TEXAS MUNICIPAL
RETIREMENT SYSTEM

2009 Legislation

2009 Legislative Package

The most important TMRS legislation since 1948.

Why is This the Most Important Session In TMRS History?

- COLAs and USC are the cost drivers. Without this legislation diversification will stop, employer contribution rates will increase even further, benefits will be difficult to sustain at current levels, and TMRS will have to reduce interest credits and annuity purchase rates at some point in the future.
- Cities and members both want benefits preserved (COLAs, USC, matching ratios)
- Cities need the benefits to be affordable and competitive
- Diversification will increase investment returns to the TMRS fund
- Member benefits will be guaranteed and city contribution rates will be mitigated by investment performance

Legislative Stakeholders Group Role

- Build consensus around the three core elements necessary to continue diversification, achieve higher investment return, lower contribution rates, and guarantee benefits to employees by providing input and feedback.

2008 – TMRS In Transition

- Changed Actuarial Cost Method
- Higher rates for many cities
- Began Diversification of Assets
  - Indexed investments
  - 12% into stocks in 2008

2009 – Legislative Proposal

- Part 1 – Allow TMRS to credit unrealized gains to <u>members</u> and unrealized gains and losses to <u>cities</u>
- Part 2 – Guarantee members an annual interest rate and annuity purchase rate
- Part 3 – Allow employers variable annual interest rates, including negative rates

Why Are All 3 Parts Important?

- Without Part 1:
  Diversification cannot continue
- Without Part 2:
  Member interest credits and the annuity purchase rate are likely to fall below 5%
- Without Part 3:
  Cities will see contribution rates rise

