

ATTACHMENT A

Key Assumptions Used in Calculating the Projections in this Letter

The projections in this letter are based on:

- Your city's plan provisions as of December 31, 2007
- Actuarial Valuation data as of December 31, 2006
- The actuarial assumptions, actuarial cost method, and closed amortization of the Unfunded Actuarial Accrued Liability adopted by the TMRS Board in December 2007

The Actuarial Valuation as of December 31, 2007 is being performed now and will be the basis for the rate you will receive in May 2008 for contribution requirements during the year beginning January 1, 2009. Because the projections in this letter are based on the 2006 valuation data, rate fluctuations due to actual experience different than expected during calendar year 2007 cannot be reflected in the projected rates. Consequently, your 2009 actual rate will differ from the projected rate based on the relative magnitude of experience gains/losses for your city. Except for very small cities, the impact of experience gains/losses on total contribution rates is, in general, relatively minor; therefore, the 2009 projected rates should be an adequate indicator of the 2009 actual rate levels and can be used for preliminary planning purposes during this interim period prior to completion of the December 31, 2007 valuation.

Actuarial Changes for 2008 / 2009

In December 2007, the TMRS Board of Trustees approved changes in the actuarial assumptions and funding methodology for all TMRS plans. These changes will first be reflected in the determination of your 2009 contribution rates as part of the December 31, 2007 Actuarial Valuation. The funding impact of the respective changes is described below.

Change in the Actuarial Cost Method from Traditional Unit Credit (UC) to Projected Unit Credit (PUC). For both methods, the annual cost equals the normal cost (NC) plus amortization of the Unfunded Accrued Liability (UAL). Under the UC method, the portion of the benefit allocated to each year of service is the increase in the **accrued benefit** during the year. The NC is the present value of the change in the accrued benefit, while the Accrued Liability represents the present value of benefits accrued to date. Increases in benefits are recognized only as they accrue each year with no allowance for the effect of future increases in salary, Updated Service Credit (USC), or Annuity Increases (COLAs) on benefits attributable to past service. Over time, the effect of USC and COLAs on prior service benefits creates an upward spiral in contribution requirements and a downward trend in funding ratios.

The PUC method is very similar to the UC method except that under the PUC method an equal portion of each active member's **projected benefit** is allocated to each year of service in determining the annual NC. The accrued liability represents the present value of future benefits not funded by the present value of future normal costs. The assignment of an equal portion of the projected benefit reflecting assumptions for increases in benefits due to future salary increases, USC, and COLAs, produces a contribution rate that is fairly stable over the long term. More importantly, the advance funding of projected benefits over the working lifetime of each active member accumulates sufficient assets at retirement to fully fund the promised benefits.

Change from a 25-year open amortization period to a 25-year closed amortization period. The UAL has been amortized over a new 25-year amortization period each year. By closing the amortization period, funding progress will be accelerated and target funded ratios achieved sooner by partially offsetting the initial decline in funding ratios caused by the change in actuarial cost method.

Changes in actuarial assumptions are summarized in the following chart:

Assumption:	Prior to 12/31/07:	For 12/31/07 valuation:
<i>Economic Assumptions:</i>		
Inflation Rate	3.50%	3.00%
Investment Rate of Return	7.00%	Diversified portfolio = 7.00%
Salary Scale	N/A	Table based on inflation rate, seniority, and age
Payroll Growth	3.00%, 4.00%, or 5.00%	3.00%
<i>Mortality Assumptions:</i>		
Pre-Retirement Mortality	Active Life Mortality Table from 1988-1992 Experience Study.	Sex-distinct RP 2000 combined Healthy Mortality Table with male rates set back 1 year and female rates unadjusted.
Service Retiree and Beneficiary Mortality	UP-1984 Table with age setback of 1 year for males and 8 years for females.	Sex-distinct RP 2000 combined Healthy Mortality Table with no adjustment to male rates and a 1-year set-forward for female rates.
Disabled Annuitant Mortality	1983 Disabled Annuitants Mortality Table.	Sex-distinct RP 2000 Disabled Mortality Table with a 4-year set-back for male rates and female rates unadjusted
Mortality Rates for Annuity Purchase Factors	UP-1984 set back 2 years for retirees and 8 years for beneficiaries.	Same.
<i>Disability Assumptions:</i>		
Disability Rates	Table adopted in 1998-2002 Experience Study. Currently listed in 12/31/06 CAFR.	Table proposed in 2003-2006 Experience Study. Will be provided in 12/31/07 CAFR.
<i>Withdrawal Assumptions:</i>		
Withdrawal with less than 20 years of service	Table adopted in 1998-2002 Experience Study. Currently listed in 12/31/06 CAFR.	Table proposed in 2003-2006 Experience Study. Will be provided in 12/31/07 CAFR.
Ultimate Withdrawal Rates	Separate tables for cities with less than and more than 500 employees adopted in 1993-1997 Experience Study.	Apply ultimate withdrawal rates only to individuals with between 20 and 25 years of service, employed by cities that have not adopted 20-Year, Any Age retirement eligibility.
<i>Turnover Assumptions:</i>		
Turnover Rate	N/A	Create select-and-ultimate tables that mirror the withdrawal rates, differentiated by less than or more than 20 years of service credit.
<i>Retirement Assumptions:</i>		
Retirement Rates	Table adopted in 1998-2002 Experience Study. Currently listed in 12/31/06 CAFR.	Table proposed in 2003-2006 Experience Study. Will be provided in 12/31/07 CAFR.

