Financial

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Independent Auditors' Report

The Board of Trustees
Texas Municipal Retirement System

Report on the Financial Statements

We have audited the accompanying statements of plan net position of Texas Municipal Retirement System (the System), as of December 31, 2012 and 2011, and the related statements of changes in net position for the years then ended and the notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Texas Municipal Retirement System as of December 31, 2012 and 2011, and the respective changes in financial position for the years then ended in accordance with U.S. generally accepted accounting principles.

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Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the Management's Discussion and Analysis on pages 24-27 and Schedules of Funding Progress and Employer Contributions for the Pension Trust and Supplemental Death Benefits Funds on pages 50-52 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the System's basic financial statements. The Other Supplementary Information – Changes in Plan Net Assets-by Fund, Schedules of Administrative Expense, Professional Services, and Investment Expenses, and Changes in Benefit Accumulation Fund on pages 53-102 is presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Other Supplementary Information – Changes in Plan Net Assets-by Fund, Schedules of Administrative Expense, Professional Services, and Investment Expenses, and Changes in Benefit Accumulation Fund is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Other Supplementary Information – Changes in Plan Net Assets-by Fund, Schedules of Administrative Expense, Professional Services, and Investment Expenses, and Changes in Benefit Accumulation Fund is fairly stated in all material respects in relation to the basic financial statements as a whole.

The introductory, investment, actuarial and statistical sections on pages 6-20, 103-112, 113-202, and 203-254, respectively, have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

KPMG LLP

Austin, Texas
May 31, 2013

Management's Discussion and Analysis (MD&A) of the Texas Municipal Retirement System (TMRS, or the System) for the years ended December 31, 2012 and 2011, provides a summary of the financial position and performance of TMRS, including highlights and comparisons. The MD&A is presented as a narrative overview and analysis in conjunction with the Letter of Transmittal, which is included in the Introductory Section of the TMRS *Comprehensive Annual Financial Report* (CAFR). For more detailed information regarding TMRS financial activities, the reader should also review the actual financial statements, including the notes and supplementary schedules.

Overview of the Financial Statements

This MD&A is intended to serve as an introduction to the TMRS basic financial statements, which comprise the following components:

- Fund Financial Statements
- Notes to Financial Statements

This report also contains Required Supplementary Information and other supplemental information in addition to the basic financial statements. Collectively, this information presents the net position and the changes in net position of TMRS as of December 31, 2012 and 2011. The information contained in each of these components is summarized as follows:

- **Fund Financial Statements.** Two statements, both containing financial information for the Pension Trust Fund and the Supplemental Death Benefits Fund (SDBF) are provided. These funds are presented as fiduciary funds of the System and reflect the resources available for benefits to members, retirees, and their beneficiaries (Pension Trust Fund) and postemployment benefits (SDBF). The Statements of Plan Net Position as of December 31, 2012 and 2011 reflect the financial position of TMRS at a point in time. The Statements of Changes in Plan Net Position for the years ended December 31, 2012 and 2011 present the activities that occurred during the respective periods.
- **Notes to Financial Statements.** The financial statement notes provide additional information that is essential to a full understanding of the data provided in the fund financial statements. Information available in the notes to the financial statements is as follows:
  - Note 1 provides a summary of significant accounting policies, basis of accounting, and explanations of major asset and liability classes. Also included is a general description of TMRS, as well as a description of each of the funds administered by TMRS.
  - Note 2 provides a general description of the benefits administered by TMRS, including eligibility and vesting requirements, contributions, and funded status as of December 31, 2012.
  - Note 3 provides information on the System's deposits and investments.
  - Note 4 provides information on the System's property and equipment.
  - Note 5 describes TMRS' commitments and contingencies.
  - Note 6 addresses the System's risk management issues.
  - Note 7 discusses an event occurring subsequent to December 31, 2012.

- **Required Supplementary Information.** Required supplementary information consists of schedules and related notes concerning the funding status and contribution trends of the benefits administered by TMRS.
- **Other Supplemental Schedules.** Supplemental schedules include additional information regarding fund activity, administrative expenses, professional services, and investment expenses. In addition, a schedule of the changes in the Benefit Accumulation Fund, by participating municipality, is provided.

Financial Highlights

Fiduciary Fund – Pension Trust Fund

The following table displays a summary of assets, liabilities, and net position for the TMRS Pension Trust Fund at December 31, 2012, 2011, and 2010 (in millions). The overall financial condition of the Pension Trust Fund reflects an increase in plan net position over the three-year period ended December 31, 2012, primarily as a result of membership activities and appreciation in the investments portfolio.

				2012 – 2011		2011 – 2010	
	2012	2011	2010	$ Change	% Change	$ Change	% Change
Investments, at fair value	$20,627.6	$18,464.8	$18,302.5	$2,162.8	11.7 %	$162.3	0.9 %
Invested securities lending collateral	147.1	1,688.6	2,693.9	(1,541.5)	(91.3)	(1,005.3)	(37.3)
Receivables and other	1,808.7	1,666.4	1,643.7	142.3	8.5	22.7	1.4
Capital assets, net	9.0	9.3	9.7	(0.3)	(3.2)	(0.4)	(4.1)
Total assets	22,592.4	21,829.1	22,649.8	763.3	3.5	(820.7)	(3.6)
Securities lending collateral	153.2	1,704.0	2,714.3	(1,550.8)	(91.0)	(1,010.3)	(37.2)
Other liabilities	1,948.6	1,553.8	1,943.0	394.8	25.4	(389.2)	(20.0)
Total liabilities	2,101.8	3,257.8	4,657.3	(1,156.0)	(35.5)	(1,399.5)	(30.0)
Net position held in trust	$20,490.6	$18,571.3	$17,992.5	$1,919.3	10.3 %	$578.8	3.2 %

The increase in investments during each of the three years ending December 31, 2012 is due to the appreciation in market values during these periods, as well as growth of the Trust Fund from net membership cash flows. The decrease in both the securities lending collateral asset and liability is due to the reduction in lending activities over the three-year period as the program became more risk adverse, and most significantly impacted by the wind-down of the securities lending program with State Street in anticipation of the transfer of the program to Deutsche Bank, effective January 1, 2013. The fluctuation of other liabilities from year-to-year is due primarily to trade activity occurring near year-end, impacting the trade payable amounts reported.

A summary of the change in net position of the Pension Trust Fund for 2012, 2011, and 2010 is as follows (in millions):

	2012	2011	2010	2012 – 2011 $ Change	2012 – 2011 % Change	2011 – 2010 $ Change	2011 – 2010 % Change
Additions							
Employer contributions	$664.8	$703.8	$679.3	$(39.0)	(5.5) %	$24.5	3.6 %
Plan member contributions	327.4	319.0	315.6	8.4	2.6	3.4	1.1
Net investment income	1,863.3	434.8	1,496.3	1,428.5	328.5	(1,061.5)	(70.9)
Total additions	2,855.5	1,457.6	2,491.2	1,397.9	95.9	(1,033.6)	(41.5)
Deductions							
Retirement benefits	864.9	810.3	743.5	54.6	6.7	66.8	9.0
Refunds	57.9	55.7	49.0	2.2	3.9	6.7	13.7
Administrative & other costs	13.4	12.8	11.9	0.6	4.7	0.9	7.6
Total deductions	936.2	878.8	804.4	57.4	6.5	74.4	9.2
Change in net position	1,919.3	578.8	1,686.8	1,340.5	231.6	(1,108.0)	(65.7)
Net position - beginning of year	18,571.3	17,992.5	16,305.7	578.8	3.2	1,686.8	10.3
Net position - end of year	$20,490.6	$18,571.3	$17,992.5	$1,919.3	10.3 %	$578.8	3.2 %

The decline in employer contributions in 2012 was a result of the fund restructuring that was reflected in the 2010 Actuarial Valuation, which reduced employer contribution rates effective for 2012. City membership totaled 849, 847, and 842 at December 31, 2012, 2011, and 2010, respectively.

Net investment income is presented after deduction of investment expenses and is comprised of interest, net appreciation in fair value of investments, and net income from securities lending activities. The significant changes in net investment income from 2010 to 2012 primarily result from the change in the net appreciation in the fair value of investments during those periods ($1.5 billion, $10.4 million, and $1.0 billion appreciation during the years ended 2012, 2011 and 2010, respectively). During 2012, TMRS' investment portfolio recognized significant market gains, with public equities contributing the most significantly. Assets such as equities, which have a greater risk profile, continue to be a source of gains during the ongoing accommodative monetary environment — both in domestic and foreign markets. In addition, while the cost basis of the securities lending collateral pool exceeded market values at each of the three years ending December 31, 2012, the collateral pool continued to experience recovery, resulting in appreciation each year of $9.3 million, $5.0 million, and $33.9 million, respectively. At December 31, 2012, the cumulative unrealized loss on the collateral was $6.1 million.

The increase in retirement benefits is due primarily to growth in the number of retired members each year (42,931, 40,534, and 38,260 in 2012, 2011, and 2010, respectively), as well as annuity increases (COLAs) that may be applied each year.

Fiduciary Fund – Supplemental Death Benefits Fund

The following table displays a summary of net position and changes in net position for the Supplemental Death Benefits Fund at December 31, 2012, 2011, and 2010. The overall financial condition of the Supplemental Death Benefits Fund reflects an increase in plan net position from December 31, 2010 to 2011, with a decrease from December 31, 2011 to 2012.