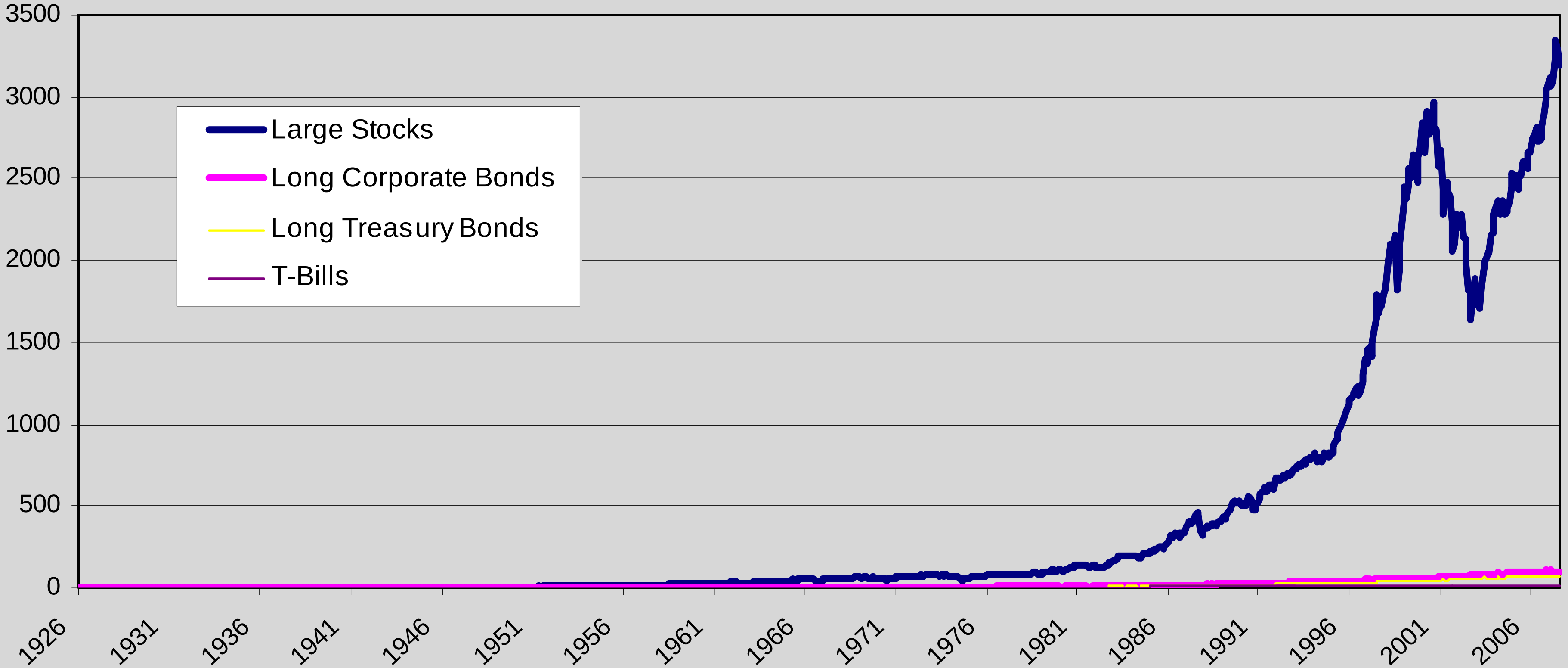
PART 1 – Diversification

- Allow TMRS to credit unrealized gains to members and unrealized gains and losses to cities.
  - Why diversify?

PART 1 – Why Diversify?

Over long periods of time, stocks outperform bonds

Total Return of Large Stocks, Long Treasuries, Long Corporates and T-Bills
1926 - 2007



PART 1 – Why Diversify?