Why Did TMRS Make These Changes?

The change in Actuarial Cost Method was made to facilitate advance funding of the annually repeating USC and COLAs that have been adopted by many TMRS cities.

The change from an open amortization period to a closed period was made in conjunction with the change in Actuarial Cost Method and is intended to provide funding progress for all benefits each year. It is also intended to prevent the rising unfunded actuarial liabilities and declining funding ratios that some cities have experienced in recent years.

The changes in actuarial assumptions are part of the ongoing process of retirement plan funding. Every four years, the TMRS actuaries examine the plan's experience and adjust assumptions as needed.

Annually Repeating and Ad Hoc Benefits

The change in Actuarial Cost Method has been made to facilitate advance funding of annually repeating benefits. Many cities have chosen to provide this benefit as part of their TMRS plan, and 15 years of experience has shown that the benefits are likely to be continued into future years. Under GASB rules, these are "committed benefits" and must be advance funded.

For many cities, the main factor that is causing contribution increases is the cost of pre-funding the annually repeating benefits, especially Annuity Increases to retirees. TMRS provides two ways of granting USC and COLAs — on an annually repeating basis or on an ad hoc basis, the latter requiring an annual election by the city council to grant the benefits.

Some cities are considering "turning off" the annually repeating benefits and adopting USC and/or COLAs on an ad hoc basis each year. TMRS will provide cost information associated with both choices, but does not recommend any particular course of action. Some of the factors that might affect cities' decisions include:

- Annually repeating benefits will be advance-funded using the PUC cost method. Under PUC, the repeating benefits will be reflected in determining the projected benefit at retirement as well as the respective contribution requirements.
- Ad hoc benefits will be reflected in the contribution rate for the current year, but future years' increases will not be recognized until granted. For cities with a fairly stable workforce and a sufficient number of participants to make generalizations meaningful, expected changes in contribution rates due to ad hoc increases are anticipated to range from 0.3% to 0.6% of pay. Typically about 65% to 80% of this increase is due to the updated annuity increase to retirees. Based on current demographic characteristics and assumptions, these "rules of thumb" are expected to reflect future experience for the next few years.
- The ultimate cost of annually repeating benefits and ad hoc benefits is the same. What differs is the "payment schedule."
- A city that adopts ad hoc increases every year is likely to experience increases from year to year in both contribution rates and unfunded actuarial liabilities, and decreases in funding ratios.

8-Year Phase-in of 30-Year Closed Amortization Rates

If the changes in actuarial assumptions and funding method increased your city's 2009 rate by more than 0.05%, the TMRS Board approved the automatic recalculation of the 2009 contribution rate using a 30-year closed amortization period and an 8-year phase-in period. The amount to be phased in over a maximum of 8 years is simply the difference between the 2009 full 30-year rate (new assumptions)

and the 2009 Unit Credit rate (old assumptions). For purposes of estimating the effect of the change in funding method and assumptions on your estimated 2009 contribution rate, we have assumed that your 2009 Unit Credit contribution rate will be identical to your 2008 contribution rate.

ATTACHMENT B

GASB Disclosure Information

TMRS will provide all cities with GASB disclosure information for the year ending 12/31/07 in May 2008, along with the Annual Contribution Rate letter. Several cities have requested “temporary” language to be included in financial reports prepared prior to that time.

The following language can be used by municipalities for disclosure purposes between now and May 2008. This language is “temporary” and will be modified to reflect actual valuation numbers specific to each city, once the 12/31/07 valuation is completed.

