

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

On July 18, 2008, the Legislative Stakeholder Group (Committee) of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 10:02 a.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas, with the following members present:

**Legislative Stakeholder Group**

H. Frank Simpson, Chair

April Nixon, Vice Chair

Present also were: Roy Rodriguez, Chair of the Board of Trustees  
The Honorable Keith Brainard, Member of the Advisory Committee and Councilman of Georgetown

David Crow, Arlington PFA

Darlene Lanham, TMPA

The Honorable John Lewis, Member of the Advisory Committee and Councilman of N. Richland Hills

Richard Martinez, SEIU

Joe McLaughlin, SEIU

Randle Meadows, Member of the Advisory Committee

Jim Moore, Member of the Advisory Committee

Keith Morton, TSAFF

Jim Parrish, TMHRA

Mike Perez, TCMA

Bob Scott, GFOAT

Andrew Smith, City of San Antonio

Jim Starr, Member of the Advisory Committee

Ian Allan, Director of Internal Auditing

Patricia Brown, Executive Assistant

Rhonda Covarrubias, Director of Finance

Colin Davidson, Regional Representative

Eric Davis, Deputy Executive Director

David Gavia, General Counsel

Nancy Goerdel, Director of External Investments

Leslee Hardy, Decision Support Actuary - Director

Eric Henry, Executive Director & CIO

Michelle Mellon-Werch, Associate General Counsel

Anthony Mills, Regional Manager

Cindy Morse, Executive Assistant

Debbie Muñoz, Director of Member Services

Eddie Solis, Director of Government Relations

Sean Thompson, Membership Analyst

Bill Wallace, Director of Communications

Scott Willrich, Director of Information Services

Participating by Conference Phone:

Jim Thomas, City of San Antonio

Dr. Susan Helt, Member of the Advisory Committee  
Chris Jones, CLEAT

Absent:

Ron Cox, Member of the Advisory Committee  
The Honorable Rufus Duncan, Jr., City of Lufkin  
Chris Heaton, TMPA  
Mike Higgins, TSAFF  
Mayor Debora McCartt, City of Amarillo  
The Honorable Lynn McIlhaney, Member of the Advisory Committee and  
Councilwoman of College Station  
Isaac Valencia, Member of the Advisory Committee  
Greg Vick, TCMA  
Monty Wynn, TML

Guests:

Natalie Foerster, Governor's Office  
Joe Newton, GRS  
Tadd Phillips, San Angelo  
Mark Randall, GRS  
Blake Rocap, House Committee on Pensions & Investments

The meeting was called to order at 10:02 a.m. and Mr. Simpson gave the invocation and asked for a moment of silence in honor and memory of Terry Kendall, longtime Legal Counsel and friend to TMRS who passed away July 12, 2008. Mr. Simpson welcomed all of the Committee members and guests and thanked them for participating in these discussions.

#### **Consider and Act on Adoption of Minutes from April 17<sup>th</sup> and May 29<sup>th</sup> Meetings**

Mr. Simpson stated that the draft minutes for the April 17, 2008 and the May 29, 2008 Legislative Stakeholder Committee meetings were sent to all of the participants in advance of the meeting and asked if there were any comments or corrections to be made. Mr. Brainard stated that there appeared to be a mistake on page 3 of the May 29<sup>th</sup> meeting minutes. Mr. Glass was accidentally referred to as Mr. Green. Mr. Simpson accepted the correction. Ms. Nixon moved to approve the minutes of both meetings with the correction from Mr. Brainard. Mr. Perez seconded and the motion passed unanimously.

#### **Recap of Previous Meetings and Timeline**

Mr. Simpson said that he expects today to be a further continuation of the productive discussions that have already begun. He wanted to review the timeline for decisions. The next meeting of the Committee will be in August, just prior to the Joint Board and Advisory Committee meeting on the 15<sup>th</sup> to approve a final recommendation for a legislative package to the Board.

#### **Presentation and Explanation of Sample Employee Benefit Comparisons and Funding Scenario Data by GRS**

Mr. Simpson introduced Mark Randall and Joe Newton from Gabriel Roeder Smith & Company, TMRS's new consulting actuary. Mr. Randall began with a definition of volatility, explaining the difference between high and low volatility. He also defined the term "standard deviation."

Volatility is a measure of risk in the fund and standard deviation is the way to measure volatility that expresses the probability that the fund will generate investment returns within a certain range. Mr. Randall reviewed TMRS' different funds and discussed the volatility of each fund. He explained that because the Employee Savings Fund (ESF) and Current Service Annuity Reserve Fund (CSARF) are "guaranteed" a certain interest crediting rate under the base legislative proposal, all of the volatility in the fund is borne by the Municipal Accumulation Fund (MAF). He then explained how volatility decreases the overall investment return of the fund. Each time the return is lower than expected, it takes longer for the fund to make up the lost income because there are less funds to earn the return necessary to reach the target.