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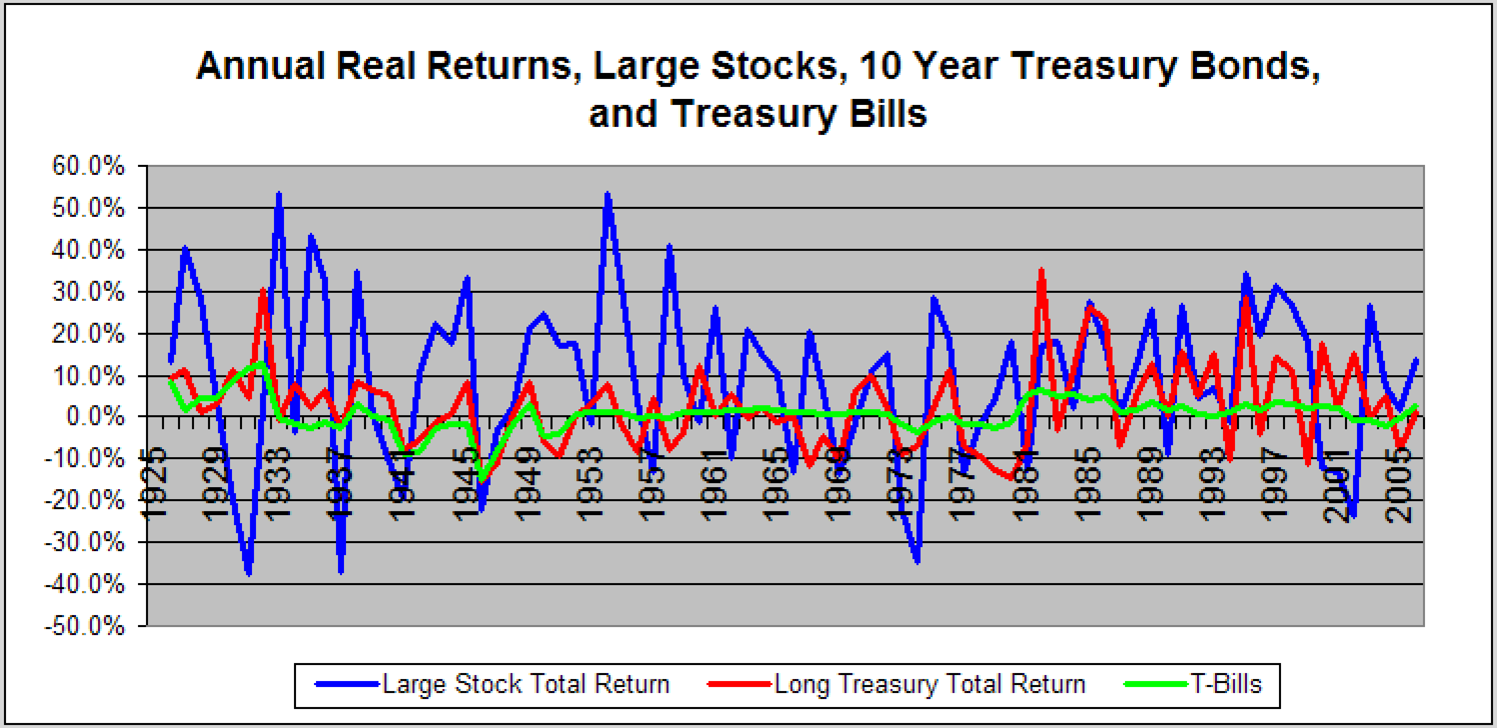
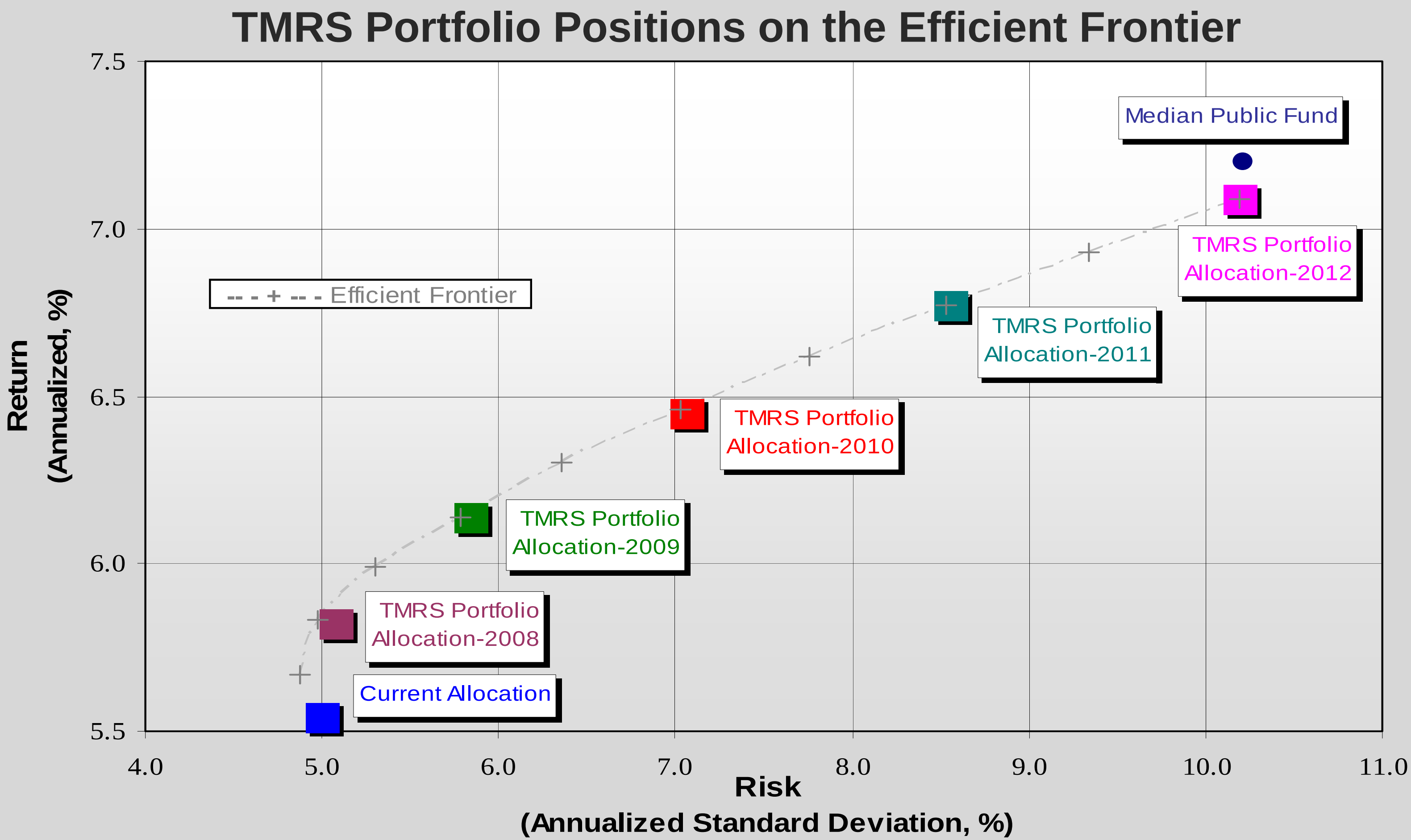