To be used before May 2008:

Note to city:

Begin your disclosure with the current GASB template that is currently on the TMRS website (under “City Services”). This portion of the footnote provides a general description of participation in TMRS, how contributions are made to the System and the benefits that your city has elected to provide (as of April 2007). In addition, this template also provides your city’s Schedule of Funding Progress and actuarial assumptions as of the most recent actuarial valuation (12/31/06). Following that portion of the disclosure, the following may be included by your city to give additional information regarding the upcoming changes and their possible effects to your city’s contribution rate.

At its December 8, 2007 meeting, the TMRS Board of Trustees adopted actuarial assumptions to be used in the actuarial valuation for the year ended December 31, 2007. A summary of actuarial assumptions and definitions can be found in the December 31, 2007 TMRS Comprehensive Annual Financial Report (CAFR).

Note to city:

The 12/31/07 TMRS CAFR will be distributed and available on the TMRS Website at the end of June 2008.

Since its inception, TMRS has used the traditional Unit Credit actuarial funding method. This method accounts for liability accrued as of the valuation date but does not project the potential future liability of provisions adopted by a city. Two-thirds of the cities participating in TMRS have adopted the Updated Service Credit and Annuity Increases provisions on an annually repeating basis. These provisions are considered to be “committed” benefits (or likely to be guaranteed); as such, the TMRS Board has adopted the Projected Unit Credit (PUC) actuarial funding method, which facilitates advance funding for future updated service credits and annuity increases that are adopted on an annually repeating basis. For the December 31, 2007 valuation, the TMRS Board determined that the PUC method will be used.

In addition, the Board also adopted a change in the amortization period from a 25-year “open” to a 25-year “closed” period. TMRS Board of Trustee rules provide that, whenever a change in actuarial assumptions or methods results in a contribution rate increase in an amount greater than 0.5%, the amortization period may be increased up to 30 years, unless a city requests that the period remain at 25 years. For cities with repeating features, these changes will likely result initially in higher required contributions and lower funded ratios. To assist in this transition to higher rates, the Board also approved an eight-year phase-in period, which will allow cities the opportunity to increase their contributions gradually (approximately 12.5% each year) to their full rate (or their required contribution rate).

Using demographic data from the 12/31/06 valuation, TMRS' actuary has made calculations with the new actuarial assumptions. For cities with annually repeating benefits, those calculations resulted in estimated higher contribution rates, increased unfunded actuarial liabilities, and lower funded ratios.

The City adopted the Updated Service Credit provision in XXXX (city to state the year), on a repeating basis (*if applicable to your city*). Additionally, the City adopted annuity increases for its retirees, on a repeating basis (*if applicable to your city*) in XXXX (city to state the year) equal to XX% (city's percentage) of the change in the consumer price index (CPI).

Note to city: The last paragraph above, relating to USC and annuity increases, should be tailored to fit your specific city provisions.

Final notes to city:

(1) To the extent that the city submits contributions to TMRS that are less than the Full Rate (i.e. – the city submits contributions based on the phase-in rate), the city will need to accrue a net pension obligation in its financial statements.

(2) Also, Paragraph 8 of GASB 34 (dealing with MD&A) requires the government to include all “currently known” facts, decisions or conditions (with “currently known” defined as of the date of the audit opinion). Many cities with annually repeating USC and Annuity Increases will be seeing significant increases in contributions. TMRS provided general estimates of the USC and Annuity Increases effect on rates in a November 19, 2007 letter to each city; at that time, many city audits had likely not been completed. Your City should consider including a sentence in the MD&A referring the reader to the footnote regarding TMRS.

ATTACHMENT C

Issues, Timelines, and Resources

This letter is the latest in a series of communications to cities about changes the System is undergoing that affect the funding of benefits. Past communications are archived on the TMRS Website at www.TMRS.com, and we encourage you to look there for information on the history of these issues.

What's Next?

The projections in this letter represent an estimate of what your city's rate for 2009 will be and are intended to help you see both the short- and long-term cost of your current benefit plan. TMRS is committed to helping cities find the best solution to funding their benefits.

The scenarios in this letter represent only a few of the many changes cities may wish to consider to their plans. We are fine-tuning software, provided by our actuary, which will enable us to work directly with city finance officers to model "what-if" benefit designs and the resulting contribution rates. Beginning in February, TMRS will host a series of Regional Funding Workshops throughout the state. We will announce these as soon as they are finalized and encourage all cities to try to attend one if they have concerns about their plan. Cities may also, of course, call TMRS to discuss alternatives.

