Moving into the Future
Funding Workshop

TMRS
Texas Municipal Retirement System

60 Years of Retirement Security

A Course for 2008 and Beyond

TMRS Mission Statement

"To deliver secure and competitive retirement plans through a professionally managed organization that anticipates diverse needs; provides quality services; and openly and effectively communicates with members, retirees, and cities."

TMRS

- Retirement program of choice for over 820 Texas cities
- Provides flexibility and portability
- Each city controls the level of benefits it offers

What Has Changed?

- TMRS is diversifying its investments
- TMRS has changed its Actuarial Cost Method and Amortization Period and adopted new actuarial assumptions

Proposed legislative changes ahead – interest allocation

Investments

- Historically: TMRS has invested primarily in bonds
- 2008: TMRS has begun to diversify into stocks
- 2009 and beyond: Diversification will continue <u>if legislation passes</u>

Why Change Investment Policy?

- Potential returns from bond-based, income return strategy are not likely to be as high as in the past
- Without higher investment earnings, interest credits and annuity discount rate are likely to fall below 5% in a few years
- Annuities for future retirees will be reduced

Plan for Change - Investments

New Resources

- Investment Consultant: R.V. Kuhns & Associates
- Passive Equity Manager: Northern Trust
- Fixed Income Portfolio Advisor: BlackRock

Target for 2008 - Investments

- 12% in indexed equities by year-end
- 6% domestic – Russell 3000 index
- 6% foreign – MSCI-EAFE index
- Approximately 1% moved to equities per month
- Shorten duration of bond portfolio to reduce interest rate risk

Investment Strategy

- Gradual pace minimizes risk of short-term market downturns
- Indexed investment ensures equity market returns at low investment costs

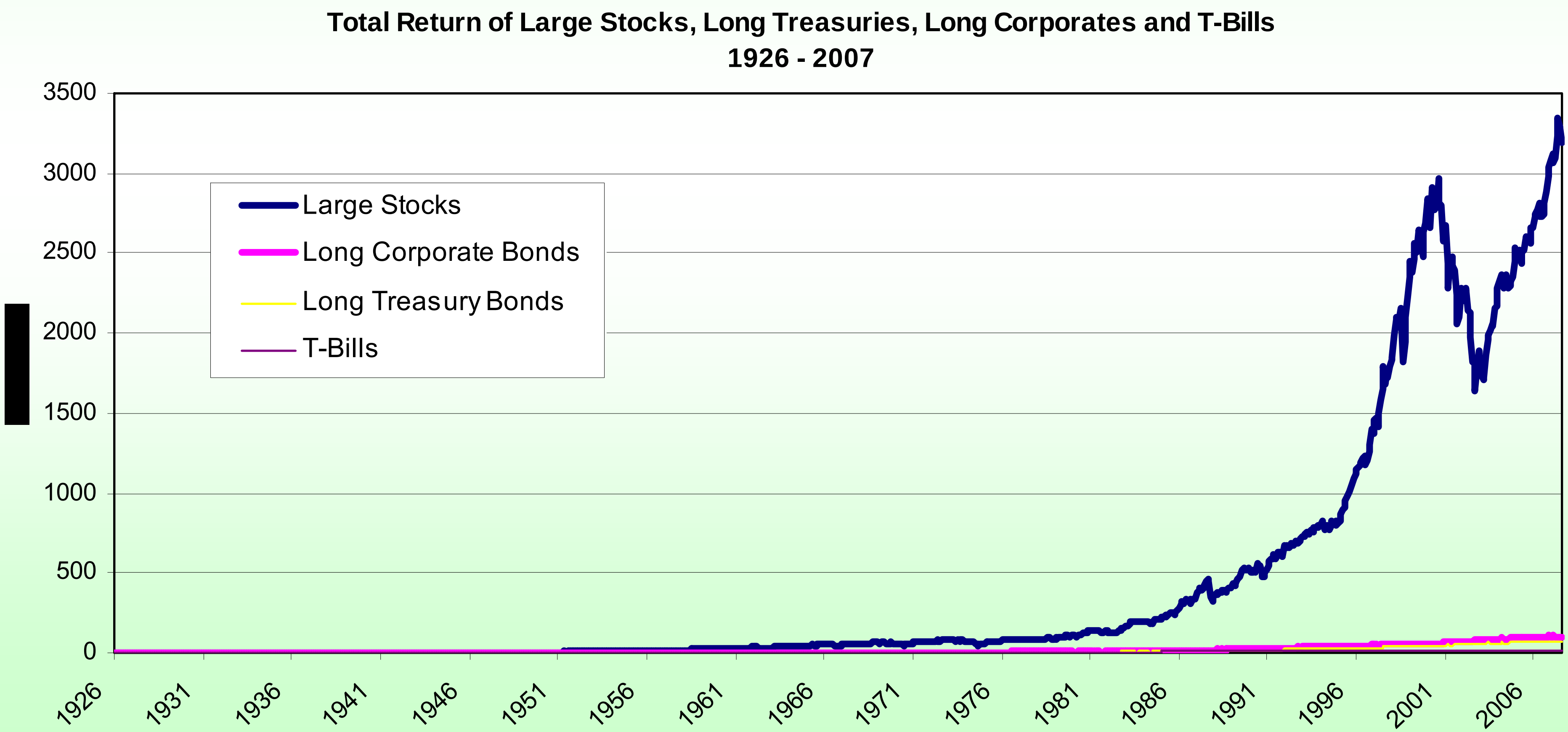
Immediate Gains from Diversification

- Supports 7% investment return assumption
- Reduces risk of bond portfolio declining in value due to rising interest rates
- Higher funded ratios and lower employer contribution rates
- Lower overall portfolio risk

Long-term, stocks historically out-perform bonds

Why Diversify?

