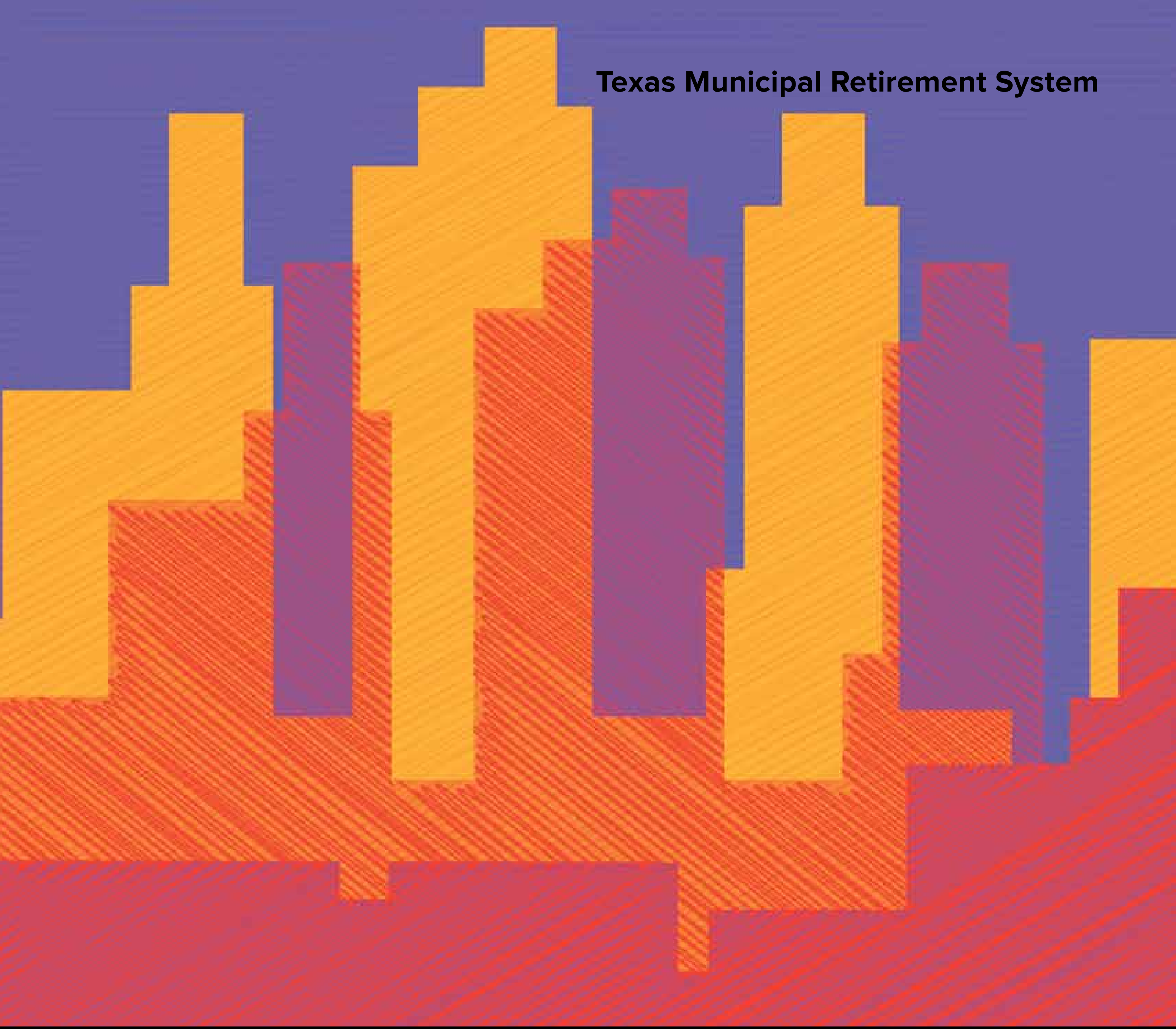
Texas Municipal Retirement System



TMRSFACTS

For City Officials

Table of Contents

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Purpose of this Guide

This guide for city officials — city managers, finance officers, and elected and appointed officials — is intended to provide the information you need to understand how the Texas Municipal Retirement System (TMRS) works. For a complete description of TMRS plan benefits, see the *Member Benefits Guide*.

What Is TMRS?

TMRS is a retirement system created by the Texas State Legislature in 1947 and administered in accordance with the **Texas Municipal Retirement System Act, Subtitle G, Title 8, Government Code**, for municipal employees in the State of Texas. TMRS is a public trust fund that bears a fiduciary obligation to the public employees and retirees who are its beneficiaries. The Administrative Rules governing the System are adopted by the TMRS Board of Trustees and are contained in the **Texas Administrative Code, Title 34, Part 6.**

Pension and other benefits are administered by TMRS on behalf of more than 830 participating municipalities throughout the State of Texas. Cities voluntarily elect to participate in the System, and once they do so, state law requires full participation by all employees of the member city. Cities choose from a menu of plan options to provide benefits they deem appropriate. The city's retirement plan description, as stated in the Governmental Accounting Standards Board (GASB) Compliance Data section of the Annual Rate Letter, reads as follows:

> *The City provides pension benefits for all of its full-time employees . . . through a non-traditional, joint contributory, hybrid defined benefit plan in the statewide Texas Municipal Retirement System (TMRS), an agent multiple-employer public employee retirement system.*

All employees must participate in TMRS except for any excluded departments (such as firefighters or police who may be covered by other pension plans). The plan is "non-traditional," which means it is not a standard salary and service-formula pension plan. It is "joint contributory," which means that both the member and the employer city contribute to the plan; and it is a "hybrid defined benefit" plan, which means it has some elements of both defined benefit (DB) and defined contribution (DC) plans. Cities join TMRS voluntarily, and the plan decisions and modifications remain in the city's hands. Cities may change their plan provisions by ordinance.

Who Governs TMRS?

The TMRS Act provides that the governance of TMRS is entrusted to a six-member Board of Trustees, appointed by the Governor of Texas with the advice and consent of the Senate. Three Trustees are "Executive Trustees," who are the chief executive officer; chief finance officer; or other officer, executive, or department head of a participating municipality. Three Trustees are "Employee Trustees," who are employees of a participating municipality. A current list of Board members may be found on the TMRS website under "About TMRS."

What Is the TMRS Advisory Committee? The 19-member Advisory Committee on Retirement Matters is appointed by the TMRS Board of Trustees and serves at the pleasure of the Board. The Advisory Committee provides valuable assistance to the Board in considering benefit changes and improvements to the System, and acts as a voice for member, retiree, and city issues. Nine of the Advisory Committee members are "individual class" members, appointed by the Board from a list of applicants. The other ten are "group class" members representing the following organizations: Combined Law Enforcement Associations of Texas, Texas Municipal Police

Association, Texas State Association of Fire Fighters, Service Employees International Union – San Antonio, Arlington Professional Firefighters Association, City of San Antonio, Texas Municipal League, Texas City Management Association, Government Finance Officers Association of Texas, and Texas Municipal Human Resources Association.

Full details on the Advisory Committee, the committee's charter, and the application form for individual class membership are available on the TMRS website.

Where Can I Find the TMRS Statutes?

The law that specifically governs TMRS is the Government Code, Title 8, Subtitle G, Texas Municipal Retirement System, Chapters 851 General Provisions, 852 Membership, 853 Creditable Service, 854 Benefits, and 855 Administration. All amendments to the TMRS Act in the form of laws passed by the Texas Legislature (including the passage of HB 1244 by the 80th Legislature in 2007 and HB 360 by the 81st Legislature in 2009) are incorporated into this law. Updated laws are available through the Texas Legislature Online *(http://www.capitol.state.tx.us/#Texas State Legislature Online),* and Rules are available through the Texas Secretary of State's website *(http://www.sos.state.tx.us/).*

How Does the Plan Work?

TMRS is one of the nation's oldest "hybrid" pension plans. Being a hybrid means we share some traits of defined benefit (DB) and defined contribution (DC) plans (see the Glossary, page 14, for definitions). TMRS has many of the features of a DC, or "cash balance," plan (where a member's basic benefit is calculated based on account balances rather than on a benefit multiplier applied to salary and service), but investments are not member-directed like most DC plans. TMRS' DB plan features include a 5% interest credit "floor," Prior Service Credits (PSC), Updated Service Credit (USC), Cost of Living Adjustment (COLA) options, and a lifetime annuity payable upon retirement.

TMRS does not receive state money; it is funded by TMRS members and municipalities, plus earnings from investment income. As shown in Figure 1, the overall System assets reflect the accumulated value of employer and employee contributions, plus earnings from investments, less benefit payments and expenses.

