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

On June 21, 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:

Advisory Committee Members

Frank Simpson, TMRS Trustee and Advisory Committee Chair
Julie Oakley, TMRS Trustee and Advisory Committee Vice Chair
Don Byrne, Texas Municipal Human Resources Association
Ron Cox, TMRS Retiree
David Crow, Arlington Professional Fire Fighters Association
Dean Frigo, City of Amarillo
Flor Garcia, City of San Antonio
Jerry Gonzalez, Service Employees International Union (SEIU), San Antonio
Scott Kerr, Texas State Association of Firefighters
Randle Meadows, President, Arlington Police Association
Mike Perez, Texas City Management Association (TCMA)
Wayne Riddle, City of Deer Park
Bob Scott, Government Finance Officers Association of Texas (GFOAT)
Mike Staff, Combined Law Enforcement Association of Texas (CLEAT)

Joining the meeting via telephone conference call at approximately 9:50 a.m. was Allen Bogard, City of Sugarland.

The following staff, consultants and guests were also present:

David Gavia, TMRS Executive Director
Eric Davis, TMRS Deputy Executive Director
Brian Dickerson, City of Mesquite
Bernie Eldridge, TMRS Director of Human Resources
Meredyth Fowler, Speaker's Office, Texas House of Representatives
Keith Hopkins, City of Mesquite
Glenn Johnson, Garland Firefighters Association
Chris Jones, CLEAT
George Kauffman, City of Garland
Pete Kravnek, TMRS Information Systems Manager
Ron Lewis, Ron Lewis and Associates
Rick Menchaca, BOSC, Inc.
Michelle Mellon-Werch, TMRS Associate General Counsel
George Mones, City of Mesquite
Jim Moore, Mesquite Fire Department
Debbie Munoz, TMRS Director of Member Services
Joe Newton, Gabriel, Roeder, Smith and Company (GRS)
Mark Randall, GRS
David Rodriguez, TMRS Regional Manager
Christine Sweeney, TMRS General Counsel
Stephanie Toman, Hewitt EnnisKnupp

Greg Vick, TCMA
Bill Wallace, TMRS Director of Communications
Dan Wattles, TMRS Director of Government Relations
Nancy Williams, Hewitt EnnisKnupp

Frank Simpson called the meeting to order at 9:00 a.m. He welcomed the the members of the Advisory Committee on Retirement Matters of the Board of Trustees for TMRS (the "Committee Members") and guests and asked them to introduce themselves. Nancy Williams of Hewitt EnnisKnupp reviewed the agenda and Dan Wattles reviewed the documents in the information packets provided for the Committee Members.

Approval of Minutes for the Advisory Committee Meetings on March 29, 2012 and May 3, 2012.

Mr. Simpson asked if there were any comments or revisions to the minutes for the Committee meetings of March 29 and May 3, 2012. No comments were made. Mike Perez moved to adopt the minutes and Ron Cox seconded the motion. The minutes were unanimously approved.

State Legislative Pension Changes

Mark Randall of Gabriel, Roeder, Smith and Company presented information in response to the chart presented at the last Committee meeting regarding national trends in changes to state pension benefit systems across the United States, and a question regarding what changes were made in Texas. He reviewed that SB 1664 froze member contributions to Texas ERS and increased the Rule-of-80 minimum service requirements from 5 to 10 years. Mr. Randall noted that in the current environment, GRS is seeing most systems looking at ways to decrease costs. If markets continue to be volatile, they expect this trend to continue. He also stated that TMRS is not in the same situation as most other systems nationwide, so he does not see the same pressure on TMRS. Mr. Randall discussed the defined benefit / defined contribution (DC/DB) debate and the increased interest in a hybrid approach by other public employers. Ms. Williams added that she has heard of one proposed plan to tie eligibility for retiree health care to the selection of a DC plan option. Under that proposal, if you stay in the DB plan then you cannot get retiree health care benefits. She thinks this may be a new trend. Mr. Randall mentioned the current national discussion regarding pension plans and 401(k) plans. He said Nebraska had terrible experience with a DC plan. He believes the private sector is starting to realize that the 401(k) plans are not working. Older employees defer retirement and the issue of providing a retirement income remains. TMRS had better investment returns than most systems last year.