Over long periods of time, stocks outperform bonds



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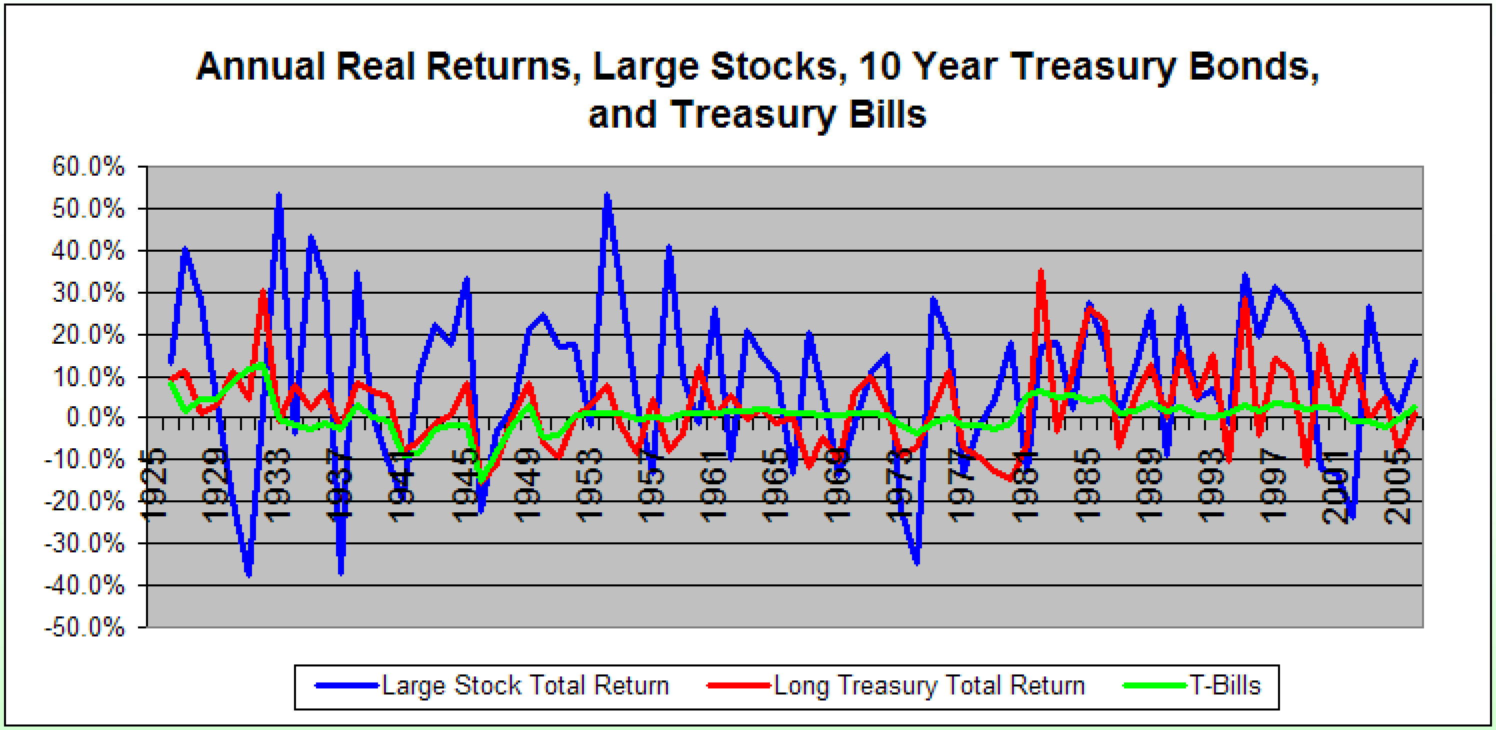
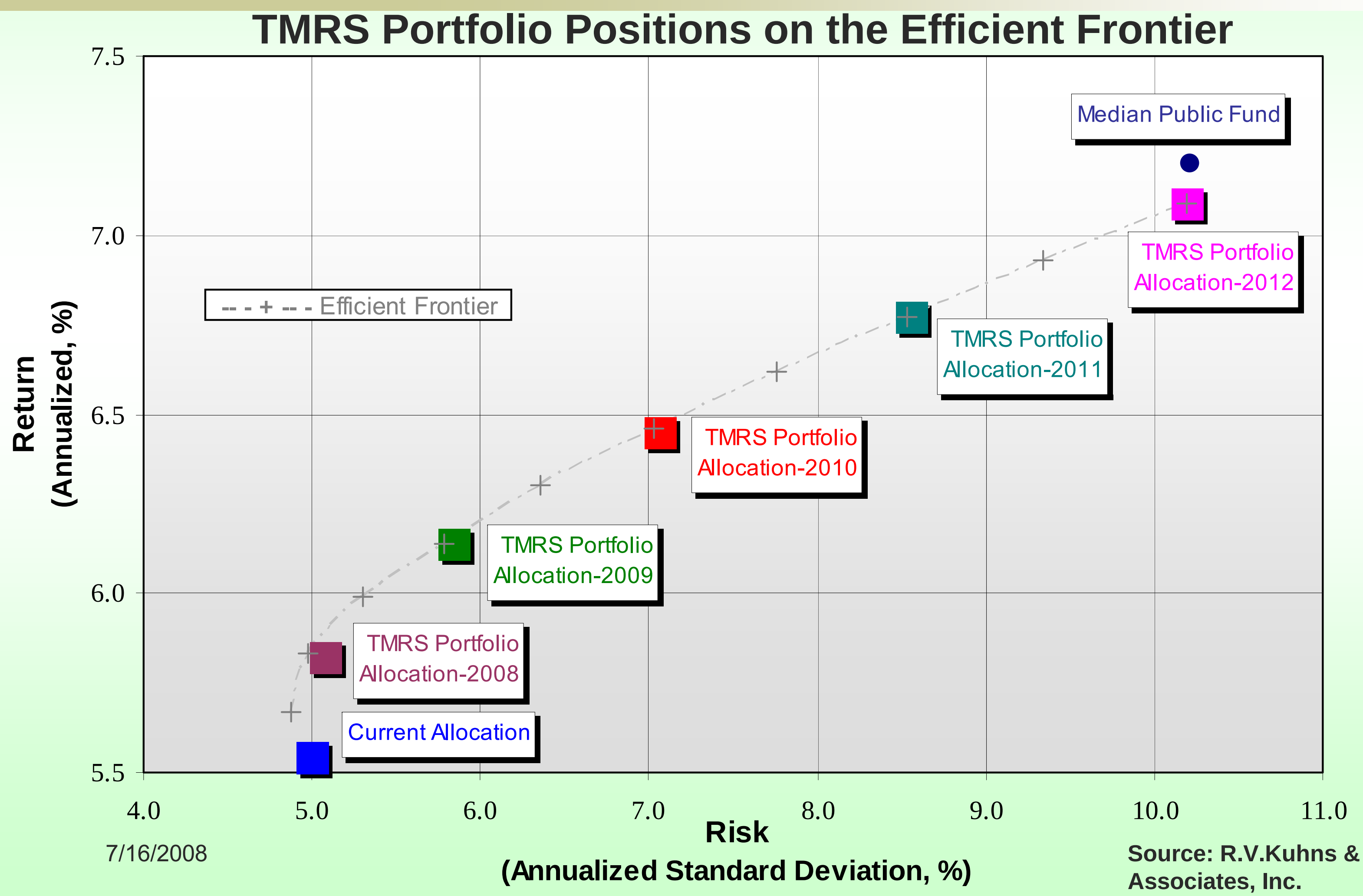