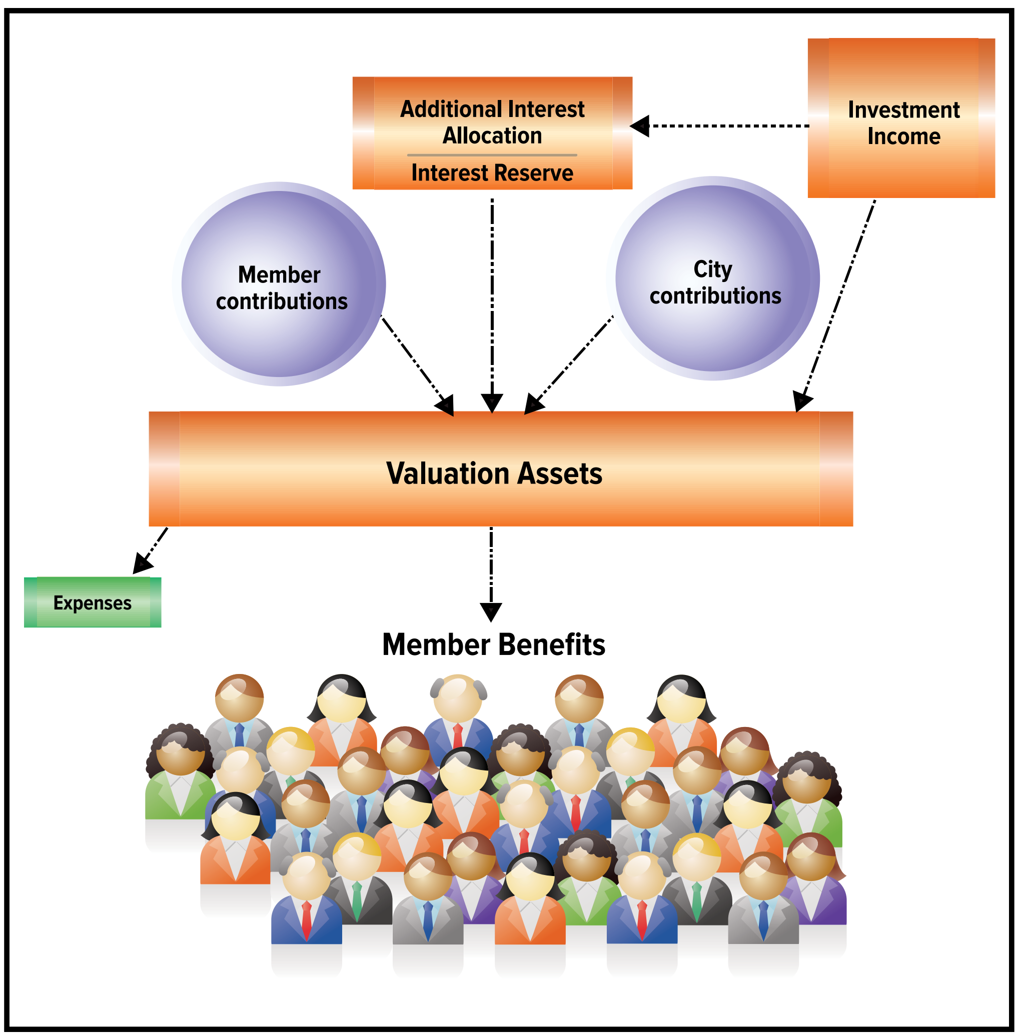


FIGURE 1. TMRS SYSTEM FUNDING MECHANICS (NOT TO SCALE)

Cities maintain close contact with TMRS in the three key areas of administration, plan design, and recordkeeping/payroll reporting:

City Correspondents – Each city designates at least one representative, or City Correspondent, to be responsible for the city's administration of TMRS. To help with that responsibility, we offer a City Correspondent's certification training course several times each year covering member benefits administration, and we include training courses in the TMRS Annual Training Seminar. Correspondents handle the day-to-day administrative work and serve as the city's primary contact with TMRS. A key part of their role at the city level is to educate members about the way TMRS works, but they are not considered to be "agents" of the retirement system.

City Decision-Makers – The city's decision-makers include the mayor, city council or commission members, the city manager, the finance officer, and other municipal employees. These officials make decisions involving TMRS benefits, decide which plan provisions to offer to the employees and retirees, and consider changes that affect plan costs.

Payroll Reporting – Every city must send its payroll report and transfer funds to TMRS each month. These functions are usually performed by finance or accounting personnel. For more information, see "How Does My City Report Payroll?" on page 7.

How Are TMRS Retirement Benefits Funded?

All pension plans are funded on one basic equation: Contributions (C) = Benefits (B) + Expenses (E) – Income (I). Actuaries use actuarial assumptions to predict the values of B, E, and I, which then determine C. In TMRS, benefits plus expenses are funded by employee deposits, employer contributions, and investment earnings. For an update on TMRS' investment diversification, see Exhibit B.

From the city's point of view, the deposit it makes each month pays for the matching portion of current service accruals, the payment needed to pay off any unfunded Prior Service accruals, and Supplemental Death Benefits (if adopted). In other words, your city's retirement plan cost is the Normal Cost plus amortization of the Unfunded Actuarial Accrued Liability (UAAL) (see the Glossary and the City Cost section, page 8, for more information about Normal Cost and UAAL). Your city's total plan cost is the combined cost of the retirement plan and Supplemental Death Benefit plan, if applicable.

As certified by our independent actuary, TMRS is funded in accordance with GASB principles and state law. Each city's funding objective, based on the benefit provisions chosen, is to accumulate over the working career of each active member sufficient assets to pay benefits as they become due and to finance any unfunded benefit obligations over a period of time not greater than 30 years (25 years for some cities). To accumulate funds for benefits, each member city has its own accumulation account (the Municipality Accumulation Fund, or MAF). Funds accumulated in the MAF are held in trust and are only used to match employee deposits and interest for transfer to the Current Service Annuity Reserve Fund (CSARF) at retirement and to pay any monthly benefits attributed to Prior Service Credit (PSC)/Updated Service Credit (USC) and Cost of Living Adjustments (COLAs). Each year, TMRS provides your city with actuarially determined plan cost information and the most recent funded ratio. The year-to-year change and the trend over time in the funded ratio reflects your city's progress toward funding its promised benefits. Member deposits and interest are also held in trust and are accounted for in a separate fund (the Employees Saving Fund, or ESF).

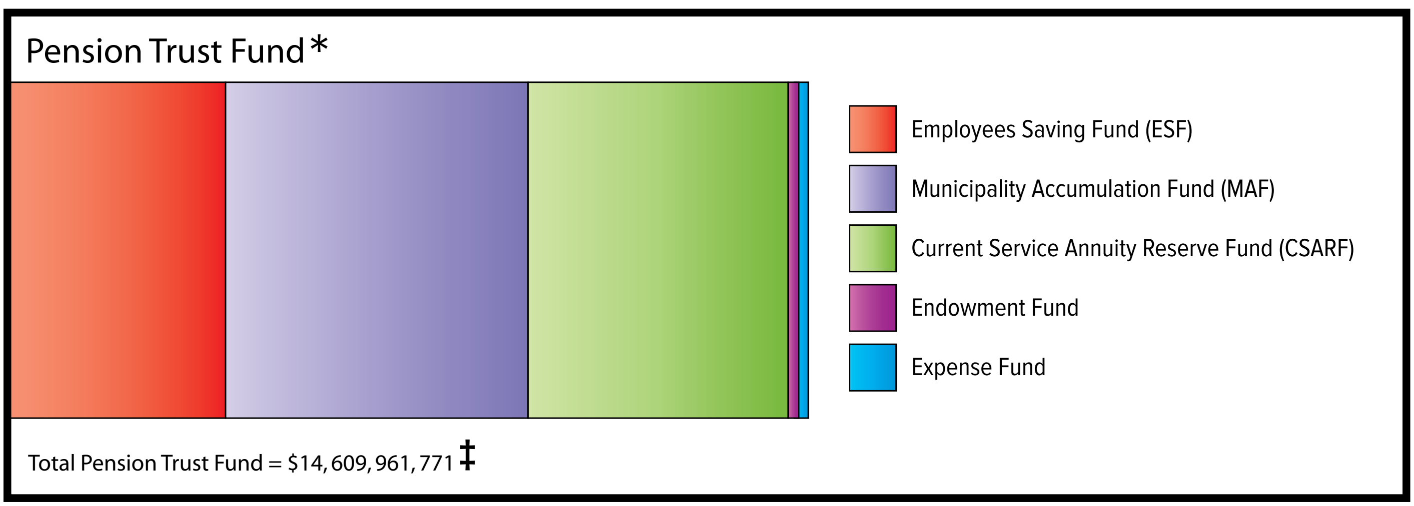
The accumulation accounts are part of TMRS' Fiduciary Fund. The Fiduciary Fund is reported in two parts: the Pension Trust Fund and the Supplemental Death Benefits (SDB) Fund. If your city elects to provide SDBs for active members and/or retirees, that money is held in a separate trust.