	2012	2011	2010
Total assets and net position	$25,685,451	$27,746,020	$27,062,123

A summary of the change in net position of the Supplemental Death Benefits Fund for 2012, 2011, and 2010 is as follows (in thousands):

				2012 – 2011		2011 – 2010	
	2012	2011	2010	$ Change	% Change	$ Change	% Change
Additions							
Employer contributions	$5,248.4	$6,978.5	$6,465.5	$(1,730.1)	(24.8) %	$513.0	7.9 %
Income allocation	1,310.7	1,331.6	1,312.3	(20.9)	(1.6)	19.3	1.5
Total additions	6,559.1	8,310.1	7,777.8	(1,751.0)	(21.1)	532.3	6.8
Deductions							
Supplemental death benefits	8,619.7	7,626.2	7,883.2	993.5	13.0	(257.0)	(3.3)
Total deductions	8,619.7	7,626.2	7,883.2	993.5	13.0	(257.0)	(3.3)
Change in net position	(2,060.6)	683.9	(105.4)	(2,744.5)	(401.3)	789.3	748.9
Net position - beginning of year	27,746.0	27,062.1	27,167.5	683.9	2.5	(105.4)	(0.4)
Net position - end of year	$25,685.4	$27,746.0	$27,062.1	$(2,060.6)	(7.4) %	$683.9	2.5 %

Employer contributions are based on the covered payroll of the participating municipalities at actuarially determined rates. The increase in supplemental death contributions from 2010 to 2011 is due to the aging of the active members contributing to increased rates for 2011. The decrease in supplemental death contributions from 2011 to 2012 is due to the change in the mortality assumptions used in determining the 2012 rates, resulting in generally lower contribution rates. The increase in supplemental death benefits is due to the increase in the number of active member death claims (117 in 2012 compared with 84 in 2011). The Supplemental Death Benefits Fund receives a 5% statutory interest allocation from the Pension Trust Fund based on the fund's average balance during the year.

Requests for Information

This financial report is designed to provide a general overview of the Texas Municipal Retirement System's finances. Questions and requests for additional information should be addressed to the Finance Department of the Texas Municipal Retirement System, P.O. Box 149153, Austin, TX 78714-9153. ◆

Statements of Plan Net Position

As of December 31, 2012 and 2011	2012			2011		
	Pension Trust Fund	Supplemental Death Benefits Fund	Total	Pension Trust Fund	Supplemental Death Benefits Fund	Total
ASSETS						
Cash	$ 5,654,551	$ -	$ 5,654,551	$ 797,941	$ -	$ 797,941
Receivables						
Contributions	75,436,878	435,571	75,872,449	95,551,513	719,110	96,270,623
Interest and dividends	66,767,057	-	66,767,057	70,479,407	-	70,479,407
Securities lending income	74,239	-	74,239	391,920	-	391,920
Investment trades	7,142,838	-	7,142,838	299,726,573	-	299,726,573
Securities sold on a when-issued basis	1,653,347,322	-	1,653,347,322	1,199,369,859	-	1,199,369,859
Total receivables	1,802,768,334	435,571	1,803,203,905	1,665,519,272	719,110	1,666,238,382
Investments, at fair value						
Short-term investments	387,575,445	-	387,575,445	268,028,054	-	268,028,054
Forward currency contracts	(1,536,236)	-	(1,536,236)	1,856,537	-	1,856,537
Fixed income securities	11,138,105,889	-	11,138,105,889	10,632,326,799	-	10,632,326,799
Equity index funds	8,715,108,770	-	8,715,108,770	7,465,614,184	-	7,465,614,184
Real estate funds	338,688,809	-	338,688,809	97,000,000	-	97,000,000
Real estate securities	49,617,019	-	49,617,019	-	-	-
Total investments	20,627,559,696	-	20,627,559,696	18,464,825,574	-	18,464,825,574
Invested securities lending collateral	147,077,460	-	147,077,460	1,688,567,121	-	1,688,567,121
Property and equipment, at cost, net of accumulated depreciation of $15,993,037 and $15,391,184 at December 31, 2012 and 2011, respectively	9,049,918	-	9,049,918	9,261,818	-	9,261,818
Funds held by Pension Trust Fund	-	25,249,880	25,249,880	-	27,026,910	27,026,910
Other assets	277,256	-	277,256	115,622	-	115,622
TOTAL ASSETS	22,592,387,215	25,685,451	22,618,072,666	21,829,087,348	27,746,020	21,856,833,368
LIABILITIES						
Due to depository bank	4,356,873	-	4,356,873	5,228,104	-	5,228,104
Accounts payable and other accrued liabilities	5,613,372	-	5,613,372	4,770,874	-	4,770,874
Funds held for Supplemental Death Benefits Fund	25,249,880	-	25,249,880	27,026,910	-	27,026,910
Securities lending fees payable	36,261	-	36,261	35,211	-	35,211
Securities lending collateral	153,187,500	-	153,187,500	1,703,958,593	-	1,703,958,593
Investment trades payable	217,702,310	-	217,702,310	382,108,470	-	382,108,470
Securities purchased on a when-issued basis	1,695,641,997	-	1,695,641,997	1,134,665,262	-	1,134,665,262
TOTAL LIABILITIES	2,101,788,193	-	2,101,788,193	3,257,793,424	-	3,257,793,424
NET POSITION						
Net position held in trust for pension benefits	20,490,599,022	-	20,490,599,022	18,571,293,924	-	18,571,293,924
Net position held in trust for other postemployment benefits	-	25,685,451	25,685,451	-	27,746,020	27,746,020
TOTAL NET POSITION	$ 20,490,599,022	$ 25,685,451	$ 20,516,284,473	$ 18,571,293,924	$ 27,746,020	$ 18,599,039,944

See accompanying notes to financial statements.

For the Years Ended December 31, 2012 and 2011	2012 Pension Trust Fund	2012 Supplemental Death Benefits Fund	2012 Total	2011 Pension Trust Fund	2011 Supplemental Death Benefits Fund	2011 Total
ADDITIONS						
Contributions						
Employer	$ 664,852,429	$ 5,248,375	$ 670,100,804	$ 703,778,739	$ 6,978,502	$ 710,757,241
Plan member	327,363,043	-	327,363,043	318,986,168	-	318,986,168
Total contributions	992,215,472	5,248,375	997,463,847	1,022,764,907	6,978,502	1,029,743,409
Net investment income						
From investing activities						
Net appreciation in fair value of investments	1,522,241,364	-	1,522,241,364	10,362,765	-	10,362,765
Interest and dividends	343,348,148	-	343,348,148	431,472,930	-	431,472,930
Total investing activities income	1,865,589,512	-	1,865,589,512	441,835,695	-	441,835,695
Less investment activities expense	(14,489,729)	-	(14,489,729)	(16,220,867)	-	(16,220,867)
Net income from investing activities	1,851,099,783	-	1,851,099,783	425,614,828	-	425,614,828
From securities lending activities						
Securities lending income	4,860,469	-	4,860,469	6,319,374	-	6,319,374
Securities lending expenses						
Borrower rebates	(1,449,491)	-	(1,449,491)	(1,501,957)	-	(1,501,957)
Agent fees	(511,652)	-	(511,652)	(722,620)	-	(722,620)
Net appreciation in fair value of collateral pool	9,281,432	-	9,281,432	5,056,028	-	5,056,028
Net income from securities lending activities	12,180,758	-	12,180,758	9,150,825	-	9,150,825
Net investment income	1,863,280,541	-	1,863,280,541	434,765,653	-	434,765,653
Other miscellaneous	13,962	-	13,962	24,289	-	24,289
Income allocation from Pension Trust Fund	-	1,310,740	1,310,740	-	1,331,570	1,331,570
TOTAL ADDITIONS	2,855,509,975	6,559,115	2,862,069,090	1,457,554,849	8,310,072	1,465,864,921
DEDUCTIONS						
Benefit payments						
Service retirement	729,636,554	-	729,636,554	675,504,722	-	675,504,722
Disability retirement	16,049,912	-	16,049,912	15,923,372	-	15,923,372
Partial lump sum distributions	119,250,573	-	119,250,573	118,889,171	-	118,889,171
Supplemental death benefits	-	8,619,684	8,619,684	-	7,626,175	7,626,175
Total benefit payments	864,937,039	8,619,684	873,556,723	810,317,265	7,626,175	817,943,440
Refunds of contributions	57,842,723	-	57,842,723	55,666,288	-	55,666,288
Administrative expenses	12,114,375	-	12,114,375	11,439,672	-	11,439,672
Income allocation to Supplemental Death Benefits Fund	1,310,740	-	1,310,740	1,331,570	-	1,331,570
TOTAL DEDUCTIONS	936,204,877	8,619,684	944,824,561	878,754,795	7,626,175	886,380,970
CHANGE IN NET POSITION	1,919,305,098	(2,060,569)	1,917,244,529	578,800,054	683,897	579,483,951
NET POSITION						
Net position held in trust for pension benefits						
Beginning of year	18,571,293,924	-	18,571,293,924	17,992,493,870	-	17,992,493,870
End of year	20,490,599,022	-	20,490,599,022	18,571,293,924	-	18,571,293,924
Net position held in trust for other postemployment benefits						
Beginning of year	-	27,746,020	27,746,020	-	27,062,123	27,062,123
End of year	-	25,685,451	25,685,451	-	27,746,020	27,746,020
TOTAL NET POSITION	$ 20,490,599,022	$ 25,685,451	$ 20,516,284,473	$ 18,571,293,924	$ 27,746,020	$ 18,599,039,944

See accompanying notes to financial statements.

