



**City Guide to**

**USC**

**Updated Service Credit**

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# City Guide to Updated Service Credit

## What is Updated Service Credit (USC)?

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Updated Service Credit (USC) is an optional benefit provision within the TMRS menu of available plan design options that cities can adopt. USC is intended to help keep retirement benefits from being eroded over time due to inflation. In calculating USC, TMRS looks at the changes in a member's salary during his or her career as well as any changes the city has made to its TMRS plan, such as the member deposit rate or the city's matching ratio. In many cases, USC can raise the member's monthly retirement payment to an amount that is closer to the member's salary at retirement.

## How Does USC Work?

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USC is a credit granted to an employee by the adopting city. This credit takes into account plan changes the city may have adopted, and salary increases the employee has been granted over the course of his or her career.

Although USC may increase the value of a member's retirement benefit, it does not affect the money in the member's individual account or the amount the member receives if the account is refunded. USC only becomes part of the member's benefit if he or she retires and draws an annuity.

### **Eligibility**

To be eligible for USC, the employee must have earned 36 months of credit in TMRS for service with the city that is adopting USC. This credit must have been earned as of the USC study date (see definition on page 4).

Prior service credit, current service credit, and buyback are included in determining a member's eligibility for USC. Restricted Prior Service Credit and Military Service Credit (with the exception of USERRA) are not included.

Former employees of a city that adopts USC are also eligible. Contributing and noncontributing members are eligible as long

as they have at least 36 months of service credit as of the study date. USC may benefit former employees because even though the average salary for noncontributing members remains the same in the USC calculation, future plan changes could provide additional USC.

### **Effective Date**

The effective date for USC to be credited is always the January 1 following the city's final adoption of the ordinance granting the benefit. For cities with annually repeating USC (see below), each subsequent January 1 is the USC effective date.

### **USC Study Date**

The USC study date is always the last day of the December that falls 13 months before the effective date. An actuarial study is performed each year to determine the cost of USC. Member account balances and salary information at the time of the study date are included in the USC calculation. Plan provisions as of the effective date are also used in calculating this benefit. The study date is also used to determine member eligibility for USC.

**EXAMPLE:** *If a city adopts USC effective January 1, 2010, the study date will be December 31, 2008.*

## **How is USC Calculated for Each Eligible Employee?**

The USC calculation is computed in January for every eligible member in cities that provide this benefit and uses the following assumptions:

- ◆ That the member's average updated service compensation (see number 1 below) and the city's current TMRS plan of benefits have been in effect throughout the member's career.
  - ◆ That during the entire career, a fixed annual interest rate of 3% is applied in the calculation.
1. The average updated service compensation is calculated, based on the member's 36 monthly TMRS deposits received immediately preceding the study date. The highest and lowest monthly deposits are disregarded and the average is computed based on the remaining 34 deposits.
  2. A hypothetical reserve\* amount is calculated assuming the member contributed a percentage of the average monthly salary calculated in #1 above into their TMRS account during their tenure in that city. The percentage used is the city's current member deposit rate. Assuming the deposits earned an annual interest rate of 3%, the hypothetical total is then matched based on the city's current matching ratio.

## Key Points about USC

- ◆ Once awarded, USC grows at a rate of 5% every year. If a later USC calculation produces an amount that is greater than the USC amount previously applied to a member's account, the previous USC amount is replaced with the new USC amount. If the calculation produces an amount that is less than the previous USC amount plus interest earned, the USC is not reduced but earns 5% interest for the year.
- ◆ Not every employee receives USC. Some employees may not receive USC because their actual reserve totals (deposits, interest, matching funds) are larger than the USC calculation. USC assumes 3% annual interest, and the employee account grows using actual annual interest. (The 3% interest assumption is likely to be a lower interest rate than what the member's actual account has earned. Actual annual interest rates have ranged from 11% to 5% from 1992 to present.) Also, if an employee has had no significant salary increases or has not experienced any plan changes, there would typically be no USC granted.
- ◆ If an employee is eligible to buy back previously forfeited TMRS service, the buyback may increase the amount of the USC because it increases the amount of time figured into the calculation. Employees considering buyback should request retirement estimates to determine if the buyback is beneficial to their individual retirement goals.

3. If the hypothetical reserves\* are greater than the member's actual reserves\* as of the study date, the difference is credited to the member's account based on the USC percentage adopted by the city (50, 75, or 100%).

\* The reserves include member deposits, interest, city matching funds, and other credit funded by the city.