Age / Years Retired Restrictions on COLA

Mr. Randall then moved into the discussion of cost-of-living adjustment (COLA) options, specifically setting restrictions on age or years retired in order to grant a COLA. Mr. Randall explained that these options delay the start of a COLA for a given number of years until the retiree reaches a threshold either of age or years from retirement. The purpose for these restrictions is to reduce costs. As an example, Mr. Randall looked at a "typical TMRS city" with a 7% employee contribution rate, 2-to-1 matching, 100% USC and 70% CPI repeating COLA, and a 14% city contribution rate. If this city could delay granting a COLA to retirees for the first 10 years of retirement, the city would receive a decrease in the normal contribution rate of about 185bp (1.85%), and decrease the Actuarial Accrued Liability ("AAL") by a relative 11%. The net reduction in the city's contribution rate would be approximately 3.27%. If the City were to delay a COLA until retirees reach at least age 62, the city would only decrease its contribution rate by 90 bp (0.90%) and its AAL by a relative 6%, for a net rate reduction of 1.61%. Mr. Gavia asked what the most common restriction GRS was seeing in other plans. Mr. Randall stated that age 62 and three to five years of retirement were fairly common. This type of COLA provision may help address the perception that public employees are retiring too early. Many systems are looking at a reduction of benefits for earlier retirement.

Flat Rate Ad-hoc & Repeating COLA Options

Next, Mr. Randall moved the discussion into flat-rate, ad-hoc and repeating COLA options. He reviewed the effect on the Unfunded AAL ("UAAL"), funded ratio, contribution rates, and the total cost to the city, of an ad-hoc COLA determined on the basis of (1) the current (with catch-up) TMRS COLA method, (2) a percent of CPI-U without catch-up, and (3) a flat rate. He then reviewed some examples of how repeating COLA options at 70% CPI, with catch-up or without catch-up, affect the same factors. City contribution rates increase by an additive 10% and 9%, respectively, versus the baseline cost of a no-COLA plan. The flat-rate COLA and non-retroactive CPI-based COLA are the two options that were proposed by Senator Seliger's Bill in the 2011 legislative session. Mr. Randall reviewed the pros and cons of these options. Advantages for the flat rate include better employer control of the costs and the effect of a smaller, non-catch-up COLA to dampen the growth of plan liabilities. The cons for flat rate COLAs include that they may not keep pace with inflation if not tied to CPI and may not maintain purchasing power for retirees.

Mr. Wattles led a review of two follow-up items from the last Committee meeting regarding COLA adoptions of TMRS cities that discontinued repeating COLAs from 2007 to 2012 and phase-in rates. Mr. Gavia stated that 37 cities have dropped repeating COLAs since 2007 and reviewed the handout that listed these cities as well as those cities that have adopted an ad hoc COLA. Mr. Crow asked how many cities have not adopted a COLA since they terminated the repeating option. Mr. Gavia stated that 18 cities have not adopted a COLA since terminating their repeating COLAs. Mr. Perez raised his concern regarding the current political status of the Legislature, and what will likely happen if they take an issue to legislators. The Committee Members discussed their thoughts on the legislative session. Several Committee Members agreed with Mr. Perez, but thought that if there was a consensus, there is a chance they could get a bill passed. Others thought it would be better not to propose legislation, while some said it was best to get out in front of the issues. Mr. Wattles stated that he and Ron Lewis will be doing a presentation on the current legislative status later in the day. Mr. Frigo asked if the Rhode Island cap on COLAs for only the first $25,000 was well received. Mr. Randall responded that because most annuities were less than the COLA cap amount , there was little political push-back.

Mr. Wattles reviewed the second follow-up item regarding phase-in rate status. A total of 215 TMRS cities still have a phase-in rate option. TMRS participating municipalities will be in the fifth year of eight-year phase-in during 2013. Mr. Gavia stated that there were originally more cities in the phase-in, but over time and because of SB 350, most of them have been able to reach their full, phased-in contribution rate.

Variable Non-Retroactive Repeating COLA Options

- Flexible 30%, 50% and 70%
- Window Options

Mr. Randall began discussion on what has come from previous Committee discussions, an interest in a variable COLA option, non-retroactive on a repeating basis. He explained that the retroactive feature would be removed, but the COLA would be repeating. The benefit would be funded at a base level, and the city could either increase or decrease the COLA percentage in any given year. He provided an example of a city choosing to have a baseline COLA at 50% CPI for ongoing funding purposes, but then granting a 70% COLA in any given year. The increased cost would be amortized over a 15-year period using level dollar amortization. He also explained how a reduction in the COLA would affect the AAL and funding. Committee Members asked if a city could select to go up or down from its baseline percentage of CPI. Mr. Frigo stated that they would not want to add different levels of percentage of CPI than those that are already an option in TMRS. Mr. Gavia stated that, from a staff perspective, the default would be the city's stated selection but they could change it annually, if desired. Ms. Sweeney asked if a city adopts an increased percentage of CPI COLAs relatively consistently over a period of years, would there need to be actuarial review to consider increased funding at the more frequently adopted levels. Mr. Randall answered that they would probably keep an eye on it, but he also stated that the difference between the percentage options of CPI is fairly small unless CPI increases into the double digits.

