



**DIVERSIFICATION AND FUNDING**

**TML Annual Conference  
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Presented by  
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and  
**Nancy Goerdel, Acting Chief Investment Officer**

2009, Texas Municipal Retirement System.

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*A Little Recent History*

In Fall 2007, the TMRS Board:

- ◆ Began diversifying investments to improve returns and reduce risks
- ◆ Authorized change of actuarial cost method from traditional Unit Credit to Projected Unit Credit to provide advance funding of repeating benefits



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*A Little Recent History, cont.*

In 2008:

- ◆ TMRS created Legislative Stakeholder Group to devise recommended legislation resulting in introduction of HB 360
- ◆ Investment diversification put on hold pending outcome of legislative session
- ◆ Cities with contribution increases allowed to phase-in rates beginning in 2009

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*A Little Recent History, cont.*



- In 2009:
- ◆ HB 360 passes
  - ◆ Board expands TMRS Advisory Committee
  - ◆ Diversification resumes
  - ◆ Board continues to refine funding policy

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*Legislative Success*

- ◆ HB 360, by Kuempel, et al. (Senate sponsor Williams)
- ◆ Contains Board's recommendations based on interim work of the Legislative Stakeholder Group (now the TMRS Advisory Committee)
- ◆ TMRS Board was neutral on other legislation



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*New Law*

- ◆ Establishes a 5% minimum interest credit for member accounts and a 5% minimum discount rate used in setting the annuity purchase rate for retirees
  - ◆ Allows the crediting of interest to city accounts at a rate different from member accounts
  - ◆ Allows the crediting of interest, including negative interest, to city accounts at a variable rate



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### *What Else Does the New Law Do?*

- ◆ Enables further diversification of TMRS investments
- ◆ Keeps city contribution rates from immediately rising further by supporting a higher investment income assumption, resulting from diversification
- ◆ Establishes the basis for potential future gain-sharing between cities and members after sufficient reserves have accumulated
- ◆ Provides the basis for stabilization of municipal contribution rates

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### *What's Next for TMRS?*

- ◆ Investment diversification
- ◆ Actuarial topics
- ◆ Legislative interim work
- ◆ Customer service improvements



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### *Investment Diversification*

- ◆ Was on hold pending passage of HB 360
- ◆ At June meeting, TMRS Board approved change in investment policy to begin full diversification



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### Further Diversification

- ◆ Gradual and strategic
- ◆ Broad diversification into non-correlated asset classes improves risk management and enhances return
- ◆ Dollar cost averaging equity purchases to avoid trying to time the market



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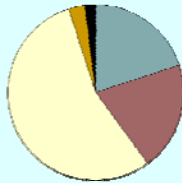
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### Interim Target for End of 2010

- ◆ 40% Equities (20% each to Domestic and International)
- ◆ 55% Fixed Income
- ◆ 3% Real Estate
- ◆ 2% Real Return



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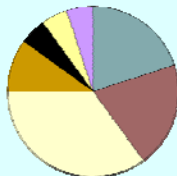
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### Target by End of 2013

- ◆ 40% Equities (20% each to domestic and international)
- ◆ 35% Fixed Income
- ◆ 10% Real Estate
- ◆ 5% Absolute Return
- ◆ 5% Real Return
- ◆ 5% Private Equity



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### *Amortization Policy for Ad Hoc Benefits*

- ◆ Effective for ad hoc benefit increases adopted after December 31, 2009; will affect contribution rates beginning January 2011
- ◆ Ad hoc benefit increases will be funded by level dollar contributions over a 15-year period
- ◆ Change means that ad hoc benefits are fully funded over an appropriate period as a standalone financial arrangement
- ◆ Contribution rates for cities adopting ad hoc benefits will be slightly higher

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### *Important Notes on Ad Hoc Benefits*

- ◆ Although the new Board policy improves the funding of ad hoc benefit increases, a city that adopts ad hoc benefits every year will not be advance funding those benefits.
- ◆ A city that adopts ad hoc benefits every year will see contribution rates continue to rise while funding ratios decrease.