TMRS has hired a staff actuary — Leslee Hardy — and she is available to assist cities with questions and scenarios.

In May, you will receive your annual Rate Letter package from TMRS showing your contribution rate for the year beginning January 1, 2009.

- If your city's contribution rate has increased by more than 0.5%, your amortization period will be 30 years unless you notify TMRS that you wish to remain at 25 years.
- If your rate has increased more than 0.5%, your contribution rate for 2009 (your "phase-in rate") will include approximately 12.5% of the difference resulting from changes in the actuarial cost method or assumptions. Your annual contribution may be more than the phase-in rate if you wish, and some cities may choose to pay the full rate beginning in 2009.

If a City Wants to Change Benefits...

Call TMRS, and we will assist you by showing the effects of any changes you wish to consider. Changes made and communicated to TMRS before April will be reflected in the May Rate Letter. Plan changes made in April or later and communicated to TMRS before December 2008 will be reflected in your 2009 contribution rate and in the Actuarial Valuation performed as of December 31, 2008.

Benefit changes will not retroactively affect members. For example, if a city turns off annually repeating Updated Service Credit (USC), any USC that members have already been granted will not be affected. If a city chooses to reduce its matching ratio, the reduction will affect members' benefits after the effective date of the change, but service prior to the change will be matched at the former ratio.

Statutory Maximum Contribution Rates

State law provides maximum contribution rate levels (Stat Max) for TMRS cities. Many cities have, by ordinance, removed the Stat Max, but some cities' rates will exceed their maximum rate for the first time in 2009. Cities affected by this provision will need to make arrangements to pay the phased-in rate by removing the Stat Max or taking other action. The Rate Letter in May will discuss this issue in detail for those cities that may wish to remove the Stat Max.

GASB Financial Statement Disclosure

Attachment B contains information on the GASB disclosures related to participation in TMRS.

TMRS Investments

TMRS has begun to diversify its investments. The System has traditionally invested almost entirely in bonds but will begin diversifying into stocks during 2008. Approximately 12% of TMRS' investments will be invested in passive market indexes during 2008 — 6% in domestic companies that make up the Russell 3000 Index and 6% in foreign equities that make up the MSCI-EAFE Index. Please see the TMRS Website and publications for more information on TMRS investments.

The diversification of investments is intended to increase the return on the TMRS portfolio, to preserve benefit levels for members, and to assist cities by helping mitigate increased contribution requirements.

TMRS Seminars

- TMRS will be conducting Regional Planning Workshops across the state this year. Watch the Website and TMRS publications for dates and locations.
- The 2008 TMRS Annual Training Seminar will be in Corpus Christi, September 2 and 3. Although there will be some sessions to discuss the changes, the emphasis at the seminar this year will be on training for correspondents in plan administration. Space will be limited.
- We are planning a statewide seminar focused on funding and investments sometime early in 2009. Place and date to be announced.

Legislation in 2009

There are three issues of critical importance to TMRS that will be introduced in the 81st Texas Legislature:

1. Gaining authority to credit unrealized gains on investments to members' and cities' accounts. This is needed before TMRS can fully diversify its investments.
2. Guaranteeing an interest rate for members' accounts and the annuity discount rate that is applied at the time of retirement. Current law contemplates a 5% rate, but that rate is not guaranteed.

3. Providing a mechanism for interest rates to vary between members and cities. Discussion of this mechanism and the appropriate level of rates is underway with cities and employee associations. TMRS is committed to working with all interested parties to provide a method that preserves the future benefits of members while helping cities meet the contribution requirements for their plans.

Other issues may arise before the legislative session, but these three are at the forefront of current discussion. Please see the TMRS Website and publications for ongoing developments on legislative initiatives, or contact TMRS' Governmental Relations Director, Eddie Solis, for specific information.

Resources

TMRS is committed to keeping cities, members, and retirees fully informed. Useful resources include:

- E-bulletins — sent once or twice each month to all city officials for whom we have valid e-mail addresses. These are the best source of quick updates and changes in schedules or plans. If you do not currently receive the e-bulletins, please send a request to be added to bulletin@TMRS.com.
- The TMRS Website — www.TMRS.com — contains an archive of past communications as well as announcements of important developments.
- *TMRS Facts for City Officials* — a recently published booklet on TMRS plan features, funding, and governance issues that will be useful for city decision-making.
- The TMRS Travel Team — Field representatives who travel across the state to assist cities with member issues as well as funding questions. The Travel Team is available upon request. If you wish to schedule a visit, call TMRS or send an e-mail to communications@tmrs.com.

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