Mr. Newton explained the difference between a crediting rate and a total fund return and gave examples for scenarios of better- and worse-than-expected returns. He then defined various statistical terms, such as "mean," "geometric average" and "risk adjusted expected return." He explained the current standard deviation to be expected by the MAF with the current assumptions and showed a 30 year simulation of expected returns. If the ESF and CSARF were guaranteed 5% annual credits and the MAF were allowed to capture all returns, the leveraged mean for the MAF would be 10.3%, however the effect of standard deviation at 26.6% would give a geometric average rate of 7.59% and a risk adjusted expected return rate of 7.07%. He then showed the change in these adjusted rates if TMRS were to build a reserve. The reserved mean would be 10.3% with a 2.66% standard deviation and would provide a risk adjusted expected return rate of 10.28%. Mr. Newton then showed projections on the effects of four different scenarios – deterministic (an ideal 7% return each year), simulated (a typically divested fund with a mean of 7% and 10% standard deviation), leveraged (TMRS' structure, 10.3% mean with 26.6% standard deviation) and reserved (a fund with a reserve that has already been established, 10.3% mean with 2.66% standard deviation) on annual returns, employer contribution rates and funding ratios. The final example demonstrates reduced volatility in employer contribution rates and funded ratios.

Various participants asked questions regarding the way TMRS funds are invested, actual experience in volatility of other Texas state-wide diversified plans and the effect of volatility on the funds. Mr. Scott asked if the MAF were better funded would the volatility decrease. Mr. Newton answered that it is the size of the MAF compared to the rest of the fund and its position currently as the only fund with flexibility to absorb fluctuations that creates the volatility. There was a discussion regarding the timing of lump sum payments to TMRS, how cities may react to a low rate of return and the consideration to move from a Defined Benefit (DB) plan to a Defined Contribution (DC) plan. Mr. Moore asked what happens to the MAF if we are not concerned with cash flow, just looking at earnings. Mr. Newton explained that if the legislature accepts the base proposal, the MAF would grow faster than the other funds because it is getting 7% to their 5%. Mr. Scott clarified that this assumes no retirements from the MAF. Other participants asked what an appropriate level of reserves might be, how TMRS could establish reserves and what to expect while building reserves. Mr. Newton explained that the Board of Trustees would have to determine what they believe would be a good level of reserves, and that it might change as various other factors change, such as the projected markets, the current investment mix and other factors. The only way to build reserves is to use returns in excess of anticipated returns, which may or may not occur in the first few years of diversification. Mr. Newton also suggested a 10 year smoothing period while there is little reserve, to decrease the volatility in employer contribution rates and funding ratios.

Mr. Newton then discussed the level of probability of contribution rates falling and showed that there is a 95% chance of staying below 20% contribution rate if there is a reserve to always cover less than expected returns. Mr. Newton then reviewed 6 different scenarios for the legislative package and what each would mean in terms of the arithmetic mean, standard deviation and risk adjusted expected return. The scenarios included 5% to ESF and no reserves, 5% to ESF with reserves, 6% to ESF with no reserves, 6% to ESF with reserves, 5% to ESF and 50% gain sharing above 9% returns with no reserves, and 5% to ESF and 50% gain sharing above 9% returns with reserves. Mr. Randall summarized the presentation by showing the volatility that exists without reserves, the stabilizing effect of reserves and some things to consider until an acceptable level of reserves are developed.

### **Discussion and Presentation on Funding Scenarios**

Mr. Davis and Ms. Hardy then presented a comparison of benefits of TCDRS and TMRS. The examples presented a member in each system with the same years of service (10 and 25); for TMRS each of the following was calculated: no Cost of Living Adjustment (COLA) or Updated Service Credit (USC), only USC and both USC and COLAs and both 5% and 6% interest credit over the life of the member. For the 10 year employee, the monthly benefit for TCDRS is approximately \$1,377 which is close to a TMRS with USC and COLAs at 5%, which is \$1,476, or at 6%, which is \$1,490. Use of the USC and the COLA offsets the higher interest credit used in the TCDRS example. Mr. Brainard asked why the difference between the 5% and 6% is so little. Mr. Davis explained how USC will make up a greater portion of the benefit at 5%. Mr. Martinez requested the same figures for a member earning \$30,000 for 10-15 year of service, because that is 80% of their membership. Ms. Hardy agreed to provide that information. Ms. Hardy then presented a comparison of four different hypothetical employees' annuities under 5% and 6% interest credit with and without USC and COLA and with USC only. Ms. Hardy presented a slide showing the estimated impact on city contribution rates of a 6% employee interest credit, according to the different levels of city deposit rates, matching ratios and recurring USC. Most TMRS members accrue benefits at a 7% deposit rate, 2:1 matching. Those cities without USC would see an increase to their current contribution rate of approximately 15%, and those with USC would see an increase of approximately 4%. Participants again discussed the fact that the increase for cities without USC is much greater than the increase for those cities with USC; the additional USC is replaced by the increased interest credit in TMRS' benefits calculations.