Pension Trust Fund Accounts – The TMRS Act has established the accounts listed below and shown in Figure 2. These accounts comprise the net assets held in trust for benefits. For a full description of these funds, see the TMRS *Comprehensive Annual Financial Report* (CAFR), Financial section.

- Employees Saving Fund (ESF) — all contributions made by member employees, plus earned interest less refunds and transfers to CSARF. State law provides that the ESF will be credited with a minimum 5% interest annually.
- Municipality Accumulation Fund (MAF) — all normal and prior service contributions made by cities, plus earned interest, less transfers to CSARF and benefit payments. Interest is credited/charged annually to the MAF based on the total return on TMRS investments and other factors as determined by the Board (see page 7).
- Current Service Annuity Reserve Fund (CSARF) — used to pay current service retirement benefits. At the time of retirement, a member's accumulated funds are transferred from the ESF to the CSARF. In addition, the respective "matching" funds from the city are transferred from the MAF to the CSARF. All funds rolled into the CSARF are "combined/commingled" and become an obligation of the System. Under state law, the CSARF receives an annual interest credit of 5%.
- Endowment Fund — investment income (Interest Reserve Account).
- Expense Fund — fund to cover administrative and maintenance costs of TMRS.
- Supplemental Disability Benefits Fund — a closed fund that has not received contributions since 1987 due to a change in the TMRS Act.

Each year we issue the CAFR, which provides the changes in the Municipality Accumulation Fund and Employees Saving Fund balances for each city.

FIGURE 2. ACCUMULATION ACCOUNTS



* The Supplemental Death Benefits fund ($26,123,090 at year-end 2008) is maintained as a separate fund from the Pension Trust Fund and therefore not included. A small fund called the Supplemental Disabilty Benefits Fund is also not included because cities' participation in the program ceased in 1987.

‡ As of December 31, 2008.

How Does My City Report Payroll?

This function is usually handled by the payroll officer or TMRS City Correspondent. For monthly processing, each city sends a monthly payroll report, which must be postmarked by the 15th of the month after the month being reported. After the city has submitted the report, the information must be added to the member's account before any action (refund or retirement annuity) may be taken on that account. Items in this monthly reporting are:

- Employee Contributions Report (TMRS-2)
- Summary of Monthly Payroll Report (TMRS-3)
- City's Remittance (calculated on the Summary of Monthly Payroll Report)
- Remittance of Lump Sum Contributions (TMRS-ADD), if needed

Cities are requested to report their payroll information electronically, which allows TMRS to process monthly information faster, increases efficiency, and reduces errors. We also encourage cities to transmit their funds electronically whenever possible.

How Are Retirements Calculated?

Employees contribute to their accounts according to their city's deposit rate of 5%, 6%, or 7% (cities were formerly allowed to adopt a 3% deposit rate, and three cities still use this rate). The city agrees to match on the date of retirement the member's deposits and interest at 100%, 150%, or 200%, depending on the city's matching ratio option (1 to 1, 1½ to 1, or 2 to 1, respectively). The city's contribution is held in the city's MAF account until the member retires. At retirement, both the employee account balance and the city matching contribution are transferred to the CSARF from which the Current Service portion of the retiree's total annuity is paid. The only way the member may receive the city matching funds is to retire from TMRS and receive a monthly payment. City matching funds are not reduced if a member selects a Partial Lump Sum Distribution option.

When members retire with TMRS, a lifetime benefit is calculated based on the following factors:

- Total member deposits and interest
- City matching funds and other credits granted (such as USC)
- Member's remaining life expectancy at retirement
- Monthly payment option chosen
- Beneficiary's life expectancy (if member selects a plan that pays a lifetime benefit to a survivor), or the guaranteed term, if one is chosen
- Future interest at 5% per year
- Whether they choose to take a Partial Lump Sum Distribution

Interest on Member Accounts – Interest on member and city accounts is credited once each year. Member accounts are credited on December 31, calculated on the amount in the account as of January 1 of that calendar year. State law provides that a minimum of 5% interest be credited to each member's account each year.

Interest on City Accounts – City accounts are also credited with interest as of December 31, based on their MAF account balance as of January 1. The amount of the MAF interest credit is set by the TMRS Board of Trustees at a Board meeting after the end of the year, after the fund's total return on investments is determined. City interest credits will be based on:

- The annual total return of the fund's entire portfolio, and
- Any allocation to or from reserves (see discussion of reserves on page 8).

The actuarially assumed interest crediting rate to the MAF is 7.5%, but actual MAF crediting rates may vary from the expected rate depending on the investment return of the entire portfolio. In a year in which investment returns perform below expectations, interest credits to the MAF may be less than 7.5% and may even be negative.

Asset Smoothing and the TMRS Reserve – Asset smoothing and a reserve fund are two funding elements that are important in reducing the year-to-year volatility of city contribution rates. TMRS has always had a reserve fund, but the importance of the reserve has increased following the changes enacted in the 81st Texas Legislature with the passage of HB 360. Because of the 5% guaranteed interest credit to both the ESF and CSARF each year, the resulting MAF interest credit has a magnified impact. See the examples in the box below.

Examples of the effects of interest rates on MAF crediting (based on December 2008 percentages):

- If the total portfolio return equals the assumed 7%, then after crediting 5% to the ESF and CSARF, the effective MAF crediting rate could be as much as 10.3%.
- Similarly, a −1% return on the total portfolio could result in an effective MAF crediting rate of −11.4%.

Recognizing the impact on contribution rates of potentially volatile MAF crediting rates, the TMRS Board has adopted:

- An asset smoothing policy to minimize the rate impact of normal, short-term fluctuations in the market value of assets, and
- Initial guidelines for establishing and maintaining a reserve fund to further mitigate the additional volatility created by the effect of normal market fluctuations on MAF returns.

Asset smoothing allows the use of an Actuarial Value of Assets (AVA) instead of the Market Value of Assets (MVA) for valuation purposes. In determining the AVA, short-term investment gains/losses due to changes in the MVA are recognized over a period of years, thereby reducing the contribution rate and funded ratio volatility that would occur if the MVA were used. The TMRS Board has adopted a 10-year asset smoothing policy with a 25% "soft corridor" to help ensure that the MVA and AVA do not diverge too far.

The TMRS Board also adopted a target of 20% of the total fund to be held as a reserve. The reserve will be used to supplement interest allocations in years when the total portfolio return does not allow for a 7.5% MAF interest credit. In addition, an established and robust reserve fund may provide the basis for future gain sharing of investment returns with members.

How Do I Know My City's Cost?

Normal Cost and Prior Service Cost – The retirement portion of a member city's contribution rate consists of the Normal Cost (NC) contribution rate and the Prior Service contribution rate. The NC portion of the rate is determined by dividing the sum of the individual NC amounts for each participant by the current payroll.

The Prior Service portion of the rate amortizes a city's Unfunded Actuarial Accrued Liability (UAAL) over a specified period of time, called an amortization period. Different components of the UAAL are amortized separately (see next section for explanation); therefore, the total Prior Service rate as shown in the rate letter reflects the sum of the individual components. For most cities, the UAAL is amortized over a 25- or 30-year closed period.

What Is an Unfunded Actuarial Accrued Liability (UAAL)? Determined each year as part of the actuarial valuation, the UAAL is the difference between the Actuarial Accrued Liability (AAL) and the Actuarial Value of Assets (AVA). The existence of an UAAL, by itself, is not necessarily an indicator that a plan is underfunded. The actuarially determined contribution rate ensures that the UAAL will be funded systematically in an actuarially acceptable manner over a reasonable period of time. Funding progress is measured by the trend over time of the plan's funded ratio.

The UAAL generally has two components that determine the Prior Service rate — the Prior Service costs and actuarial gains or losses.

Liability for Prior Service is created by the following situations:

1. When the city grants Prior Service Credit to employees at the time the city begins participation in TMRS or under other special circumstances
2. When the city grants an Updated Service Credit
3. When the city grants an Annuity Increase (COLA) to its retirees

Actuarial gains or losses occur when the actual events during the year ("experience") do not match the actuarially assumed expected events during the year. Gains (losses) on assets occur when actual investment returns are higher (lower) than anticipated. Liability gains (losses) occur when long-term assumptions (e.g. mortality, withdrawal, retirement, salary increases) are not met exactly. Determined each year by the actuarial valuation, actuarial gains (losses) decrease (increase) the UAAL and are amortized separately as a level percent of payroll over the same closed amortization period.

A third component of the Prior Service rate is generated by increases in the UAAL due to the adoption of ad hoc USC and COLAs. Beginning in January 2011, the liabilities associated with ad hoc benefit adoptions are subject to a separate 15-year level dollar amortization schedule.

Why Annual Contribution Rates Fluctuate – Contribution rates may increase or decrease from year to year due to changes in the plan provisions the city adopts, experience, or, less commonly, changes in actuarial assumptions or methodologies made by the TMRS Board with the advice of its consulting actuary.