1. Summary of Significant Accounting Policies

A. Background and Reporting Entity

The Texas Municipal Retirement System (TMRS, or the System) is an agency created by the State of Texas and administered in accordance with the Texas Municipal Retirement System Act, Subtitle G, Title 8, Texas Government Code (the TMRS Act) as a retirement and disability pension system for municipal employees in the State of Texas. As such, TMRS is a public trust fund that has the responsibility of administering the System in accordance with the TMRS Act and bears a fiduciary obligation to its members and their beneficiaries.

The System's financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). TMRS has no component units and is not a component unit of any other entity. The accompanying financial statements include only the operations of the System, which is comprised of two fiduciary trust funds — the Pension Trust Fund and the Supplemental Death Benefits Fund. The TMRS Act places the general administration and management of the System with the Board of Trustees (the Board). Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas.

B. New Accounting Pronouncements

In June 2011 the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. In addition, the Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. Statement No. 63 was implemented by the System effective for its December 31, 2012 financial statements.

In June 2012 the GASB issued Statement No. 67, *Financial Reporting for Pension Plans — an Amendment of GASB Statement No. 25*, which replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements. The Statement requires defined benefit pension plans to present two financial statements — a statement of fiduciary net position and a statement of changes in fiduciary net position. In addition, the Statement requires certain new note disclosures as well as required supplementary information. Statement No. 67 is effective for the System's 2014 fiscal year, implementation of which is currently being evaluated.

In June 2012 the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions — an Amendment of GASB Statement No. 27*, which establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about pensions also are addressed. Statement No. 68 is effective for the System's 2015 fiscal year, implementation of which is currently being evaluated.

C. Basis of Accounting

The Pension Trust Fund and the Supplemental Death Benefits Fund are maintained on the accrual basis of accounting. Revenue is recorded when earned, and expenses are recorded when incurred, regardless of when payment is made. Employer and employee contributions are recognized in the period that the employer reports compensation for the employee. Participant benefits are recorded when payable in accordance with the System's plan terms. Refunds are recorded and paid upon receipt of an approved application for refund.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The System utilizes various investment instruments. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term, and that such changes could materially affect the amounts reported in the Statements of Plan Net Position and the Statements of Changes in Plan Net Position.

D. Basis of Presentation

The financial statements are organized on the basis of funds, as required by the TMRS Act, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts. These accounts are segregated for the purpose of carrying out specific activities or attaining certain objectives in accordance with applicable statutory guidelines or restrictions.

Each of the System's funds is considered a Fiduciary Fund. The following is a brief description of each fund category.

Fiduciary Fund — Pension Trust Fund

The Pension Trust Fund reports the resources held in trust for TMRS members and beneficiaries. The TMRS Act does not create legally required reserves, but establishes accounts that comprise the net position held in trust for pension benefits as follows:

Benefit Accumulation Fund — Effective with the passage of Senate Bill 350 (SB 350) in 2011, the Benefit Accumulation Fund (BAF) was created. As of January 1, 2011, the former Employees Saving Fund, Municipality Accumulation Fund, and the Current Service Annuity Reserve Fund were combined to form each city's BAF balance. The purpose of the fund is to accumulate the activity impacting the balance of each municipality's reserve fund. The fund is increased by contributions made by employers and employee members, and decreased by benefit payments and refunds due to withdrawals and death. Effective each December 31, the Board of Trustees approves an interest credit to the BAF, allocated to each municipality in proportion to its BAF balance at January 1 of that year. The fund received an approximate 9.95% interest credit on December 31, 2012.

Full Benefit Arrangement Fund — Section 415(b) of the Internal Revenue Code limits the amount of an annual benefit that may be paid by a tax-qualified pension plan trust to its retirees. This provision is known as the Section 415 limit, which is set by Congress and can be periodically adjusted by the IRS. Any portion of a retiree's annual benefit that exceeds the Section 415 limit cannot be paid from the TMRS pension trust fund. However, Internal Revenue Code Section 415(m) allows pension plans to create a separate fund, known as a qualified governmental excess benefit arrangement, to pay the benefits above the Section 415 limit. Accordingly, the TMRS Act established such an arrangement, which is referred to as the "Full Benefit Arrangement." The purpose of the fund is to record the contributions from employers as well as the benefits paid from such contributions.

Supplemental Disability Benefits Fund — The TMRS Board of Trustees initiated legislation to amend the TMRS Act in 1987, which terminated all cities' participation in the Supplemental Disability Benefits Fund effective January 1, 1988. Consequently, there have been no contributions to this Fund since 1987. The fund continues to pay the remaining benefit payments that are obligations of the fund. Each December 31, the Supplemental Disability Benefits Fund receives a 5% interest credit on the mean balance of the fund during the year. This fund will likely experience fluctuations in funding from year to year, as this is a small, closed group; TMRS management will continue to annually monitor the balances and obligations of this fund.

Endowment Fund — The purpose of the Endowment Fund is to accumulate unallocated investment income (Interest Reserve Account), escheated accounts, and funds and assets accruing to the System that are not specifically required by the other funds.

Expense Fund — The purpose of the Expense Fund is to record the expenses incurred for the administration and maintenance of the System. The Board, as evidenced by a resolution of the Board and recorded in its minutes, may transfer from the Interest Reserve Account of the Endowment Fund to the Expense Fund the amount estimated to cover the System's administrative costs for the year.

Fiduciary Fund — Supplemental Death Benefits Fund

The Supplemental Death Benefits Fund (SDBF) reports the resources available to pay supplemental death claims for covered participants. Member cities may elect, by ordinance, to provide a "Supplemental Death Benefit" for their active members, including or not including retirees. The SDBF is a separate trust administered by the TMRS Board of Trustees. The TMRS Act requires the Pension Trust Fund to allocate a 5% interest credit to the SDBF each December 31st based on the mean balance in the SDBF during the year. Death benefit payments are payable only from this fund and are not an obligation of, or a claim against, the other funds of the System.

E. Investments

Investments at December 31, 2012 and 2011 include investments in short-term custodian-managed funds, repurchase agreements, fixed income securities, equity index funds, interests in private real estate funds, and real estate securities. Investments are reported at fair value. Forward currency contracts are considered derivative financial instruments and are reported at fair value, with valuation changes reported as investment income. The fair values of fixed income securities and real estate securities are valued by the custodian using the last trade date price information supplied by various pricing data vendors. Fair values of the equity index funds (commingled funds) are determined based on the funds' Net Asset Values at the date of valuation. Short-term investment funds and repurchase agreements are reported at cost, which approximates market value. Fair values of the investments in private real estate funds are provided by the respective General Partner, and are based on audited financial statements of the fund. Withdrawal from the private real estate funds prior to liquidation is allowable, however is subject to certain constraints as defined in the respective Limited Partnership Agreement. Security transactions are reported on a trade date basis. The TBA, or "to be announced," securities market is a forward, or delayed delivery market for 30-year and 15-year fixed-rate single-family mortgage-backed securities (MBS) issued by Fannie Mae, Freddie Mac, and Ginnie Mae. A TBA trade represents a purchase or sale of single-family mortgage-backed securities to be delivered on a specified future date; however, the specific pools of mortgages that will be delivered are unknown at the time of the trade. Parties to a TBA trade agree upon the issuer, coupon, price, product type, amount of securities, and settlement date for delivery. Settlement for TBA trades is standardized to occur on one specific day each month. Notification date occurs 48 hours prior to settlement date, where the seller communicates to the buyer the exact details of the MBS pools that will be delivered. Securities must meet "good delivery guidelines." Good delivery guidelines, notification, and settlement dates are established by the Securities Industry and Financial Markets Association (SIFMA). TBAs are an eligible security per the TMRS Investment Policy Statement. The policy requires purchases of TBAs to be backed by cash until settlement, and sales of TBAs to be backed by a deliverable security. The receivables and payables associated with the sale and purchase of TBAs are reflected in the accompanying statements of plan net position as securities sold and purchased on a when-issued basis.

F. Property and Equipment

Property and equipment consisting of building and improvements, furniture, software, equipment, work in-progress, and land are recorded at cost. It is the System's policy to capitalize items that individually exceed $5,000. Depreciation on furniture, equipment, and software is calculated on a straight-line basis over their estimated useful lives, which range from three to ten years; depreciation for building and improvements is calculated on a straight-line basis over forty years.

G. Securities Lending

The Board of Trustees has authorized the System to participate in a securities lending program, administered by the custodian bank as the System's securities lending agent, whereby certain fixed income securities are loaned to an approved independent broker/dealer (borrower) with a simultaneous agreement to return the collateral for the same securities. Collateral is in the form of cash or eligible securities and is initially equal to 102% of the market value plus any accrued interest on the loaned securities, and is maintained at a minimum level of 100% of the market value plus any accrued interest. Securities received as collateral may not be pledged or sold without borrower default. The contract with the System's custodian bank requires the custodian to indemnify the System fully if the borrowers fail to return the securities or fail to pay the System for income distributions by the securities' issuers while the securities are on loan.

The fair value of securities on loan totaled $150,040,353 and $1,683,647,884 at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, TMRS had no credit risk exposure to borrowers as the collateral amounts received exceeded amounts on loan. Additionally, TMRS did not experience any losses from default of a borrower or lending agent during 2012 or 2011.