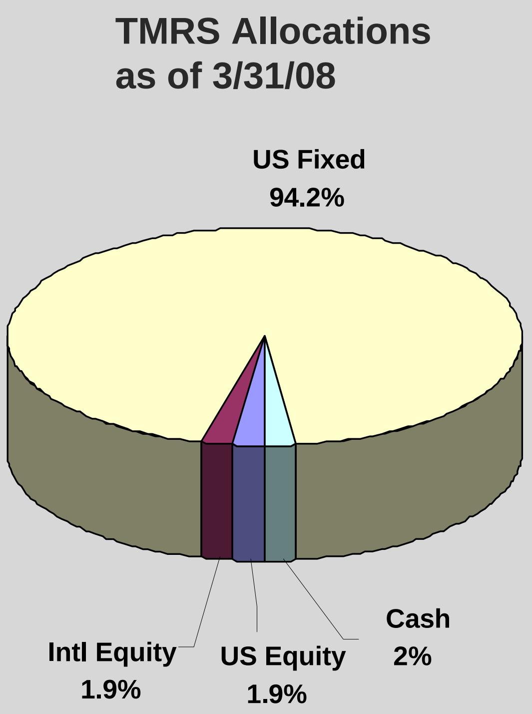
Return Projections
Under New Investment Policy

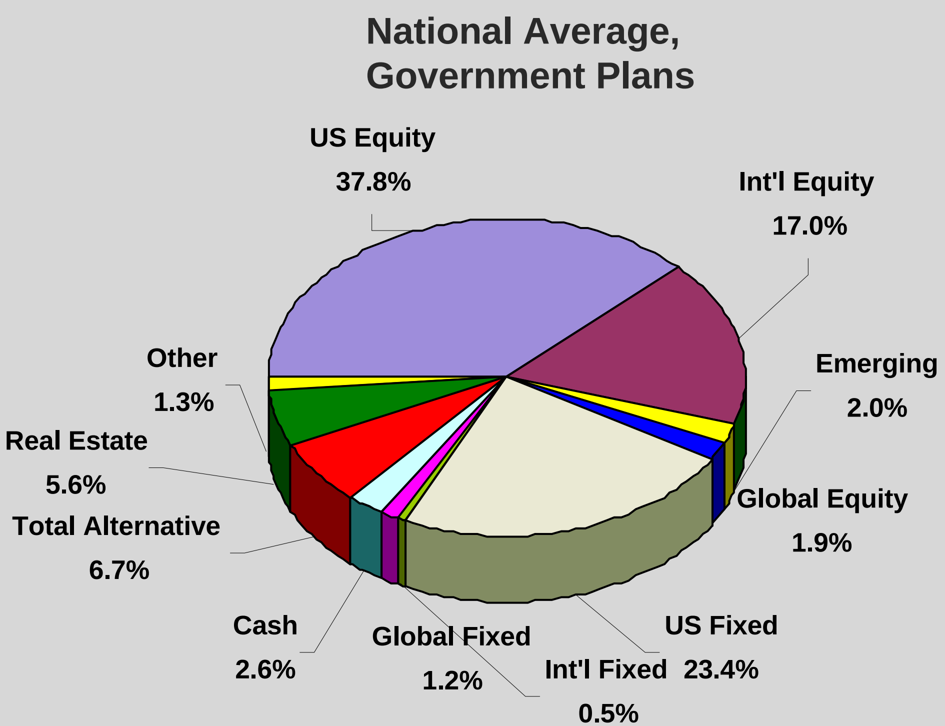


NOTE: Graph does not indicate earnings fluctuations between allocation periods.