Significant sources of annual rate changes for TMRS cities are:

- The interest crediting rate to the MAF.
- Withdrawals — If fewer members than expected terminate in a year and apply for a refund, then a city's rate can be expected to increase.
- Updated Service Credit (USC) and Annuity Increases (COLAs).
- Payroll growth — If payroll remains level or decreases, then the city's rate can be expected to increase.
- Liability variations resulting from such factors as salary increases that differed from actuarial assumptions.

A reconciliation of your city's full contribution rate from the prior valuation is included in the annual Rate Letter packet. Your city's Rate Letter and enclosures (including GASB Compliance Data) are available online under the Cities page. A list of enclosures in the packet is shown in Exhibit C.

What Are "Phase-in Rates?" In 2007, when TMRS changed its actuarial cost method from traditional Unit Credit to Projected Unit Credit, many cities with annually repeating benefits saw a significant increase in their contribution requirements due to the advance funding of projected future benefits. Any city that received a rate increase of 0.5% or greater due to actuarial method or assumption changes was given the option of paying a Phase-in Rate over an eight-year period.

A city paying the Phase-in Rate can expect to see the Phase-in Rate rise each year by approximately 1/8 of the amount being phased in until the Full Rate is reached in 2016. Note that if the Phase-in Rate is used, the Full Rate in 2016 will be higher than the comparable rate calculated in 2008 due to the accumulated impact of the previous seven years when contributions were less than the Full Rate. A city paying **any** rate less than the Full Rate will generate a Net Pension Obligation that will need to be noted in the city's financial statements.

For those cities eligible for the Phase-in Rate, TMRS provides both the Phase-in and Full Rates each year in the Rate Letter (see Exhibit C). TMRS encourages any city that can pay the Full Rate to do so. It is also possible for a city to pay a rate between the Phase-in and Full Rate or even to pay a rate higher than the Full Rate if it so chooses. For detailed information on the Phase-in Rate, see your city's Rate Letter.

What Is the Maximum Contribution Rate Limit?

The Maximum Contribution Rate Limit is commonly referred to as the Statutory Maximum, or "Stat Max." The TMRS Act sets a limit as to the maximum amount the System can require a city to contribute in a given year, based on the level of benefits the city has chosen to provide.

The Stat Max does not limit the cost of a plan; it merely limits how much a city can be charged for a certain benefit level, which may not be sufficient to fund the cost in a given year. For example, a city with a 6%, 1-to-1 ratio has a Stat Max of 8.50%. (This limit does not include the cost of Supplemental Death Benefits, if adopted.) The TMRS Act allows any city to enact an ordinance that removes the Stat Max. Cities that joined TMRS after 1996 are not subject to the Stat Max law, and many TMRS cities have enacted ordinances to remove the maximum limit.

If your city reaches this limit, we will let you know in the annual Rate Letter, which spells out some possible solutions:

- Remove the Statutory Maximum Contribution Rate Limit (by ordinance)
- Increase, in certain cases, the Statutory Maximum Contribution Rate Limit (by ordinance)
- Pay the Actuarially Determined Calculated Rate (by ordinance; this is a one-year-at-a-time option, and causes annually repeating benefits to be turned off that year)
- Pay the Maximum Contribution Rate Limit (annually repeating benefits will be turned off)

If a city's rate exceeds the limit and the city does not act to remove or increase the Stat Max, annually repeating benefits (USC and Annuity Increases) will be automatically "turned off" until the rate drops back below the limit.

Why Do Cities Reach Stat Max? There is no single reason why cities reach the Maximum Contribution Rate Limit. In most cities where the contribution rate has exceeded the Stat Max, the contribution rate has increased gradually over a period of time. This may be due to different factors, e.g., a declining payroll base, benefit adoptions that have caused significant rate increases, or privatization of a department or work unit.

Each year, several TMRS cities exceed the maximum contribution rate limit. This trend is likely to continue in future years, especially since many cities are paying contributions under the eight-year "phase-in" period that began in 2008 (see pages 9-10). Remember: the Stat Max is not intended to limit the actual cost of a certain level of benefits. Rather, it is intended to be the maximum amount TMRS can charge a city for a particular level of benefits. The limit should not rest with an arbitrary number in the statute but with what a city is willing to pay (or can afford) for its plan of benefits. If the cost of the plan is more than a city is willing to pay, then the city should consider limiting itself to only adopting a level of benefits it can afford to maintain.

The table in Figure 3 shows the differences in the Stat Max rates under the different deposit rate options and matching ratios chosen by the city.

Figure 3. Statutory Maximum Contribution Rates

	Matching Ratio		
Deposit Rate	**1 to 1**	**1 ½ to 1**	**2 to 1**
3%*	5.50%	7.50%	9.50%
5%	7.50%	9.50%	11.50%
6%	8.50%	10.50% / 11.00%	12.50% / 13.50%
7%	9.50%	11.50% / 12.50%	13.50% / 15.50%

For the four plans showing split limits, the left number is the base limit, and the right number is what the limit can be increased to.

**This deposit rate is no longer an option for new cities.*

What Role Does the TMRS Actuary Play?

The TMRS consulting actuary calculates the long-term cost of the pension benefits offered by each TMRS city and determines the annual contribution rate needed to fund those benefits. Using an actuarial funding method and actuarial assumptions, including retirement rates, salary growth, and investment income, the actuary prepares an annual actuarial valuation of each city to determine the city's actuarial accrued liability and measure it in relation to the city's funding assets, both present and future. Besides the annual valuation, the consulting actuary determines costs for mergers and major plan changes within cities, assists the TMRS Board with policy decisions, and helps determine the expected cost of proposed legislation.

TMRS performs an annual actuarial valuation for each participating municipality, the results of which are reported in the Actuarial section of our *Comprehensive Annual Financial Report* (CAFR). Historical information relating to progress in meeting the actuarial funding objective is presented in the Schedule of Funding Progress, included as a part of the Required Supplementary Information in the Financial section of the CAFR.

Every four years the consulting actuary performs an actuarial experience study and measures cities' actual experience — such as rates of retirement, withdrawal, and mortality — and then compares it to the most recent set of actuarial assumptions. The actuary recommends any adjustments needed to the actuarial assumptions, and the Board considers the actuary's recommendations and approves assumptions for the next valuation. The next TMRS experience study is likely to be performed in 2011 for the four-year period ending December 31, 2010.

In addition to a consulting actuary, TMRS employs a staff Decision Support Actuary. The staff actuary helps cities with funding analysis, plan design cost issues, and other rate questions.

How Does TMRS Account for its Benefits?

As a public entity, TMRS follows the accounting guidelines and disclosure requirements established by the Governmental Accounting Standards Board (GASB). GASB standards require the disclosure of pension asset and liability information annually in a six-year-trend Schedule of Funding Progress. This disclosure includes the calculation of the plan's Funded Ratio, which is the primary measure of funding progress (actuarial value of assets expressed as a percentage of the Actuarial Accrued Liability, or AAL). An increase in the Funded Ratio indicates improvement in the System or a city's ability to pay all projected benefits as they become due. The System or city is fully funded at a point in time, if the Funded Ratio is greater than or equal to 100%. The Schedule of Funding Progress 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.

A funding progress disclosure, referred to as "GASB Compliance Data," is sent to each city annually in the Rate Letter packet and reflects information for the previous calendar year (your GASB Compliance Data enclosure may be downloaded from the TMRS website along with the rest of the Rate Letter packet). For example, Compliance Data for your city's GASB letter for the year ended 2008 was sent to your city in the 2010 Rate Letter package in May 2009 and was also posted online.

The primary accounting rules that apply to TMRS and individual cities are:

- **GASB Statement No. 25** — Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans (November 1994)
- **GASB Statement No. 27** — Accounting for Pensions by State and Local Governmental Employers (November 1994)
- **GASB Statement No. 43** — Financial Reporting for Postemployment Benefit Plans Other than Pension Plans (April 2004)
- **GASB Statement No. 45** — Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions (June 2004)
- **GASB Statement No. 50** – Pension Disclosures — An Amendment of GASB Statements 25 and 27 (May 2007)

System-wide, the TMRS Pension Trust Fund and the Supplemental Death Benefits Fund are maintained on the accrual basis of accounting. This means that revenue is recorded when earned and expenses are recorded when incurred, regardless of when payment is made. Employer and employee contributions are recognized when due. Participant benefits are recorded when payable by law. Refunds are recorded and paid upon receipt of an approved application for refund. For more details, refer to the Financial section of the CAFR.

How Does a City Change its Plan Options?

If you wish to modify your existing plan elements, contact TMRS directly. The Regional Managers, Deputy Executive Director, or Decision Support Actuary can all help with plan change questions and requests. These members of the TMRS staff can analyze the effects of option changes on your contribution rate.