Cash collateral received is invested by the custodian bank in a pooled trust fund (the Fund). During 2010, the Fund was restructured into two separate pools, the Duration Pool and the Liquid Pool. The Duration Pool consists of securities maturing in ninety days or more as of the restructuring date, and all asset-backed securities held on the restructuring date regardless of maturity. The Liquid Pool consists of all other securities of the Fund. The Duration Pool will not accept new investments and is managed as a liquidating trust. The System's beneficial interest in each of the pools of the Fund is reflected as units representing an undivided proportionate interest in each and recorded on the books of the Fund Trustee. These units are not insured. At December 31, 2012 and 2011, the cost basis of the System's investment in the Fund totaled $153,187,500 and $1,703,958,593, and represented 1.3% and 8.7% of the Fund, respectively.

As of December 31, 2012 and 2011, the cost basis of TMRS' share in the collateral pool exceeded market value by $6,110,040 and $15,391,472, respectively, the change in which is reported as net appreciation in fair value of collateral pool on the Statement of Changes in Plan Net Position. Securities received as collateral had a fair value of $10,943,715 at December 31, 2011. The System did not have securities as collateral for the period ending December 31, 2012.

2. Plan Description

A. Pension Trust Fund

TMRS is a statewide agent multiple-employer public employee retirement system that administers 849 nontraditional, joint contributory, hybrid defined benefit plans covering all eligible employees of member cities in Texas. Membership in TMRS is summarized below as of December 31, 2012 and 2011.

	2012	2011
Annuitant accounts currently receiving benefits	46,902	44,067
Terminated employee accounts entitled to benefits		
Vested	23,709	22,672
Non-vested	17,347	17,709
Total	41,056	40,381
Current employee accounts		
Vested	65,696	64,047
Non-vested	36,131	37,104
Total	101,827	101,151
Total member municipalities	849	847

Benefits — Upon retirement, benefits depend on the sum of the employee's contributions, with interest, and the city-financed monetary credits, with interest. City-financed monetary credits are composed of three sources: prior service credits, current service credits, and updated service credits. At the inception of each city's plan, the city granted monetary credits for service rendered before the plan began (or prior service credits) of a theoretical amount at least equal to two times what would have been contributed by the employee, with interest (3% annual), prior to establishment of the plan. Monetary credits for service since each plan began (or current service credits) are a percent (100%, 150%, or 200%) of the employee's accumulated contributions. In addition, each city can grant, either annually or on an annually repeating basis, another type of monetary credit referred to as Updated Service Credit. This monetary credit is determined by hypothetically re-computing the member's account balance by assuming that the current member deposit rate of the currently employing city (3%, 5%, 6%, or 7%) has always been in effect. The computation also assumes that the member's salary has always been the member's average salary — using a salary calculation based on the 36-month period ending a year before the effective date of calculation. This hypothetical account balance is increased by 3% each year (not the actual interest credited to the member's account in previous years), and increased by the city match currently in effect (100%, 150%, or 200%). The resulting sum is then compared to the member's actual account balance increased by the actual city match and actual interest credited. If the hypothetical calculation exceeds the actual calculation, the member is granted a monetary credit (or Updated Service Credit) equal to the difference between the hypothetical calculation and the actual calculation times the percentage adopted.

At retirement, the benefit is calculated as if the sum of the employee's contributions with interest and the city-financed monetary credits with interest were used to purchase an annuity. Members may choose to receive their retirement benefit in one of seven payment options: retiree life only; one of three survivor lifetime options; or one of three guaranteed term options. Members may also choose to receive a portion of their benefit as a Partial Lump Sum Distribution (PLSD) in an amount equal to 12, 24, or 36 monthly payments under the retiree life only option, which cannot exceed 75% of the total member deposits and interest. A member city may elect to increase the annuities of its retirees, either annually or on an annually repeating basis, effective January 1 of a calendar year. Cities may adopt annuity increases at a rate equal to either 30%, 50%, or 70% of the increase (if any) in the Consumer Price Index – all Urban Consumers (CPI-U) between the December preceding the member's retirement date and the December one year before the effective date of the increase, minus any previously granted increases.

The plan provisions are adopted by the governing body of each city, within the options available in the state statutes governing TMRS. Members in most cities can retire at age 60 and above with 5 or more years of service or with 20 years of service regardless of age. Some cities have elected retirement eligibility with 25 years of service regardless of age. Most plans also provide death benefits, and all provide disability benefits. Effective January 1, 2002, members are vested after 5 years, unless a city opted to maintain 10-year vesting. Members may work for more than one TMRS city during their career. If an individual has become vested in one TMRS city, he or she is immediately vested upon employment with another TMRS city. Similarly, once a member has met the eligibility requirements for retirement in a TMRS city, he or she is eligible in other TMRS cities as well.

Contributions — The contribution rates for employees are either 5%, 6%, or 7% of employee gross earnings (three cities have a 3% rate, which is no longer allowed for new cities under the Act), and the city matching percentages are either 100%, 150%, or 200%, both as adopted by the governing body of each city. Under the state law governing TMRS, the contribution rate for each city is determined annually by the System's consulting acturary, using the Projected Unit Credit actuarial cost method. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the portion of an active member's projected benefit allocated annually; the prior service contribution rate amortizes the unfunded (overfunded) actuarial liability (asset) over the applicable period for that city. Both the normal cost and prior service contribution rates include recognition of the projected impact of annually repeating benefits, such as Updated Service Credit and Annuity Increases (COLAs). The employer contribution rate cannot exceed a statutory maximum rate, which is a function of the employee contribution rate and the city matching percentage. There is an optional higher maximum that may be applied in certain circumstances if elected by the city, or a city may elect to remove the maximum rate. For example, with a 6% employee contribution rate and a city matching percentage of 200%, the maximum employer contribution rate is 12.5% (13.5% if the higher maximum is elected). The maximum does not apply at all for cities beginning participation on or after December 31, 1999. Contribution rate information is contained within the Actuarial Section of this report.

Contributions are made monthly by both the employees and the member cities. Since each member city must know its contribution rate in advance for budgetary purposes, there is a one-year delay between the actuarial valuation that serves as the basis for the contribution rate and the calendar year when the rate goes into effect. Contributions totaling $651.4 million and $697.1 million were made in 2012 and 2011, respectively, by the member cities in accordance with the actuarially determined city contribution rates, based on the December 31, 2010 and 2009 actuarial valuations, respectively. In addition, effective January 1, 2008, member cities are allowed to make additional contributions to the Pension Trust Fund. During 2012 and 2011, nine cities contributed $13.0 million and seventeen cities contributed $6.7 million, respectively, in such additional contributions. Employees of the cities contributed $327.4 and $319.0 million in 2012 and 2011 in accordance with the city-adopted employee contribution rate for each city. If affected, a city may also pay contributions for the Full Benefit Arrangement (FBA). Such contributions totaled $478,145 in 2012. There were no contributions made to the FBA in 2011.

Funded Status and Funding Progress — The funded status of the Pension Trust Fund as of December 31, 2012, the most recent actuarial valuation date, is presented as follows (amounts in millions of dollars):

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio (1)/(2)	Unfunded AAL (UAAL) (2) - (1)	Covered Payroll	UAAL as a Percentage of Covered Payroll (4)/(5)
	(1)	(2)	(3)	(4)	(5)	(6)
12/31/2012	$19,784.8	$22,683.8	87.2%	$2,899.0	$4,961.7	58.4%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation, and reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Additional information as of the latest actuarial valuation follows:

Valuation Date	12/31/2012
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	Closed Period, which varies by municipality
Asset Valuation Method	10-year smoothed market
Actuarial Assumptions*	
Investment Rate of Return	7.0%
Projected Salary Increases	Varies by age and service
Includes Inflation at	3.0%
Cost-of-Living Adjustments	CPI assumption is 3.0%; actual COLA varies by plan adopted

*See Summary of Actuarial Assumptions in the Actuarial Section for more detailed information.

B. Supplemental Death Benefits Fund

TMRS also administers a cost sharing multiple-employer defined benefit group-term life insurance plan known as the Supplemental Death Benefits Fund (SDBF). This is a voluntary program in which participating member cities may elect, by ordinance, to provide group-term life insurance coverage ("Supplemental Death Benefits") for their active members, including or not including retirees. Employers may terminate coverage under and discontinue participation in the SDBF by adopting an ordinance before November 1 of any year to be effective the following January 1. Participation in the SDBF as of December 31, 2012 and 2011 is summarized below; these counts represent those eligible for the retiree death benefit only:

	2012	2011
Annuitants eligible for benefits	20,655	19,952
Terminated vested employees	6,758	6,225
Current employees		
Vested	42,468	40,731
Non-vested	24,535	25,066
Total	67,003	65,797
Number of municipalities providing retiree coverage	730	725

Benefits — Payments from this fund are similar to group-term life insurance benefits, and are paid to the designated beneficiaries upon the receipt of an approved application for payment. The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on the employee's actual earnings for the 12-month period preceding the month of death). The death benefit for retirees is considered a postemployment benefit other than pension benefit (OPEB, or other postemployment benefit) and is a fixed amount of $7,500. The obligations of this plan are payable only from the SDBF and are not an obligation of, or a claim against, the Pension Trust Fund.