Return Projections Under New Investment Policy



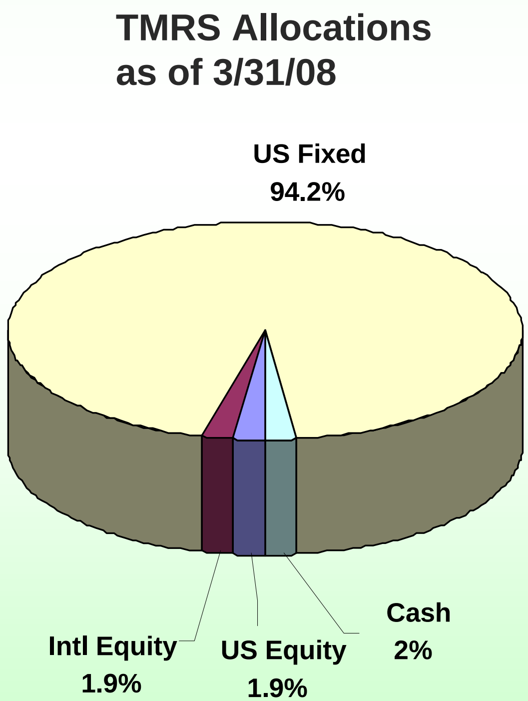
Source: R.V.Kuhns & Associates, Inc.

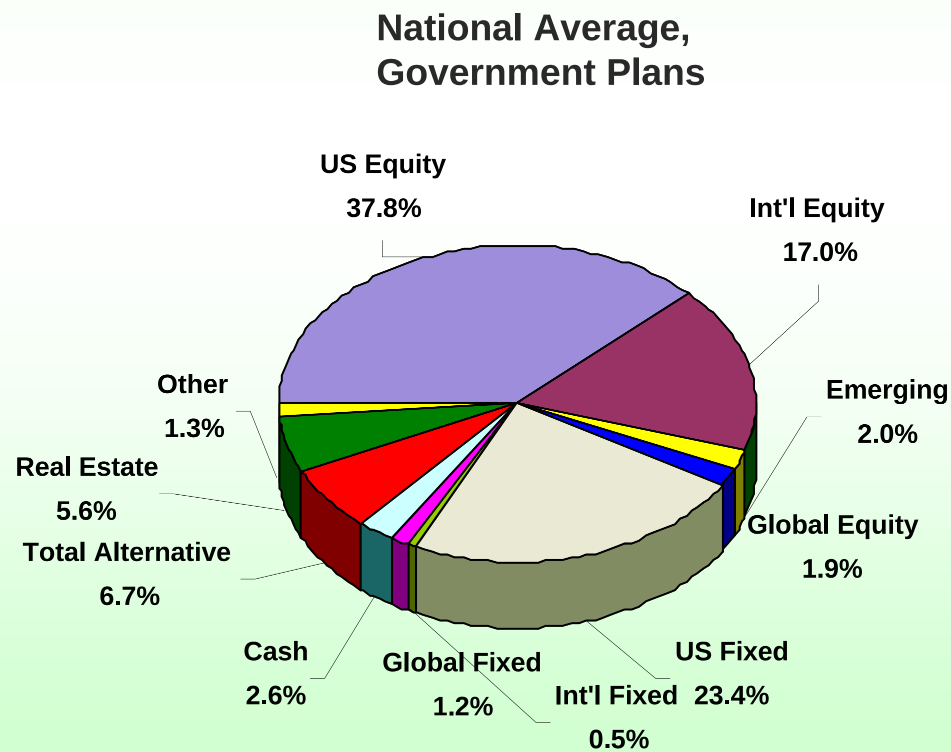
Next Critical Step - Investments

- 2009 - Legislation to allow TMRS to credit unrealized gains and losses to city accounts, help employers pay rising contribution rates, and prevent future benefit cuts.