Mr. Randall also discussed creating a "window" to opt into a variable COLA. He pointed out that windows are not really an actuarial issue, rather they are an administrative issue. He discussed limited windows to opt-in, a one-time, open-ended opportunity, and no window at all. Ms. Williams raised a concern that often when there is a window for an option for retirement, the limited time can raise litigation concerns and she feels windows are generally bad public policy. The Committee Members discussed the pros and cons of having a window, including encouraging cities to adopt the option, deterring removing the option once it is in place, and concerns with the effect of cities turning it on and off. There was also discussion regarding creating a provision for those cities that do not participate in Social Security to not be included in any window, so as to not limit their potential participation.

Legislative Update

At this point, Mr. Wattles introduced Ron Lewis from Ron Lewis and Associates to present a legislative update for the Committee and he introduced Meredyth Fowler from the Speaker's office, who was in the audience. Mr. Wattles reviewed the changes in the House and Senate based on the May Primary results. There could be up to 41 new House members (over 25% of that body) and potentially 11 new committee chairs. Representative Truitt, current Chair of the Pensions, Investments, and Financial Services (PIFS) Committee was defeated in her primary and will not return next legislative session. Altogether, four of the nine PIFS Committee members are not returning. In the Senate, there will likely be four to six new Senators, with several committee chairmanships in play, including State Affairs and Finance. Expect many new faces and loss of experience in most committees, resulting in a need to orient new members. The huge turnover in both House and Senate and committee chairs creates uncertainty and a general lack of knowledge about retirement systems. If the PIFS Committee is revamped, the new chair will most likely not have the pension experience that Rep. Truitt had. This will likely be the most challenging session pension systems have seen; not just to get something passed, but for ensuring that undesirable changes are not adopted. Mr. Gavia asked if Mr. Lewis believes that Representative Strauss will be Speaker again. Mr. Lewis thinks he is in a strong position and will be re-elected as Speaker.

Mr. Wattles reviewed important dates in the legislative calendar. Sixty days prior to session, the filing period begins, and for the first sixty days of session, there are few decisions made on bills in the House. Mr. Gavia reminded the Committee that the last two House sponsors of TMRS bills will no longer be members of the House (Edmund Kuempel and Vicki Truitt) and it will be a challenge to get someone educated on the issues. Mr. Lewis feels that if there is consensus on a bill, the new PIFS Chair may be willing to take it on, but if there is controversy, this person may not feel confident enough on the issues to take it on. The Advisory Committee Members discussed the political climate and whether they should recommend to the Board any changes to the TMRS plan.

Ms. Oakley asked about the differences in opinion between Mr. Perez and Mr. Simpson regarding getting in front of the issues or not pursuing legislation this session. Mr. Lewis felt that, if there were consensus, he would propose a bill. Mr. Simpson feels that anti-pension sentiment will continue to get worse over the next 10 years, and that he would like to try to tweak the plan now before the climate gets worse. Mr. Lewis agreed that this might be the case, but he also feels that this year will be so chaotic with so many new members and chairs that it will be a difficult session.

Mr. Crow stated that he feels that this tweaking of the system for COLAs is more personal preference of some cities rather than a systemic issue. Mr. Lewis believes that there will be COLA bills filed and the main issue is whether TMRS wants to take the lead. The Committee Members discussed how a bill gets on the Local and Consent Calendar versus the General Calendar, which one they prefer, and what happens if there is no consensus.

Mr. Wattles reminded the Committee that there still are Interim Issues to be considered by the PIFS Committee. Mr. Wattles spoke to Merita Zoga, the PIFS Committee Clerk, and she expects the committee to have a hearing on these interim issues in August. TRS and ERS must provide the results of their studies on potential DC alternatives this summer. Mr. Wattles reminded the Committee that any recommendations from the Committee will have to be approved by the Board before they would be submitted to a sponsor for filing as a bill.