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### *Closed Plan Policy*

- ◆ A few cities have asked about turning off TMRS benefits for future employees (closing the plan)
- ◆ Closed plans will be funded by level dollar contributions over 20 years, though longer or shorter periods may be appropriate for some cities
- ◆ Closing a plan may result in a higher immediate contribution rate for cities, especially in conjunction with starting a new plan for future employees

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## *Building a Reserve*



- ◆ Interim work will focus on reserve guidelines
- ◆ TMRS has always had a reserve, but reserve will be more important going forward
- ◆ Reserve will help keep city rates stable
- ◆ Reserve will also help provide basis for future gain-sharing

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## *Asset Smoothing*

- ◆ Asset smoothing will help keep contribution rates stable by not recognizing all investment gains or losses within a single year
- ◆ In most pension systems, asset smoothing is over a period up to 10 years
- ◆ In addition to smoothing period, a “corridor” may be established to assure that market value and smoothed value do not deviate too far
- ◆ Corridor may be “hard” or “soft”
- ◆ Will be more important in early years until sufficient reserves have been accumulated

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## *TMRS Fund Structure*

- ◆ ESF – Employees Saving Fund contains employee deposits and interest
- ◆ MAF – Municipality Accumulation Fund contains city contributions and interest
- ◆ CSARF – Current Service Annuity Reserve Fund receives employee and municipal funds at time a member retires. Annuities are paid from CSARF.

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### *TMRS Fund Structure*

- ◆ GRS is working with TMRS Board and Advisory Committee to examine funding structure and pros and cons of making changes
- ◆ Combining MAF and CSARF would make TMRS fund structure similar to other systems
- ◆ Combining MAF and CSARF would allow cities to fund benefits over a member's lifetime, not just over the period of active employment
- ◆ Combining MAF and CSARF would help reduce volatility of contribution rates

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### *Interest Credits 2009-2010*

- ◆ Member accounts will receive 5% effective 12/31/09
- ◆ Board will set interest credit for cities at February 2010 meeting
- ◆ City interest allocation will take into account fund's 2009 net investment income in combination with reserve guidelines established by Board
- ◆ After Board determination, city interest will be credited as of 12/31/09

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### *City Rates in the Future*

- ◆ Under HB 360, interest allocations to cities may vary widely from year to year depending on net investment income.
- ◆ The long-term expected return on the total portfolio is 7%, while the expected MAF crediting rate is 7.5% due to other funds receiving 5%
- ◆ Actuarial asset smoothing will reduce annual contribution rate fluctuations
- ◆ Policy for smoothing will be developed before the 12/31/09 valuation

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### *Help with Rate and Actuarial Issues*

- ◆ Contact your TMRS Regional Manager
- ◆ Staff actuary at TMRS can provide more detailed projections



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### *Legislative Interim*

- ◆ TMRS Advisory Committee will consider potential legislation



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### *TMRS Advisory Committee*

- ◆ 19-member body
- ◆ Combines former Advisory Committee with 2008 Legislative Stakeholder Group
- ◆ Representatives from management, employees, public safety, and elected officials
- ◆ Will review legislative proposals for 2011 legislative session
- ◆ In the August meeting of the Advisory Committee, the Board appointed April Nixon Chair and Roy Rodriguez Vice-Chair

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### Potential Legislation



- ◆ TMRS Board will adopt legislative package with input from the Advisory Committee
- ◆ Issues resulting from Board deliberations on funding may be included

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### TMRS – Taking Care of Business



- ◆ Continued commitment to transparency and communication
- ◆ New benefit calculator on website
- ◆ City service portal development in progress
- ◆ Retirement counseling at record levels

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### What Will Next Year Look Like?

- ◆ More investment diversification, but fund will still be largely in Fixed Income investments
- ◆ Actuarial assumptions should remain unchanged
- ◆ Cities using phase-in will experience rate increases until full rate is being paid
- ◆ If the investment return on the portfolio is less than 7%, interest credited to MAF may be less than 7.5%
- ◆ Smoothing policy will mitigate effect on city rates

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## Questions & Answers



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