Contributions — Contributions are made monthly based on the covered payroll of employee members of the participating member city. The contractually required contribution rate is determined annually for each city. The rate is based on the mortality and service experience of all employees covered by the SDBF and the demographics specific to the workforce of the city. There is a one-year delay between the actuarial valuation that serves as the basis for the employer contribution rate and the calendar year when the rate goes into effect. The contributions to the SDBF are pooled for investment purposes with those of the Pension Trust Fund. The TMRS Act requires the Pension Trust Fund to allocate investment income to the SDBF on an annual basis (see note 1-D). The funding policy of this plan is to assure that adequate resources are available to meet all death benefit payments for the upcoming year; the intent is not to prefund retiree term life insurance during employees' entire careers. As such, contributions are utilized to fund active member deaths on a pay-as-you-go basis; any excess contributions and investment income over payments then become net position available for OPEB.

Funded Status and Funding Progress — The funded status of the SDBF as of December 31, 2012, the most recent actuarial valuation date, is as follows (amounts in millions of dollars):

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio (1)/(2)	Unfunded AAL (UAAL) (2) - (1)	Covered Payroll	UAAL as a Percentage of Covered Payroll (4)/(5)
	(1)	(2)	(3)	(4)	(5)	(6)
12/31/2012	$25.7	$147.9	17.4%	$122.2	$3,233.4	3.8%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation, and reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Additional information as of the latest actuarial valuation follows:

Valuation Date	12/31/2012
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	25 Years – Open Period
Asset Valuation Method	Fund Value
Actuarial Assumptions*	
Investment Rate of Return	4.25%
Projected Salary Increases	N/A
Includes Inflation at	3.0%
Cost-of-Living Adjustments	None

*See Summary of Actuarial Assumptions in the Actuarial Section for more detailed information.

Assets of the SDBF are valued at "fund value" (or fund balance) as these assets are pooled with those of the Pension Trust Fund under the provisions of the TMRS Act. GASB Statement No. 43 requires the investment return (discount rate) assumption to take into account the estimated long-term investment yield on the investments that are expected to be used to finance the payment of benefits. Benefits are expected to be provided partially from accumulated plan assets (including accumulated investment earnings) and partially from direct employer contributions. While assets invested in the SDBF are expected to earn 5% interest annually, employer contributions will be made from working funds held in cash or short-term investments. Based on the expected blend of the source of these funds, the investment return assumption has been set at 4.25%.

C. TMRS as Employer

Pension Trust Fund — TMRS, as an employer, participates as one of the 849 plans in the statewide agent multiple-employer plan administered by the System, providing pension benefits for all of its eligible employees. The plan provisions that have been adopted by the TMRS Board of Trustees are within the options available in the TMRS Act. Employees can retire at age 60 and above with 5 or more years of service, or with 20 years of service regardless of age. The contribution rate for employees is 7% and the matching percentage for TMRS is 200%. TMRS, as an employer, has also adopted 100% updated service credit (USC) on a repeating basis and annuity increases (AI) on a repeating basis, at 70% of the change in the CPI. Employees are vested after 5 years of service, but their accumulated deposits and interest must remain in the plan to receive any employer-financed benefits. At retirement, death, or disability, the benefit is calculated by converting the sum of the employee's personal account balance and the employer-financed monetary credits to a monthly annuity using annuity purchase rates prescribed by the TMRS Act. Members may choose to receive their retirement benefit in one of seven payment options. Members may also choose to receive a portion of their benefit as a PLSD (see section A of this note for a full description of the pension benefits).

As an employer, TMRS contributes to the Plan at an actuarially determined rate, which for 2012 was 16.02% of annual covered payroll. TMRS' annual pension cost and net pension obligation/(asset) for the three years ended December 31, 2012 are as follows:

For Year Ended December 31	Annual Required Contribution (ARC)	Interest on Net Pension Asset	Adjustment to ARC	Annual Pension Cost (APC)	Employer Contributions	Percentage of APC Contributed	Net Pension Obligation/ (Asset)
2010	$ 927,130	$ (4,925)	$ 4,060	$ 926,265	$ 927,130	100.1 %	$ (71,221)
2011	1,050,833	(4,985)	4,043	1,049,981	1,050,832	100.1	(72,162)
2012	1,045,853	(5,051)	4,096	1,044,898	1,045,853	100.1	(73,117)

The above reported amounts for ARC and employer contributions exclude payments made by TMRS to the FBA, which for 2012 totaled $30,179. TMRS made no contributions to the FBA in either 2011 or 2010.

The funded status as of December 31, 2012 is presented as follows:

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio (1)/(2)	Unfunded AAL (UAAL) (2) - (1)	Covered Payroll	UAAL as a Percentage of Covered Payroll (4)/(5)
	(1)	(2)	(3)	(4)	(5)	(6)
12/31/2012	$22,982,217	$28,884,765	79.6%	$5,902,548	$6,715,658	87.9%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Actuarial calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation, and reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Additional information as of the latest actuarial valuation follows:

Actuarial Methods and Assumptions TMRS as Employer	
Valuation Date	12/31/2012
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percent of Payroll
Equivalent Single Amortization Period	25.3 years
Asset Valuation Method	10-year smoothed market
Actuarial Assumptions	
Investment Rate of Return	7.0%
Projected Salary Increases	Varies by age and service
Includes Inflation at	3.0%
Cost-of-Living Adjustments	2.10%

The following schedule of funding progress, presented as required supplementary information, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Required Supplementary Information (Unaudited) Schedule of Funding Progress • TMRS as Employer (Amounts in Millions of Dollars)						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio (1)/(2)	Unfunded AAL (UAAL) (2) - (1)	Covered Payroll	UAAL as a Percentage of Covered Payroll (4)/(5)
	(1)	(2)	(3)	(4)	(5)	(6)
12/31/2010	$18.7	$24.6	76.2 %	$5.8	$5.9	99.6 %
12/31/2011	20.8	26.7	77.7	6.0	6.4	93.8
12/31/2012	23.0	28.9	79.6	5.9	6.7	87.9

Supplemental Death Benefits Fund — TMRS, as an employer, participates in the cost sharing multiple-employer defined benefit group-term life insurance plan it operates known as the Supplemental Death Benefits Fund (SDBF). TMRS elected to provide group-term life insurance coverage to both current and retired employees. The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on the employee's actual earnings, for the 12-month period preceding the month of death). Retired employees are insured for $7,500; this coverage is an other postemployment benefit, or OPEB.

TMRS contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation, which was 0.14% for 2012 and 0.18% for 2011, of which 0.01% represented the retiree-only portion for each year, as a percentage of annual covered payroll. The rate is equal to the cost of providing one-year term life insurance. The funding policy for the SDBF program is to assure that adequate resources are available to meet all death benefit payments for the upcoming year; the intent is not to prefund retiree term life insurance during employees' entire careers. As an employer, TMRS' contributions to the SDBF for the years ended December 31, 2012, 2011, and 2010 were $9,405, $11,464, and $10,556, respectively, representing contributions for both active and retiree coverage, which equaled the required contributions each year.

See section B of this note for a full description of the SDBF.

TMRS Insurance Plan — TMRS, as an employer, also participates in the Employees Retirement System of Texas (ERS) Group Benefits Program (GBP). ERS provides health, life, disability, and dental insurance benefits through the GBP; the GBP is administered through a trust (irrevocable per statute – Texas Insurance Code, Section 1551.401), which is governed and managed by a Board of Trustees. The State Retiree Health Plan (SRHP) is a cost sharing multiple-employer defined benefit postemployment healthcare plan that covers retired employees of the State and other entities as specified by the state legislature, including TMRS. The plan assets are legally protected from creditors of the State of Texas and ERS. The ERS issues a publicly available financial report that includes financial statements and required supplementary information for SRHP. That report may be obtained by writing to ERS, P.O. Box 13207, Austin, TX 78711-3207 or by calling 877-275-4377.

As a cost sharing plan, all assets and risks are pooled and the contribution rates are the same for each participating employer. Contribution requirements or "premiums" are established and may be amended by the Texas Legislature. TMRS remits monthly premium contributions to ERS to cover both active employees and TMRS retirees that are covered under the plan. TMRS' contributions to ERS for the years ended December 31, 2012, 2011, and 2010 were $688,579, $578,383, and $524,852, respectively, for active employees and $29,633, $27,826, and $26,048, respectively, for TMRS retirees, which equaled the required contributions each year.

TMRS provides health coverage to TMRS retirees based on a tenure schedule approved by the TMRS Board of Trustees through the annual budget process. The retiree, at his/her own expense, may elect spouse health coverage, as well as dental and life insurance offered through the plan.

3. Deposits and Investments

A. Cash in Bank and Deposits

Cash balances represent both demand deposit accounts, held by a local banking institution under terms of a written depository contract, and cash on deposit with the custodian.

Demand deposits totaled $2,172,388 and $520,401, with carrying amounts of ($4,356,873) and ($5,228,104) at December 31, 2012 and 2011, respectively. Securities pledged had a market value of $15,193,267 and $9,655,453 at December 31, 2012 and 2011, respectively. The account, Due to Depository Bank (book overdraft), consists of benefit checks outstanding at each year-end.

Cash on deposit with the custodian totaled $5,654,551 and $797,941 at December 31, 2012 and 2011, respectively.

B. Deposit and Investment Risk

State and local governments have deposits and investments that are subject to various risks. GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3*, provides disclosure requirements related to deposit and investment risks: custodial credit risk, credit risk, concentrations of credit risk, interest rate risk, and foreign currency risk.