Mr. Simpson asked Mr. Randall if they had any final comments. Mr. Randall reiterated that a reserve fund would act as a smoothing mechanism for the Fund. Common actuarial asset smoothing techniques will not decrease the MAF's volatility sufficiently and there is potential for bias. He also stated that any time benefits are tied to actuarial assumptions, such as the concept of tying gains sharing to funding status, it may create a conflict between actuarial assumptions, contribution rates and benefit levels and may affect the ability of the actuary to be independent. Ms. Hardy agreed that Board actions can affect actuarial assumptions and require the actuary to change assumptions. Mr. Simpson stated that the Board feels that investment return projections should come from investment consultants. Mr. Henry then stated that TMRS has hired consultants to provide their professional advice to the Board when it makes decisions. Mr. Brainard asked if considering the current status of the fund, Mr. Randall believes gains'

sharing is premature. Mr. Randall stated that it would be premature, but once a reserve is created, then there would be room to consider it.

### **Discussion and Comments**

Mr. Henry reviewed the legislative package proposals. The initial package proposed by TMRS included guaranteeing a 5% interest credit to the ESF, fixing the discount rate used in the annuity purchase rate to 5%, and allowing the Board to credit/debit unrealized gains and losses to the MAF to facilitate the move to the total return style of investing. Other options that have been proposed are:

1. To allow cities to elect a 6% interest credit for ESF and the discount rate
2. Gains sharing at some trigger levels
3. Build reserves

Mr. Henry stated that he feels it is critical to build reserves to decrease volatility and secure the funds. He proposes that TMRS use interest earned over 7%, if any, to build the reserves as quickly as possible. He then stated that these discussions have helped to identify many issues of concern for the TMRS stakeholders. He observed that employees want better benefits, employers want more stable rates, TMRS does not currently have adequate reserves to do either. He then concluded that for the next session, it would be best to set the guaranteed interest credit for the ESF at 5%, focus on building reserves, and continue to have the Legislative Stakeholder Group meet and work with TMRS.

Mr. Simpson concurred with Mr. Henry's conclusions. He stated that he did not want to put any legislation in place that might have to be undone later. Perhaps in the future, the group could look at increasing the options available for COLAs. Mr. Meadows agreed with Mr. Henry and Mr. Simpson and stated the earlier the group can come to a consensus, the earlier they can begin approaching their representatives to discuss the issue with them before they get busy with session. He is looking forward to participating in discussions for the 2011 session. Ms. Nixon agreed with Mr. Henry's conclusions and suggestion that the group continue to meet. She agreed with Mr. Simpson's desire to increase the flexibility of the System. Mr. Scott reminded the Board and participants that other cities have already mentioned they will be proposing changes to TMRS at the legislature. He agrees with the move to keep this proposal simple.

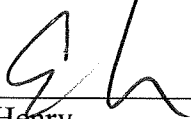
Mr. Solis stated that after the Board approves a proposal, he will look to the participants to help him generate support to move it forward in the legislature. Mr. Simpson asked staff to prepare a draft of the recommendations discussed to distribute to the group two weeks prior to the next meeting. Mr. McLaughlin concurred that he would like to see the group continue to meet. He is getting closer to feeling comfortable with the package; however he would like to see a draft of the actual legislation. Mr. Simpson and Mr. Solis clarified that the proposed legislation would only be drafted after they have the final approval from the Board on what it wants to propose. This committee is charged with recommending a legislative package. The Board has the fiduciary duty to determine what will be proposed by TMRS. Ms. Lanham stated that she would prefer to see the reserves framed by a range of a percentage of the total fund assets, such as 5-15%. Mr. Simpson asked if she meant in the statutes or by rulemaking or by Board policy. Ms. Lanham stated that she would be comfortable if it were by Board rule or policy. Mr. Simpson then stated that the Board hopes to receive a recommendation from the Committee and approve a

legislative package at the August meeting. It will probably be late September before we have a draft of the legislation. Mr. McLaughlin would like the group to meet after the legislation is drafted. Mr. Solis stated that if there is a general consensus after the legislation is drafted that the group should meet, then he will see to it; however, if there is no need he does not want to take more time from everyone's schedules.

**Any Other Business**

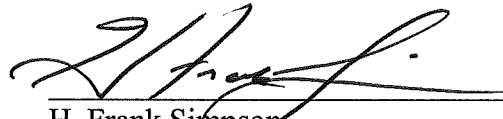
None.

There being no further business to come before the Committee, Mr. Simpson adjourned the meeting at 2:12 p.m.



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Eric Henry  
Executive Director  
& Chief Investment Officer



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H. Frank Simpson  
Committee Chair