MINUTES OF THE
ADVISORY COMMITTEE ON RETIREMENT MATTERS
OF THE BOARD OF TRUSTEES OF THE
TEXAS MUNICIPAL RETIREMENT SYSTEM

On March 29, 2012, the Advisory Committee on Retirement Matters (the "Committee") of the Board of Trustees of the Texas Municipal Retirement System (TMRS) convened for a meeting at 9:00 a.m. at TMRS Headquarters, located at 1200 North IH 35, Austin, Texas. The following members were present:

<u>Advisory Committee Members</u>

Frank Simpson, TMRS Trustee and Advisory Committee Chair
Julie Oakley, TMRS Trustee and Advisory Committee Vice Chair
Allen Bogard, City of Sugarland
Don Byrne, Texas Municipal Human Resources Association
Ron Cox, TMRS Retiree
David Crow, Arlington Professional Fire Fighters
Keith Dagen, City of Richardson (alternate)
Michael Dane, City of San Angelo
Dean Frigo, City of Amarillo
Flor Garcia, City of San Antonio
Jerry Gonzales, Service Employees International Union (SEIU), San Antonio
Scott Kerr, Texas State Association of Firefighters
Mitch Landry, Texas Municipal Police Association (alternate)
Randle Meadows, President, Arlington Police Association
Mike Perez, Texas City Management Association (TCMA)
Mike Staff, Combined Law Enforcement Association of Texas (CLEAT)
Charles Windwehen, TMRS Retiree

Joining the meeting via telephone conference call was Committee Member Monty Wynn, Texas Municipal League (TML). Mr. Perez left the meeting at approximately noon and joined back in via telephone.

The following staff, consultants and guests were also present:

David Gavia, TMRS Executive Director
Jeanna Cullins, Hewitt EnnisKnupp
Eric Davis, TMRS Deputy Executive Director
Brian Dickerson, City of Mesquite
Meredith Fowler, Speaker's Office, Texas House of Representatives
Juan Garcia, Governor's Office
Leslee Hardy, TMRS Staff Actuary
Glenn Johnson, Garland Firefighters Association
Chris Jones, CLEAT
George Kauffman, City of Garland

Rick Menchaca, BOSC, Inc. (arrived around 11:00 a.m.)
Michelle Mellon-Werch, TMRS Associate General Counsel
Anthony Mills, TMRS Regional Manager
George Mones, City of Mesquite
Lorraine Morreno, TMRS Regional Manager
Jim Moore, Mesquite Fire Dept.
Cindy Morse, TMRS Executive Assistant
Mark Randall, Gabriel, Roeder, Smith and Company (GRS)
David Rodriguez, TMRS Regional Manager
Roel ("Roy") Rodriguez, TMRS Trustee
Christine Sweeney, TMRS General Counsel
Sean Thompson, TMRS Regional Representative
Bill Wallace, TMRS Director of Communications
Dan Wattles, TMRS Director of Government Relations
Stacy White, TMRS Executive Assistant
Nancy Williams, Hewitt EnnisKnupp
Merita Zoga, House Committee on Pensions, Investments & Financial Services

Frank Simpson called the meeting to order at 9:05 a.m. He welcomed the committee members of Advisory Committee on Retirement Matters of the Board of Trustees for TMRS (the "Committee Members") and guests and asked the Committee Members to introduce themselves since there are several new members.

Following the introductions, Nancy Williams from Hewitt EnnisKnupp, reviewed the agenda. She explained that we would be discussing cost of living adjustments ("COLAs").

<u>Consider and Act on Adoption of Minutes from the December 1, 2011 Advisory Committee Meeting</u>

David Crow moved to approve the minutes as presented to the Committee. Mike Perez seconded the motion, which passed unanimously.

