

TMRS LEGISLATIVE UPDATE - OCTOBER 2008

The TMRS legislative proposal for the 81st Regular Session of the Texas Legislature includes these three key provisions:

- ★ Guarantee an annual interest credit of at least 5% to member accounts and set the annuity purchase rate for retirees at a minimum of 5%
- ★ Allow the crediting of realized and unrealized income to city accounts
- ★ Allow city accounts to receive annual interest at a rate different from the member rate, including negative interest

This proposal represents the consensus of the TMRS Board of Trustees and the interim Legislative Stakeholder Group (LSG) that has worked throughout 2008 to consider potential legislative changes to the System.

Why is this Legislation Needed?

— ***To allow continued diversification of the TMRS fund and improve investment returns.*** In 2007, the TMRS Board voted to begin diversifying the System's investments from its traditional 100% investment in bonds to a diversified portfolio similar to that of other public retirement systems. To preserve members' benefits, to more effectively manage investment risks, and to mitigate future city contribution rate increases, TMRS is moving to a market return-based investment strategy.

— ***To guarantee that member interest rates and annuity purchase rates will remain at or above 5% in the future.*** Without diversification, member interest rates and annuity purchase rates will fall below 5%. Although many members believe that 5% is currently a guaranteed statutory rate, this is not true.

— ***To provide a more robust income stream within acceptable risk parameters.*** In 2007 TMRS changed the actuarial cost method that is used to determine city contribution rates, which resulted in contribution increases for cities that provide annually repeating benefits.

Asset diversification will improve investment income over time and help keep retirement benefits affordable for cities while reducing the risk associated with a portfolio invested entirely in a single class of investment.

— ***To enable TMRS, over time, to build a strong reserve fund for the future.*** One item discussed by the LSG and the TMRS Board that does not require legislative change is also crucial to the future health of the System. TMRS maintains a reserve fund now, but with the new funding structure, the role of a strong reserve policy will be more important. The Board will work with the Advisory Committee and the System's actuaries in 2009 to determine a sound reserve policy for the future. Once established,

This legislation is the most important in the 60-year history of TMRS.

a reserve fund can help to reduce volatility in city contribution rates and, in the long term, provide a basis for equitably sharing investment returns in the future.

What Happens if this Legislation Doesn't Pass?

— **Member interest rates will fall below 5%.** If TMRS remains invested mainly in bonds, the income stream will not support a 5% interest rate over time, and the rate could fall below 5% as early as 2016. Likewise, the annuity purchase rate that is used to calculate monthly benefits at the time a person retires will not be sustainable at 5%. Rates below 5% represent a direct benefit reduction for future members and retirees.

— **City contribution rates will rise even higher in the near future.** The current actuarial valuation of TMRS is based in part on an assumption that TMRS investments will earn an average 7% return over time. Without diversification, the assumed rate of return will need to be set at a lower percentage. Without assumed future investment earnings at a 7% rate, city contributions will increase immediately, beginning with the December 2009 actuarial valuation. Cities with annually repeating benefits that have already experienced significant contribution rate increases will see even higher rates. Some cities that cannot afford the higher rates may reduce TMRS benefits for members prospectively.

Who Helped Craft the TMRS Legislative Proposal?

In 2008, TMRS created the Legislative Stakeholder Group (LSG). The chair and vice-chair of the LSG were TMRS Board members, and the organizations participating in the LSG included Arlington Professional Firefighters Association, Combined Law Enforcement Associations of Texas, Government Finance Officers Association of Texas, Service Employees International Union – San Antonio, Texas City Management Association, Texas Municipal Human Resources Association, Texas Municipal League, Texas Municipal Police Association, and the Texas State Association of Fire Fighters. Members of the TMRS Advisory Committee on Retirement Matters also participated in the meetings. In recognition of the value of the LSG, in September 2008, the TMRS Board expanded the Advisory Committee to include representatives from each of the associations that participated in the LSG.

What About Other TMRS Issues?

The TMRS Board chose to limit its proposal to the three core items listed above. No changes to TMRS benefit provisions (other than the 5% guaranteed rate) are included in the proposal, but we are aware that other ideas may be brought forward for discussion. During the legislative session, TMRS will act as a resource for other bills that might affect the System.

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