Custodial Credit Risk — Deposits

Custodial credit risk is the risk that, in the event of a bank failure, the System's deposits might not be recovered. TMRS does not have a formal deposit policy for custodial credit risk of its deposits. Demand deposits held by the depository bank as of December 31, 2012 and 2011, to the extent not insured by the Federal Deposit Insurance Corporation (FDIC), were collateralized by securities held by a third party independent custodian in the System's name under a joint custody agreement giving the System unconditional rights and claims to collateral. U.S. dollar-denominated cash balances held by the custodian bank were fully insured by the FDIC as of December 31, 2011 under the Dodd-Frank Wall Street Reform and Consumer Protection Act that expired December 31, 2012. The current FDIC coverage limit is $250,000 for deposits held in noninterest-bearing accounts. Deposits denominated in a foreign currency are neither collateralized nor insured as of December 31, 2012 and 2011.

Custodial Credit Risk — Investments

Custodial credit risk is the risk that, in the event of failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The assets of the System may be held in the name of agents, nominees, depository trust companies, or other entities designated by the Board of Trustees. At December 31, 2012 and 2011, all investment securities were registered in the System's name or in the name of the System's custodian, which was established through a master trust custodial agreement, and are held by the custodian in the name of the System.

The System's investments in repurchase agreements of $72,600,000 at December 31, 2011 were collateralized by U.S. Treasury notes, held in the System's name, with a total market value of $73,634,027. TMRS held no repurchase agreement investments at December 31, 2012.

The fair values of investments at December 31, 2012 and 2011 are as follows:

	2012		2011	
	Fair Value	Cost	Fair Value	Cost
Short-term investments				
Short-term investment funds	$ 55,943,504	$ 55,943,504	$ 99,028,620	$ 99,028,620
U.S. Treasury bills	332,596,941	332,585,689	96,399,434	96,399,039
Broker collateral	(965,000)	(965,000)	-	-
Repurchase agreements	-	-	72,600,000	72,600,000
Forward currency contracts	(1,536,236)	-	1,856,537	-
Fixed income securities				
U.S. Treasury bonds/notes	3,016,807,707	2,998,574,511	2,325,019,373	2,284,283,739
U.S. Treasury inflation-protected	378,116,223	341,970,508	497,127,168	470,434,737
U.S. government agency	495,270,167	443,677,841	647,345,452	573,930,952
Municipal	179,165,115	150,680,318	166,201,697	146,109,913
Corporate	2,643,165,877	2,516,404,749	2,819,745,766	2,710,093,702
Residential mortgage-backed	3,427,666,881	3,315,004,522	2,917,382,493	2,783,575,164
Commercial mortgage-backed	100,749,121	94,309,030	419,552,522	395,117,647
Other asset-backed	50,349,056	47,767,747	67,866,413	67,132,733
Foreign government	432,692,697	394,543,216	300,309,328	316,800,449
Foreign government inflation-linked	414,123,045	364,056,102	471,776,587	440,074,015
Equity index funds				
Domestic	4,416,058,793	3,109,097,852	3,796,989,718	3,049,076,613
International	4,299,049,977	4,051,855,623	3,668,624,466	4,046,389,640
Real estate				
Private real estate funds	338,688,809	316,904,517	97,000,000	97,000,000
Real estate securities	49,617,019	49,568,348	-	-
TOTAL	$ 20,627,559,696	$ 18,581,979,077	$ 18,464,825,574	$ 17,648,046,963

Credit Risk — Investments

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. According to TMRS investment policy as adopted by the TMRS Board of Trustees, credit risk is managed by requiring minimum credit ratings by sector and mandate as outlined below:

Core Fixed Income: All securities must be rated investment grade, at least BBB- by S&P or Fitch, or Baa3 by Moody's. (2) The portfolio shall maintain a minimum weighted average credit quality of A+. (3) Global U.S. dollar denominated – issuer and issuer's national government (if the issuer is not the national government itself) must be rated investment grade, at least BBB- by S&P or Fitch, or Baa3 by Moody's. (4) Securitized – the weighted average credit quality of securitized product must be AA.

Core Plus Fixed Income: (1) At least 85% of the portfolio shall be invested in fixed income securities with a quality rating of investment grade by one or more nationally recognized statistical rating organizations (NRSRO), such as Moody's, S&P, or Fitch. (2) The portfolio shall maintain a minimum weighted-average credit quality of A. (3) Global U.S. dollar denominated – issuer and issuer's national government (if the issuer is not the national government itself) must be rated investment grade, at least BBB- by S&P or Fitch, or Baa3 by Moody's. (4) Securitized – must be rated investment grade and the weighted average credit quality must be AA.
(5) Municipal – must be rated investment grade, at least BBB- by S&P or Fitch, or Baa3 by Moody's. (6) Non U.S. dollar denominated – issuer and the issuer's national government (if the issuer is not the national government itself) must be rated at least A- by S&P or Fitch, or A3 by Moody's. (7) High yield or non-investment grade corporate – issuers must be rated at least B- by S&P or Fitch, or B3 by Moody's.

Real Return: (1) The portfolio shall maintain a minimum weighted average credit quality of A. (2) The portfolio shall be invested in fixed income securities with a quality rating of investment grade by Moody's, Standard & Poor's, or Fitch. (3) Local-currency/non U.S. dollar denominated – (a) Both the issuer and national government of the country where the issuer's primary operations are located (if the issuer is not the national government itself) must be rated investment grade. Within his set, investments rated BBB+/Baa1 and below shall be at a maximum of 10%. (b) Long-term foreign currency ratings will apply instead of local currency ratings. (c) For 95% of the portfolio, the issuer's country must be part of the Barclays Capital Global Aggregate Index, a widely followed index that includes only those local markets that are fairly liquid and fairly well developed. The portfolio may invest up to 5% of the total market value of the portfolio in countries that are not a part of the Barclays Capital Global Aggregate Index, subject to credit quality restrictions. (4) Global U.S. dollar denominated – Both the issuer and the national government of the country where the issuer's primary operations are located (if the issuer is not the national government itself) must be rated investment grade, at least BBB- by S&P or Fitch, or Baa3 by Moody's.

The System's investments with exposure to credit risk as of December 31, 2012 and 2011 are presented below by quality category:

	Fair Value at 12/31/12	Fair Value at 12/31/11	Rating
Short-term investment funds	$ 55,943,504	$ 99,028,620	NR
U.S. government agency	394,060,946	647,345,452	AAA
U.S. government agency	2,671,325	-	AA
U.S. government agency	90,172,856	-	A
U.S. government agency	8,365,040	-	NR
Municipal	45,847,255	49,429,347	AAA
Municipal	90,033,832	90,581,244	AA
Municipal	29,603,615	21,709,488	A
Municipal	13,680,413	4,481,618	BBB
Residential mortgage-backed	3,018,221,003	2,899,624,261	AAA
Residential mortgage-backed	132,345,242	205,933	AA
Residential mortgage-backed	4,619,030	606,839	A
Residential mortgage-backed	5,418,596	10,572,461	BBB
Residential mortgage-backed	-	6,372,999	B
Residential mortgage-backed	267,063,010	-	NR
Corporate	280,726,741	492,947,716	AAA
Corporate	183,096,246	301,936,738	AA
Corporate	904,633,437	947,249,254	A
Corporate	1,186,760,237	879,230,781	BBB
Corporate	70,466,012	111,542,458	BB
Corporate	7,387,000	20,088,341	B
Corporate	10,096,204	66,750,478	NR
Other asset-backed	-	10,262,647	AAA
Other asset-backed	4,923,566	5,101,411	AA
Other asset-backed	5,401,886	5,355,627	BBB
Other asset-backed	950,893	-	BB
Other asset-backed	39,072,711	47,146,728	NR
Commercial mortgage-backed	29,672,685	350,793,287	AAA
Commercial mortgage-backed	5,596,501	18,196,152	AA
Commercial mortgage-backed	30,753,768	43,732,194	A
Commercial mortgage-backed	21,051,868	-	BBB
Commercial mortgage-backed	5,618,775	-	BB
Commercial mortgage-backed	8,055,524	6,830,889	NR
Foreign government	47,736,610	116,074,763	AAA
Foreign government	206,576,469	32,398,384	AA
Foreign government	36,864,414	66,811,380	A
Foreign government	141,515,204	85,024,801	BBB
Foreign government inflation-linked	414,123,045	428,454,257	AAA
Foreign government inflation-linked	-	12,355,914	A
Foreign government inflation-linked	-	30,966,416	BBB
Total	$ 7,799,125,463	$ 7,909,208,878	

Concentration of Credit Risk — Investments

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The System's investment policy requires that investments in a single corporate issuer will not exceed more than 2% of the System's assets. For asset-backed, non-agency mortgage-backed, and commercial mortgage-backed securities, each separate trust (pool of assets) is defined as a separate issuer and shall not exceed 1.5% of the System's assets. For global inflation-linked bonds, investments in a single issuer (excluding U.S. government guaranteed bonds and sovereign government guaranteed bonds) will not exceed 5% of the total market value of the portfolio. As of December 31, 2012 and 2011, the System did not exceed any of the issuer diversification limits.

