



1301 Fifth Avenue
Suite 3800
Seattle, WA 98101-2605
USA

Tel +1 206 624 7940
Fax +1 206 623 3485

milliman.com

November 26, 2008

Ms. Patricia F. Pabst
Retirement System Director
Tacoma Employees' Retirement System
747 Market Street # 1544
Tacoma, WA 98402

Re: Recommended Contribution Increases

Dear Patricia:

As discussed at the November 21, 2008 Retirement Board Meeting, I am writing this letter to recommend the System increase contributions. Specifically, an increase in contributions equal to two percent of pay is consistent with the System's Funding and Benefits Policy (attached) and we believe it is an appropriate action given the likelihood that as of January 1, 2009 the System will no longer have a funding reserve to finance the difference between the current 14.00% of pay contribution rate and the 16.94% normal cost rate. We also recommend the Tacoma Municipal Code be revised to ensure that the additional employee contributions are used to fund the current benefit structure, not benefit increases. This requires that increases in the employee contribution rate above the current 6.44% are not included in the two times retirement annuity, the 150% refund of member contributions, and the two times death benefit paid over ten years.

We do not know what the System's 2008 investment return will be. However, the severity of the current investment market crisis implies increases much larger than two percent of pay may ultimately be needed. The System's 2008 investment return through October 31 was estimated by Wilshire to be -28.68%. Our November 17, 2008 updated early warning letter shows a -15% return in 2008 would reduce the System's market value of assets below its estimated actuarial accrued liability at January 1, 2009. When the System's actuarial assets become less than its actuarial accrued liability contributions larger than the 16.94% normal cost rate will be required to pay for the unfunded actuarial accrued liability.

A two percent increase near the beginning of 2009 represents a disciplined, measured response. Contribution increases start soon. It is consistent with the Retirement System's Funding and Benefits Policy which states contribution increases may be made in increments. Members and the City are allowed some opportunity to adjust to the need for increased contributions. Based on a 46% / 54% member / employer split this increase is close to one percent of pay for each. As further investment experience unfolds similar increases may well be needed in future years. How many increases are needed will depend largely on investment returns.

The last actuarial valuation was based on a January 1, 2007 census. The next actuarial valuation will be based on a January 1, 2009 census and is expected to be completed in May of 2009. The 2009 valuation will give a more exact measurement of the System's January 1, 2009 funded status including the extent of future required contribution increases. However, the most important factor in the System's future funding will be investment returns. Returns after January 1, 2009 above or below the 7.75% investment return assumption are likely to have a large impact on the funding of the System. The current volatility of the investment markets supports a measured and disciplined response such as repeated annual increases of two percent of pay. If returns are better than expected, the schedule of contribution increases can be shortened. If returns are worse than expected the schedule of contribution increases can be extended.

Certification

The analysis in this letter is based on the member data and plan provisions used in the January 1, 2007 actuarial valuation. December 31, 2007 assets were supplied by the System. Estimates of 2008 asset returns through October 31, 2008 were supplied by Wilshire Associates. These estimates do not include any other gains or losses from asset or liability experience. The assumptions and methods are based on our experience study report dated June 16, 2008.

Milliman's work product was prepared exclusively for the use or benefit of the Tacoma Employees' Retirement System for a specific and limited purpose. It is a complex, technical analysis that assumes a high level of knowledge concerning the System's operations, and uses the System's data which Milliman has not audited. Any third party recipient of Milliman's work product who desires professional guidance should not rely upon Milliman's work product, but should engage qualified professionals for advice appropriate to its own specific needs. Any distribution of this report must be in its entirety, unless prior written consent from Milliman is obtained.

These estimates are subject to the uncertainties of a regular actuarial valuation; they are inexact because they are based on assumptions that are themselves necessarily inexact, even though we consider them reasonable. Thus, the emerging costs may vary from those presented in this letter to the extent actual experience differs from that projected by the actuarial assumptions.

Future actuarial measurements may differ significantly from the current measurements presented in this report due to such factors as the following: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period or additional cost or contribution requirements based on the plan's funded status); and changes in plan provisions or applicable law. Due to the limited scope of our assignment, we did not perform an analysis of the potential range of future measurements.

We have not explored any legal issues with respect to the proposed plan changes. We are not attorneys and cannot give legal advice on such issues. If plan changes are considered, we suggest that you review them with counsel.

On the basis of the foregoing, I hereby certify that, to the best of my knowledge and belief, this letter is complete and accurate and has been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Actuarial Standards of Practice promulgated by the Actuarial Standards Board and the applicable Guides to Professional Conduct, amplifying Opinions, and supporting Recommendations of the American Academy of Actuaries.

I, Mark C. Olleman, am a consulting actuary for Milliman, Inc. I am a member of the American Academy of Actuaries and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

If you have any questions, please call.

Sincerely,



Mark C. Olleman, FSA, EA, MAAA
Consulting Actuary

MCO/trs

Attachment

cc: Mr. Jeff Belfiglio
Mr. Joshua Davis

Tacoma City Employees' Retirement System Funding & Benefits Policy

Objective

This policy is intended to provide guidance as to when adjustments to the Retirement System's contributions and benefits should be considered. The Funding & Benefits Policy is meant to assist in establishing a contribution rate which is relatively stable over the long term while the System provides its members superior retirement income.

Policy

When the Funding Ratio is:

- (a) Above 120% - The potential for benefit improvements will be reviewed providing the Retirement System's funding status is expected to be stable and remain stable after the improvements.
- (b) Between 95% and 120% - There will be no action, provided that either:
 - 1. The Contribution Rate is greater than or equal to the Normal Cost Rate, or
 - 2. There is a Funding Reserve which is projected to be amortized over not less than 20 years.

If neither of these conditions is met, then the Retirement Board will consider an increase in the contribution rates.

- (c) Between 80% and 95% - The Retirement Board will consider an increase in the contribution rates.
- (d) Under 80% - The funding and benefits policy will be reviewed and reevaluated.

Additional Guidelines

- (a) The amount by which the Normal Cost Rate exceeds the Contribution Rate should not be allowed to grow larger than 3.25%. This was the estimated difference in May of 2006.
- (b) There is a long term goal of achieving a Contribution Rate greater than or equal to the Normal Cost Rate so that if the Funding Reserve is lost due to adverse experience, there will not be a sudden increase in the calculated required contribution.
- (c) Increases in the contribution rate may be made in small increments.
- (d) Requests for increases in the contribution rate should be made at least 1 year prior to the beginning of the financial biennium.

Terminology

- (a) The Funding Ratio is calculated by dividing the System's Actuarial Value of Assets by the Actuarial Accrued Liability.
- (b) The Funding Reserve is the dollar amount by which the System's Actuarial Value of Assets exceeds the Actuarial Accrued Liability.