

**MINUTES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM
Legislative Stakeholder Group,
an Ad Hoc Committee of the Board of Trustees**

On April 17, 2008, the Legislative Stakeholder Group (Committee) of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 10:00 a.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

Legislative Stakeholder Group

April Nixon, Vice Chair

Present also were:

- Roy Rodriguez, Chair of the Board of Trustees
- Carolyn Linér, Member of the Board of Trustees
- The Honorable Keith Brainard, Member of the Advisory Committee and Councilman of Georgetown
- Ron Cox, Member of the Advisory Committee
- David Crow, Arlington PFF
- Chris Heaton, TMPA
- Dr. Susan Helt, Member of the Advisory Committee
- Mike Higgins, TSAFF
- Chris Jones, CLEAT
- Darlene Lanham, TMPA
- The Honorable John Lewis, Member of the Advisory Committee and Councilman of N Richland Hills
- Richard Martinez, SEIU
- Joe McLaughlin, SEIU
- Jim Moore, Member of the Advisory Committee
- Keith Morton, TSAFF
- Jim Parrish, TMHRA
- Mike Perez, TCMA
- Bob Scott, GFOAT
- Jim Starr, Member of the Advisory Committee
- Greg Vick, TCMA
- Monty Wynn, TML
- Eric Henry, Executive Director & CIO
- Eric Davis, Deputy Executive Director
- David Gavia, General Counsel
- Eddie Solis, Director of Government Relations
- Bill Wallace, Director of Communications
- Leslee Hardy, Decision Support Actuary - Director
- Debbie Muñoz, Director of Member Services
- Michelle Mellon-Werch, Associate General Counsel
- Rhonda Covarrubias, Director of Finance
- Debbie Farahmandi, Investment Operations Specialist

Participating by Conference Phone:

The Honorable Lynn McIlhaney, Member of the Advisory Committee and
Councilwoman of College Station
Randle Meadows, Member of the Advisory Committee
The Honorable Debra McCartt, Mayor of Amarillo
Marilyn Timlake, Employee Benefits Administrator, City of San Antonio

Absent: H. Frank Simpson, Chair
The Honorable Larry Melton, Mayor of Odessa
Isaac Valencia, Member of the Advisory Committee

Guests: Patrick Hillis, North Richland Hills
Tadd Phillips, TMHRA
Blake Rocap, House Committee on Pensions & Investments
2 Staff members in College Station on phone with Lynn McIlhaney

The meeting was called to order at 10:04 a.m. and Ms. Nixon gave the invocation.

Ms. Nixon announced that the Chair, Frank Simpson, was out sick, therefore she will conduct the meeting. Ms. Nixon welcomed all of the participants and thanked them for participating. Roy Rodriguez also thanked the participants on behalf of the Board of Trustees. He explained that he will not be participating as a member of the Committee, but as a guest.

Introduction of Legislative Stakeholder Group Participants

Ms. Nixon asked all of the Participants to introduce themselves and name the organization they are representing, if any. All of the Participants and TMRS Staff introduced themselves.

Presentation Regarding TMRS Changes and Discussion

Mr. Henry gave a presentation on the changes TMRS is facing and why the Committee has been gathered here today. TMRS is facing many challenges: actuarial changes are increasing city contribution rates and declines in bond yields are driving down interest earned on the current portfolio. Cities and members both want benefits preserved and cities need benefits to be affordable and competitive. TMRS has begun taking steps to diversify its portfolio, but it needs statutory changes to continue diversification. The role of the Committee is to build consensus around the three core elements TMRS staff has identified as necessary to continue diversification, achieve higher returns, lower contribution rates and guarantee benefits, and to discuss concerns, and talk openly about expectations and realities. The three main components of the legislative package that TMRS has identified as crucial to the System are (1) Allow TMRS to credit unrealized gains and losses to cities (2) Guarantee a set annual interest rate and annuity purchase rate for members' accounts, and (3) Allow employers variable annual interest rates (whether negative or positive). Without these three components, diversification will not be able to continue, member interest credits and the discount rate used in calculating the annuity purchase rate will drop below 5% within 10 years and contribution rates will continue to increase. Mr. Henry explained that the System would move from an income investment strategy to a total return strategy, which will allow the System to move away from long-term bonds and into the equities markets.

