



August 9, 2007

Mr. Joel Texan
City Manager
TMRS Sample City
P.O. Box 12345
Sample City, TX 78000

Sample City
City # 9999

Dear Joel:

In May, TMRS sent you your city's contribution rate for the year beginning January 1, 2008. As stated in the Rate Letter, your rate for 2008 is: **12.95%**

TMRS will be considering changes to several funding components in the coming months, but your contribution rate for 2008 will not change. There may be opportunity for your city to make additional contributions to reduce your liabilities, but the required monthly rate will be as shown above.

Exhibit 1 provides a 6-year history of key items from your city's annual actuarial valuations. The first box provides the 6-year total change in contributing members, average age and service and covered payroll. The second box provides the 6-year cumulative change in funded ratio, dollar amount of unfunded actuarial liability and contribution rates. The last two boxes include year-by-year details for various measurements. TMRS is providing you this historical information about your plan to help you understand the changes that are under consideration. Similar information will become a regular part of your Rate Letter beginning in 2008.

When considering this information, the following general guidelines will be useful. Please remember that these are general guidelines and actual results for your city may vary due to other factors. In addition, individual factors may often offset one another.

In general, the following factors have a tendency to increase contribution requirements and decrease funded ratios.

- Adoption of annually repeating updated service credits and annuity increase.
- Decreasing number of contributing members.
- Payroll growth less than assumed.
- Increasing average age.
- Increasing average service.
- Privatization or reduction in workforce.
- Adoption of additional benefits.
- Recent changes in assumptions.

Exhibit 2 includes additional important information for TMRS cities regarding the impetus for considering changes and a brief description of the changes being considered.

Sincerely,

Eric Henry
Executive Director

Enclosures

Exhibit 1
Historical Summary of Valuation Results
Texas Municipal Retirement System

City # 99999
City Name: Sample City

Demographic Changes (based on 6 years of active member data)							
<u>Change in Number of Contributing Members</u>		<u>Change in Average Age</u>	<u>Change in Average Service</u>	<u>Change in Total Covered Payroll of Contributing Members</u>			
<u>Count</u>	<u>Percentage</u>			<u>Total</u>	<u>Annual %</u>	<u>Assumed %</u>	<u>vs. Assumed</u>
+ 6	+ 11.3%	+ 3.2	+ 1.3	+ 1,026,519	+ 5.9%	4.0%	+ 1.9%

Liability/Cost Changes (based on 6 years of liability history)							
<u>Change in Funded Ratio*</u>		<u>Change in Dollar Amount of Unfunded Actuarial Liability</u>		<u>Change in Contribution Rate as a percentage of Payroll</u>			
<u>Without CSARF**</u>	<u>With CSARF**</u>	<u>Amount</u>	<u>Percentage</u>	<u>Normal Cost</u>	<u>Prior Service</u>	<u>Supplemental Death</u>	<u>Total</u>
- 3.1%	+ 0.2%	+ 992,327	+ 60.6%	+ 0.63%	+ 0.62%	+ 0.07%	+ 1.32%

<u>Valuation Date</u>	<u>Number of Contributing Members</u>	<u>Actuarial Liability (a)</u>	<u>Actuarial Value of Assets (b)</u>	<u>Unfunded Actuarial Liability (a) - (b)</u>	<u>Funded Ratio Excluding CSARF** (b)/(a)</u>	<u>CSARF** (c)</u>	<u>Funded Ratio Including CSARF** ((b)+(c))/((a)+(c))</u>
12/31/2001	53	8,184,163	6,547,029	1,637,134	80.0%	1,877,163	83.7%
12/31/2002	56	9,532,957	7,668,454	1,864,503	80.4%	1,833,347	83.6%
12/31/2003	57	10,970,284	8,798,062	2,172,222	80.2%	1,787,859	83.0%
12/31/2004	55	10,825,277	8,585,434	2,239,843	79.3%	3,176,004	84.0%
12/31/2005	57	11,748,232	9,204,009	2,544,223	78.3%	3,605,855	83.4%
12/31/2006	59	11,403,717	8,774,256	2,629,461	76.9%	4,974,105	83.9%

<u>Valuation Date</u>	<u>Total Covered Payroll</u>	<u>Average Age</u>	<u>Average Service</u>	<u>Contribution Rate</u>			
				<u>Normal Cost</u>	<u>Prior Service</u>	<u>Supplemental Death</u>	<u>Total</u>
12/31/2001	3,116,184	42.3	9.0	8.57%	2.86%	0.20%	11.63%
12/31/2002	3,557,714	42.3	9.4	8.75%	2.85%	0.20%	11.80%
12/31/2003	3,820,713	43.1	9.5	9.07%	3.12%	0.21%	12.40%
12/31/2004	3,874,308	44.1	10.4	9.19%	3.17%	0.23%	12.59%
12/31/2005	4,155,518	44.4	10.7	9.18%	3.35%	0.25%	12.78%
12/31/2006	4,142,703	45.5	10.3	9.20%	3.48%	0.27%	12.95%

*Funded Ratio is the actuarial value of assets divided by the actuarial liability.