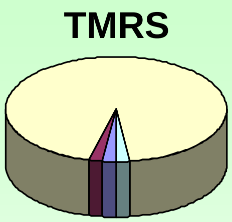
Asset Allocation Differences

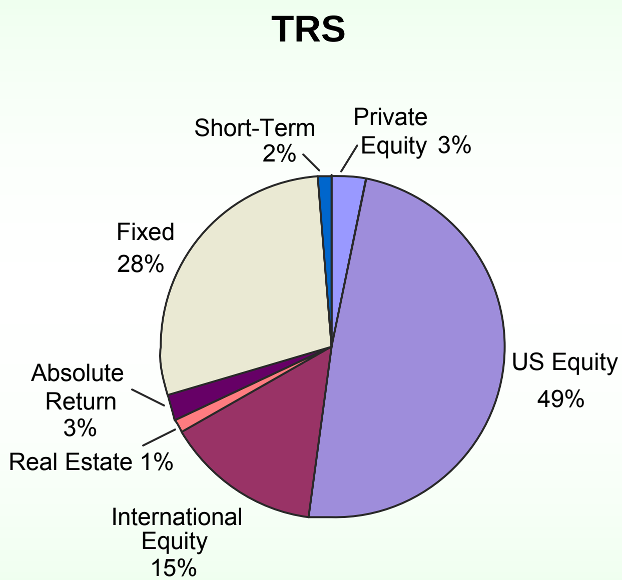
How is TMRS different from other government pension plans?

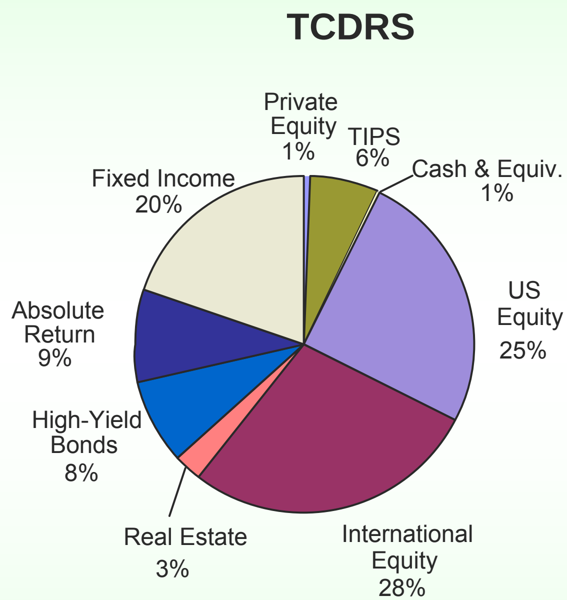


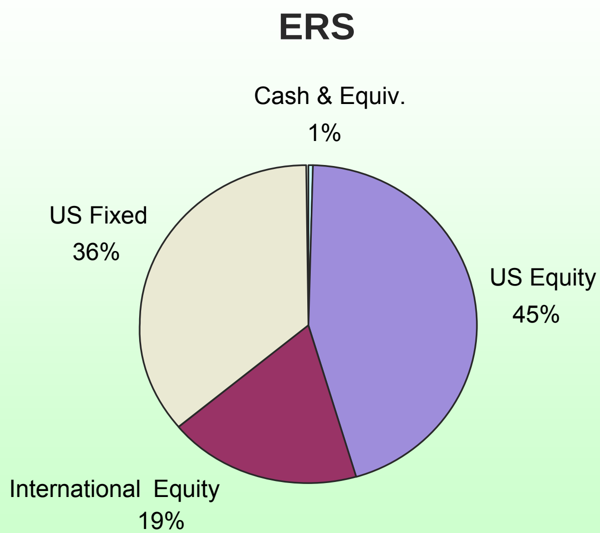


Asset Allocations – Other Statewide Plans









2007 Allocations –
rounded to nearest whole percent

Questions about Investments?

Actuarial Changes

- Actuarial Cost Method

  Definition: A technique that assigns the present value of expected pension benefits and expenses to past and future time periods.

- Historically: TMRS has used the Traditional Unit Credit actuarial cost method
- Effective for 2009 contribution rates: TMRS begins using Projected Unit Credit (PUC) actuarial cost method.

Why Change?

- Under PUC, contribution rates will remain level as a percent of payroll and will produce annual increases in the funded ratio
- PUC projects benefits (including future Updated Service Credit and COLAs) to be paid at retirement and assigns an equal portion to each year of an employee's expected working lifetime.

Cities with repeating benefits will see significant increases in contributions

Actuarial Changes

- Amortization Period –
  Definition: The time period for fully funding any unfunded actuarial accrued liabilities.

- Historically: TMRS has used a 25-year open period
- Beginning in 2009: Most cities will have a 30-year closed period unless they choose to remain at 25

Why Change?