Presentation of City Survey Results

Mr. Wallace presented the results of the survey of cities that discontinued repeating COLAs from 2007-2012. Twenty cities were surveyed and all responded. Mr. Wallace reviewed the questions asked and discussed the results. He concluded that COLAs are highly valued by the cities as are ways to make them affordable and sustainable.

After a break for lunch, the meeting resumed.

Gainsharing Options

Joe Newton from GRS began the discussion on gainsharing. The official definition of gainsharing is a system by which employees receive a share of the profits of a business enterprise. In the pension world, this means allowing employee accounts to share in investment returns that outpace certain thresholds. Mr. Newton reviewed some points to consider regarding gainsharing. He stated that any mechanism for gainsharing has a cost to the employer and it is important to have discipline and prudence. He reviewed several points that should be considered, including determining when has a gain has occurred, whether gainsharing should be system-wide or employer specific, and whether gains can be taken back. He described the cyclical nature of investments and actuarial assumptions vs. experience. Mr. Newton reviewed the issues that arise during periods of underperformance. He showed some examples of sample state-wide systems' actual annual yields and how sharing returns over 12% affected contribution rates. Mr. Newton demonstrated the cost to employers for gainsharing with an example. He also said that it is not equitable across cycles, those that happen to be employed while the cycle is up get benefits of gainsharing, while those in the down period don't see the benefit and lack the cushion that was paid out to the other employees.

Mr. Newton mentioned that TMRS has over 1,400 possible combinations of benefit options. Employers have different demographics, which causes differences in funding levels and contribution rates. If gainsharing is planned at a system-wide level, it will cause problems with those cities that are on the lower end of funded ratios and higher contribution rates. He reviewed and compared the surplus returns vs. "gains"; a one-time payment vs. ongoing policy and the potential siphon of income. Mr. Newton walked the Committee though the effect of gainsharing when the city is 100% funded (it balances out) vs. 80% funded (creates a UAAL).

Mr. Newton then introduced a program he felt was a reasonable gainsharing policy that did not put funding at risk. He detailed several of the key factors that should be addressed: control at the local level; the TMRS Board would set limitations on when allowed and how much; policies to address retrospective and prospective benefits as well as funding policy; and segmented applicability based on funding ratio and contribution patterns. He also discussed how contribution rates would be stabilized and suggested creating a funding policy that would allow a city to achieve a well-funded status and then let investment earnings on surplus assets pay for supplemental benefits.

Mr. Newton also addressed the issues of gainsharing vs. risksharing. Risk sharing options include a COLA dependent on investment performance and member account interest credits tied to actual investment performance. Mr. Newton discussed how, in a standard DB plan, member contribution rates can be tied to the employer rate, though this is difficult in a cash balance plan. In summary, any gainsharing needs to be at the local level, and conservatively planned and managed. Mr. Wattles reviewed one last follow-up from the last Committee Meeting, on the history at TMRS of interest rate crediting and distributive benefits from the beginning of TMRS. Mr. Davis reviewed the statutory interest rate that started at 2.5% and rose to 5% in 1981. Historically, TMRS was on actual interest, not total return, so any gains were divided between employees, employers, and retirees. The Committee Members discussed the changes that have occurred, including higher turnover and growth in Texas cities.

Next Steps/Future Meeting Schedule

Ms. Williams moved the discussion to the next Committee meeting. She stated that the group will be asked to vote on items the Committee would like to recommend to the Board. There was consensus to have the Committee meeting prior to the Board meeting on August 17, 2012. Mr. Simpson asked Ms. Williams to bring in a short list of issues to determine if there is consensus among the Committee members with regard to those issues. The Committee discussed how to determine which issues would move forward to the Board and how long the discussion will take.

Mr. Scott explained TML's committee structure. Both he and Jim Parrish are on the TML benefits legislative committee. At the TML committee's last meeting, the committee was generally in favor of local control, was willing to defer action on a COLA recommendation until the TMRS Advisory Committee finishes its work, and was also in favor of a city option to change the employee TMRS participation threshold from 1,000 hours to 1,250 or 1,500 hours. Ms. Williams suggested putting together the bullet points summary of discussion from today for consideration, getting those out to the Advisory Committee and hearing from them what issues they would like to bring to the August meeting.

Mr. Gavia stated that the next Committee meeting will be on Thursday, August 16, 2012 at 9:00a.m. Mr. Simpson adjourned the meeting at 1:55 p.m.

David Gavia
David Gavia
Executive Director

Frank Simpson
Chair of the Advisory Committee and Board Trustee