Interest Rate Risk — Investments

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The System's investment policy states that interest rate risk will be controlled through duration management, by mandate, as follows:

– Core Fixed Income – maintained within +/- 10% of the Barclay's Aggregate Index.
– Core Plus Fixed Income – maintained within +/- 25% of the Barclay's Aggregate Index.
– Real Return (Global Inflation-Linked Bonds) – maintained within +/- 25% of the Barclay's Capital World Government Inflation-Linked Bond Index.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates, and is expressed as a number of years.

The following tables display the fair value and weighted-average effective duration as of December 31, 2012 and 2011 for TMRS' long-term fixed income securities.

	Fair Value at 12/31/2012	Effective Duration
U.S. Treasury bonds/notes	$3,016,807,707	6.03
U.S Treasury inflation-protected	378,116,223	11.60
U.S. government agency	495,270,167	7.09
Municipal	179,165,115	12.43
Corporate	2,643,165,877	4.80
Residential mortgage-backed	3,427,666,881	3.47
Commercial mortgage-backed	100,749,121	2.36
Other asset-backed	50,349,056	7.56
Foreign government	432,692,697	9.42
Foreign government inflation-linked	414,123,045	8.16
TOTAL	$11,138,105,889	5.47

	Fair Value at 12/31/2011	Effective Duration
U.S. Treasury bonds/notes	$2,325,019,373	6.99
U.S. Treasury inflation-protected	497,127,168	5.78
U.S. government agency	647,345,452	6.63
Municipal	166,201,697	11.32
Corporate	2,819,745,766	4.65
Residential mortgage-backed	2,917,382,493	3.34
Commercial mortgage-backed	419,552,522	4.27
Other asset-backed	67,866,413	6.18
Foreign government	300,309,328	7.34
Foreign government inflation-linked	471,776,587	7.90
TOTAL	$10,632,326,799	5.29

Note: Mortgage-backed securities are sensitive to changes in prepayment rates, which impact duration.

Foreign Currency Risk — Investments

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. TMRS' exposure to foreign currency risk (in U.S. dollars) as of December 31, 2012 and 2011, is presented below:

Foreign Currency Exposure at December 31, 2012

Currency	Cash Equivalents	Forward Currency Contracts	Fixed Income Securities	Real Estate Securities	Total
Australian Dollar	$ 57	$ 129,429	$ 71,746,643	$ -	$ 71,876,129
Canadian Dollar	-	-	-	1,052,566	1,052,566
Euro Currency	-	(607,917)	220,323,304	-	219,715,387
Mexican Peso	886,461	-	41,009,709	-	41,896,170
New Zealand Dollar	192,289	(299,216)	59,146,086	-	59,039,159
Polish Zloty	-	(758,532)	36,864,414	-	36,105,882
United Kingdom Pound Sterling	1,644,411	-	290,957,028	-	292,601,439
Total	$ 2,723,218	$ (1,536,236)	$ 720,047,184	$ 1,052,566	$ 722,286,732

Foreign Currency Exposure at December 31, 2011

Currency	Cash Equivalents	Forward Currency Contracts	Fixed Income Securities	Total
Australian Dollar	$ 48,311	$ 56,565	$ 67,127,874	$ 67,232,750
Euro Currency	-	1,283,548	156,207,380	157,490,928
Mexican Peso	749,563	-	30,966,416	31,715,979
New Zealand Dollar	67	49,822	56,149,626	56,199,515
Polish Zloty	-	320,091	12,355,914	12,676,005
United Kingdom Pound Sterling	-	-	270,772,331	270,772,331
Swedish Krona	-	146,511	32,920,816	33,067,327
Total	$ 797,941	$ 1,856,537	$ 626,500,357	$ 629,154,835

Note: Amounts in U.S. Dollars.

Note: Excluded from this schedule are foreign government securities denominated in US dollars, which total $126,768,558 and $145,585,558 at December 31, 2012 and 2011, respectively.

According to TMRS' Investment Policy, foreign currency risk is managed through the use of spot and forward currency contracts (including non-deliverable forward currency contracts). The notional values associated with these derivative instruments are not recorded on the financial statements; however, the exposure to such instruments is recorded in the Statements of Plan Net Position. The following table summarizes the forward currency contracts in the portfolio as of December 31, 2012 and 2011.

Forward Currency Contracts at December 31, 2012		
Currency	**Net Notional Long/(Short)**	**Exposure**
Australian Dollar	$ (68,734,573)	$ 129,429
Euro Currency	(61,593,988)	(607,917)
New Zealand Dollar	(56,399,231)	(299,216)
Polish Zloty	(33,886,265)	(758,532)
U.S. Dollar	219,077,821	-
Total	$ (1,536,236)	$ (1,536,236)

Forward Currency Contracts at December 31, 2011		
Currency	**Net Notional Long/(Short)**	**Exposure**
Australian Dollar	$ (63,593,066)	$ 56,565
Euro Currency	(32,819,584)	1,283,548
New Zealand Dollar	(52,895,053)	49,822
Polish Zloty	(8,870,174)	320,091
Swedish Krona	(6,908,487)	146,511
U.S. Dollar	166,942,901	-
Total	$ 1,856,537	$ 1,856,537

Note: Amounts in U.S. Dollars.

TMRS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. Currently, TMRS limits counterparty exposure on its forward currency contracts to its custodian bank.

4. Property and Equipment

The following is a schedule of property and equipment balances as of December 31, 2012 and 2011, and changes to those account balances during the years then ended:

	Land	Buildings and Improvements	Furniture, Software, and Equipment	Total
Property and Equipment				
Balances, December 31, 2010	$ 254,388	$ 11,962,243	$ 12,292,053	$ 24,508,684
Additions	-	8,260	136,058	144,318
Retirements	-	-	-	-
Transfers	-	-	-	-
Balances, December 31, 2011	254,388	11,970,503	12,428,111	24,653,002
Additions	-	14,281	375,672	389,953
Retirements	-	-	-	-
Transfers	-	-	-	-
Balances, December 31, 2012	254,388	11,984,784	12,803,783	25,042,955
Accumulated depreciation				
Balances, December 31, 2010	-	3,206,543	11,608,095	14,814,638
Additions	-	343,607	232,939	576,546
Retirements	-	-	-	-
Balances, December 31, 2011	-	3,550,150	11,841,034	15,391,184
Additions	-	344,054	257,799	601,853
Retirements	-	-	-	-
Balances, December 31, 2012	-	3,894,204	12,098,833	15,993,037
Net balances, December 31, 2012	$ 254,388	$ 8,090,580	$ 704,950	$ 9,049,918

5. Commitments and Contingencies

As of December 31, 2012 and 2011, TMRS had outstanding commitments to private real estate funds of $337.5 million and $103.0 million, respectively.

6. Risk Management

The System is exposed to various risks of loss related to torts; errors and omissions; violation of civil rights; theft of, damage to, and destruction of assets; and natural disasters. These risks, with the exception of pension and welfare fund fiduciary responsibility insurance, are covered by the System's participation in the Texas Municipal League Intergovernmental Risk Pool. This is a pooled arrangement whereby the participants pay experience-rated annual premiums that are designed to pay claims and build sufficient reserves so that the pool will be able to protect the participating entities with its own capital. The pool reinsures excess losses to preserve the capital base. Property physical damage is insured to replacement value with a $1,000 deductible and a limit of coverage of $12,123,450; automobile liability limits are set at $1,000,000 for each occurrence and physical damage is insured to actual value with a $10,000 deductible per occurrence; general liability is limited to $1,000,000 per occurrence; sudden events involving pollution are limited to $1,000,000 for each occurrence with an annual aggregate of $2,000,000; workers' compensation coverage is in compliance with the workers' compensation laws of the State of Texas with no accident or aggregate deductibles.

The System maintains a pension and welfare fund fiduciary responsibility insurance policy with a commercial carrier. The policy has an aggregate limit of liability of $1,000,000.

No significant reductions in insurance coverage occurred in the past year, and settled claims have not exceeded insurance coverage in any of the past three fiscal years.

7. Subsequent Event

Effective January 1, 2013, TMRS moved from a custody agent model with State Street as its securities lending agent, to third party lending agent Deutsche Bank AG. ◆

Pension Trust Fund

Schedule of Funding Progress (Amounts in Millions of Dollars)						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio (1) / (2)	Unfunded AAL (UAAL) (2) - (1)	Covered Payroll	UAAL as a Percentage of Covered Payroll (4) / (5)
	(1)	(2)	(3)	(4)	(5)	(6)
12/31/2007	$ 14,203.3	$ 19,278.8	73.7 %	$5,075.5	$ 4,221.3	120.2%
12/31/2008	15,149.7	20,360.8	74.4	5,211.1	4,530.0	115.0
12/31/2009	16,305.7	21,525.1	75.8	5,219.4	4,769.0	109.4
12/31/2010	16,986.0	20,481.5	82.9	3,495.5	4,797.9	72.9
12/31/2011	18,347.0	21,563.3	85.1	3,216.3	4,853.3	66.3
12/31/2012	19,784.8	22,683.8	87.2	2,899.0	4,961.7	58.4

See accompanying Independent Auditors' Report.

Schedule of Employer Contributions (Amounts in Millions of Dollars)			
For Year Ended December 31	Annual Required Contribution	Amount Contributed	Percentage Contributed
2007	$ 512.9	$ 512.9	100.0 %
2008	564.7	567.2	100.4
2009	757.1	641.7	84.8
2010	771.9	679.3	88.0
2011	764.4	703.8	92.1
2012	654.3	664.4	101.5

See accompanying Independent Auditors' Report.

