

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

On May 29, 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

H. Frank Simpson, Chair

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 PFA

The Honorable Rufus Duncan, Jr., City of Lufkin

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

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

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

Nancy Goerdel, Director of External Investments

Bill Wallace, Director of Communications

Leslee Hardy, Decision Support Actuary - Director

Ian Allan, Director of Internal Auditing

Debbie Muñoz, Director of Member Services

Patricia Brown, Executive Assistant

Candace Nolte, Controller

Michelle Mellon-Werch, Associate General Counsel

Rhonda Covarrubias, Director of Finance
Kate Reed, Investment Analyst

Participating by Conference Phone:

Jim Thomas, City of San Antonio

Absent:

Isaac Valencia, Member of the Advisory Committee
Mayor Debora McCartt, City of Amarillo

Guests:

Chris Bucknall, TCDRS
Kenneth Friesehahn, Texas Legislative Service
Gene Glass, TCDRS
Jason McElvaney, TCDRS
Mark Randall, GRS (by phone)
Marie Connie Rendon, SEIU
Blake Rocap, House Committee on Pensions & Investments
Paul Williams, TCDRS

The meeting was called to order at 10:02 a.m. and Ms. Nixon gave the invocation. 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, 2008 Meeting

Mr. Simpson stated that the minutes of the last meeting have not yet been distributed. They will be distributed and brought forward for approval by the Committee at the next meeting.

Recap of First Meeting by Chair and Vice Chair

Mr. Simpson said that in his review of the draft minutes of the first meeting he felt that there had been a good open discussion among all interested parties and he asked all of the participants to continue in the same vein today. Ms. Nixon agreed that many of the participants had voiced their opinions and were open to the discussions presented by TMRS Staff.

Presentation by Texas County & District Retirement System

Gene Glass, Executive Director of TCDRS presented a PowerPoint with an overview of TCDRS as compared to TMRS. Mr. Glass introduced several other employees from TCDRS in attendance: Paul Williams, Investment Officer, Chris Bucknall, Director of Actuarial Services, and Jason McElvaney, Director of Governmental Relations. Mr. Glass then proceeded to explain the shared history of TCDRS and TMRS. He described the current plan and the major changes in plan design, actuarial methods and investments that moved TCDRS to its current status.

Mr. Glass explained that TCDRS's philosophy is to have a conservative approach to maintain stable employer rates, long-term sustainability of the plan and to help employers make educated plan design decisions. He reviewed a table showing the number of employers that have adopted COLAs. TCDRS allows employers to select varying levels of CPI-based or flat-rate COLAs. For 2008, approximately 27% of employers elected to enact a COLA. However, over the past 3 years, less than 40% of those employers provided COLAs.

Mr. Glass then reviewed the fixed-rate funding approach, fixed income portfolio and high turnover rates in the 70's and 80's. He discussed how the plan design and investment portfolio have changed over time and the trends that drove these changes. In 1991, TCDRS changed its actuarial accounting methodology to Entry Age Normal and adopted "variable-rate" plans, where employee rates were set first, then 2% more was credited to employer accounts. They moved to a diversified portfolio in 1997 and set the statutory rate at 7% for employee accounts and a target rate of 9% for employers. Mr. Glass then reviewed TCDRS' allocation rate history and the benefits of a reserve fund created to help them manage periods where actual returns were less than expected. In 2000, they used reserves to credit employers, in 2001, employers received only 5% and, in 2002, employers funds were decreased by 11% to enable employee accounts to be credited 7%. In 2003, earnings allowed them to make up the differences from the past three years and credit higher earnings to employer accounts as if they had earned 9% for those years.

The reserve account is currently approximately 14% of the total portfolio. A graph showing the effects of lower than expected earnings indicated that at the current level, it could be depleted in one year with earnings below -7.14% or over several years where returns are slightly lower than expected. The reserves have varied from 8% to 16% of the total portfolio since inception. During the early 2000's, while there was a lot of volatility in the fund accounts, Mr. Glass explained, there was very little movement in contribution rates due to the smoothing method employed by TCDRS. TCDRS implemented a 10 year smoothing method which decreases volatility in employer contribution rates by recognizing only 1/10th of any actuarial gains or losses each year for 10 years.