<u>National Overview of COLA Trends</u>

Mark Randall, from Gabriel Roeder Smith and Company, began the presentation by discussing that national trends do not necessarily pertain to TMRS because of the System's enviable funding position. He explained that nationally there have been sharp investment declines due to equity losses, falling funding ratios, increasing contribution rates, increasing pressure on plan sponsors and political antagonism towards public plans. Several states have recently reduced their long-term rates of return assumptions. TMRS's rate of return assumption is lower than most states, at 7%. Committee Members asked if other Texas funds were decreasing their assumptions. Mr. Randall responded that he has not seen any Texas funds change their assumptions, although it has been a topic of discussion. He explained that a key component of the changes has to do with assumptions related to inflation. Many systems have lowered this assumption to 2.75%, thus lowering the overall assumed rate of return. He does not suggest that higher rates cannot be obtained, but they may have to stretch the investment risk to obtain higher rates. Mr. Randall then stated that he believes that TMRS' 7% rate is a good long-term investment return assumption for TMRS.

Mr. Randall moved the discussion to mortality assumptions and the changes that have occurred in the last 50 years. Life expectancies have been increasing. There were dramatic changes every 3 to 5 years from the 1960 through the eighties, but less so in the past 10 years. TMRS mortality trends mirror national trends; however, mortality assumptions have not kept up. Mr. Randall next discussed the changes in funding ratios nation-wide, which have been trending downwards. The primary reason for most systems' downward trend in funding ratio has been the nonpayment of the actuarially required contributions. Mr. Frigo asked how the changes in assumptions affect the System's liabilities. Mr. Randall stated that the lower inflation rate assumption means assumed projected salaries and related liabilities would not increase as much as previously assumed at the higher inflation rate. TMRS has had increasing funding ratios since 2007.

Ms. Williams asked if cities were paying their actuarially required contribution more consistently than states. Mr. Randall responded that cities tend to have more discipline to pay and there is more involvement by the public whereas at the state level, there is a tendency to pay less. However, stand-alone city plans tend to be less disciplined than the larger statewide plans. Ms. Oakley stated that the statutory requirements for TMRS help cities to stay on track. Mr. Crow stated that he would like to know the assumptions and funded ratios for all of the Texas systems, including the statewide and the local systems, to compare TMRS.

Mr. Randall concluded his discussion on national trends with an overview of external economic factors, such as financial market declines and rising unemployment, and internal factors, which includes benefit increases and underpayment of contributions.

Mr. Randall then discussed where public plans are going. He sees benefit changes, mostly decreases, and the changing GASB standards as the two major changes for public pension systems. Mr. Gavia pointed out that the new GASB standards are for disclosures and do not directly affect funding. This will be a big change with unknown implications. Mr. Randall then discussed the decreases in COLAs nationally. More than ten states have revised automatic COLAs. He discussed the changes in Arizona, Rhode Island, Connecticut and Hawaii. Some changes were tied to funding ratios or investment returns. States are looking at various cost-saving measures, including extending the time before a retiree first becomes eligible for a COLA, alternative methods to pay for COLAs, and capping the amount of annuity or salary eligible for COLAs. Mr. Dane asked if individual cities could be allowed to make COLA decisions based on their own individual funded ratio. Mr. Randall responded that this would be possible. GRS has performed purchasing power studies regarding the effect of inflation on the purchasing power of retirees. The findings indicated that a person retiring in 1981 had 60% less purchasing power in 2011 with their annuity. Mr. Bogard asked if pension envy is overruling rational business decisions in making COLA changes. Mr. Randall believes that there is some pension envy affecting decision-making and the changes in corporate benefits has affected thinking about public benefits. Mr. Crow asked what legislators will see if they begin looking into changing benefit plans in Texas. Ms. Williams stated that many state constitutions do not allow the removal of defined benefits because it is a property right. Mr. Randall stated that generally, states move new employees to a new plan, a hybrid or DC plan. Mr. Crow expressed an interest in educating legislators on the cost to change the benefits to a DC plan in light of the anti-pension publicity and politics. The Committee also discussed the conversation taking place in Texas regarding the defined benefit versus defined contribution plan design.