Mr. Vick asked for clarification regarding the annuity purchase rate and why it would be guaranteed, too. Mr. Henry explained that when a member retires, the amount in their account,

plus the amounts matched by their city (or cities) is put into the Current Service Annuity Reserve Fund (CSARF). The discount rate used in calculating the annuity purchase rate is an assumption of the interest rate CSARF will earn as the retiree's annuity is paid. Mr. Scott asked what would happen to the current annuities that were calculated at 5% if the portfolio yield drops below 5%. Will the unfunded portion of the fund be paid by the city? Mr. Davis explained that once the funds are moved into the CSARF, it is no longer a liability of the city and becomes a liability of the System. Mr. Gavia stated that CSARF has first priority on returns up to 5%, therefore other accounts would be reduced accordingly and cities will see increased contribution rates and decreased funding status due to lower than expected interest credits to the remaining accounts. Other committee members stated their concern with unlimited gains going to the Municipal Accumulation Fund (MAF), when historically equity market returns have been positive. Mr. Henry stated that the projections and historical analysis indicates we will not be able to pay 5% interest beyond 2017 if we do not diversify the portfolio and set the other guarantees in place. Another member stated his concern that if the annuity purchase rate were to decrease, it could force those members eligible to retire to do so, so they would not lose the additional interest on their annuity calculations. Mr. Wynn asked if we expected to revisit the statutorily set guaranteed interest credit we are proposing every legislative session. Mr. Henry indicated that this is an open issue for the Committee. There have been suggestions to set triggers so that if there are unusual circumstances, the System would have alternatives.

Discussion Regarding Committee Timelines

Next, Ms. Nixon asked Mr. Solis to discuss the timeline for the Committee. Mr. Solis thanked all of the Committee members for taking the time to participate. He stated that the Committee would meet once a month, in Austin; the May date has not yet been determined. The Board hopes to have a recommendation from this Committee by its August 15th Meeting to allow other stakeholder groups to pass the proposals through their legislative review processes. Other important dates to remember are: November 10th - the pre-filing date for the 2009 Legislative Session and January 13th - the first day of the Session.

Discussion and Comments From Participants

Mr. Solis then explained that Ms. Munoz would be taking notes on proposals and the discussion on a spreadsheet that is projected for all the participants to see. At the end of the meeting, this document will be printed out for everyone to take with them and discuss with their stakeholders. Mr. Henry stated that to begin, the three proposals by TMRS are on the spreadsheet. Various proposals were then added to the spreadsheet by request of various Committee members. (See the attached spreadsheet.) Mr. Moore requested a presentation on TCDRS's system and its funding, since it appears to him that we are trying to model their current system, and possibly some other statewide systems, from inside and out of Texas. Mr. Heaton asked if TMRS would use a smoothing method. Mr. Henry affirmed that most likely the System would, but the specifics have not yet been determined. Mr. Henry explained how a smoothing period would work: if it is a 10 year smoothing period, then only 1/10th of any gains or losses would be realized for that year. There was discussion of TCDRS's current interest rate assumptions and credits. Ms. Hardy stated that they have a reserve to protect the fund during downturns. Mr. Solis stated that he understood that the reserves were depleted rather quickly after TCDRS made similar changes to its investment policies. Mr. Vick asked what the effect of a high interest rate over many years would be to the System under the three initial proposals. Mr. Henry stated the

System as a whole would, due to the smoothing mechanisms, gradually see a decrease in contribution rates and an increase in funding status. Several participants stated that they would like to see projections of the effects of smoothing on these proposals for different market scenarios. Mr. Henry agreed that TMRS could model the effect of several smoothing periods at 5, 7 and 9% interest rates. Ms. Hardy stated that a shorter smoothing period will likely show more volatile contribution rates. Ms. Nixon requested that different funding status scenarios also be modeled so the group could see the effect smoothing would have on funding status for cities.

Mr. Perez asked what would happen to employee benefits for a certain city, if the city were to go bankrupt and not be able to continue to pay its contribution rate. Mr. Henry explained that while TMRS has never had this occur, employee benefits would be reduced to cover what could be paid. A city could also make additional payments to pay off its liability. But, each city is individually valued and does not affect the liability of other cities or the System as a whole. Mr. Henry then clarified that once a member retires, the liability for the retiree's annuity does switch over to the System. So, if a city goes bankrupt, only the current participating members' benefits would be affected. And, if a member then goes to work for another city, the second city would only pay for liability incurred while working for that second city. Mr. Jones inquired as to the benefit of TMRS to employers and employees. Mr. Henry explained that the economies of scale allow TMRS to pay less for administration of a retirement plan than each individual city could afford separately. Cities and members also benefit from the portability of TMRS benefits.

Ms. Nixon stated that the discussion would now shift to focus on the pros and cons of each legislative proposal, beginning with the first proposal by TMRS to credit a fixed interest rate to member accounts and unrealized gains and losses to employer accounts. Mr. Henry stated that it is important to focus on these three main issues; TMRS must accomplish them and he does not want to see them clouded by other proposals. Group members inquired about the formula for interest rates and the impact of equity markets on those rates and the cost of the risk cities are taking. Mr. Henry stated that we cannot know what the future will be, so the cost of the risk is unknown. Mr. Moore pointed out that cities have infinite timelines, but employees do not. Mr. Jones also commented on the value of competitive benefits among municipal employees. Mr. Henry agreed that that would be a "pro" under proposal #1. Another "pro" for recruitment purposes is that TMRS benefits are portable from city to city. Mr. Solis asked if the participants thought that having a fixed interest amount is a "pro", and also, if they thought 5% is sufficient. Mr. Moore suggested that maybe if TMRS can do projections for the average plan (20 years, 2:1 ratio at 7%), so they can compare the outcomes for different scenarios to a DB plan to address concerns with competitiveness.