- Closed period provides level contributions over a fixed period of time and reduces unfunded actuarial liability on a set schedule

Cities that see a contribution increase of 0.5% or less will use a 25-year closed period

Implementation

- For cities with a contribution increase greater than 0.5% — optional 8-year phase-in
- Approximately 12.5% of the increase required each year
- The longer a city defers payment of the full 30-year Actuarially Required Rate, the higher the rate will be at the end of the 8-year phase-in period

Flexibility

- Cities can increase contributions within the 8-year time frame at their own pace
- Full Actuarially Required Rate must be paid in 2016

City Options

- Phase-in contributions
- Adjust plan design

Higher investment returns will help mitigate employer contribution rate increases.

City Options (cont.)

Cities can adjust benefits by ordinance:

- Reduce city matching ratio
  - 2 to 1, 1.5 to 1, 1 to 1
- Change level of USC
  - 100%, 75%, 50%
- Change Annuity Increase %
  - 30%, 50%, 70% of CPI
- Turn off annually repeating benefits

City Options (cont.)

- USC may be adopted without COLA,
  BUT
- COLA may **<u>not</u>** be adopted without USC

- If city stops USC, members do not lose USC already credited
- If city changes city match, the change affects service after the date of the change but not before

City Options (cont.)

Should Cities Turn off Annually Repeating Benefits?

- TMRS does not recommend turning off automatically repeating benefits and replacing them with ad hoc benefits if the city's intent is to continue granting these benefits each year.
- Ultimate cost is the same if ad hocs are granted each year, but payment schedule differs.
- Ad hoc benefits will be funded one year at a time. Cities will see continued increases in contribution rates and declining funded ratios.
- In the future, TMRS may require shorter amortization period for ad hoc benefits.

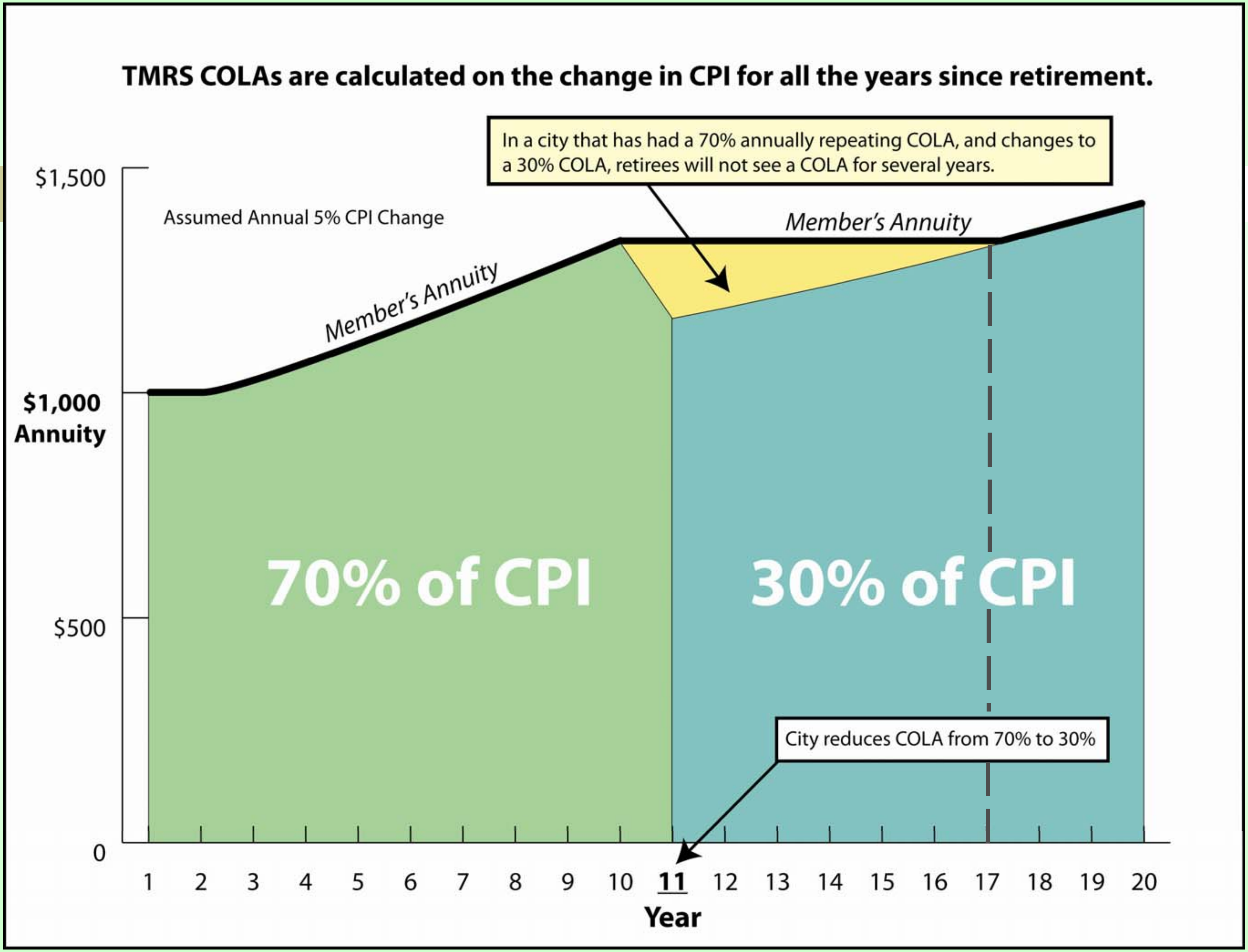
City Options (cont.)

Should Cities Turn off Annually Repeating Benefits?