We will also send you model ordinances that can be used by your city council to adopt plan changes (see Exhibit D for a list of provisions that may be adopted by the council). By running an actuarial study for proposed plan changes, we can determine the effect the proposed changes will have on your city rate.

What Plan Modifications Are Allowed? TMRS offers a menu of choices. Full information about options that may be changed by ordinance is available by calling TMRS. To review potential plan changes and the effects of such changes, see the Plan Changes Table in Exhibit F (inside back cover).

Summary of Recent TMRS Changes

In late 2007, the TMRS Board of Trustees approved several changes for the System, effective in 2008. These changes included:

- Amending the System's Investment Policy to diversify the investment portfolio (see Exhibit B).
- Changing the System's actuarial cost method from Unit Credit to Projected Unit Credit to provide advance funding of projected benefits, including annually repeating USC and COLAs.
- Extending the amortization period for the UAAL from a 25-year open period to a 30-year closed period for most cities.
- Adopting an eight-year schedule for phasing in contribution rate increases due to the changes in actuarial funding method and assumption changes.

In 2009, following interim deliberations by the TMRS Advisory Committee, the TMRS Board of Trustees adopted legislative recommendations that resulted in the passage of HB 360, by Kuempel (House) and Williams (Senate). HB 360 made three fundamental changes to the System:

- A 5% minimum annual interest credit was approved for member accounts and for the discount rate to be used in determining annuity purchase rates for retirees.
- Annual interest credits to cities can now be set at a rate different than the rate credited to members.
- Annual interest credits to cities may be credited at a negative rate.

Glossary

Actuarial Accrued Liability (AAL) – The present monetary value, actuarially determined, of the estimated cost of benefits payable to active and retired members, accrued in periods prior to the valuation date.

Actuarial Cost Method, or Actuarial Funding Method – Technique for establishing the amount of current service cost for a pension plan and the related accrued liability. The appropriate method is chosen to calculate the liabilities accruing under a pension plan and the funds that are needed to pay for them over time.

Actuarial Experience Study – An analysis performed every few years by the actuary, in which the actuarial assumptions used are reviewed, both individually and in the aggregate, to ensure they are reasonable given current economic and demographic experience.

Actuarial Gain (Loss) – The difference between actual experience and that expected based on actuarial assumptions, during the period between the two actuarial valuation dates. A gain indicates better than expected experience, while a loss indicates experience less than anticipated.

Actuarial Value of Assets (AVA) – the value of plan assets used in the actuarial valuation. The AVA may differ from the Market Value of Assets (MVA).

Actuary – A professional trained in the mathematics of finance, probability, and statistics and credentialed by organizations representing their profession. Pension actuaries assign values to the probable amounts to be paid in the future and help establish a method for responsibly budgeting for those payments.

Amortization Period – The designated length of time that it takes for a liability to be reduced by means of periodic payments sufficient to liquidate the liability at maturity; the time over which pension liabilities will be "paid off." In retirement systems, amortization periods may either be ***closed*** (so that all liabilities will be paid at a certain date, if assumptions are met) or ***open*** (where the amortization period is reset each year).

Annual Required Contributions (ARC) – The rate calculated by the actuary as required to fund the city retirement plan for a given year.

Annuity Increase, or Cost of Living Adjustment (COLA) – An option chosen by cities to provide an increase in annuities for retirees. The city chooses the adjustment amount: 30%, 50%, or 70% of the change in the Consumer Price Index (CPI) increase from the December before retirement through the December that is 13 months prior to the effective date of the increase. Annuity increases may be adopted on either an annually repeating or ad hoc basis.

Closed Amortization – The required contribution is calculated by the actuary so that at the end of the period the liability will be fully funded. TMRS cities have a closed 25- or 30-year amortization period.

COLA, or Cost of Living Adjustment (see Annuity Increase)

Contribution Rate – The annual percentage of your city's payroll required to fund its TMRS plan. TMRS notifies you of your contribution rate each year (in the Rate Letter), and this sets the percent of payroll for the upcoming year. The contribution rate is the sum of the Normal Cost, the Prior Service Cost, and the Supplemental Death Benefit Cost, if that provision has been adopted by your city.

Current Service Annuity Reserve Fund (CSARF) – The account to which an employee's deposits and interest plus the city matching funds are transferred when a person retires, and from which the current service portion of the person's retirement benefit is paid.

Defined Benefit Plan (DB Plan) – A retirement plan in which the benefit paid to the employee is based on a formula set in law (determined by statute, regulation, or plan document), and *not* determined by the account balance. A DB plan literally "defines" the future benefit to be paid. Examples of DB plans are the Teachers Retirement System of Texas and Social Security. DB plans are usually qualified pension trusts under Section 401(a) of the Internal Revenue Code.

Defined Contribution Plan (DC Plan) – A retirement plan in which the benefit is based on the amount of money in the account at retirement. A DC plan "defines" the contributions and maintains an individual account for each plan participant. Examples of DC plans include private-industry plans such as 401(k), 403(b), and governmental 457 deferred compensation plans.

Deposit Rate – The percentage of the member's salary that constitutes the member deposits deducted from gross salary. Also called employee contribution rate.

Employee – Municipal employees must join TMRS if they are employed with a city that participates in TMRS and in a position that regularly requires at least 1,000 hours of work per year. The city must classify each position as to whether or not it is "membership eligible." Membership starts the first day of employment.

Employees Saving Fund (ESF) – An account containing all contributions made by member employees, plus earned interest, less refunds and transfers to CSARF.

Full Rate (see also Phase-in Rate) **–** Retirement Plan Full Rate equals the sum of the Normal Cost Rate and Prior Service Rate, whereas the Combined Plan Full Rate adds the SDB Rate, if applicable, to the Retirement Plan Full Rate.

Funded Ratio – The ratio of actuarial assets to liabilities or AVA/AAL; an overall reflection of a pension plan's health at a point in time. In TMRS, both the System as a whole and individual cities have funded ratios. Your city's funded ratio is shown in the Rate Letter and in the CAFR.

Funding Policy – The program for the amounts and timing of contributions to be made by plan members and employers to provide the benefits specified by the plan.

Governmental Accounting Standards Board (GASB) – The governing body whose mission is to establish and improve standards of state and local governmental accounting and financial reporting. Most public entities follow the disclosure requirements of the GASB.

Matching Ratio – The ratio at which the city will match member deposits and interest at retirement. Options are 1 to 1, 1½ to 1, and 2 to 1 (100%, 150%, and 200%, respectively). City matching funds are held in the city's MAF account until needed for retirement funding.

Maximum Contribution Rate Limit ("Stat Max") – The maximum percent of payroll, as set by the TMRS Act, that a city can be required to pay for a given plan level (deposit rate and matching ratio). This is not the calculated rate; it is simply the most a city can be required to pay. For example, a city with a 6%, 1-to-1 ratio has a Stat Max of 8.50%. This limit does not include the cost of Supplemental Death Benefits, if adopted; it only applies to the retirement portion of the city's contribution rate. TMRS cities have the authority to enact ordinances that remove, increase, or override the Stat Max. Many cities have chosen to remove this limit.

Member (see Employee)

Municipality Accumulation Fund (MAF) – An account containing all Normal and Prior Service contributions made by cities, plus earned interest, less transfer to CSARF and benefit payments.

Glossary

Net Pension Obligation – This is the cumulative amount that a city has underpaid or overpaid (net pension asset), as compared to its required contribution rate, in a given year. This will normally be zero for a city, unless the city is paying a Phase-in Rate.

Normal Cost Contribution Rate – Actuarial present value of benefits allocated to the current valuation year by the actuarial cost method, expressed as a percentage of the covered payroll. Normal cost information is included in the City Rate Letter.

Open Amortization – The method whereby an amortization period is renewed every year as part of the valuation process (also called a “rolling” amortization).

Other Post-Employment Benefits (OPEBs) – Post-employment benefits other than pension benefits. Specifically, for TMRS, the $7,500 Supplemental Death Benefit payable to the beneficiaries of retirees of municipalities that have elected to offer the SDB falls under OPEB accounting rules.

Phase-in Rate (see also Full Rate) **–** Following TMRS’ change in actuarial cost method in late 2007, cities with annually repeating benefits saw a significant increase in contribution requirements. Cities with an increase in excess of 0.5% were allowed to “phase in” the increased contribution over an eight-year period beginning January 1, 2009. Each year, the Rate Letter provides these cities with a Full Rate and a Phase-in Rate to help them make their funding decision.

Prior Service Contribution Rate – The percentage of payroll required to amortize the unfunded or overfunded actuarial accrued liability over a closed period, in TMRS 25 or 30 years.

Projected Unit Credit Actuarial Cost Method – A method under which the benefits of each individual included in the valuation are allocated by a consistent formula to valuation years based on years of service. Benefits are allocated equally to each year of service over the individual’s career from date of hire to retirement. Under this method, actuarial gains (or losses) reduce (or increase) the Unfunded Actuarial Accrued Liability.