PART 1 – Why Diversify?

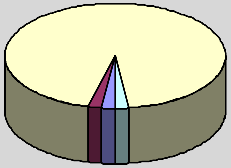
Diversified portfolios are common practice for large pension funds



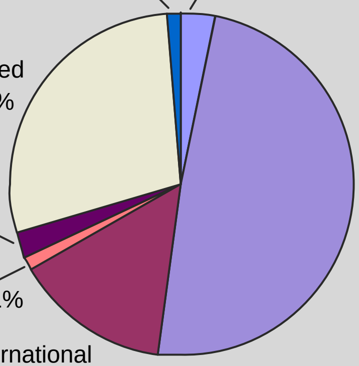


Other Statewide Plans

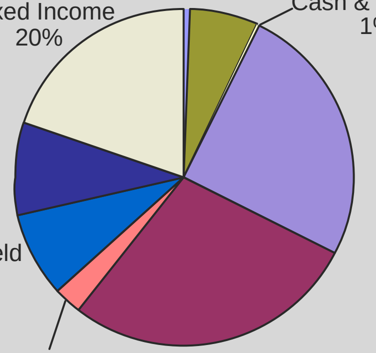
TMRS



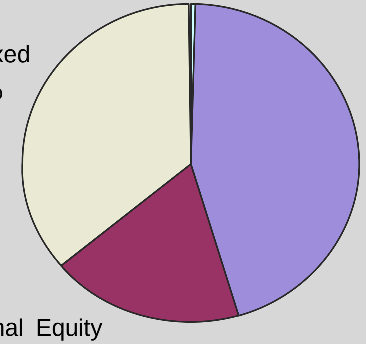
TRS



TCDRS



ERS



2007 Allocations –
rounded to nearest whole percent

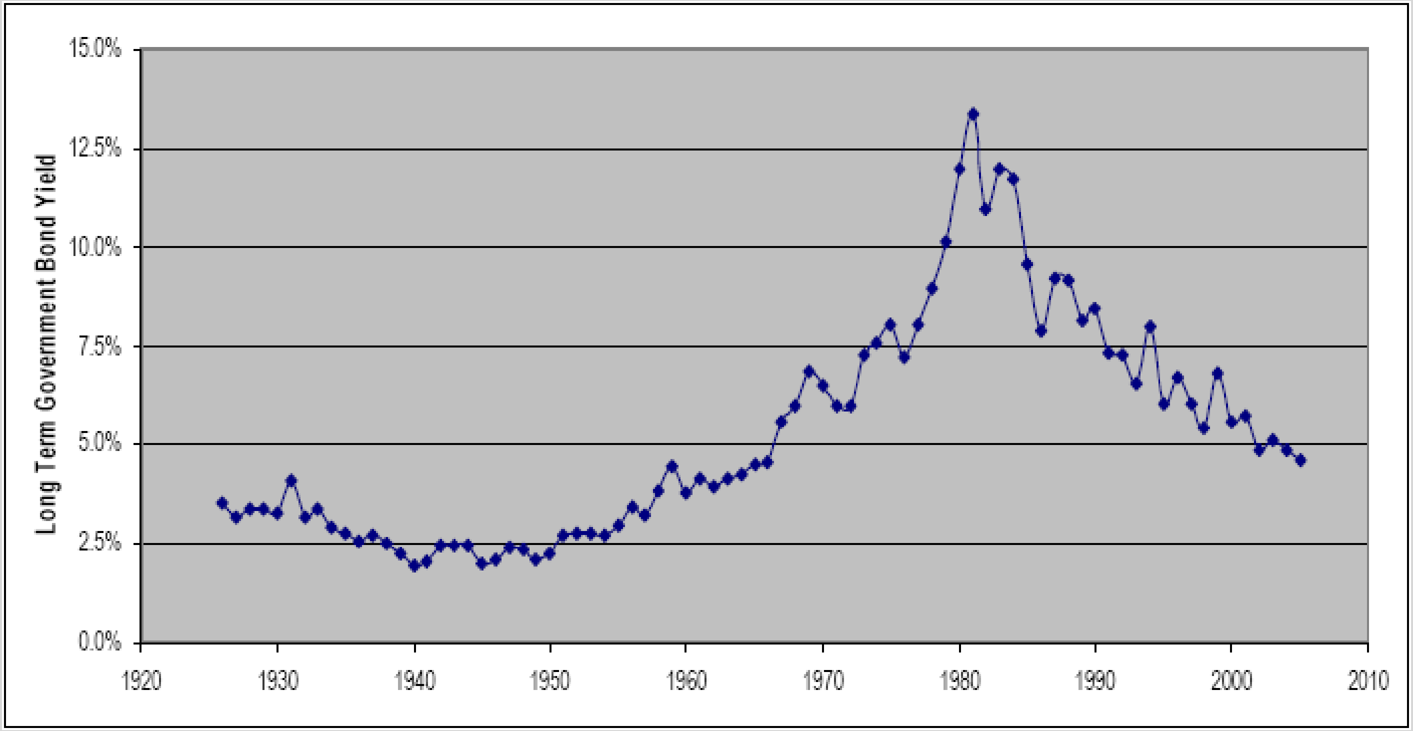
TMRS Investment Changes

TMRS is moving from an <u>income investment strategy</u> to a <u>total return strategy</u>.

- Earnings will include an increase or decrease in market value
- Under a total return strategy, focus will be on market value of assets as well as on annual dollar income
- Interest will be credited to city accounts based on annual performance
- Changes in market value will significantly impact the interest credited to city accounts
- **<u>Down years can result in “negative interest”</u>**