- When preparing financial statements, cities that adopt repeated ad hoc benefits should be very careful in disclosing costs.
- TMRS encourages you to seek individual advice on the most accurate and complete way to make disclosures to the market regarding current and anticipated future adoptions of ad hoc benefits and the likely impact on your pension liabilities.

Important Note about COLAs

- TMRS COLAs are calculated on the change in CPI over the entire time a member is retired.
- One effect of this is that, if a city has been granting 70% of CPI annually repeating COLAs and changes to a lower COLA percentage, retirees will not see any benefit increase for several years.


TMRS COLAs are calculated on the change in CPI for all the years since retirement.
In a city that has had a 70% annually repeating COLA, and changes to a 30% COLA, retirees will not see a COLA for several years.
$1,500
$1,000
Annuity
$500
0
Assumed Annual 5% CPI Change
Member's Annuity
Member's Annuity
70% of CPI
30% of CPI
City reduces COLA from 70% to 30%
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20
Year

Plan Change Timing

City plan changes made from April through December 2008 will be reflected in 2009 employer contribution rates

Rate Letter - May 2008

- Rates
  - Based on 12/31/07 valuation data and revised actuarial assumptions
  - Show Actuarially Required Rate (full rate due in 2016) and 2009 Phase-in Rate
  - Letter contains GASB disclosure information for FY 2007 reporting

2009 Rates

- Cities with a rate increase greater than 0.5% – **due to actuarial changes**:
  - Will have a 30-year amortization period
  - Will have up to 8 years to phase in the increase

Cities may request a 25-year rate and should consider paying more than the Phase-in Rate.

GASB Liability Figures

- <u>All</u> liability recognized as of 12/31/07 valuation
  - Lower funded ratios for cities with repeating benefits
- TMRS provides data, footnote, and suggested language for city letters

Net Pension Obligation

- A city that pays Phased-in Rate will incur a Net Pension Obligation (NPO), which is recorded as a liability on the city's financial statement
- A city that pays the Actuarially Required Rate will not disclose an NPO

Voluntary Contributions

- Cities may choose to pay above the 2008 actuarially required rate to lower liabilities
- <u>Cities with a Phase-in Rate should consider paying more than the Phase-in Rate</u>

Voluntary Contributions (cont.)

- Voluntary contributions are deposited in city's account in Municipal Accumulation Fund
  - Reduces unfunded actuarial liability and improves funded ratio in subsequent valuations
  - Voluntary contributions made in 2008 will be reflected in 12/31/08 valuation and 2010 contribution rate

Ongoing Communications

- E-bulletins as needed
- Website updates
- *TMRS Facts for City Officials*
- Newsletters
- Annual Seminars
  - September 2008 Seminar in Corpus Christi — focused on training
  - Early 2009 — funding seminar, location to be announced

Timeline

- December 31, 2007: Actuarial Valuation – results in April
- February – December 2008: Regional Funding Workshops
- May: Rate Letters
- Voluntary contributions may be made any time
- Plan change elections may be made all year

Questions on Actuarial Changes?

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 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 should increase investment returns to the TMRS fund
- Member benefits will be guaranteed and city contribution rates should be mitigated by investment performance

2009 – Legislative Proposal

- Part 1 – Allow TMRS to credit unrealized gains and losses to cities
- 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

TMRS Investment Changes

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

Member Rate

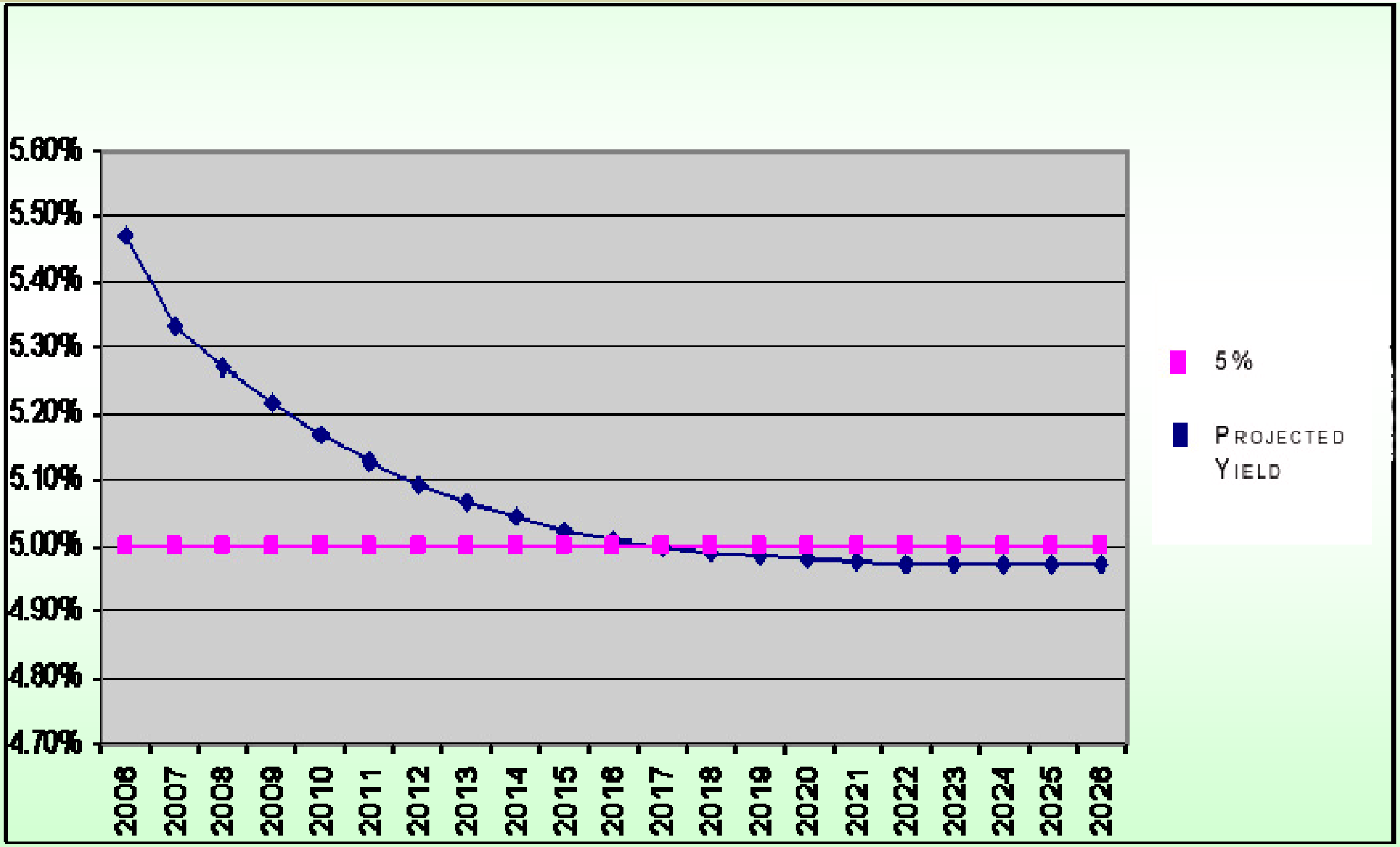
Goal: Guarantee members an annual interest rate and annuity purchase rate