Retirement Contribution Rate – The sum of the Normal Cost contribution rate and the Prior Service contribution rate stated as a Full Rate and Phase-in Rate, if applicable.

Supplemental Death Benefit (SDB) – A benefit payable, if adopted by the city, to the beneficiaries of deceased contributing members. This benefit is approximately equal to the active member’s annual salary; an optional benefit is also payable to the beneficiary or estate of a deceased retiree in the amount of $7,500.

Unfunded Actuarial Accrued Liability (UAAL) – The difference between the actuarial accrued liability and the assets held as of the study date. The UAAL is not necessarily an indication that a plan is not properly funded. The UAAL is funded systematically in an actuarially acceptable manner over a reasonable period of time.

Updated Service Credit (USC) – A provision adopted by city ordinance that may increase the value of employee retirement benefits by accounting for increases in salary later in the employee’s career and factoring in city plan improvements. If a city adopts USC, it chooses the percentage of USC it will provide (50%, 75%, or 100%) and whether it will adopt USC on an annually repeating or ad hoc basis.

Vesting – When a member has met the city’s length-of-service requirement (either 5 or 10 years of service) to be guaranteed a retirement benefit upon the attainment of a certain age, provided they do not terminate their membership in the plan. Becoming vested increases an employee’s potential to retire and therefore increases the plan’s liability. ◆

Exhibit A • TMRS Provisions Timeline

1947 ➤	Enactment of the TMRS Act, creating the Texas Municipal Employees Retirement System.
1948 ➤	TMRS deposit rate established at 5%. First cities begin participation with a 1-to-1 city match.
1955 ➤	Maximum earnings limit for contributions to TMRS raised. 3% deposit rate added.
1960 ➤	Distributive Benefit (extra check) paid for the first time to retirees, equaling ½ a regular annuity check.
1963 ➤	TMRS allowed to invest in corporate securities. 2.5% interest rate limit removed.
1966 ➤	Multiple matching of future employee deposits by cities made available. 1½ to 1 and 2 to 1 matches added.
1968 ➤	Maximum TMRS deposit rate increased to 7%.
1969 ➤	Prior Service Credit options added. 20-year vesting and an earlier retirement provision added.
1975 ➤	Updated Service Credit, retirement Annuity Increases, and buyback of previously forfeited credit provisions added. Could only be adopted once every four years.
1977 ➤	Proportionate Retirement Program created. Supplemental Death Benefit fund established; $2,500 to survivors of retirees.
1979 ➤	10-year vesting provision, retirement eligibility at 60 with at least 10 years of service, maximum entry age raised to 59, added as optional provisions for cities. Maximum entry age raised from 49 to 54 for all cities. Spouse or estate allowed to elect certain payment options upon the death of a member eligible to retire.
1981 ➤	Military Service Credit provision added. Elected officials allowed to participate as members of TMRS if they meet the 1,000-hour rule.
1983 ➤	Updated Service Credit for transfer employees provision added.
1984 ➤	Employer "pickup" adopted. This year also marks the start of taxation on withdrawals of deposits. Any return of deposits made after January 1, 1984 (refund or benefit) became subject to taxation.
1987 ➤	Maximum age for participation removed. 25-year, any-age retirement added. Surviving spouse benefit and Occupational Disability Retirement benefit added. 6% deposit rate added.
1989 ➤	Probationary Prior Service Credit added for employees working for a TMRS city on a probationary basis before 1989. 3% deposit rate dropped.
1991 ➤	Restricted Prior Service Credit and annually repeating Updated Service Credit and Annuity Increases added.
1993 ➤	Supplemental Death Benefit for survivors of retirees increased to $5,000.
1995 ➤	20-year, any-age retirement eligibility provision added.
1997 ➤	Partial Lump Sum Distribution added. "Pop-up" provision added (if retiree's beneficiary dies before retiree, and retiree chose a retirement option that provided survivor benefits, the option "pops up" to retiree-only).
2001 ➤	Five-year vesting added.
2003 ➤	Military service credit changed to time credit only, with some exceptions. Supplemental Death Benefit for survivors of retirees increased to $7,500.
2007 ➤	Cities allowed to voluntarily make payments above their contribution rate and above the statutory maximum contribution limit. Board allowed to modify amortization periods, establish rules regarding distributions to public safety officers under the federal Pension Protection Act, and clarify the calculation of Updated Service Credit.
2009 ➤	5% minimum member interest allocation and 5% minimum discount rate for annuity purchase calculation enacted. City interest credit varies from member rate and is based on total fund return.

Exhibit B • Investment Overview

TMRS investments are held in trust for the exclusive benefit of members and invested under the provisions of the TMRS Act. The statutory investment guidelines for TMRS are found in the Texas Government Code, Sections 855.301 through 855.303. The Board of Trustees further defines investment guidelines for TMRS, and a copy of the Board's current TMRS Investment Policy may be found on the Investments page of the TMRS website.

Principles and Objectives

The overall objective of TMRS' investment program is to ensure that members, retirees, and beneficiaries are provided with the benefits they have been promised by their employers at a reasonable and predictable cost to the employers. Assets will be invested for total return with appropriate consideration for portfolio volatility (risk) and liquidity. Emphasis should be on both capital appreciation as well as the production of income in order to satisfy the short-term and long-term funding needs of TMRS. Total return includes dividends, interest, and realized and unrealized capital appreciation.

Investments in Transition

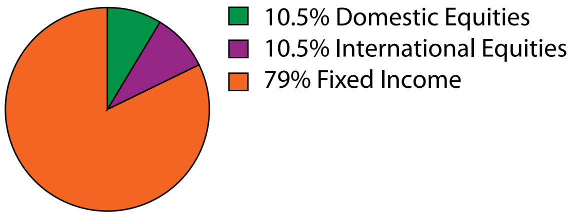
In 2007, the TMRS Board of Trustees voted to begin diversification of the TMRS investment portfolio. Prior to their action, the TMRS fund had been invested almost 100% in bonds to maximize income and allow crediting of annual interest to member and city accounts. Faced with declining interest rates on fixed income investments and the risks associated with a portfolio invested entirely in one class of investment, the Board acted to begin diversification of the fund.

In June 2009, the Board adopted an Investment Policy that reflects the change from an income to a total return objective and approved a strategic asset allocation policy that fully diversifies the investment portfolio.

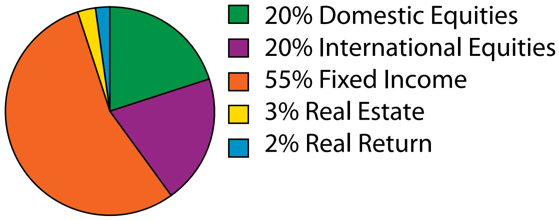
The Board has adopted a five-year diversification strategy that will result in TMRS' portfolio resembling most other large institutional investors. Targets for asset allocation over the transition period are shown at right.

Diversification of the TMRS fund is expected to reduce risk and support the fund's conservative actuarial assumption of 7% annual interest return on the portfolio. For current asset and performance information, see the Investment page on the TMRS website.◆

As of 11/30/09, TMRS investments were allocated between fixed income and equity investments:



The asset allocation **target for 2010** is:



The asset allocation **target for 2013** is:

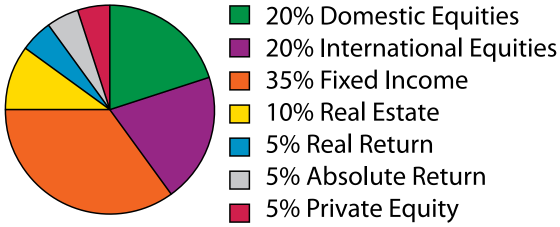


Exhibit C • Annual Rate Letter Packet

The Rate Letter packet contains several sections, including:

- **Cover Letter** – A summary of the Municipal Contribution Rate for the next plan year and an explanation of the contents of the packet, tailored for each city.
- **Executive Summary** – A comparison of the highlights of the prior year and the previous year's actuarial valuation for your city. Included are membership counts, asset information, actuarial information, and contribution rate requirements.
- **Calculation of Contribution Requirement**s – Detail on the calculation of the Full Retirement Rate (TMRS Plan Year - GASB ARC), Minimum Required Phase-in Retirement Rate, and the Supplemental Death Rate, if applicable, for your city. A comparison to the prior year's actuarial valuation results is included.
- **Reconciliation of Full Retirement Rate from Prior Actuarial Valuation Report** – A detailed reconciliation of changes in your city's Full Retirement Rate since the prior valuation.
- **Development of the Actuarial Value of Assets** – A detailed reconciliation between Actuarial Value and Market Value of Assets.
- **Actuarial Experience** – A comparative analysis of recent actuarial values and related factors.
- **Membership Data** – An analysis of data by membership category (actives, retirees, inactives).
- **GASB Compliance Data** – A summary of information to assist you in completing the disclosures in your city's annual financial statements regarding your participation in TMRS. This information may also be useful in making various other disclosures, such as the city's official statement provided in connection with a bond offering.
- **Phase-in Rates, if applicable** – An explanation of "Phase-in," including a question and answer section on Phase-in contributions and how they might affect your city.
- **Other information as needed for your city** – Additional material may include information about Statutory Maximum rates.