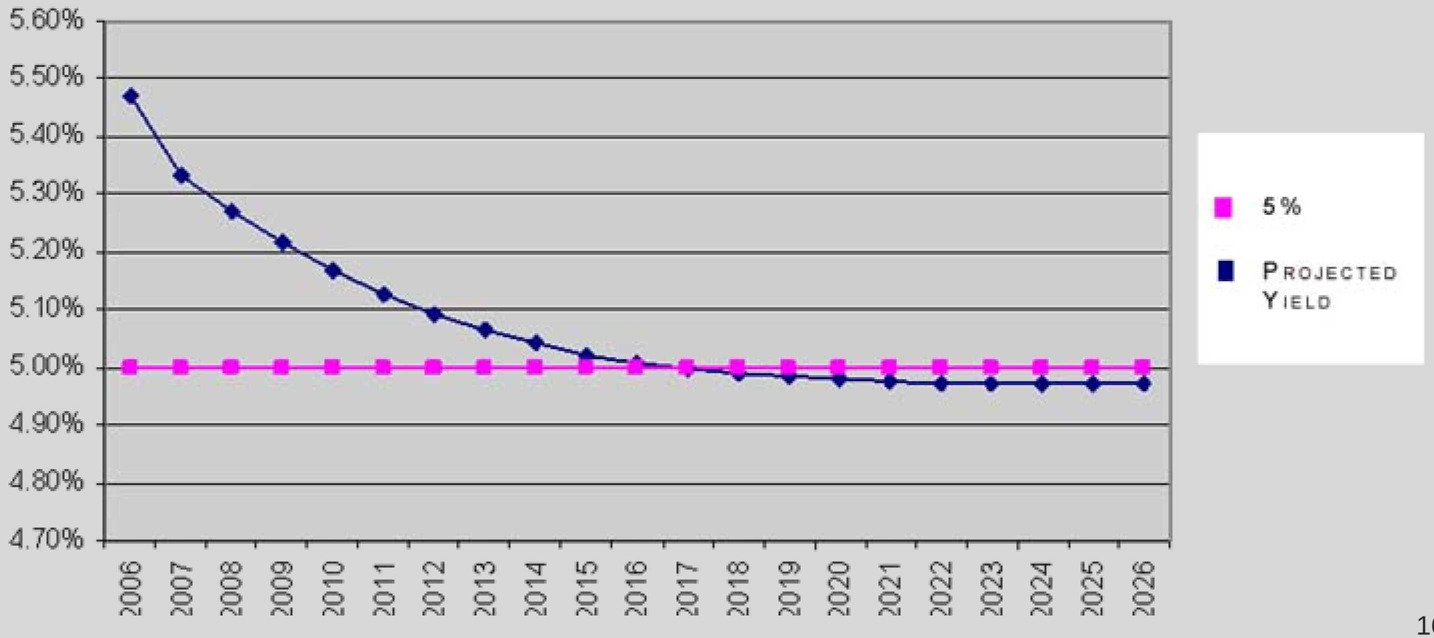
Investment Strategy

- TMRS has historically relied on income



Investment Strategy

- Forecasts show that the current strategy will produce interest credits under 5% by 2017



PART 1 – Conclusion

- To continue diversification under a total return strategy, TMRS must have authority to credit unrealized gains to member accounts and unrealized gains and losses to city accounts.
- Without this authority, diversification will stop.

PART 2 – Member Rate

- Guarantee members an annual interest rate and annuity purchase rate

* Statute currently anticipates 5% interest.

PART 2 – Member Rate

- 5% has been “statutory target rate” – NOT a guarantee, though widely misunderstood as one
- Annuity purchase rate – assumed rate of future interest earnings at retirement – is 5%
- TMRS retirement estimates use a 5% interest rate
- 2007 interest rate to member and city accounts was 5%
- 12/31/07 valuation projected 5% interest credit; all projections based on 5%

PART 2 – Member Rate

- Under a total return strategy, without a guaranteed “floor,” member accounts could lose value in bad investment return years

PART 2 – Member Rate

- To preserve the future value of members’ benefits, 5% guarantees the rate that has historically been a statutory target

PART 2 – Conclusion

- Without action, before 2017, member interest rates and the annuity purchase rate (the interest credited at retirement) will be below 5%

PART 3 – Employer Rate

- Legislation to allow employers variable annual interest rates, including negative rates

PART 3 – Employer Rate

- Total market returns will be credited to city accounts annually
  - Annual returns can be negative or positive
  - There will be bad years
  - Cities will gain from good years
  - Good years will also help build a reserve fund

PART 3 – Employer Rate

- If city and member rates continue to be tied together, future actuarial projections will require even higher city contributions.
- Cities will face increased pressure to cut benefits.
- Can’t guarantee pension benefit to members.

PART 3 – Conclusion

- Proposal will make TMRS funding more like other statewide systems

Benefits Funding Comparison

Traditional Defined Benefit Plan (ERS, TRS)

- Fixed employee contributions + Variable employer contributions + investments
  - Employee receives fixed benefit under plan formula
  - Employee benefit is not reduced even when investments perform poorly
  - Employer bears all investment risk
  - If investments perform well, employer contributions can be reduced, BUT if investments perform poorly, contributions rise

Benefits Funding Comparison

TMRS Under Legislative Proposal

- Member Account:
  Fixed employee contributions + fixed interest rate
- City Account:
  Variable employer contributions +
  variable interest rate
  - Employee receives benefit based on combined accounts
  - Employee benefit is not reduced even when investments perform poorly
  - Employer bears all investment risk
  - If investments perform well, employer contributions can be reduced, BUT if investments perform poorly, contributions rise

Timeline 2008

- First Meeting – April 17
- Proposed Second Meeting – May
- Proposed Third Meeting – June
- June TMRS Board Meeting
- August – Joint Board and Advisory Committee Meeting to consider legislative proposals

Bottom Line

- TMRS is committed to working with cities and members to provide a soundly funded retirement program that provides competitive benefits to Texas municipal employees

Questions About Legislation?

How to Contact TMRS

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