Mr. Henry asked for opinions from the elected officials in the group with respect to the proposed changes. Mr. Lewis stated that he supports the three initial proposals by TMRS. He wants to be able to take care of employees, but he doesn't agree with gains sharing if the city takes all the risk. Perhaps there could be a buy-in feature for the additional benefit. Mr. Brainard stated that if a city has unfunded liabilities, the employees benefit if the funding status improves by gaining risk free benefits. Mr. Crow stated that this is not really risk free for employees; they will be impacted if a city goes bankrupt or has to cut benefits. Mr. Jones felt that employees could get less elsewhere if a city has to pay more to TMRS, and echoed comments on gain sharing. Mr. Perez then asked for clarification on how the initial proposal of 5% guaranteed interest credit was determined. Mr. Henry explained that 5% is what is currently credited to member accounts and it is in the TMRS Act. Mr. Solis then clarified that if a higher interest credit is posted to

employee accounts, there is less to credit the employer accounts, and the matching liability for employer's increases.

Mr. Scott stated that the reality is that contribution rates have increased for 8 years and funding statuses have decreased. We need to show that these changes do stabilize rates and move funding statuses up before we can consider gains sharing. Mr. Rodriguez recalled that the industry standard for a retirement plan to have a healthy funded status is approximately 88%. The participants asked if there is a required funding status level. Mr. Henry stated that there is no set funding status target.

Mr. Heaton asked what happens if a city drops TMRS and moves to another retirement plan? Mr. Henry explained that the current annuitants would continue to get annuities, and current members would continue to make deposits to TMRS. However, a city that moves new hires to a new plan, no longer has that payroll growth to offset costs, so their contribution rates rise rapidly. Mr. Heaton expressed his concern that there is nothing to keep cities in TMRS. He is concerned that cities will pull out and move to defined contribution plans. He then proposed the interest credit for employee accounts be set at 6%. Mr. Solis stated that TMRS has been talking to cities and employees across Texas since the Fall and cities do not want to turn off benefits, but they do need stability in the contribution rates. Mr. Wynn asked if TMRS will continue to diversify at the rate of 1% monthly. Mr. Henry stated that it would, until TMRS gets statutory approval from the legislature, then the System may increase its rate of transition to a 60/40 asset class mix. Certain members inquired as to whether TMRS has been talking to the specific legislators who have very strong opinions about TMRS. Mr. Solis affirmed that TMRS has been in constant communications with the senators, representatives and their staff who usually concern themselves with pensions and investments, but also with many other representatives. Many cities have expressed support and willingness to approach their representatives in support of the package. TMRS would like to see many co-sponsors to show a broad consensus to the proposed legislation. TMRS will also work with its stakeholders to educate as many representatives and senators about the need for these changes. Mr. Perez stated that the work of the Committee should help remove most of the obstacles to the bill, because all of the interested parties are at the table, working together to resolve their differences. He believes that the work in this Committee will decrease or almost eliminate the number of interests working to defeat it.

Mr. McLaughlin cautioned that while he and Mr. Martinez are representing SEIU, they cannot commit to what the organization as a whole will support. They will provide the perspective of the organization and take any proposals and ideas back to their organization to consider. He then asked if the employer groups had received the rate letters. Mr. Henry stated sample rate letters were sent to the cities in November and again in February, and copies of specific ones can be requested from the cities themselves. Several participants who represent organizations described the timeline their group has for vetting legislative proposals affecting their constituents. For instance, Mr. Wynn stated that TML has a government committee that will review legislative proposals in mid-August, and then the proposals will be submitted to the membership for approval. Mr. Rodriguez stressed that the important work will be when the participants return to their organizations and educate them on the need for these proposals, and begin considering compromises to bring the Committee to assist with reaching a consensus on the details. Mr. Phillips asked if TMRS would consider a return-to-work proposal. Mr. Henry stated that because this has been a controversial issue with stakeholders on both sides, TMRS will not carry a proposal on the issue. The decision is up to the TMRS Board, but such a controversial proposal

could jeopardize the three components in the TMRS legislation. If it is proposed through another channel, TMRS will naturally provide information and resource support to the committees.

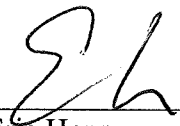
Discussion Regarding Next Meeting

Mr. Solis restated that the next meeting is planned for May, but the date has not yet been set.

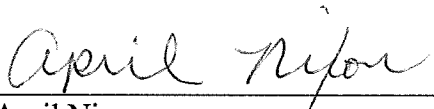
Any Other Business

None.

There being no further business to come before the Committee, the meeting was adjourned at 1:55 p.m.



Eric Henry
Executive Director
& Chief Investment Officer



April Nixon
Committee Vice Chair