** CSARF is the portion of Current Service Annuity Reserve Fund attributable to each city's annuitants.

EXHIBIT 2

IMPORTANT INFORMATION FOR TMRS CITIES

CHANGES AHEAD:

TMRS is a retirement system that provides cities with a wide range of choices about the retirement benefits they offer their employees. The System is funded in accordance with actuarial and accounting standards as well as Texas law.

The TMRS Board of Trustees is working to ensure that TMRS benefits continue to be appropriately funded and that cities have a clear understanding of the current and future costs of their plan.

The Board is examining all aspects of TMRS – liabilities, contributions, and assets. No decisions have been made yet, but the following are under consideration:

- Change the actuarial funding method that is used to calculate plan costs. TMRS currently uses the Unit Credit actuarial cost method and is considering moving to the Projected Unit Credit cost method, which will include up-front recognition of all future liabilities due to annually repeating updated service credit and annuity increase adoptions.
- Change the current amortization policy from a 25-year “rolling” period to a 25-year “fixed” period. With a 25-year fixed period, liabilities will be amortized over a set 25-year period instead of being “re-set” over a new 25-year period each year.
- Examine and change as appropriate TMRS’ traditional investment policy. For most years of its existence, TMRS has invested almost entirely in bonds and other fixed income instruments. Beginning this fall, the Board will be looking at ways to diversify TMRS’ investments to maximize return with an acceptable level of risk.
- TMRS’ primary actuary is The Segal Company. In August and September, TMRS will engage a second actuarial firm to review the recommendations made by Segal, to ensure that any changes to funding policy made by the Board have been thoroughly examined and considered.

Any changes made by the Board are likely to be phased in over a period of time so that effects on city rates or members’ benefits will not be abrupt and so that TMRS will have time to work with your city to chart the course that’s best for you and your employees.

WHY ARE CHANGES BEING CONSIDERED?

- Most TMRS cities have adopted Updated Service Credit and Cost-of-Living Adjustments on an automatic, annually repeating basis. Traditionally, TMRS has recognized the liability for these benefits one year at a time, since cities always have the option of turning off the benefit. After 15 years of experience, it has become clear that – for most cities that have made this adoption – these benefits will continue to be granted in the future. The TMRS actuaries have advised that these liabilities need to be recognized as ongoing expenses in the plan’s funding method. The change from the Unit Credit actuarial cost method to the Projected Unit Credit method will include these liabilities in the rate-setting calculation.
- Many cities are concerned about rising Unfunded Actuarial Accrued Liability (UAAL) numbers and declining funding ratios. Cities that are experiencing little or no workforce growth face special issues. The approach under consideration by the Board – switching to a 25-year fixed amortization schedule – will improve funding progress each year.
- TMRS believes that a strategic examination of the System’s investment policy needs to be made. While the System’s traditional reliance on income-producing fixed income securities has been successful for 60 years, the current market of low inflation and low interest rates requires TMRS to explore ways to increase investment revenue to ensure that future members’ benefits continue to be soundly funded and that city costs remain reasonable.

Exhibit 2 (continued)

WHAT WILL THESE CHANGES MEAN TO MY CITY?

If your city is one of those that has adopted annually repeating USC and COLAs, your contribution rate is likely to increase significantly under the Projected Unit Credit actuarial cost method. Any change to this method, and to your city's rate, will be phased in gradually. **If your city has not adopted annually repeating USC and COLAs, you will see no effect from this change.**

Under the current funding method and amortization policy, the funded status of TMRS is not projected to improve over the next 25 years. Moving to a fixed amortization period is likely to increase contribution rates for most cities, but has the advantage of funding a larger share of liabilities each year and of improving each city's – and the System's – funded ratio over time. As with the actuarial cost method, any change in this policy will be phased in.

WHAT'S NEXT? WHAT DOES MY CITY NEED TO DO?

For now, the most important thing you can do is to stay tuned to TMRS communications. Understanding the funding of your plan will help you consider future actions.

In October, TMRS will send you further rate information, showing projected future liabilities if you retain your current benefit structure. That letter will contain further discussion of the Board's findings and any recommendations that have been adopted at that point.

The TMRS Annual Training Seminar, *Focus on Funding*, October 14 – 16, in Austin, will provide an opportunity for you to hear more details from TMRS staff and actuaries. Please see the TMRS Website (www.TMRS.com) for information on the seminar.

In December 2007, results of the Board's deliberations will be sent to all cities at the same time you receive your reminder letter for your 2008 contribution rate. Please remember – no matter what changes in policy or practice the Board makes, your contribution rate for 2008 will not change.

However, beginning in January 2008, cities will also have the option of making additional contributions to their TMRS plan. If a city is concerned about its UAAL number or its funding ratio the city will have the ability to put more money in its TMRS plan to reduce actuarial liabilities. You will receive details on this new provision in the fall.

QUESTIONS?

TMRS has begun sending an E-Bulletin to cities once or twice each month as information warrants. The latest information will be contained in these bulletins.

If you have specific questions about your city's plan, call 1-800-924-8677. We can help you over the phone or arrange for a member of the TMRS Travel Team to visit your city.

TMRS is committed to our partnership with cities, to ensure that you have a good retirement program for your employees at a reasonable cost.