- 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, and the 2007 interest rate to member and city accounts was 5%

Member Rate (cont.)

- 12/31/07 valuation projected 5% interest credit; all projections based on 5%
- Under a total return strategy, without a guaranteed “floor,” member accounts could lose value in bad investment return years
- To preserve the future value of members’ benefits, 5% guarantees the rate that has historically been a statutory target
- Without action, before 2017, member interest rates and the annuity purchase rate (the interest credited at retirement) will likely be below 5%

Without guaranteed member rate…



Employer Rate

Goal: Legislation to allow employers variable annual interest rates (gains and losses)

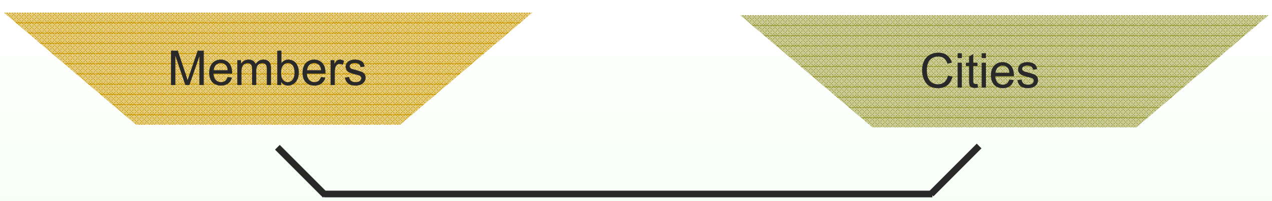
- Total market returns will be credited to city accounts annually
  - Annual returns can be negative or positive
  - There will be bad years
  - Cities will gain from good years
  - Good years will also help build a reserve fund

Employer Rate (cont.)

- 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.

Competing Views

- Members want more interest
- Cities want relief from rising contribution rates



- TMRS working with all parties

What if Legislation Doesn't Pass?

- Cities will be more likely to cut benefits
- Interest credits and annuity discount rates will likely fall below 5%
- Investment diversification will stop
- Contribution rates will rise further

Other Legislation

- TMRS Bill will remain focused on critical issues
- Members and cities may seek other amendments
- TMRS will assist members, cities, and associations to provide information, resource testimony, and assistance

Legislative Stakeholders Group

- Representatives of employee and municipal official associations
- Members of TMRS Advisory Committee
- Monthly meetings held in Austin

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.