This list reflects the Rate Letter packet for 2009. Some variation in rate letter contents may occur in 2010 and subsequent years. A copy of your city's most current rate letter is available on the TMRS website.

Exhibit D • Menu of Optional Plan Benefits

Contact TMRS for sample resolutions to adopt or change plan features.
See inside back cover (Exhibit F) for details about adoption or change.

Basic Plan Options

- Employee contribution rate (5%, 6%, or 7%)*
- City matching ratio (1 to 1, 1½ to 1, 2 to 1)
- Vesting (5-year)**
- Retirement Eligibility (20-year, any age) ‡

* 3% contribution rate is no longer an option for new cities.
** 10-year vesting is no longer an option for new cities.
‡ 25-year eligibility is no longer an option for new cities.

Additional Features

- Updated Service Credit (USC)
- Annuity Increases (COLAs)
- Military Service Credit
- Probationary Prior Service Credit
- Restricted Prior Service Credit
- Buyback of forfeited TMRS credit
- Supplemental Death Benefits

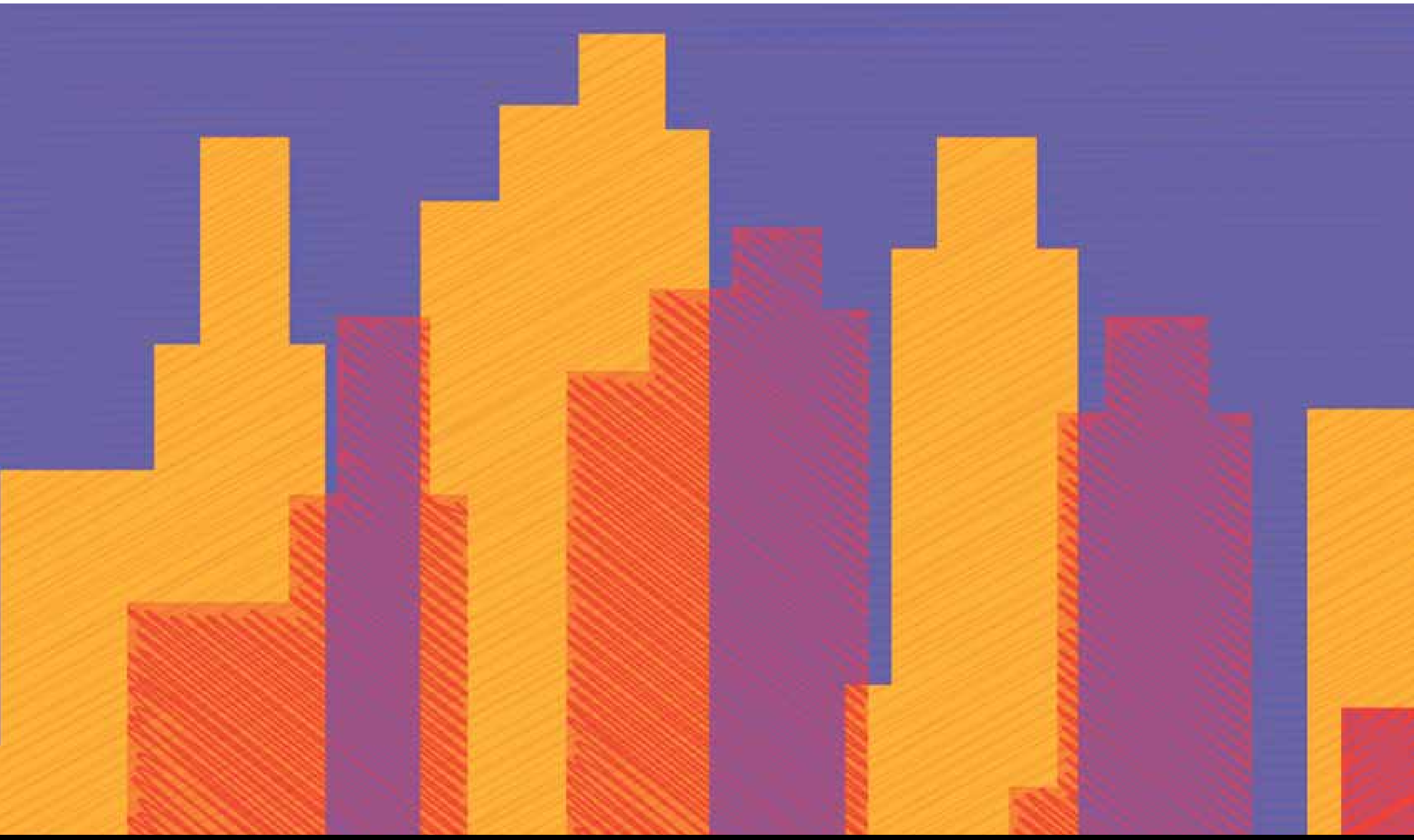


Exhibit E • Other Resources for Cities

- E-bulletins*
- City visits, council presentations upon request
- Seminars
- Website
  - News items, including Legislative updates
  - City-specific section with tutorials
  - Forms and publications (PDF format)
- Print publications
  - *Main Street* (newsletter for city officials)
  - *Member Benefits Guide*
  - *City Guide to USC and COLAs*
  - *TMRS Facts* and My City Plan (for members)

*E-bulletins contain late-breaking news affecting cities and are issued as needed, approximately monthly. If you are not receiving e-bulletins, you may fill out the online form on the website under the Cities page.

