, to require the preparation of an actuarial valuation on an annual basis. However, since the advent of a fully frozen plan, there may come a time when the frequency of valuations is adjusted. GBRA management will evaluate the needs of the DB Plan and related costs of annual valuations in making that determination.

Investment Policy & Asset Allocation Strategy

An investment policy serves to outline the investment philosophy and strategy of the DB Plan and provide guidance for future decisions to the Board of Directors, Retirement & Benefit Committee members, and GBRA staff serving as administrators of the DB Plan. It is also provided to ensure a clear understanding and direction to the investment consultant and investment managers.

GBRA adopted an Investment Policy Statement on July 29, 2011 which continues to govern the activities of the DB Plan. The policy includes minimum and maximum ranges for exposure to different asset classes and includes planned targets for each class. The policy focuses, not only on cash flow needs to meet current monthly benefit obligations, but also seeks long term goals for ongoing obligations.

By reference, the Investment Policy Statement is made a part of this Funding Policy.

Post-Retirement Benefit Increases

The management and oversight of the DB Plan is an ongoing and evolving process that includes an emphasis on fiscal health and sound decision making. Any increase in benefits will be evaluated on specific case by case elements. Many considerations will be necessary before a decision can be reached including, but not limited to, the actuarial soundness of the DB Plan, its relationship to the targeted funding ratio, and stress testing of performance in down market conditions. The Board of Directors and Retirement & Benefit Committee will be fully involved in the decision making process.

Funding Objectives & Target

A retirement plan is considered fully funded when the Fiduciary Net Position as a percentage of the Total Pension Liability is equal to 100%. According to Standard & Poor's *U.S. Public Finance: U.S. State Ratings Methodology* published October 17, 2016 and republished October 7, 2019, an entity's "commitment to funding annual contributions that address the long-term pension liability is a key credit consideration". The publication assesses the plan's liability in four categories based on its three-year average funded ratio as follows:

Funded Ratio	Assessment
90% or above	Strong
80-90%	Good
60-80%	Relatively Low
60% or below	Weak

It will be GBRA's target to fund 110% of the Total Pension Liability. While this percentage can be defined as "over-funded", which by nature is a conservative approach, once reached, this target allows for future flexibility due to volatility in the markets as well as responding to other economic constraints that may require a response.

GBRA anticipates that any favorable experience will help the plan attain full funding on or before the end of the closed amortization period. On the other hand, any adverse experience will increase the recommended annual contribution that will be evaluated by GBRA management and the Board of Directors. One possibility to deal with an unexpected increase would be to work with the actuarial firm in testing the effects of extending the closed amortization period to mitigate the effect on the employer contribution.

LEGAL REQUIREMENT

The Texas Government Code 802.2011 created by Senate Bill 2224 during the 86th Legislative Session in 2019 requires the governing board of a Texas public retirement system to adopt a written funding policy by January 1, 2020. In addition to providing guidance to the Guadalupe-Blanco River Authority Board of Directors and the Retirement & Benefit Committee, this Funding Policy is intended to meet the requirements outlined in Texas statute.

CHANGES TO FUNDING POLICY

The adoption of this Funding Policy in no way restricts future modifications. However, any changes will require the approval from the Board of Directors.

ADOPTED BY THE BOARD OF DIRECTORS OF THE GUADALUPE-BLANCO RIVER AUTHORITY AT A REGULAR MEETING HELD ON THE 20th DAY OF NOVEMBER, 2019.

APPROVED:

Dennis L. Patillo
Chairman, Board of Directors

ATTEST:

Ron Hermes

Ron Hermes
Secretary/Treasurer Pro-Tem, Board of Directors

Appendix:

10 Year Historical Contributions
Defined Benefit Pension Plan

Calendar Year	Funded Ratio as of January 1	Recommended Contribution	Supplemental Contribution	Total Contribution	% of Payroll	% of Payroll (all retirement plans)*
2019	86.9%	$653,540	----- 2019 - data not yet finalized and available -----			
2018	85.6%	$1,128,049	$0	$1,128,049	9.8 %	13.5 %
2017	84.9%	$1,067,716	$0	$1,067,716	9.4 %	13.2 %
2016	85.7%	$1,038,202	$300,000	$1,338,202	12.3 %	15.4 %
2015	86.3%	$1,033,464	$700,000	$1,733,464	17.4 %	20.6 %
2014	83.4%	$984,302	$700,000	$1,684,302	18.0 %	20.9 %
2013	79.4%	$993,893	$600,000	$1,593,893	18.1 %	20.9 %
2012	76.6%	$1,011,297	$500,000	$1,511,297	17.4 %	20.0 %
2011	75.3%	$1,013,649	$600,000	$1,613,649	19.1 %	21.4 %
2010	58.3%	$1,020,832	$3,000,000	$4,020,832	46.3 %	48.5 %
2009	54.9%	$970,248	$500,000	$1,470,248	16.8 %	18.9 %

*Beginning January 1, 2011, newly hired employees became participants in the Defined Contribution 401(a) plan. GBRA contributed a percentage of employee's total compensation based on years of service from 5% to 7%. Employees did not contribute to this plan.

In addition, all employees were eligible to voluntarily participate in a 457(b) deferred compensation retirement plan. GBRA contributed 50% of the employee's salary deferral, up to a maximum of 3% of total compensation.

On January 1, 2019, all employees were enrolled in the TCDRS retirement plan. At that time, the DB Plan was frozen, the Defined Contribution 401(a) plan was terminated, and employer matching contributions to the 457(b) plan were discontinued.