Bottom Line

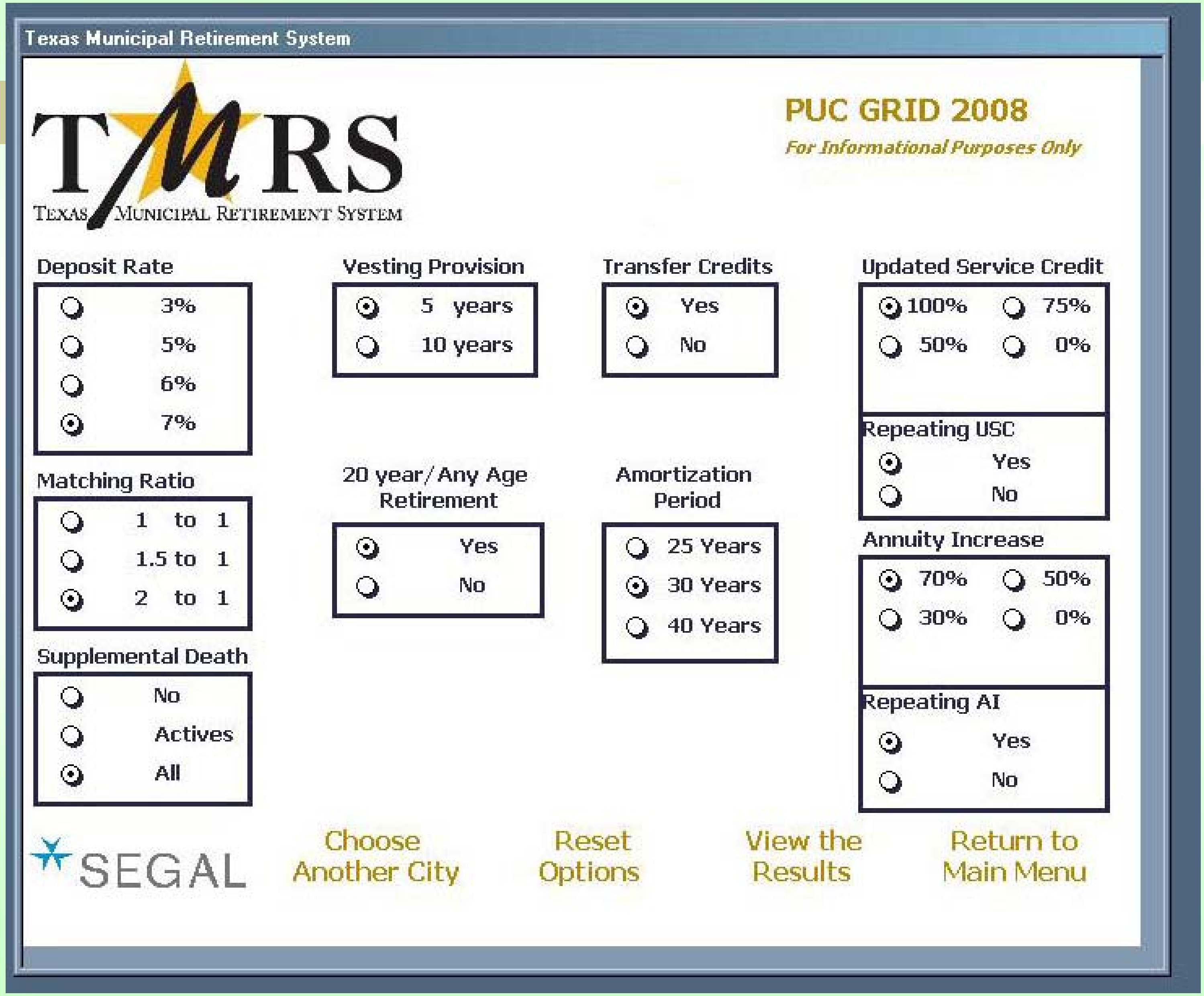
- TMRS is committed to working with cities and members to provide a soundly funded retirement program that provides competitive benefits to Texas municipal employees

Questions on Legislation?

Today’s Funding Workshop

- A chance to ask “what if” questions using the “TMRS Actuarial Grid”
- The Grid is a modeling tool that shows the effects of plan changes on a city’s contribution rate.

Options on the Grid:



Enter Variables and See the Results:

Texas Municipal Retirement System - Plan Options GRID

File Edit View Insert Format Records Tools Window Help Adobe PDF

Type a question for help

TMRS
Texas Municipal Retirement System

Plan Improvement Study

PUC GRID 2008

For Informational Purposes Only

Effective Date - January 1, 2008

Report Date - February 13, 2008

Plan Provisions	Present Plan	PUC / New Assumptions: Preliminary	PUC / New Assumptions: Adjusted	Proposed Plans: 1	Proposed Plans: 2	Proposed Plans: 3
Deposit Rate	7.00%	7.00%	7.00%	6.00%	6.00%	7.00%
Matching Ratio	2 to 1	2 to 1	2 to 1	2 to 1	2 to 1	1.5 to 1
Updated Service Credits	100% (Repeating)	100% (Repeating)	100% (Repeating)	100% (Repeating)	100% (Repeating)	100% (Repeating)
Transfer USC **	Yes	Yes	Yes	Yes	Yes	Yes
Annuity Increase	70% (Repeating)	70% (Repeating)	70% (Repeating)	70% (Repeating)	50% (Ad-Hoc)	50% (Repeating)
Buyback Provision	No	No	No	No	No	No
20 Year/Any Age Ret.	No	No	No	Yes	Yes	Yes
Vesting	5 years	5 years	5 years	5 years	5 years	5 years
Contribution Rates	**2008**	**2008**	**2008**	**2008**	**2008**	**2008**
Normal Cost Rate	9.86%	12.00%	12.00%	10.87%	9.15%	9.90%
Prior Service Rate	5.69%	9.94%	8.97%	8.12%	4.27%	6.52%
Retirement Rate	**15.55%**	**21.94%**	**20.97%**	**18.99%**	**13.42%**	**16.42%**
Supplemental Death Rate	0.32% (A & R)	0.26% (A & R)	0.26% (A & R)	0.26% (A & R)	0.26% (A & R)	0.26% (A & R)
Total Rate	**15.87%**	**22.20%**	**21.23%**	**19.25%**	**13.68%**	**16.68%**
Unfunded Actuarial Liability	$13,406,015	$20,674,521	$20,674,521	$18,733,339	$9,842,870	$15,041,288
Amortization Period	25 years	25 years	30 years	30 years	30 years	30 years
Funded Ratio	74.3%	65.2%	65.2%	67.4%	79.7%	72.0%
Phase-In Total Rate	--	--	**16.49%**	**16.24%**	N/A	**15.92%**

** This is the addition to the Initial Prior Service Rate for USC for transfers. There were 11 eligible transfer employees on the valuation date.

SEGAL

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How to Contact TMRS

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