**FOR EXAMPLE:**

\$ 40,000 hypothetical reserves	
- \$ 38,000 actual reserves	
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\$ 2,000 difference	
× 100% (or other USC percentage adopted by city)	
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\$ 2,000 USC applied to member's account	

4. If the hypothetical reserves are not greater than the member's actual reserves, the member 1.) keeps any previous USC granted (which earns 5% annual interest), and 2.) no additional USC is granted.

**NOTE:** Cities may request estimates for each member to determine how each person's benefits will be affected with the adoption of USC.

## What is Transfer USC?

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Cities may choose to include a “transfer” feature in the USC calculation to extend the USC benefit to those employees who have worked in multiple cities. The transfer provision in the USC calculation works just like the regular calculation but factors in any service the employee may have with previous TMRS cities. For example, for a contributing employee who has previously worked for another TMRS city and did not refund his or her account balance upon leaving the city, the USC calculation uses the total service for both cities in determining the hypothetical and actual reserve account balances.

The USC credit (if any) that was previously granted from the first city is still that city’s obligation, but any increase is the obligation of the new city. Transfer USC has the biggest cost impact when an employee transfers from a city with a lower deposit rate and/or matching ratio to a new city with a higher rate and/or match. As a result, the transfer feature may make a city’s USC cost (and overall contribution rate) higher. TMRS can provide an estimate of the city’s cost with and without a transfer feature. Remember that an employee must have 36 months of service credit as of the study date, with that city, before they become eligible for USC in that city.

## How Does a City Adopt USC?

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Since USC is an optional feature that requires additional funding from the city, the USC provision must be adopted by city ordinance. When a city decides to adopt USC, it chooses the percentage of USC it will provide (50%, 75%, or 100% of the calculated credit), whether or not to include transfer credits, and whether it will adopt USC on an “annually repeating” or “ad hoc” basis. Requests for a model ordinance may be made through the TMRS Regional Managers (Travel Team) or by calling TMRS. Once the city council votes to adopt the ordinance, the adoption of USC is effective the next January 1. USC may be added in any year.

### **Link between USC and COLAs**

Some cities adopt Cost of Living Adjustments (COLAs) for their retirees. A city that grants COLAs to retirees must also provide USC, but a city may provide USC without granting a COLA.

### **Ad Hoc or Annually Repeating Adoption**

A city may decide to adopt USC on an annual basis effective January 1 of any calendar year. This is called “ad hoc” adoption because the council decides from year to year if the benefit is offered and the rate at which it is offered. Studies are prepared every year for every city.

Alternatively, USC can be adopted as a repeating, ongoing plan feature, so that it is calculated and automatically applied on January 1 of each year after the adoption. This is known as “annually repeating” USC. The new USC is automatically calculated every January. A city that adopts USC on a repeating basis may repeal the adoption at any time.

To continue providing the USC benefit in an environment of rising contribution rates, some cities have considered changing from annually repeating (automatic) USC to ad hoc USC. If the city simply adopts the ad hoc benefit every year, the ultimate cost is the same; what differs is the “payment schedule.”

For cities with annually repeating USC, the actuarial funding methodology adopted by TMRS in 2007, called Projected Unit Credit (PUC), pre-funds this benefit by projecting the potential cost of future USC benefits and including that expected liability in the current contribution rate. Ad hoc USC is funded year-by-year; but, without pre-funding, a city should expect to see contribution rates rise each year while the funded ratio decreases. TMRS may, in the future, adopt a shorter amortization period for ad hoc benefits.

If a city is considering “turning off” the annually repeating benefits and adopting USC and/or COLAs on an ad hoc basis, TMRS will provide cost information associated with both choices, but does not recommend this course of action. We urge any city that is considering changing USC to contact TMRS.

## How Much Does USC Cost the City?

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Providing USC is an excellent way for cities to keep their employees’ retirement benefits in line with the effects of inflation. But adopting the benefit will require an increase in the city’s contribution rate. Since USC can increase a member’s retirement benefit, the cost of the USC becomes a pension liability that must be paid for by city contributions. The actual cost of USC depends on many factors, including the other options the city has chosen, the demographics of its workforce, salary history, tenure, and other considerations. Cities must contact TMRS to determine the potential cost for adopting USC. (See the Plan Change Study on page 8 for an example.) We can also send members of the TMRS Travel Team to the city to visit with staff and council and present the various scenarios and their impact on the city’s rate.