The Impact of Proposed GASB Disclosures

Mr. Randall then introduced the new GASB Standards. He explained that in 2011, GASB released its Exposure Drafts of potential changes to public pension accounting and reporting. The stated reasons for these changes are to improve the transparency and disclosure of pension systems financial condition. These included decoupling accounting and funding and including unfunded pension liability (net pension liability) directly on an employer's financial statements, rather than in the supplemental information. These changes will create two sets of numbers, one for accounting and one for funding. It will also make pensions look more expensive and more volatile because reporting can no longer be based on 30-year amortization periods but must be based on average future working years of the actual labor force. This period will be much shorter for mature systems. There was also an explanation on changes to the treatment of ad hoc COLAs if they are substantively automatic. The Committee discussed whether this could have a chilling effect on employers granting COLAs. Mr. Randall also stated that actuaries would have to calculate an "expected depletion date" at which point they would have to use a "risk free" discount rate. The Committee discussed the effect these changes may have on decisions by City council members and bond rating agencies.

Current TMRS COLAs and Employer Flexibility

Leslee Hardy outlined the current COLA options available to TMRS employers and the ad hoc versus repeating COLA adoption options. She discussed how TMRS funds ad-hoc COLAs versus repeating COLAs. She showed the Committee a sample of the TMRS GRID output for a city without a COLA, if it grants various alternative COLA options and the effect this action would have on contribution rates and funding ratios for that city. The short-term analysis shows that ad-hoc COLA costs are lower, but costs increase with each adoption. Repeating COLA rates are stable but initially higher than the ad-hoc COLA rates. She then reviewed the results of a short-term (10-20 year) and longer-term (40 year) analysis on contribution rates, unfunded actuarial accrued liability, funded ratios and benefit amount. Ms. Hardy discussed the retroactive nature of the current TMRS COLA. She explained how it works and the effect on retirees when a city reduces its COLA percentage. Mr. Davis was asked to explain the historical background of how this feature was developed. There was some discussion on the political issues surrounding COLAs generally and this COLA methodology specifically. Mr. Gavia stated that no other public pension systems have this methodology, and it is a good feature for maintaining the purchasing power of retirees. There was more discussion regarding the utilization of this feature and the effect of changing the COLA.

COLAs Based on Investment Earnings

Next Mr. Randall began a discussion of COLAs based on investment earnings. He first reviewed the pros and cons and discussed recent examples from Arizona and Rhode Island. This alternative spreads plan funding risks between employers and retirees and dampens the growth of plan liabilities when returns are low, but the COLAs are not guaranteed. The Committee asked questions about how the thresholds were created and the cost of these COLAs. Committee members also discussed issues regarding how this type of COLA might work within the TMRS structure.

COLAs Based on a Bank or Reserves

Mr. Randall began this discussion by reviewing how this type of COLA was implemented in Wisconsin. Committee members asked questions regarding the administration of this method and variations to this method. Mr. Randall explained the effect of these COLAs on risk, plan liabilities and benefits.

Employees' Annuity Options for a COLA

Mr. Randall described this alternative. It is an option the employee can select upon retirement. He gave an example of how it would work from the member's perspective, what the reduction in annuity would be for a guaranteed 2% COLA. Several Committee Members discussed why individuals might select this option and whether any retirees would. Some Committee Members felt that this might be a complicated administrative process for small benefit that is not likely to be selected often. Nebraska and Louisiana have this option available to retirees, and Wyoming is considering this alternative.

Mr. Dane stated that instead of viewing each option as an alternative, perhaps a combination of these approaches would be best for TMRS.

Ms. Williams asked if there was general discussion regarding the presentations. Mr. Frigo asked if there was an approach similar to the comprehensive gain-sharing approach TMRS used to take. There was discussion regarding how this might be accomplished.

Ms. Williams reviewed the agenda for the next meeting and asked if there were any additional questions or comments. Mr. Simpson asked staff to provide a review of Plano's supplemental benefit plan at the next meeting. The next meeting is scheduled for May 3, 2012, the day before the Joint Board and Advisory Committee Meeting on May 4. The meeting was adjourned at 2:13 p.m.

David Gavia
Executive Director

Frank Simpson
Chair of the Advisory Committee and Board Trustee