Mr. Williams then presented information regarding the diversification process at TCDRS. He began with the basic pension fund formula, Contributions + Investments = Benefits + Expenses, and stated that if you change one variable, it must be balanced in the equation. He explained that asset allocation is the most important factor in a pension plan's long term return and risk, and that growth can only come from two sources: contributions (employee and employer) and returns. He reviewed various graphs; the first showing the history of the diversification of the portfolio from fixed income to a fully diversified, non-correlated portfolio, managing the desired long-term return with risk, other graphs showed expected returns with the current asset allocation, return, risk and yield assumptions for each asset category (2008), one and two year standard deviation distributions for the total portfolio and the portfolio's return history since 1996, when they began diversifying. Participants asked many questions with respect to the reserves, smoothing and its effects, COLAs and the effect of smoothing on COLAs, various asset classes, factors regarding TCDRS participant counties and districts and members, actuarial methodology and changes, the history of legislative changes, and plan design.

Mr. Simpson thanked Mr. Glass and Mr. Williams for taking the time to share their experience and insights with the Committee. The Committee took a 30 minute break for lunch.

Discussion and Presentation on Funding Scenarios

Mr. Henry reviewed the reasons why TMRS needs to make certain statutory changes in the upcoming legislative session. He then reviewed the base scenario proposed by TMRS which would guarantee member accounts 5% interest annually. The city accounts would receive the remaining earnings, whether positive or negative. City rates and liabilities would be discounted by a 7% return assumption, which was the basis for the current projection letters and May rate letters. Option 1 would be an option for cities to adopt by ordinance and could be tied to attaining a certain funding level. This option would guarantee 6% to employee accounts with the remainder going to the city accounts. Ms. Hardy stated that as a general rule, Option 1 would increase actuarial liabilities and employer contribution rates.

Ms. Hardy then illustrated the differences between a pension based on a 5% interest credit and one based on a 6% interest credit. For a new employee in a city with no COLA or USC beginning at a salary of \$35,000 increasing 3% annually, at 5% after 25 years of service that employee will receive a monthly annuity of approximately \$3284, whereas with the same history at a 6% interest credit, the employee would receive approximately \$3724, a \$440/month difference, 13.5% more. TMRS will provide additional outcome scenarios for the group prior to the next meeting. Upon request, Mr. Davis explained how USC is calculated and the impact of USC on benefits. He then answered questions regarding USC.

Next, Mr. Henry discussed Option 2, which would be an option cities could adopt by ordinance and could also be tied to achieving a certain funding level. This option would give employee accounts a 7% return, the city would receive up to a 9% return and amounts above 9% would be divided between the city and employee accounts. The participants discussed using a 5-year average return rate versus a 10-year average return rate, the TMRS assumptions regarding expected returns and how risk is distributed. Mr. Henry clarified that any additional funds added to city accounts stay in TMRS to fund benefits and cannot be retracted by a city for its general fund and that any gain sharing will increase a city's liability because it removes a portion of the upswing that was expected to offset a downswing when calculating the estimated average return for the portfolio. At Mr. Simpson's request, the group discussed whether employees would rather have an increased guaranteed percentage or COLAs. The participants requested more information regarding benefits for the same employee work histories from TMRS and TCDRS. Mr. Simpson agreed that TMRS staff will work to provide this information for participants.

Discussion and Comments From Participants

Mr. Simpson stated that this discussion occurred earlier during Mr. Henry's presentation above and recommended that all of the participants forward their thoughts and comments to TMRS staff. He distributed a memorandum from the City of North Richland Hills expressing its opinions regarding TMRS' 2009 legislative proposals.

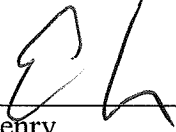
Discussion Regarding Next Meeting

Mr. Solis stated that the next meeting is planned for June around the time of the Board Meeting, but nothing has been set.

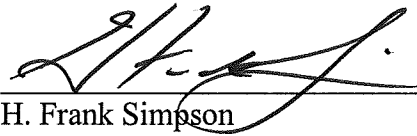
Any Other Business

None.

There being no further business to come before the Committee, Mr. Simpson adjourned the meeting at 2:27 p.m.



Eric Henry
Executive Director
& Chief Investment Officer



H. Frank Simpson
Committee Chair