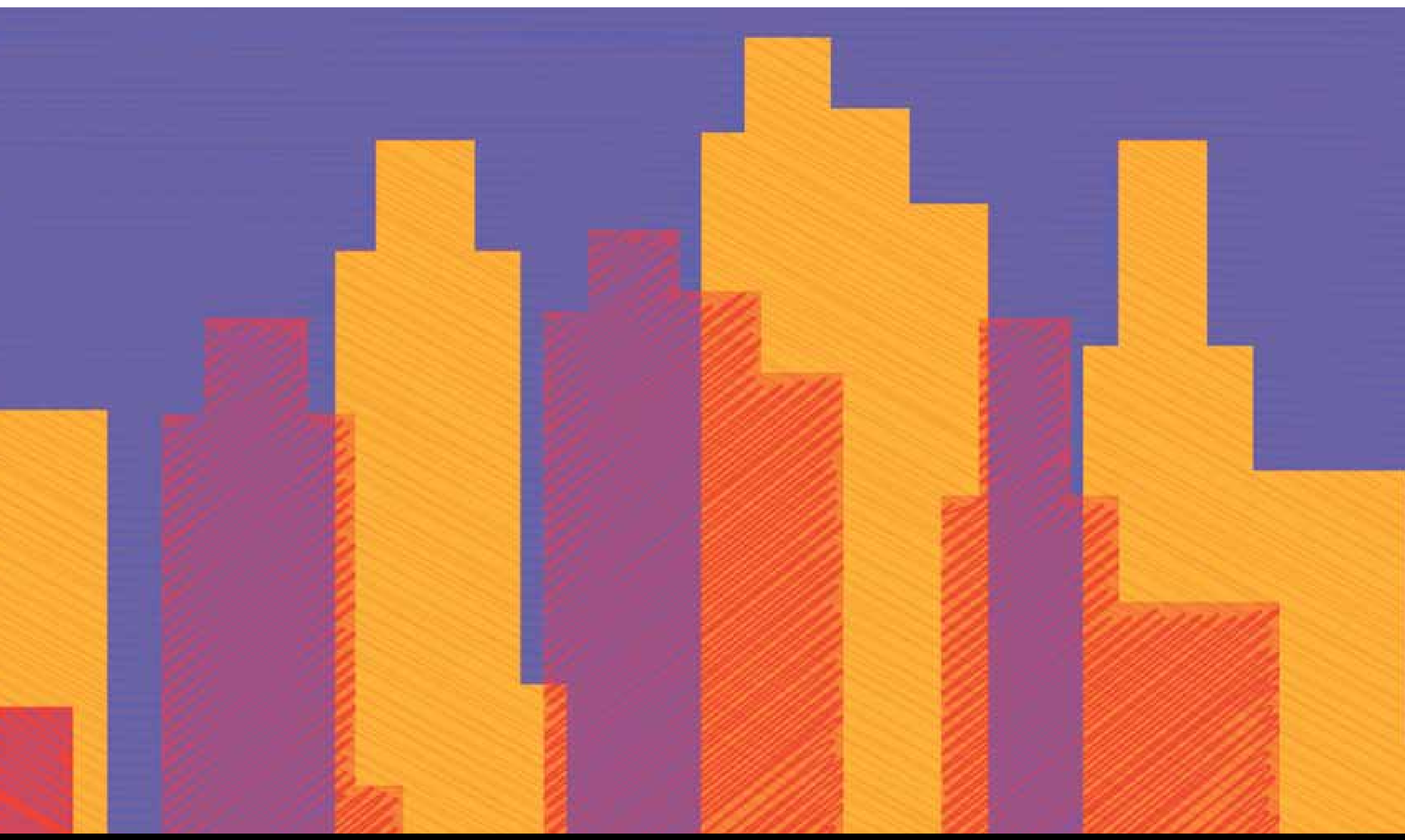


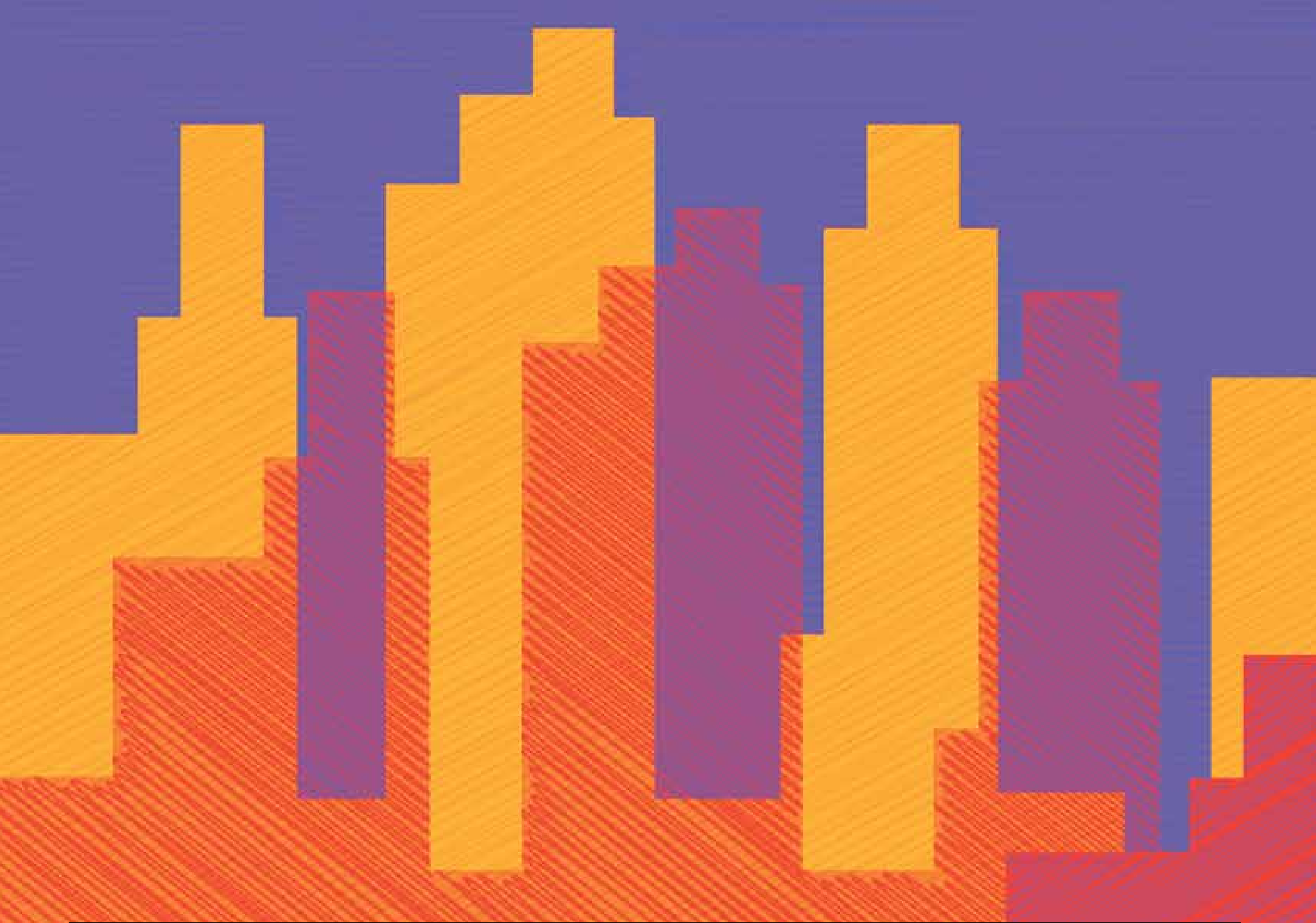
Exhibit F • Plan Changes Table

By law, each city that decides to join TMRS must adopt the basic plan features designed for all cities (left column of Exhibit D). The options that individual cities may choose to add, modify, or discontinue are shown in this table. Changes may be made at any time, but are effective on the dates shown.

Action / Plan Option	How are plan options added or changed?
Join TMRS	City Council, by ordinance
Increase employee contribution rate (up to 7%)	City Council, by ordinance; no employee consent required
Reduce employee contribution rate	To reduce rate takes a 2/3 vote of employees, then Council must adopt by ordinance
Change city matching ratio	City Council, by ordinance; no employee consent required
Reduce vesting requirement (from 10 years to 5) NOTE: Vesting may not be increased.	City Council, by ordinance; no employee consent required
Change retirement age/service requirement to 20-year, any age	City Council, by ordinance (after public hearing); no employee consent required
Adopt USC	City Council, by ordinance; USC can be adopted on its own or with COLAs; USC can be adopted ad hoc or annually repeating
Rescind repeating USC	City Council, by ordinance
Adopt or rescind USC – transfers	City Council, by ordinance
Adopt Annuity Increases (COLAs)	City Council, by ordinance. If this option is chosen, it must be adopted in tandem with USC or repeating USC. COLAs can be adopted ad hoc or annually repeating
Rescind annually repeating annuity increases (COLAs)	Must be dropped if annually repeating USC is dropped
Adopt or rescind Supplemental Death Benefit	City Council, by ordinance
Military Service Credit	City Council, by ordinance
Restricted Prior Service Credit (also Probationary Prior Service)	City Council, by ordinance
Buyback of refunded TMRS service	City Council, by ordinance. Employee must have previously refunded service, be on the payroll at time of adoption, and have 24 consecutive months of deposits with the city
Stop enrolling new employees*	City Council, by ordinance
Reduce USC percentage (reduction options are 50% or 75% of USC calculation)	City Council, by ordinance
Reduce COLA percentage (reduction options are 30% or 50% of CPI)	City Council, by ordinance

* Once a city has joined TMRS, it must continue to provide TMRS benefits for all eligible employees. By law, if a city stops active participation in TMRS, it must maintain the retirement accounts of the employees who have already joined the System. It must continue to fund existing pensions, and it must match at its established rate when its current employees retire.

When do changes take effect?	Outcome of changes
First day of month selected	Installs quality, competitive retirement plan for members.
First day of month selected	The higher the rate, the larger the benefit earned by the member; increases employee deposit pool.
First day of month after the 90th day after ordinance adopted	Reduces benefit for employees, by reducing future accumulation of reserves.
January 1 of the calendar year after adoption	By law, cities must match at least 1 to 1.
First day of month after adoption	Reducing vesting to 5 years allows members to vest earlier, or be guaranteed a retirement benefit assuming a refund is not taken.
First day of month after adoption	Allows for earlier retirement; city can't go back to 25-year retirement once change is made.
January 1 of the year after adoption	Recalculation based on employee's most recent average salary can mean a better benefit for retirees but increases costs for employer city.
January 1 of the year after adoption	Benefits no longer adjusted for salary or plan changes.
January 1 of the year after adoption	Potentially increases costs for employer city because it allows USC eligibility to be transferred from another city.
January 1 of the year after adoption	Helps protect retiree benefits from inflation, but increases costs for employer city.
January 1 of the year after adoption	Future increases will only occur when city makes an ad hoc adoption. Benefits are not adjusted annually.
First day of the month after adoption. Benefit can only be discontinued effective January 1, if ordinance adopted before preceding November 1	Reduces cost to city and eliminates a benefit. Adding will increase costs.
First day of the month after adoption	Applying this credit to members' accounts does not increase the retirement benefit but may affect retirement eligibility for some members.
First day of month after adoption	Allows full-time employees who have previous public service, including active military, to receive time credit. Applying this credit to members' accounts does not increase the amount of their benefit but can add actuarial cost.
Date of adoption	No up-front cost for adoption of buyback. TMRS will estimate costs that accrue if some or all employees purchase their refunded service.
First day of month after adoption. This change only applies to employees starting after that date	City still must fund retirements of employees enrolled prior to adoption.
January 1 of the year after adoption	If employee is eligible for USC, amount will be smaller; previously granted USC continues to earn 5% interest.
January 1 of the year after adoption	Retirees previously receiving larger COLA percentage may not see an Annuity Increase for one or more years.



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