# Plan Change Study

12345 Sample City

For Informational Purposes Only

Effective Date - January 1, 2009

Report Date - December 30, 2008

	PUC / New Assumptions		Proposed Plans	
	Preliminary	Adjusted	1	2
<b>Plan Provisions</b>				
Deposit Rate	7.00%	7.00%	7.00%	7.00%
Matching Ratio	2 to 1	2 to 1	2 to 1	2 to 1
Updated Service Credit	0%	0%	100% (Repeating)	100% (Ad-Hoc)
Transfer USC **	Yes	Yes	Yes	Yes
Annuity Increase	0%	0%	70% (Repeating)	70% (Ad-Hoc)
Buyback Provision	No	No	No	No
20 Year/Any Age Ret.	Yes	Yes	Yes	Yes
Vesting	5 years	5 years	5 years	5 years
<b>Contribution Rates</b>				
Normal Cost Rate	2009 6.57%	2009 6.57%	2009 9.57%	2009 6.80%
Prior Service Rate	2.97%	3.37%	7.80%	3.82%
Retirement Rate	12.49%	9.94%	17.37%	10.62%
Supplemental Death Rate	0.20% (A & R)	0.20% (A & R)	0.20% (A & R)	0.20% (A & R)
Total Rate	12.69%	10.14%	17.57%	10.82%
Unfunded Actuarial Liability	\$18,794,588	\$16,828,886	\$38,963,579	\$19,084,707
Amortization Period	25 years	25 years	25 years	25 years
Funded Ratio	72.5%	74.6%	56.0%	72.2%
Phase-In Total Rate	--	N/A	N/A	N/A

\*\* This is the addition to the Initial Prior Service Rate for USC for transfers. There were 16 eligible transfer employees on the valuation date.

This table shows the effect of USC on the city rate and liability. The third column from the left shows the city rate and liability before adopting USC. Proposed Plan 1 shows the adoption of repeating USC, and Proposed Plan 2 show the adoption of ad hoc USC.

In general, for a city that has had a steady salary progression over the years and that has not made plan changes, the cost for USC will be lower than for a city that has seen large salary increases or that has changed its deposit rate or matching ratio.

**Note:** For cities that have adopted USC on an annually repeating basis, any changes to the member deposit rate or the city's matching rate will require a readoption of USC. Cities may discontinue future USC calculations at any time by adopting an ordinance ending the annually repeating provision.

## What Happens if USC is Reduced or Eliminated?

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A city always has the option of decreasing or terminating the USC provision. Such action is likely to result in lower retirement benefits for at least some of the city's employees than they would receive if USC continued to be granted at the same level. The amount of this effect will vary from employee to employee. Furthermore, the city must still meet its obligations for employees that have previously received USC. Remember, once awarded, USC grows at a rate of 5% every year even if USC is terminated under the city's plan provisions. See the table on page 10 for a summary of the Effect of USC Changes on Employees.

A city ordinance is required for a city to discontinue annually repeating USC. If USC is terminated, COLAs for retirees must also be terminated. If a city modifies USC by lowering the rate (changing to a lower percentage) or by turning off transfer USC, the city may — but does not have to — make changes to COLAs.

## Effect of USC Changes on Employees

	<b>Current employees</b>	<b>Future employees</b>	<b>Retired employees</b>
<b>Adopt USC</b>	USC calculated if eligible – potential benefit increase	USC calculated if eligible (annually repeating adoption)— potential benefit increase; no impact if ad hoc adoption	COLA may or may not be adopted
<b>Adopt Transfer USC</b>	Transfer USC calculated for contributing employees with service in other TMRS cities – potential benefit increase	Transfer USC calculated for contributing employees with service in other TMRS cities (annually repeating adoption) – potential benefit increase; no impact if ad hoc adoption	N/A
<b>Cancel USC</b>	No future USC calculations; previously granted USC will continue to receive 5% annual interest	Will not receive benefit	COLAs must be cancelled when USC is cancelled
<b>Reduce USC percentage</b>	USC calculated at lower rate if eligible; if granted, USC increases smaller; previously granted USC will continue to receive 5% annual interest	USC calculated at lower rate if eligible – potential benefit increase	City may, but does not have to, reduce COLA percentage along with USC percentage
<b>Change from annually repeating to ad hoc</b>	USC calculated when granted – potential benefit increase; previously granted USC will continue to receive 5% annual interest	USC calculated when granted – potential benefit increase	City must move COLAs to ad hoc as well or eliminate them

## Contact TMRS if You Have Additional Questions

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To analyze the effect of USC adoption or changes on your city, contact TMRS and ask for a Plan Change Study, like that shown on page 8. This study will be based on your city's actual actuarial valuation. Our staff will look at your city plan options using the TMRS Actuarial Grid, a modeling tool that shows the effects of plan changes on a city's contribution rate.

### City Plan Questions

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