Notes to Trend Data

The Schedule of Funding Progress summarizes the actuarial value of the System's assets and actuarial liability as of December 31, 2012 and each of the five preceding fiscal years. The data presented in the schedule were obtained from the System's independent actuary's annual valuation report for each year presented.

The schedule is presented to provide a consistent basis for measuring the System's annual progress toward funding its actuarial liability in accordance with its actuarial funding method. The primary measure of funding progress is the System's funded ratio (i.e., actuarial value of assets expressed as a percentage of the actuarial accrued liability). An increase in the funded ratio indicates improvement in the System's ability to pay all projected benefits as they become due. The System is fully funded if the funded ratio is greater than or equal to 100%. As of December 31, 2012, the System's funded ratio increased from 85.1% to 87.2%.

The Schedule of Funding Progress also discloses the relationship between the System's covered payroll (i.e., all elements included in compensation paid to active members on which contributions are based) and the unfunded actuarial accrued liability. This relationship, expressed as a ratio, is a measure of the significance of the unfunded actuarial accrued liability relative to the capacity to pay all contributions required to fund the liability. As of December 31, 2012, the System's ratio of the unfunded actuarial accrued liability to its covered payroll decreased from 66.3% to 58.4%.

Effective January 1, 2008, the TMRS Act was amended to allow member cities to make additional contributions. During 2012 and 2011, nine cities and seventeen cities respectively, made additional contributions to the Pension Trust Fund totaling $13.0 million and $6.7 million, respectively.

Additional information as of the latest actuarial valuation follows:

Valuation Date	12/31/2012
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	Closed period, which varies by municipality
Asset Valuation Method	10-year smoothed market
*Actuarial Assumptions:	
Investment Rate of Return	7.0%
Projected Salary Increases	Varies by age and service
Includes Inflation at	3.0%
Cost-of-Living Adjustments	CPI assumption is 3.0%; actual COLA varies by plan adopted

* See Summary of Actuarial Assumptions in the Actuarial Section for more detailed information.
See accompanying Independent Auditors' Report.

Supplemental Death Benefits Fund

Schedule of Funding Progress (Amounts in Millions of Dollars)						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Funded Ratio (1) / (2)	Unfunded AAL (UAAL) (2) - (1)	Covered Payroll	UAAL as a Percentage of Covered Payroll (4) / (5)
	(1)	(2)	(3)	(4)	(5)	(6)
12/31/2010	$ 27.1	$ 147.7	18.3%	$ 120.6	$ 3,103.5	3.9%
12/31/2011	27.7	139.2	19.9	111.5	3,129.2	3.6
12/31/2012	25.7	147.9	17.4	122.2	3,233.4	3.8

See accompanying Independent Auditors' Report.

Schedule of Employer Contributions (Amounts in Millions of Dollars)			
For Year Ended December 31	Annual Required Contribution	Amount Contributed	Percentage Contributed
2010	$8.3	$2.2	26.5%
2011	9.3	2.9	31.3
2012	10.5	0.2	1.9

See accompanying Independent Auditors' Report.

Notes to Trend Data

The Schedule of Funding Progress summarizes the actuarial value of the System's assets and actuarial accrued liability for the fiscal years ended December 31, 2012, 2011, and 2010. The amount contributed represents the contributions allocated for OPEB after the payment of active benefits. The data presented in the schedule were obtained from the System's independent actuary's annual valuation report for each year presented.

Additional information as of the latest actuarial valuation follows:

Valuation Date	12/31/2012
Actuarial Cost Method	Projected Unit Credit
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	25 Years – Open Period
Asset Valuation Method	Fund Value
*Actuarial Assumptions:	
Investment Rate of Return	4.25%
Projected Salary Increases	N/A
Includes Inflation at	3.0%
Cost-of-Living Adjustments	None

* See Summary of Actuarial Assumptions in the Actuarial Section for more detailed information.
See accompanying Independent Auditors' Report.

Changes in Plan Net Position — by Fund • Year Ended December 31, 2012

	Benefit Accumulation Fund	Full Benefit Arrangement	Supplemental Disability Benefits Fund	Endowment Fund	Expense Fund	Total Pension Trust Fund	Supplemental Death Benefits Fund	Total
ADDITIONS								
Employer contributions	$ 664,374,284	$ 478,145	$ -	$ -	$ -	$ 664,852,429	$ 5,248,375	$ 670,100,804
Plan member contributions	327,363,043	-	-	-	-	327,363,043	-	327,363,043
Net investment income	-	-	-	1,866,105,049	(2,824,508)	1,863,280,541	-	1,863,280,541
Other miscellaneous	-	-	-	13,962	-	13,962	-	13,962
Total additions	991,737,327	478,145	-	1,866,119,011	(2,824,508)	2,855,509,975	5,248,375	2,860,758,350
DEDUCTIONS								
Service retirement benefits	729,158,409	478,145	-	-	-	729,636,554	-	729,636,554
Disability retirement benefits	15,955,163	-	94,749	-	-	16,049,912	-	16,049,912
Partial lump sum distributions	119,250,573	-	-	-	-	119,250,573	-	119,250,573
Supplemental death benefits	-	-	-	-	-	-	8,619,684	8,619,684
Refunds of contributions	57,842,723	-	-	-	-	57,842,723	-	57,842,723
Administrative expenses	-	-	-	-	12,114,375	12,114,375	-	12,114,375
Total deductions	922,206,868	478,145	94,749	-	12,114,375	934,894,137	8,619,684	943,513,821
FUND TRANSFERS								
Operating budget transfer	-	-	-	(15,515,000)	15,515,000	-	-	-
Income allocation	1,835,478,122	-	35,086	(1,836,823,948)	-	(1,310,740)	1,310,740	-
Escheated funds	(1,328,587)	-	-	1,328,587	-	-	-	-
Net Fund Transfers	1,834,149,535	-	35,086	(1,851,010,361)	15,515,000	(1,310,740)	1,310,740	-
Total Change in Plan Net Position	1,903,679,994	-	(59,663)	15,108,650	576,117	1,919,305,098	(2,060,569)	1,917,244,529
Net Position, beginning of year	18,447,746,134	-	749,603	110,041,729	12,756,458	18,571,293,924	27,746,020	18,599,039,944
Net Position, end of year	$ 20,351,426,128	$ -	$ 689,940	$ 125,150,379	$ 13,332,575	$ 20,490,599,022	$ 25,685,451	$ 20,516,284,473

See accompanying Independent Auditors' Report.

Schedule of Administrative Expenses Year ended December 31, 2012	
Personnel services	
Staff salaries	$ 5,835,566
Payroll taxes	390,721
Retirement contributions	936,273
Insurance	642,070
Total personnel services	7,804,630
Professional services	
Consulting	448,469
Actuarial	434,175
Banking	40,719
Legal	108,647
Medical	24,800
Audit	89,000
Total professional services	1,145,810
Communication	
Printing	9,984
Postage	82,930
Travel	226,494
Telephone	92,199
Member education and mailings	375,794
Total communication	787,401
Rentals/equipment maintenance	
Data processing	410,322
Office equipment	85,726
Offsite record storage	161,982
Total rentals/equipment maintenance	658,030
Miscellaneous	
Dues, subscriptions, and training	275,256
Utilities	157,521
Supplies	179,716
Building/grounds maintenance	144,183
Building security	118,756
Bonds and insurance	73,357
Board and Advisory Committee expenses	114,717
Depreciation	601,853
Other administrative expenses	53,145
Total miscellaneous	1,718,504
TOTAL ADMINISTRATIVE EXPENSES	$ 12,114,375

See accompanying Independent Auditors' Report.

Schedule of Professional Services Year ended December 31, 2012	
Consulting	
Information systems support	$ 230,331
Governance/strategic planning	100,050
Legislative	95,205
Disaster recovery	11,800
Annuity mortality records and address research	9,493
Human resources management	1,590
Total Consulting	448,469
Actuarial	
Gabriel, Roeder, Smith & Company (GRS)	434,175
Banking	
JPMorgan Chase Bank	40,719
Legal	
Klausner, Kaufman, Jensen & Levinson	74,628
Jackson Walker LLP	31,791
Fulbright & Jaworski LLP	1,358
Hull Hendricks LLP	870
Total Legal	108,647
Medical	
Grover Bynum, M.D.	5,200
Marvin Cressman, M.D.	8,700
John A. Genung, M.D.	3,200
Thomas I. Lowry, M.D.	4,300
William E. McCarron, M.D.	3,400
Total Medical	24,800
Audit	
KPMG LLP	89,000
TOTAL PROFESSIONAL SERVICES	$ 1,145,810

Note: The members of the Board of Trustees serve without compensation; they are reimbursed for actual expenses incurred.

See accompanying Independent Auditors' Report.

Schedule of Investment Expenses Year ended December 31, 2012	
Internal operating expenses	
Staff salaries	$ 967,387
Contract labor	1,404
Payroll taxes	59,758
Retirement contributions	154,164
Insurance	80,197
Electronic investment services	603,101
Travel	46,638
Dues, subscriptions, and training	58,552
Other administrative expenses	1,857
	1,973,058
Investment management and other external expenses	
Investment management	11,665,221
Consulting	693,890
Legal	157,560
	12,516,671
TOTAL INVESTMENT EXPENSES	$ 14,489,729

See accompanying Independent Auditors' Report.